HOUSING MARKET ASSESSMENT
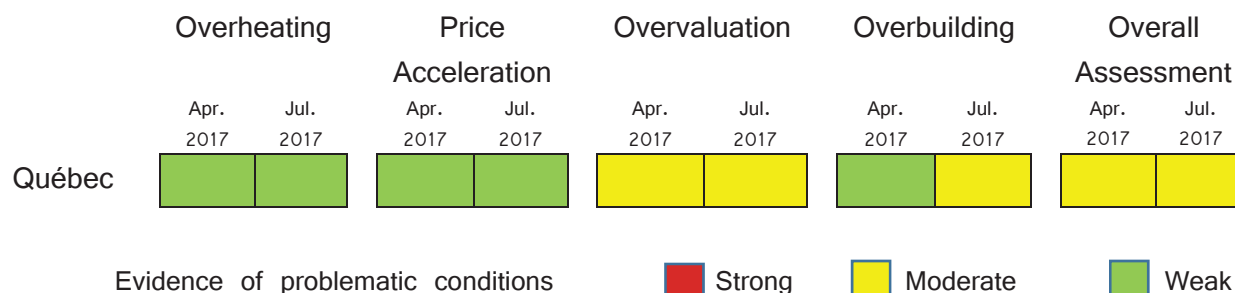## Québec CMA

Date Released: Third Quarter 2017

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Highlights

	Overheating	Price Acceleration	Overvaluation	Overbuilding	Overall Assessment
	Apr. 2017 / Jul. 2017	Apr. 2017 / Jul. 2017	Apr. 2017 / Jul. 2017	Apr. 2017 / Jul. 2017	Apr. 2017 / Jul. 2017
Québec	Weak / Weak	Weak / Weak	Moderate / Moderate	Weak / Moderate	Moderate / Moderate

Evidence of problematic conditions   ■ Strong   ■ Moderate   ■ Weak

- Overall, the results from the Housing Market Assessment (HMA) still indicated moderate evidence of problematic conditions for the Québec census metropolitan area (CMA) in the first quarter of 2017.[1]

- Evidence of overvaluation remained moderate, but continued to weaken gradually. This evolution can be explained by the strengthening of the job market and of income growth, as well as the stability of the average price of homes in the area.

- Evidence of overbuilding went from weak to moderate, as the number of conventional rental apartments under construction or recently completed was high relative to demand, which put upward pressure on the vacancy rate.

- The HMA still did not raise any concerns with regard to overheating and price growth acceleration.

- The HMA analytical framework considers four factors to assess the evidence of problematic housing market conditions: overheating; acceleration in the growth of house prices; overvaluation; and overbuilding. A brief summary of the framework is presented on page 7 of this report.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's market analysts' knowledge of local market conditions. These insights position

CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects problematic market conditions in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates on account of supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolve an excess supply imbalance by supporting stronger demand and/ or reducing supply. However, other

unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance.

Colour codes indicate the level of evidence of problematic conditions. The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is from its historical average) and the persistence

[1] Results are based on data as of the end of March 2017 and local market intelligence up to end of June 2017. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

over time. Generally, low intensity and persistence are associated with potential weaker evidence of problematic conditions. As the number of intense and persistent signals increases, the associated evidence of problematic conditions becomes stronger.

In Detail

Evidence of overheating remained weak

According to the analytical framework, evidence of overheating remained weak in the Québec census metropolitan area (CMA) in the first quarter of 2017. In fact, the level of supply in relation to demand on the resale market remained sufficiently high so as not to raise any concerns with regard to overheating.
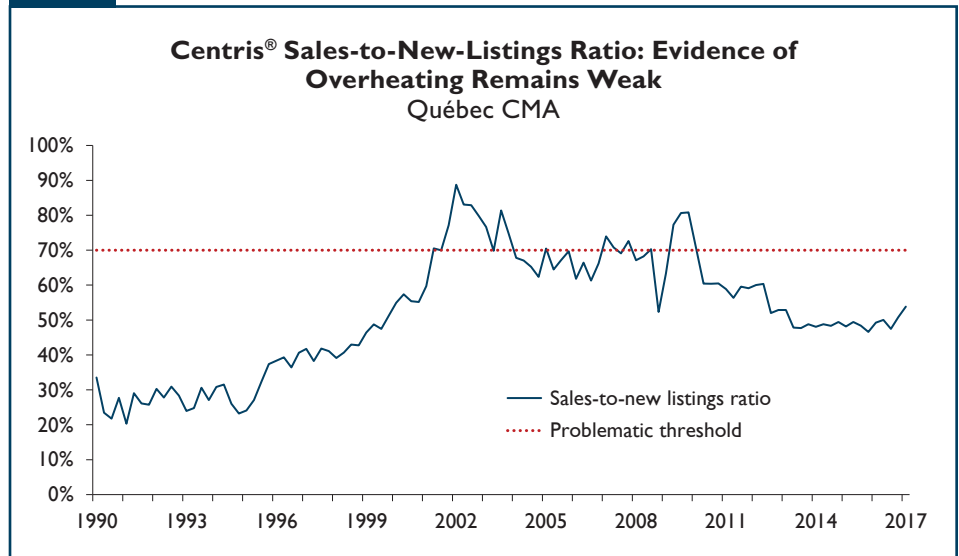
Between the fourth quarter of 2016 and the first quarter of 2017, Centris® sales increased slightly (+2%), while the number of new listings decreased (-3%)[3]. As a result, the sales-to-

> *"Overall, evidence of problematic conditions remain moderate in the Québec market. Evidence of overvaluation remained moderate, but continued to weaken. Evidence of overbuilding went from weak to moderate given the significant number of rental apartments under construction or recently completed."*
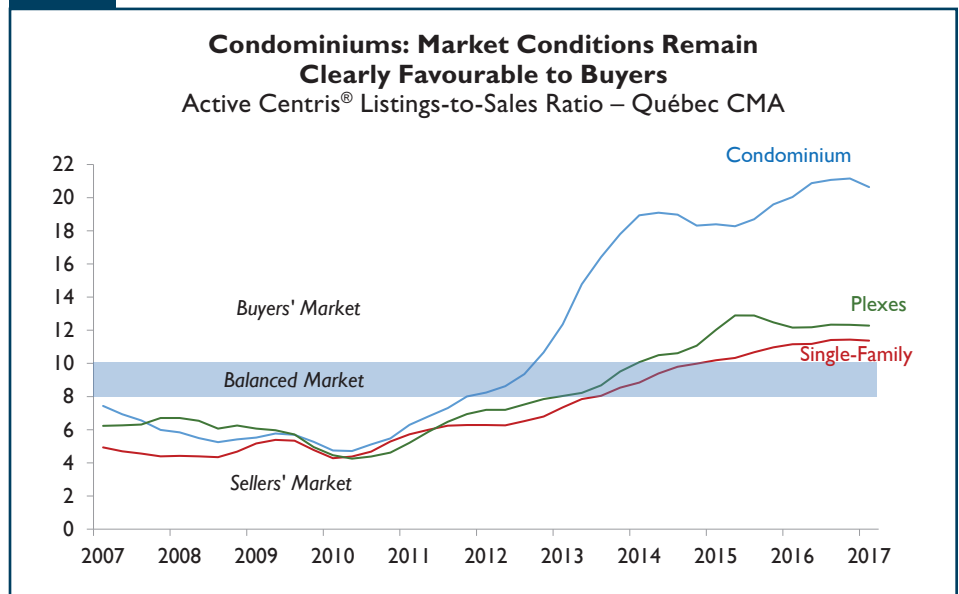>
> **Nicolas Bernatchez**
> **Market Analyst**

Figure 1

Centris® Sales-to-New-Listings Ratio: Evidence of Overheating Remains Weak
Québec CMA

Sources: Quebec Federation of Real Estate Boards (QFREB), CMHC (calculations)
Last data point: 2017 Q1

Figure 2

Condominiums: Market Conditions Remain Clearly Favourable to Buyers
Active Centris® Listings-to-Sales Ratio – Québec CMA

Source: QFREB by the Centris® system, four-quarter weighted moving average, CHMC calculations
Last data point: 2017 Q1

new listings ratio rose from 51% to 54%. Still, the ratio stayed below the problematic threshold of 70% (figure 1).

The relationship between supply and demand continued to indicate soft market conditions in all market segments: single-family homes, plexes and condominiums. This was evidenced by another indicator of resale market conditions, that is, the active Centris® listings-to-sales ratio (figure 2). While market conditions

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[3] Quebec Federation of Real Estate Boards (QFREB) by the Centris® system, seasonally adjusted data by CMHC.

have stabilized since the end of 2016 for single-family homes, which represent 70% of transactions in the Québec CMA, the market remained slightly favourable to buyers. During the 12 months to the end of the first quarter of 2017, the number of single-family houses for sale rose slightly faster than the number of sales in the metropolitan area[4]. This was also the case for plexes (income properties with two to five housing units).
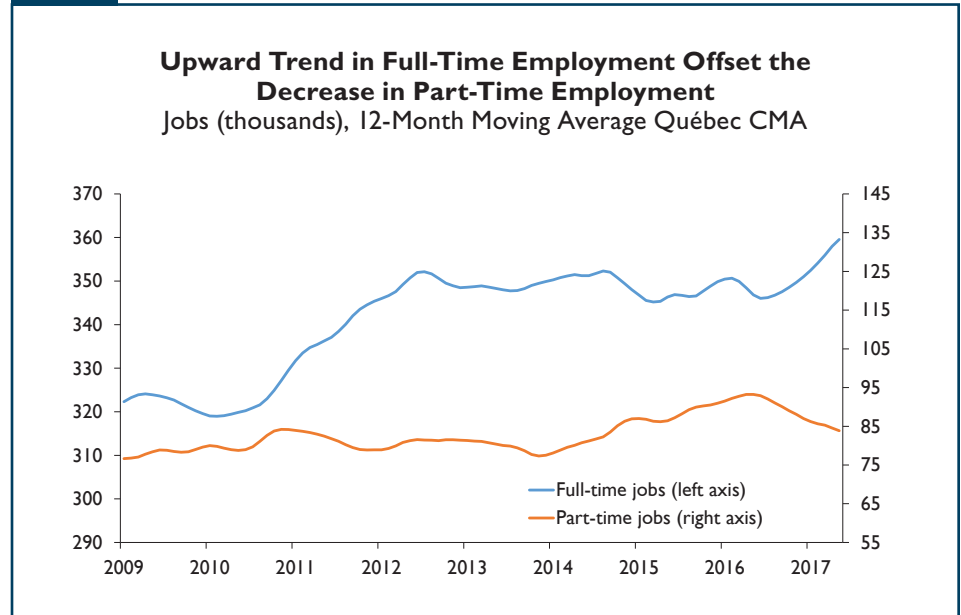
The relationship between supply and demand still effectively indicated very soft market conditions in the condominium segment—a situation that has lasted since 2013. On average, in the condominium segment, there were 21 active listings for every buyer, meaning that the market is clearly favourable to buyers. As well, the condominium market posted soft conditions in all sectors of the CMA

Evidence of price growth acceleration remained weak

According to the HMA, there was no indication of housing price growth acceleration in the Québec area in the first quarter of 2017. The average Centris® price of residential properties[5], which includes all property types, in fact recorded a slight decrease for a second consecutive quarter.

Overall, the price of residential properties has remained rather stable since 2014 in the Québec CMA, which is attributable to the continued soft conditions on the resale market (see previous section), limiting price growth. During the 12 months to the end of the first quarter of 2017,

Figure 3

Upward Trend in Full-Time Employment Offset the Decrease in Part-Time Employment
Jobs (thousands), 12-Month Moving Average Québec CMA

Full-time jobs (left axis)
Part-time jobs (right axis)

Sources: Statistics Canada (Labour Force Survey), CMHC (calculations)
Last data point: May 2017

the median sale price of single-family homes ($248,000) and condominiums ($192,000) remained unchanged. In the case of condominiums, this stability followed three consecutive years where the median price decreased. Therefore, there is currently no concerns in the Québec CMA about price growth acceleration.

Evidence of overvaluation continued to weaken

In the first quarter of 2017, evidence of overvaluation in the Québec market remained moderate, but continued to gradually weaken. House prices are increasingly moving closer to the levels warranted by underlying demographic and economic fundamentals. This evolution is attributable, on the one hand, to the strengthening of the job market and the growth in income and, on the other hand, to the stability of prices

in the area.

In the Québec CMA, an upward trend in full-time employment started in the second half of 2016, which offset the downward trend in part-time employment (figure 3). Therefore, while total employment remained relatively stable, the job market tightened. This regain in ground is mainly attributable to employment among people aged 25 to 44. Also, the actual personal disposable income per capita has been rising at a slightly faster pace since the second half of 2016 compared to the previous quarters. This trend on the job market appears to have helped further support sales of residential properties and lower the degree of overvaluation.

Also, it should be noted that according to the most up-to-date information available to us, the downward trend in the population

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[4] According to the Quebec Federation of Real Estate Boards (QFREB), during the 12 months to the end of the first quarter of 2017 (April 2016 to March 2017), the number of active Centris® listings of single-family houses in the Québec CMA rose by 5%, while sales edged up by 3%.

[5] Seasonally adjusted data

aged 25 to 34, the "first-time buyers," is weaker than anticipated. New population estimates[6] therefore contributed to reducing the intensity of overvaluation signals in the HMA analytical framework.
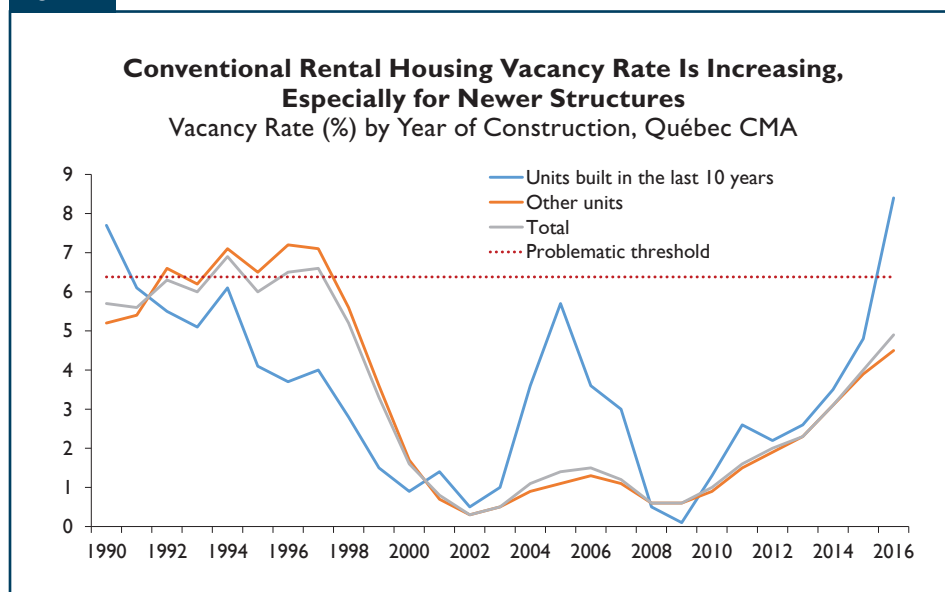
The greater alignment of fundamentals and home prices is also attributable to stagnant prices in the area. In the first quarter of 2017, seasonally adjusted average Centris® price of residential properties decreased slightly (-0,2%) over the same period a year ago. In real terms, the drop was of 1.4%. In fact, as mentioned in the previous section, the evolution of prices in the Québec CMA has shown a relative stability for the last three years. The increase in the average Centris® price for residential properties reached -1.1% in 2014, 0.3% in 2015 and -0.3% in 2016[7]. These results were due to the decrease in condominium prices and the weak price growth of single-family homes.

With the overall average price in the Québec CMA staying unchanged and full-time employment regaining some ground, the evidence of overvaluation continued to weaken. Given the persistence and the increasingly lower intensity of the evidence of overvaluation, the evidence of problematic conditions should continue to decrease over the next few quarters.

Evidence of overbuilding went from weak to moderate

In the first quarter of 2017, the two indicators used to assess the risk of overbuilding, namely, the number of completed and unsold freehold[8] and

Figure 4

Conventional Rental Housing Vacancy Rate Is Increasing, Especially for Newer Structures
Vacancy Rate (%) by Year of Construction, Québec CMA

Source: CMHC (Rental Market Survey)

condominium housing units per 10,000 population and the rental housing vacancy rate, were below their respective problematic thresholds.

Nevertheless, the number of conventional rental apartments under construction or recently completed remained high relative to demand, which put upward pressure on the vacancy rate, particularly for newly built projects. There are therefore moderate risks of overbuilding in this market segment.

The vacancy rate for conventional rental housing[9] is on the rise in the Québec CMA, as shown by the results of the latest CMHC Rental Market Survey conducted in October 2016. This rate climbed from 4.0% in 2015 to 4.9% in 2016 (figure 4). This hike was due to the strong growth in the supply of conventional rental housing in the last two years. In fact, housing starts in this category

reached an historical high in 2015 and 2016 with close to 2,500 units for each of these two years, compared to an annual average of 1,300 units over the past 10 years. The growth in supply was felt between 2015 and 2016, as the vacancy rate in newly built projects (10 years old or less), jumped from 4.8% to 8.4%.

At the end of May 2017, there were close to 2,200 conventional rental units under construction in the Québec CMA. These units will be completed over the next few quarters, which will increase even further the supply of rental housing units in the area, at a pace that remains greater than the growth in demand. The overall vacancy rate is expected to continue to rise and reach 6% this year[10]. Given these factors, evidence of overbuilding went from weak to moderate in the first quarter of 2017.

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[6] Conference Board of Canada estimates based on data from Statistics Canada.

[7] Changes in current dollars.

[8] Freehold homes refer to dwellings where the owner also holds the title of ownership to the land.
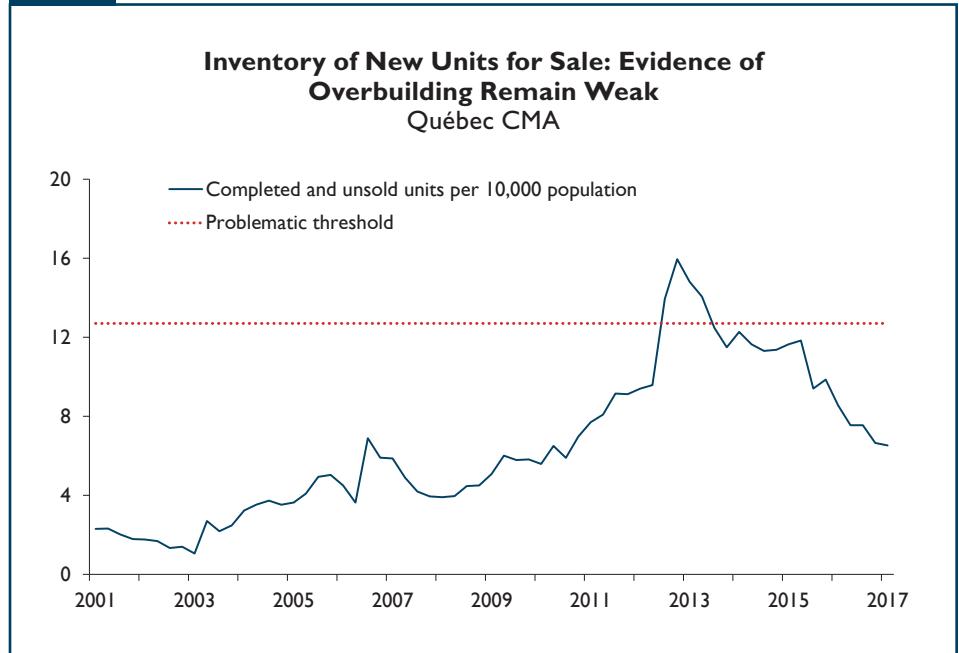
[9] Apartments in private rental buildings with three or more units, excluding seniors' housing units.

[10] See Housing Market Outlook – Québec CMA, Fall 2016

The search for new markets in view of maintaining their levels of activity are among the factors motivating some developers who want to build rental housing projects, mostly sizable ones. Nevertheless, the pace of conventional rental housing construction has slowed down since the beginning of 2017 and we expect this downward adjustment to continue throughout the year to allow existing units to be absorbed. The situation will continue to be monitored closely.

As for the inventory of completed and unsold freehold homes and condominiums, the HMI showed weak evidence of overbuilding. After having peaked at the end of 2012, inventories of unsold new condominiums have been gradually absorbed, such that the number of completed and unsold units per 10,000 population in the Québec CMA has followed a clear downward trend (figure 5). It was the slowdown in housing starts in the past few years that allowed for the absorption of the recently completed units. The supply of condominiums still remains high on the resale market, which should help maintain a weaker pace of construction for this housing type over the next few years.

Figure 5

Inventory of New Units for Sale: Evidence of Overbuilding Remain Weak
Québec CMA

Source: CMHC
Last data point: 2017 Q1

All in all, with an inventory of completed and unsold homes whose level tends to move away from the problematic threshold and a vacancy rental rate that tends to move closer to that threshold, evidence of overbuilding in the Québec CMA was moderate in the first quarter of 2017.

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to assess housing market conditions.

Specifically, the framework considers four main factors that may provide an early indication of potentially problematic housing market conditions: (1) overheating when demand outpaces supply; (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below);

and, (4) overbuilding when the inventory of available housing units is elevated.

For each factor, the framework tests for: (1) the presence or incidence of signals of potentially problematic conditions, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with weak evidence of problematic conditions. Conversely, as the intensity, number, and/or persistence of the signals increases, the likelihood of a factor becoming problematic increases.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect potentially problematic housing market conditions. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect problematic housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect current problematic conditions relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify problematic overheating conditions, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating conditions on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers.

The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed.

To assess overbuilding conditions in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the level of evidence of problematic conditions. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of potentially problematic conditions, but also considers the intensity of signals (that is, how far the indicator is from its historical average) and the persistence of signals over time. Generally, low intensity and persistence are associated with a lower potential of upcoming problematic conditions. As the number of persistent signals increases, the evidence of a problematic condition developing increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators signaling significant incidence, intensity and persistence of potentially problematic conditions. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators of a problematic condition from the previous assessment.

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* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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