HOUSING MARKET ASSESSMENT
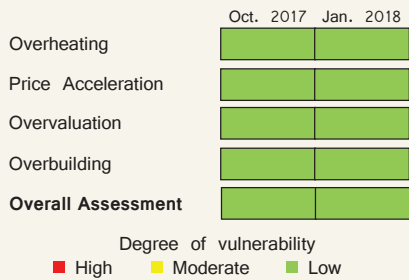## Montréal CMA

Date Released: First Quarter 2018

Canada

CMHC ◆ SCHL

Highlights

Results Overview
Montréal CMA

	Oct. 2017	Jan. 2018
Overheating		
Price Acceleration		
Overvaluation		
Overbuilding		
Overall Assessment		

Degree of vulnerability
■ High ■ Moderate ■ Low

- In the third quarter of 2017,[1] the degree of vulnerability of the Montréal census metropolitan area (CMA) housing market remained low, according to the Housing Market Assessment (HMA) analytical framework.

- Evidence of overvaluation remained weak, owing to house prices that remained in line with economic and demographic fundamentals.

- Evidence of both overheating and acceleration in the growth of house prices remained weak. However, on the Montréal resale market, the relationship between supply and demand continued to tighten.

- Evidence of overbuilding remained weak, as the number of completed and unsold homes per 10,000 population, as well as the rental vacancy rate, both decreased.

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 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.

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[1] Results are based on data as of the end of September 2017 and local market intelligence up to end of December 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.

In Detail

Evidence of overheating remained weak, but markets tightened

During the third quarter of 2017, evidence of overheating on the resale market remained weak. Indeed, the seasonally adjusted sales-to-new listings ratio was 65% (see figure 1), which is below the problematic threshold[3]. Still, the ratio went up for a fifth straight quarter, as Centris® sales increased, while new listings decreased.
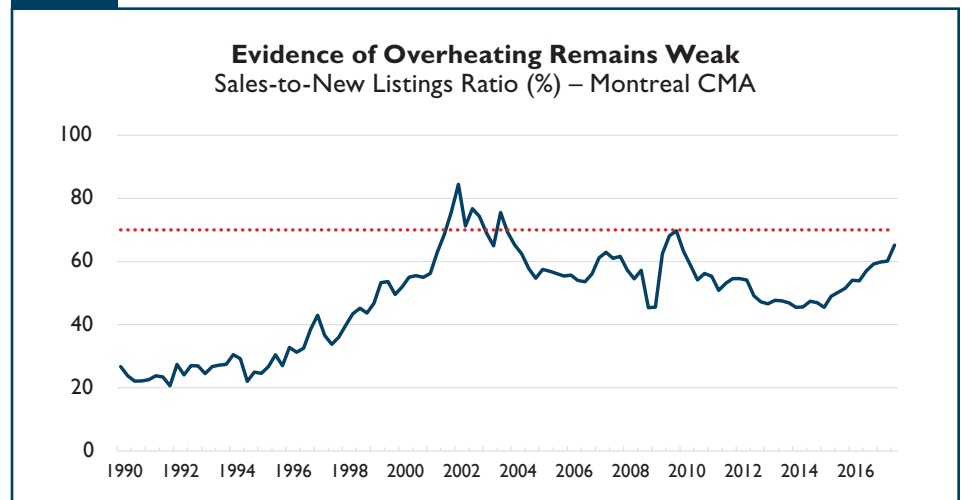
For its part, the active listings-to-sales ratio[4], another market indicator, went down to such a degree that the Montréal resale market shifted from being balanced in the second quarter of 2017 to being an overall sellers' market[5]. Conditions differed, however, from one market segment to another (see figure 2). The single-family and plex segments favoured sellers[6], while the condominium segment was on the fence between a balanced and a buyers' market[7]. Over the next few quarters, we expect market conditions to tighten further, since sales should continue to increase while active listings should continue to decrease.

From a geographic standpoint, the decrease in the active listings-to-sales ratio for single-family homes was evident across the larger sectors

Genevieve Lapointe
Principal,
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"For a fourth straight quarter, the degree of vulnerability of the Montréal CMA housing market remained low. The strength of the fundamentals supported the price levels observed. However, the Montréal resale market continued to tighten, and this increased pressure on prices."

Figure 1

Evidence of Overheating Remains Weak
Sales-to-New Listings Ratio (%) – Montreal CMA

Source: Quebec Federation of Real Estate Boards (QFREB) by the Centris® system, seasonally adjusted data by CMHC. Last data point: 2017 Q3.

Figure 2

Resale Market Continued to Tighten
Active Centris® Listings-to-Sales Ratio – Montréal CMA
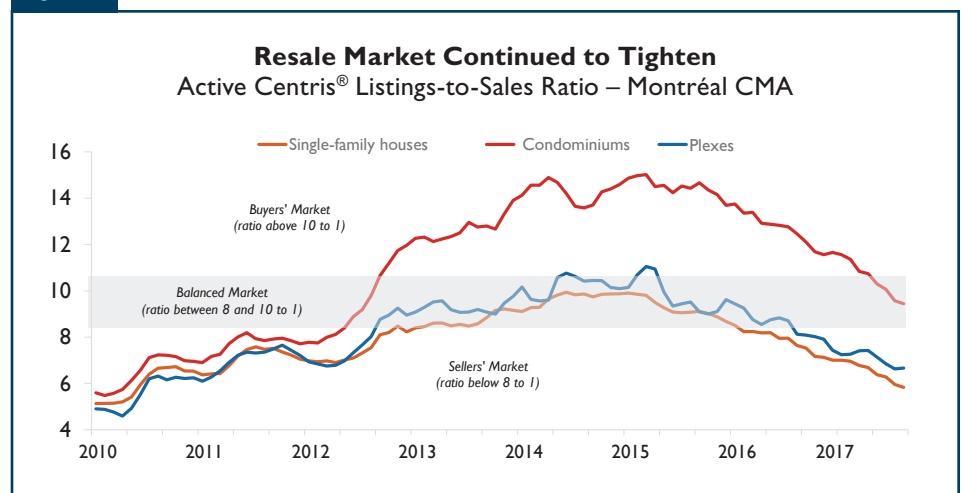
Source: QFREB and CMHC calculations. Last data point: September 2017

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[3] This rate is set at 70%.

[4] While the sales-to-new listings ratio tells us about sales in relation to the pace of new listings on the resale market, the active listings-to-sales ratio provides information on the status of inventories relative to the rate of sales.

[5] In a sellers' market, the ratio is less than 8 sellers (in other words, active listings) for each buyer (in other words, Centris® sale). In a balanced market, the ratio is between 8 and 10, and, in a buyers' market, it is higher than 10 sellers for each buyer.

[6] In a sellers' market, sellers have greater negotiating power relative to buyers, and there is usually higher pressure on prices.

[7] In a buyers' market, buyers have greater negotiating power relative to sellers, and there is usually little or lower pressure on prices.
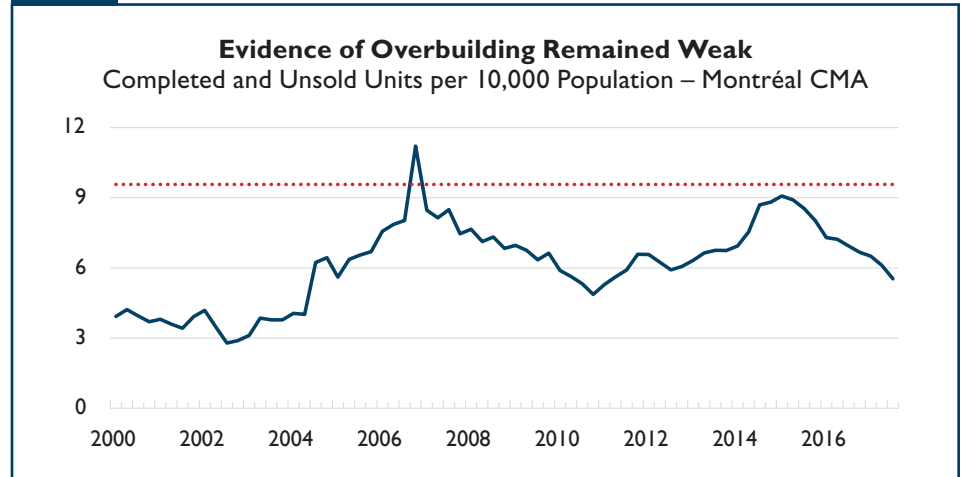
of the metropolitan area. Indeed, on Montréal Island, on the South Shore and in Laval, market conditions became even more favourable to sellers. Meanwhile, on the North Shore and in Vaudreuil-Soulanges, conditions tightened so much that the market went from being balanced to being favourable to sellers[8].

In the condominium segment, the active listings-to-sales ratio decreased in almost all of the larger sectors of the CMA[9], but market conditions remained favourable to buyers, except on Montréal Island, where the market remained balanced. It was in Laval and on the North Shore, however, that the ratio remained highest, with around 14 sellers to each buyer. As such, the supply of condominiums remained high in the North Crown, just as it had over the previous four quarters.

Evidence of price growth acceleration remained weak, but close to the problematic threshold

Evidence of price acceleration remained weak in the third quarter of 2017. Still, the results of the model remained close to the threshold beyond which evidence of price acceleration would have been significant. In fact, due to the tightening of the relationship between supply and demand on the resale market over the last few quarters, pressure on prices has risen and triggered a significant increase in the average price. In the third quarter of 2017, however, the average

Figure 3

Evidence of Overbuilding Remained Weak
Completed and Unsold Units per 10,000 Population – Montréal CMA

Sources: Statistics Canada and CMHC. Last data point: 2017 Q3.

Centris® price (adjusted for inflation and for seasonal variations) showed some stability (+0.2%).

The single-family home segment continued to stand out, recording the highest rates of price growth. In the third quarter of 2017, growth in the average price of single-family homes in the larger sectors of the Montréal area was between 4% and 9%[10], greater than at the same time the year before. The South Shore was the exception, where growth remained the same, at 5%.

In the condominium segment, however, where conditions were still relatively soft, a slight decrease in the average price (between -1% and -3%) was recorded instead for the third quarter of 2017 in most of the sectors of the greater Montréal area. Only in Vaudreuil-Soulanges was an increase observed (about 4%).

Over the next few quarters, the economic outlook should remain favourable to housing demand, and the market should continue to

tighten. Given the recent evolution of the price acceleration indicator and its proximity to the problematic threshold, the classification could change over the next few quarters.

Evidence of overvaluation remained weak

Since 2016, the economic climate and population growth have both gotten stronger in the Montréal area. This improved economic context has allowed the market to absorb recent price increases. As a result, evidence of overvaluation remained weak.

Indeed, between the second and third quarters of 2017, developments in the fundamentals in the area were generally favourable to housing demand. The population of young people aged 25 to 34 once again increased (+0.3%), and the five-year fixed rate[11] continued to decrease (from 1.8% to 1.2%). However, real personal disposable income per capita remained relatively stable (0.1%) from one quarter to the next.

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[8] Since the second quarter of 2015, single-family home market conditions have been tightening at similar rates in all sectors of the CMA. However, on the Island of Montréal and the South Shore, conditions were tighter to begin with than in Laval, on the North Shore or in Vaudreuil-Soulanges.

[9] Island of Montréal, Laval, North Shore, South Shore and Vaudreuil-Soulanges.

[10] Change compared to the third quarter of 2016. Actual data, non-adjusted.

[11] Adjusted for inflation observed during the third quarter in the Montréal CMA.

All price measures considered together, the models indicate that the price levels recorded during the third quarter were warranted by the economic and demographic fundamentals. That said, the various measures of real house prices (adjusted for inflation and seasonal variations) used by the models evolved in slightly different ways. Indeed, compared to the previous quarter, the average Centris® price remained relatively stable (+0.2%), while Statistics Canada's New House Price Index (NHPI) decreased slightly (from 0.791 to 0.788), and the Teranet–National Bank House Price Index™ increased (from 121.2 to 122.5).

Evidence of overbuilding remained weak

During the third quarter of 2017, both overbuilding indicators (the number of completed and unsold homes per 10,000 population, and the vacancy rate for conventional rental units) suggested weak evidence of overbuilding (see figures 3 and 4).

The number of completed and unsold homes per 10,000 population continued to decline, reaching 5.5 (compared to 6.1 the previous quarter). It remained, therefore, under the threshold[12] that would indicate an imbalance in homebuilding in Montréal. In fact, this was the lowest level this indicator had reached in the metropolitan area since the

Figure 4

Vacancy Rate Decreased to 2.8 % in 2017
Vacancy Rate (%) – Montréal CMA
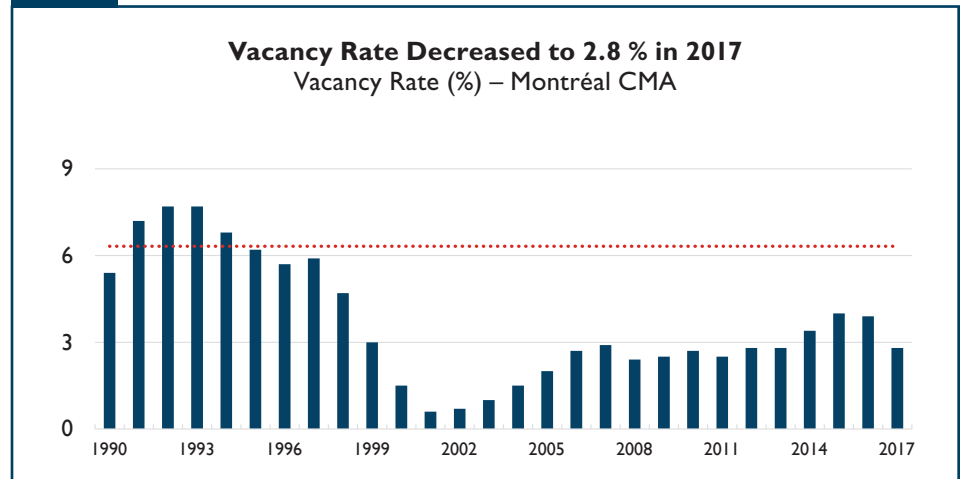
Source: CMHC. Last data point: October 2017

beginning of 2011. The decrease is attributable to both an increase in the population and a decrease in the inventory of unsold units. The decrease in inventory recorded for the third quarter is the result of a slight increase in the absorption of new, completed condominiums, as well as of a slowdown in starts over the last two years[13].

However, the strength of construction activity over the last four months of the year led to a 40% increase in condominium starts in 2017. This will result in an increase in completions, and will likely put upward pressure on the inventory of unsold new condominiums over the next few quarters, without, however, pushing it past the problematic threshold in the short term.

The vacancy rate for conventional rental units, for its part, recorded a significant decrease in the third quarter of 2017. Indeed, according to the Rental Market Survey, it fell from 3.9% in October 2016 to 2.8% in October 2017, for the strongest decline recorded in over 15 years. The reason for the decline: an increase in conventional rental demand driven by an upswing in net migration. In fact, data indicate a marked rise in net international migration in the Montréal area, particularly in the category of non-permanent residents, as well as a slight decrease in the interprovincial migration deficit[14]. These factors caused rental demand to increase[15] at a faster pace than supply between the 2016 and 2017 surveys.

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[12] This threshold is 9.6.

[13] Condominium starts decreased by 25% in 2015 and by 14% in 2016.

[14] Net international and interprovincial migration in the province increased by about 9,000 people from July 2016 to June 2017. The Montréal CMA generally receives 60% of this gain.

[15] Census data from 2011 shows that migrants tend to opt for rental accommodations when they arrive in a new area. The large number of migrants that arrived in the Montréal area therefore likely contributed to stronger rental demand.

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 detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (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 incidence of signs of vulnerability, 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 a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

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 vulnerability. 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 vulnerable 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 vulnerabilities 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 signs of overheating, 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 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 signs of overbuilding 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 degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance 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 that can identify imbalances. 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 showing vulnerability 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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