HOUSING MARKET INFORMATION

# HOUSING MARKET ASSESSMENT

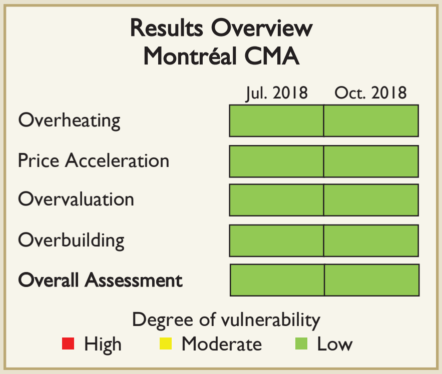
## Montréal CMA

Date Released: Fourth Quarter 2018

Canada

CMHC SCHL

## Highlights




- According to the Housing Market Assessment (HMA) analytical framework, the degree of vulnerability of the Montréal census metropolitan area (CMA) housing market remained low during the second quarter of 2018.[1]
- Evidence of overvaluation remained weak, with house prices having stayed in line with economic and demographic fundamentals.
- Evidence of both market overheating and price growth acceleration remained weak. However, the Montréal resale market stayed tight, and this maintained upward pressure on prices.
- Evidence of overbuilding remained weak, as the inventory of completed and unsold housing units per 10,000 population and the rental housing vacancy rate stayed at relatively low levels.

# 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 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 degrees of vulnerability 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 due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolving 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 degrees of market vulnerability. 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 potentially low degree of vulnerability. As the number of intense and persistent signals increases, the associated degree of vulnerability increases.



[1] Results are based on data as of the end of June 2018 and local market intelligence up to the end of September 2018. 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 low, but the market continued to increasingly favour sellers

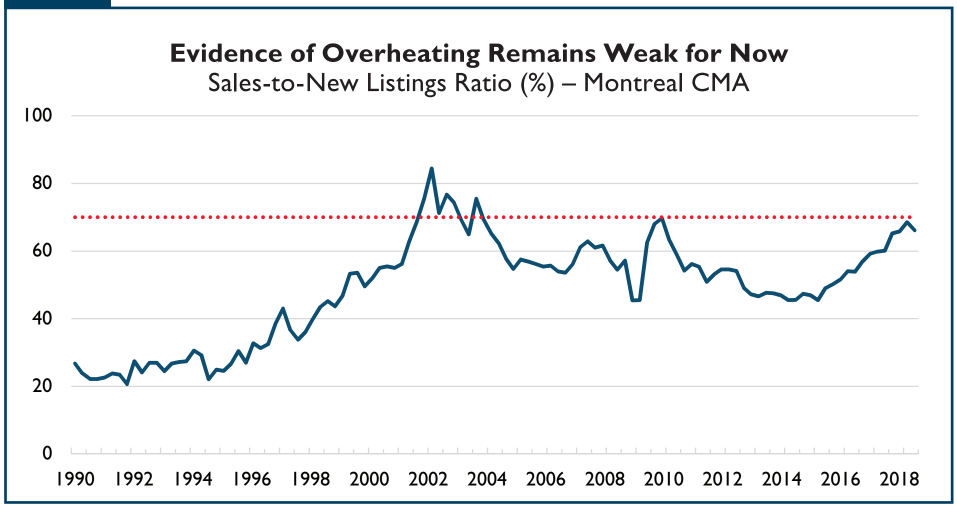
In the second quarter of 2018, evidence of overheating remained low, although the market stayed relatively tight. The seasonally adjusted sales-to-new listings ratio was close to 66% (see figure 1), which remained just below the threshold for problematic conditions.[3] It should be noted, though, that the sales-to-new listings ratio was down slightly from the previous quarter, for a first decrease in two years, as the growth in Centris® sales was outpaced by the rise in new listings.

As well, the active listings-to-sales ratio,[4] another market indicator, continued to decrease, thereby also showing that the Montréal resale market has been tightening and increasingly favourable to sellers.[5] The tighter conditions could in fact be observed in all market segments (see figure 2). For single-family houses and plexes (rental properties with two to five units), market conditions have favoured sellers for over a year,[6] while this became the case only much more recently for condominiums.

Marie-Claude Guillotte, Economist

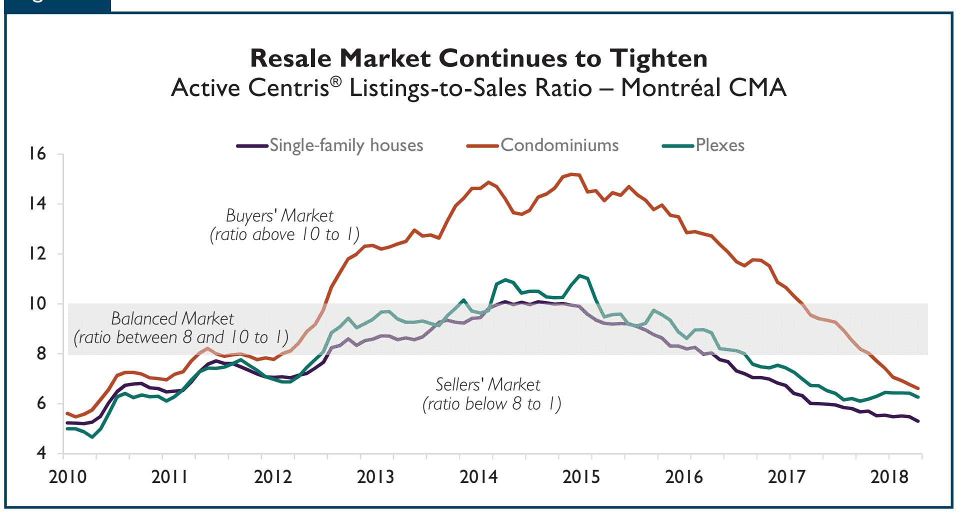
*"For a seventh straight quarter, the degree of vulnerability of the Montréal CMA housing market remained low. The strength of the fundamentals supported the price levels observed on the market. However, the significant tightening of the resale market continued to put upward pressure on prices."*

Figure 1




Last data point: 2018 Q2.
Sources: Quebec Federation of Real Estate Boards (QFREB) through the Centris® system, seasonally adjusted data by CMHC.

Figure 2




Last data point: August 2018
Sources: QFREB through the Centris® system, seasonally adjusted data by CMHC, three-month moving average.

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[3] This threshold 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 below 8 sellers (or active listings) per buyer (or Centris® sale); in a balanced market, the ratio is between 8 and 10 sellers per buyer; and, in a buyers' market, the ratio is above 10 sellers per buyer. In a sellers' market, sellers have greater negotiating power relative to buyers, such that price increases are usually higher. In a buyers' market, buyers have greater negotiating power relative to sellers, such that prices rise only slightly or can even fall. In a balanced market, buyers and sellers have similar negotiating power, such that prices tend to increase at about the rate of inflation.

[6] See footnote 5.

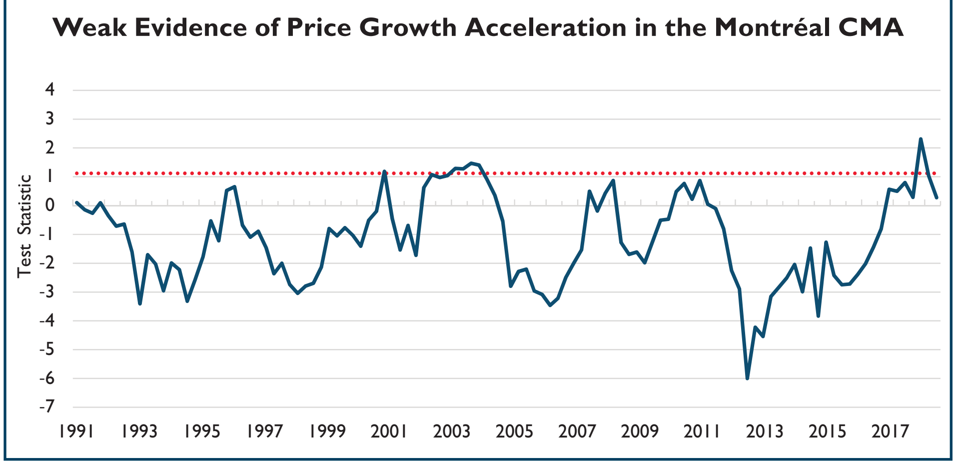
For single-family homes, the active listings-to-sales ratios decreased in the large sectors[7] of the metropolitan area, and market conditions therefore became even more favourable to sellers than in the previous quarter.[8] This was particularly evident in certain sectors of the Island of Montréal, where there were as few as four sellers (sometimes even fewer) for each buyer. This was the case, for example, in the southern part of the West Island, Le Sud-Ouest, Rosemont, Villeray, Notre-Dame-de-Grâce, Montréal West and L'Île-des-Sœurs.

Just like for single-family houses, market conditions for condominiums also varied from one sector to another in the CMA. In Laval and on the North Shore, the active listings-to-sales ratios (around 10 to 1 in Laval and 11 to 1 on the North Shore) were indicative of a buyers' market. On the South Shore, the market was balanced,[9] while, in Vaudreuil-Soulanges, conditions moved into sellers' market territory, for the first time since 2011. On the Island of Montréal overall, the market has been favourable to sellers for the past two quarters. Some of the Island's central subsectors, including Le Sud-Ouest, Westmount, Outremont, Mount Royal, Le Plateau-Mont-Royal and Rosemont, stood out as the most favourable to sellers.

## Evidence of price growth acceleration was weak but continues to be monitored

Evidence of price growth acceleration remained weak in the second quarter of 2018 (see figure 3). However, the tightening of the resale market in recent months maintained pressure on prices.

Figure 3




Last data point: 2018 Q2.
Sources: QFREB through the Centris® system, CMHC calculations.

In the second quarter of 2018, the average Centris® price rose by 5.0% over the second quarter of 2017, which was a slightly smaller increase than the rises registered in the two previous quarters. It should be noted, however, that the rates of growth in average prices varied depending on the market segments and the sectors of the Montréal metropolitan area.

Single-family homes were the housing type that recorded the smallest increase in average price in the Montréal area in the second quarter of 2018 (+3.0%). Despite slower growth in a number of sectors on the Island of Montréal, compared to the second quarter of 2017, several of them[10] registered gains of more than 10% in their average prices for single-family houses. In the suburbs, Laval and the North Shore stood out, as they saw decreases in their average price growth rates, which fell to 2% and -1%, respectively, in the second quarter of 2018. In Vaudreuil-Soulanges and on the South Shore, the average price growth rates were down slightly in the second quarter of 2018 from the same period last year but still hovered around 5%.

In the condominium segment, the growth in the average price in the Greater Montréal area picked up in the second quarter of 2018 (+4.5%), compared to the second quarter of 2017 (+3.2%). By large geographic sector, increases were recorded on the Island of Montréal, in Laval and in Vaudreuil-Soulanges. On the Island, the more central districts[11] were the ones where the growth in prices picked up the most between the second quarters of 2017 and 2018.

Over the coming quarters, it is expected that the economic outlook will remain favourable to housing demand and that the market will continue to tighten.

7 Island of Montréal, Laval, North Shore, South Shore and Vaudreuil-Soulanges.

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 See footnote 5.

10 Notre-Dame-de-Grâce, Montréal West, the southern part of the West Island of Montréal, the boroughs of Lachine, LaSalle, Montréal-Nord, Ahuntsic-Cartierville, Villeray and Côte-des-Neiges as well as Côte-Saint-Luc and the central districts (Westmount, Outremont, Hampstead and Mount Royal).

11 Le Sud-Ouest, L'Île-des-Sœurs, Ville-Marie and Le Plateau-Mont-Royal.

Given the recent trend in prices on the Montréal resale market, the price growth acceleration indicator will therefore continue to be monitored over the coming months.

## Evidence of overvaluation remained weak

In the second quarter of 2018, the HMA model did not identify any significant imbalance between real house prices[12] and the price levels dictated by housing market fundamentals, such as personal disposable income and population (see figure 4). The economic and demographic indicators continued to show results justifying the price levels observed on the Montréal housing market. As a result, the model revealed no significant evidence of overvaluation.

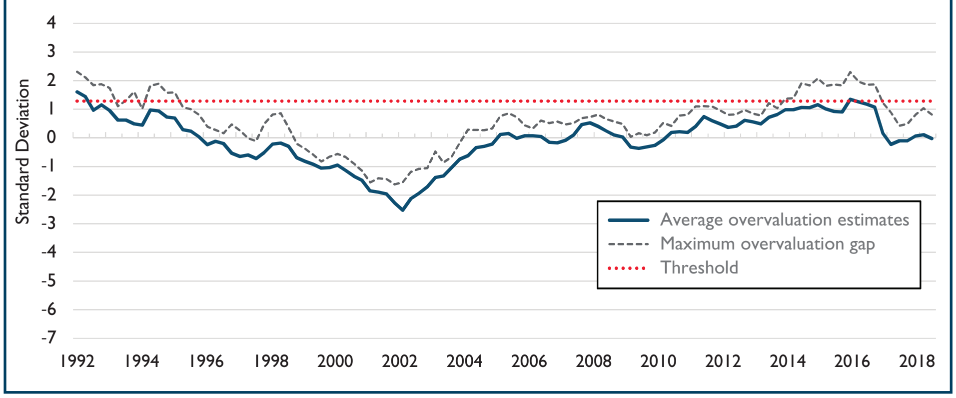
A more detailed analysis revealed that most fundamentals remained at levels supporting housing demand in the second quarter. The population aged 25 to 34 continued to grow (+1.4% over the same quarter in 2017). As for real personal disposable income per capita, albeit stagnant in the second quarter, the substantial gains registered since 2015 have pushed this indicator to high levels. Lastly, the real five-year fixed mortgage rate (adjusted for inflation) increased in the second quarter (from 1.8% to 2.3%) but remained at a historically low level.

As for real house prices (adjusted for inflation), they all increased. Statistics Canada's New Housing Price Index (NHPI),[13] the average Centris® price[14] and the Teranet–National Bank House Price Index™ rose by 0.8%, 3.6% and 2.8%, respectively, compared to the second quarter of 2017.

Since 2016, economic conditions in the Montréal area have remained favourable to housing demand. In that sense, even though prices increased, they did so in a context of strengthening fundamentals, as mentioned earlier.[15] Reflecting this, the overvaluation analysis showed little difference between real house prices and the prices dictated by the fundamentals.

Figure 4

**Weak Evidence of Overvaluation in the Montréal CMA**




Sources: QFREB through by the Centris® system, Statistics Canada, Teranet and National Bank, CMHC calculations.
Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. These include demand, supply, hybrid and affordability models, each of which is estimated using four measures of house prices to generate 16 unique estimates of overvaluation. The selection of models is conducted with a set of cointegration tests, and the selected models are estimated with dynamic ordinary least squares (DOLS). The maximum overvaluation gap is obtained from the model that has the largest gap between the actual price and the estimated price. The threshold is fixed at a critical value of 1.29 for a confidence level of 80%. Overvaluation is signalled when overvaluation estimates lie above the threshold.

## Evidence of overbuilding remained negligible

In the first quarter of 2018, both overbuilding indicators, namely, the inventory of completed and unsold housing units per 10,000 population and the vacancy rate for conventional rental housing, suggested weak evidence of overbuilding (see figures 5 and 6).

The inventory of completed and unsold housing units per 10,000 population remained relatively low in the second quarter of 2018, reaching 5.9 units, compared to 5.7 in the previous quarter. The increase in

12 Observed prices adjusted for inflation.

13 Source: Statistics Canada.

14 Source: Quebec Federation of Real Estate Boards, through the Centris® system.

15 The presence of foreign buyers in the Montréal CMA does not seem to be a determining factor in the price increase, since it is limited overall. In fact, foreign buyers have accounted for less than 2% of all residential transactions in the Montréal CMA since the beginning of 2018 (sources: JLR; CMHC, calculations). As well, a recent CMHC study, *Examining Escalating House Prices in Large Canadian Metropolitan Centres*, revealed that demand factors (employment, population, etc.) and supply constraints (land scarcity, etc.) were key in explaining the growth in prices.

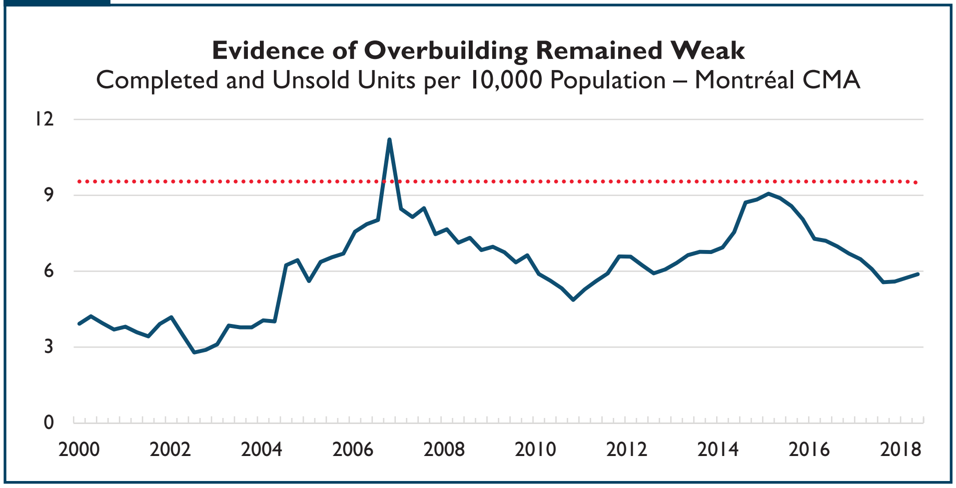
demand, combined with the marked slowdown in condominium starts in 2015 and 2016,[16] kept the inventory of unsold new condominiums relatively low.

However, the surge in construction in Montréal since 2017 will result in an increase in completions, which will likely put upward pressure on the inventory of unsold new condominiums over the next few quarters. That said, given the strong demand, evidence of overbuilding will nevertheless remain weak.

The vacancy rate for conventional rental units, for its part, decreased. According to the Rental Market Survey, it fell from 3.9% in October 2016 to 2.8% in October 2017. The reason for the decline: an increase in conventional rental demand driven by an upswing in net migration. Indeed, net international migration in the Montréal area rose sharply between 2016 and 2017, particularly in the category of non-permanent residents.[17]

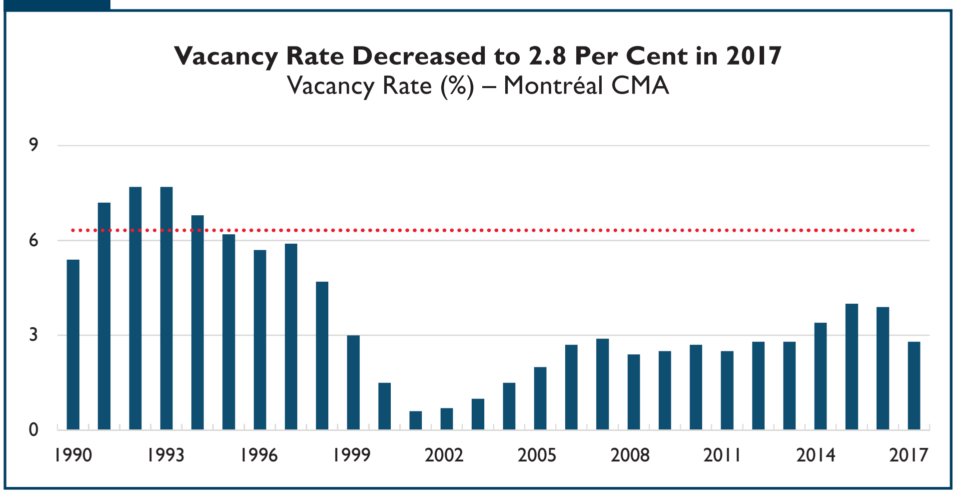
However, conventional rental apartment construction in the Greater Montréal area was strong in 2017 and in the first eight months of 2018, recording increases of 69% and 70%, respectively, in these two periods. We will therefore have to wait and see if the vast majority of these new units find tenants in the next few quarters. If not, the result would be upward pressure on the vacancy rate, but the increase would not be sufficient to change our assessment of weak evidence of overbuilding.

Figure 5




Last data point: 2018 Q2.
Sources: Statistics Canada and CMHC.

Figure 6




Last data point: October 2017
Source: CMHC

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

[17] Net international and interprovincial migration in the Montréal CMA increased by about 7,700 people from July 2016 to June 2017. This gain was essentially attributable to net non-permanent resident migration, which reached nearly 9,500 people over the same period.

## 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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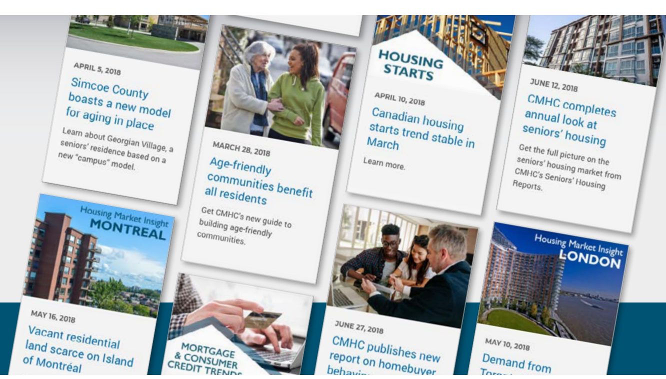


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