HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

Québec CMA

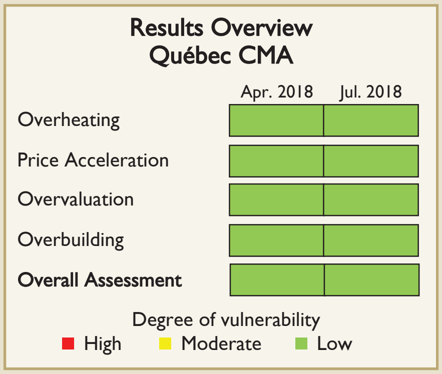
Date Released: Third Quarter 2018



Canada

CMHC SCHL

Highlights



- According to the CMHC's Housing Market Assessment (HMA) analytical framework, the overall degree of vulnerability of the market in the Québec CMA remained low in the first quarter of 2018.[1]
- Overall, house prices in the area remained close to levels supported by the economic and demographic fundamentals. Evidence of overvaluation therefore remained weak.
- As well, there was still no indication of any overheating or price growth acceleration. Indeed, supply was relatively abundant on the resale market and the rise in prices in the area stayed low.
- Evidence of overbuilding, for its part, was also weak in the first quarter of 2018. However, the pace of conventional rental housing construction remained high from a historical standpoint. Given the large number of units recently completed or currently under construction, supply of rental apartments could outpace demand, and this would put upward pressure on the vacancy rate.

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 March 2018 and market intelligence as of the end of June 2018. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] The methodology is presented in greater detail in the national HMA report.

In Detail

Overheating

In the Québec census metropolitan area (CMA), the recent supply of residential properties for sale remained relatively abundant relative to demand. In the first quarter of 2018, the Centris® sales-to-new listings ratio was 49.8%, well below the threshold for overheating, set at 70% for the Québec area (see figure 1). This indicator is therefore not pointing to any overheating of the housing market, based on the HMA analytical framework.

This diagnosis was confirmed by another measure, that is, the number of sellers per buyer, or listings per sale. In the first quarter of 2018, the average number of active Centris® listings per sale was 11.5 for single-family houses, 13 for plexes and 19.3 for condominiums[3] (see figure 2). The market is said to be "balanced" when there are, on average, 8 to 10 properties for sale for every buyer. The Québec area resale market therefore remained generally favourable to buyers, which also explains why the evidence of overheating remained weak.

Nicolas Bernatchez,
Senior Analyst

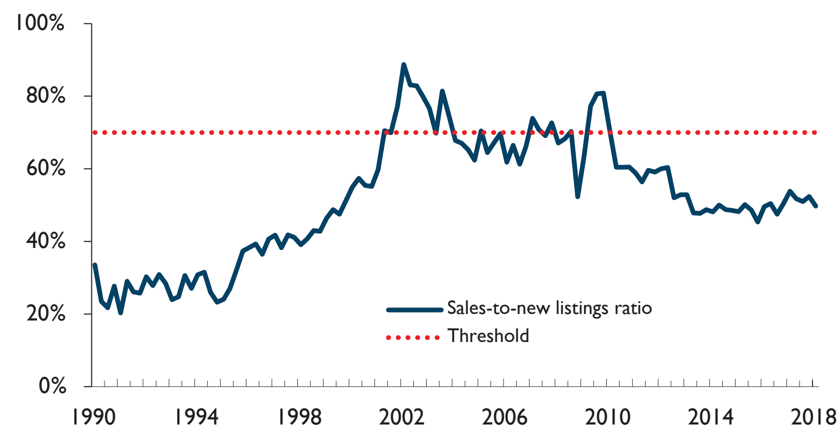
"The overall degree of vulnerability of the Québec area housing market remained low in the first quarter of 2018. However, evidence of overbuilding must continue to be monitored, given the large number of rental units recently completed or under construction."

While no major concerns were raised for the overall CMA, there were certain differences among the sectors. In fact, some sectors in the area showed balanced market conditions for single-family houses in the first quarter of 2018[4], namely, Val-Bélair–L'Ancienne-Lorette, Charlesbourg, La Haute-Saint-Charles and Sainte-Foy–Sillery. And the single-family home market remained favourable to sellers in Québec's Les Rivières and Basse-Ville sectors.

As well, the relationship between supply and demand remained tighter for more affordable single-family houses (under $300,000). At any rate, demand did not seem to be significantly or persistently exceeding supply in the Québec area, which kept evidence of overheating weak.

Figure 1

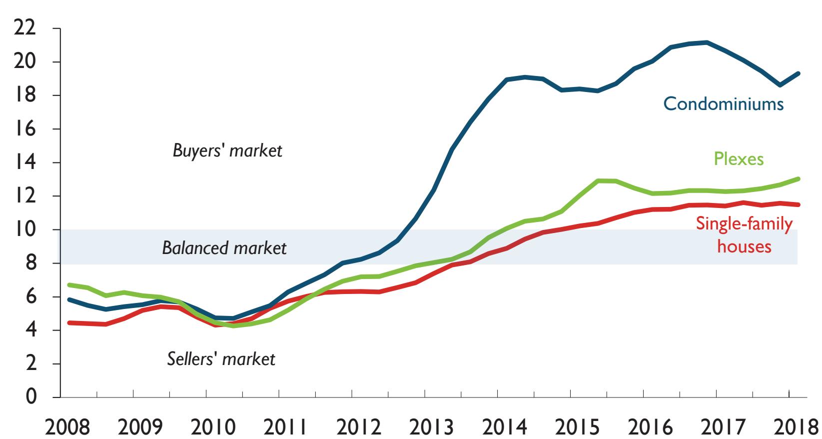
Evidence of Overheating Remains Weak
Québec CMA



Sources: Québec Federation of Real Estate Boards (QFREB), CMHC calculations.
Last data point: First quarter 2018.

Figure 2

Market Conditions Remain Generally Favourable to Buyers
Active Centris® Listings per Sale, Québec CMA



Sources: QFREB, CMHC calculations. Last data point: First quarter 2018.

[3] Figures for the 12 months to the end of the first quarter of 2018.
[4] Single-family (single-detached, semi-detached and row) houses account for the majority of the Centris® sales in the Québec CMA, or about 70%.

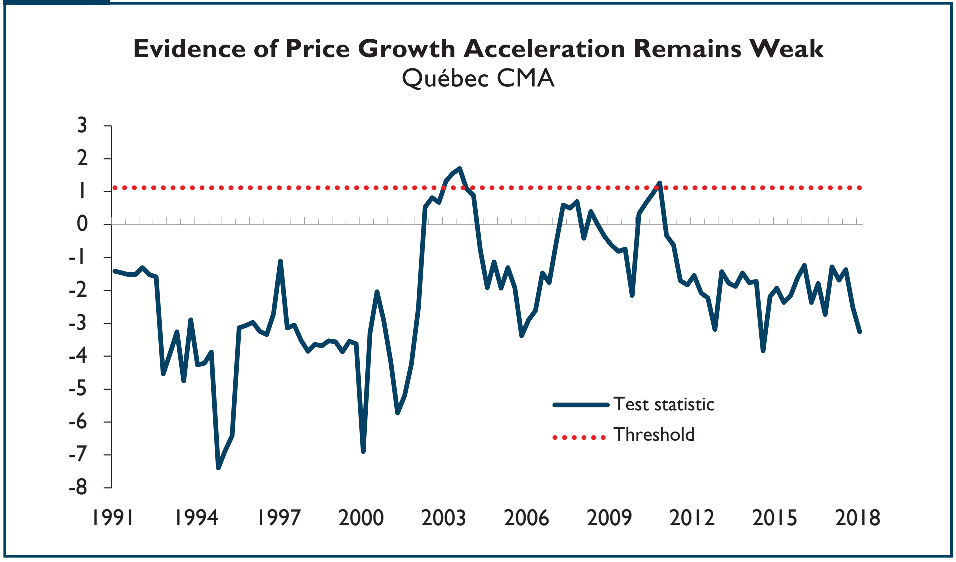
Price growth acceleration

The HMA analytical framework did not detect any evidence of price growth acceleration in the Québec CMA (see figure 3). This was not surprising, given the relatively low rise in house prices in the area (see figure 4). Between the first quarter of 2017 and the first quarter of 2018, the average Centris® price, for all housing types combined, rose by 2%[5]. When adjusted for inflation, this represents a real increase of barely 1%.

This result was influenced in particular by the trend in prices in the condominium segment. Over the year preceding the first quarter of 2018, the median Centris® price of condominiums decreased by 1% in the Québec CMA, reaching $189,900[6]. In the single-family home segment, which accounts for about 70% of the sales in the area, the median price grew by 2%, to $252,000. Although slightly greater than the gains registered in the previous three years, the growth in prices remained modest.

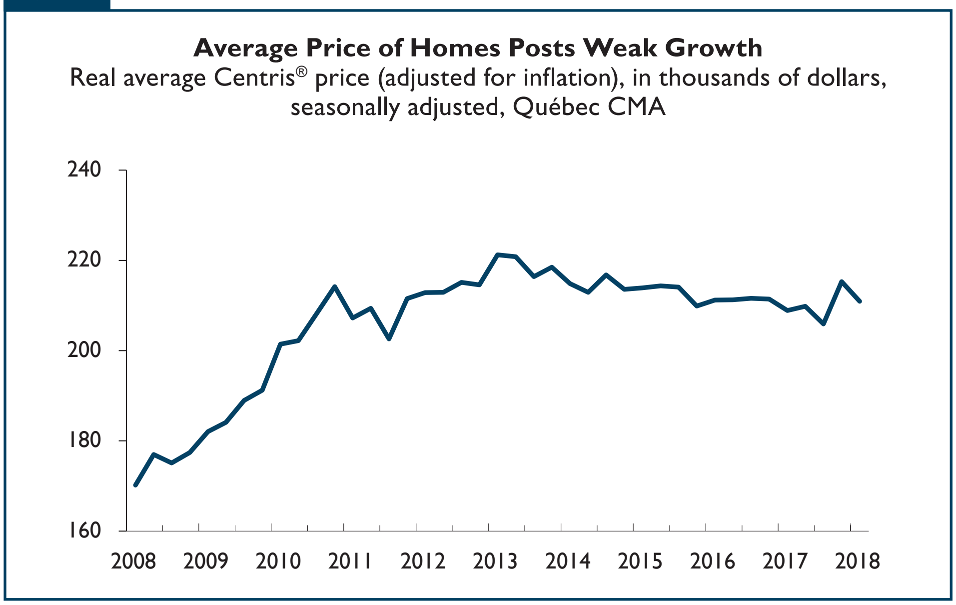
The other available measures for the area also indicated weak growth in home prices. In fact, when accounting for inflation, the Teranet–National Bank House Price Index™ for the Québec CMA fell by 2.4% between the first quarter of 2017 and the first quarter of 2018, and the Statistics Canada New Housing Price Index decreased by 0.6%[7]. This downward trend in prices in real terms also supports the diagnosis of our analytical framework to the effect that there was no evidence of price growth acceleration in the Québec area.

Figure 3



Sources: QFREB, CMHC calculations. Last data point: First quarter 2018.

Figure 4



Sources: QFREB, CMHC calculations. Last data point: First quarter 2018.

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[5] Seasonally adjusted data.

[6] Data from Québec Federation of Real Estate Boards, QFREB Barometer—Residential Market, first quarter 2018, for the 12 months to the end of the first quarter of 2018.

[7] Seasonally adjusted data.

Overvaluation

In the first quarter of 2018, evidence of overvaluation remained weak in the Québec metropolitan area. Indeed, none of the models used for the HMA suggested that house prices were above the levels supported by the fundamentals in the area (see figure 5). In other words, home prices remained consistent with the overall economic and demographic trends.

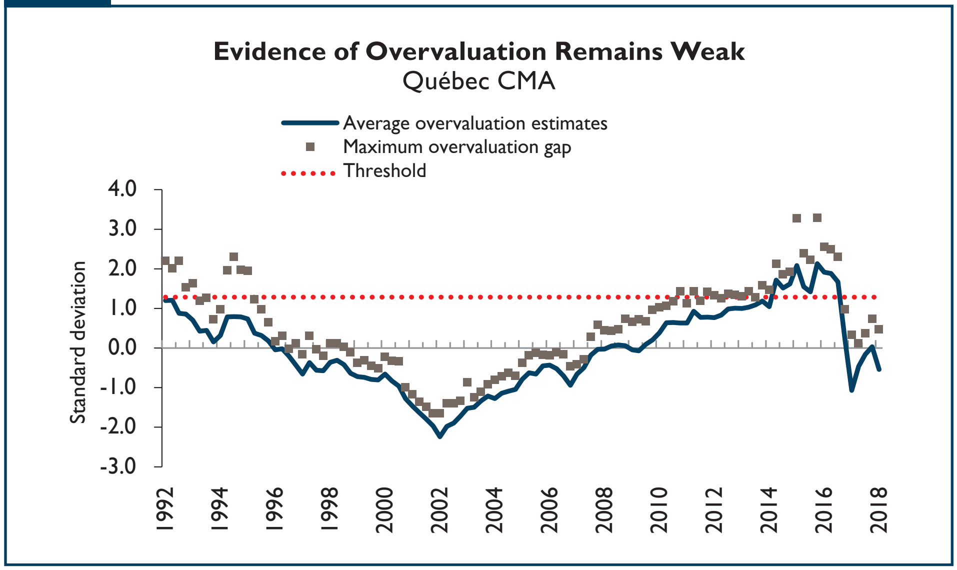
According to the estimates, the population aged 25 to 34—potential first-time homebuyers—in the Québec area is at a standstill, and mortgage rates across the country have been rising again over the past year. These factors are likely to somewhat weaken housing demand and lower the anticipated level of prices. However, economic conditions have improved over the past year. Between the first quarter of 2017 and the first quarter of 2018, full-time employment rose sharply in the area. This may well have contributed to supporting growth in real personal disposable income per capita and demand on the housing market.

Also, as noted in the previous section, growth in home prices remained rather weak in the Québec area. There was no indication of any significant or persistent imbalances appearing between the prices observed in the area and those corresponding to the economic and demographic conditions and the level of activity on the housing market. Evidence of overvaluation therefore remained weak.

Overbuilding

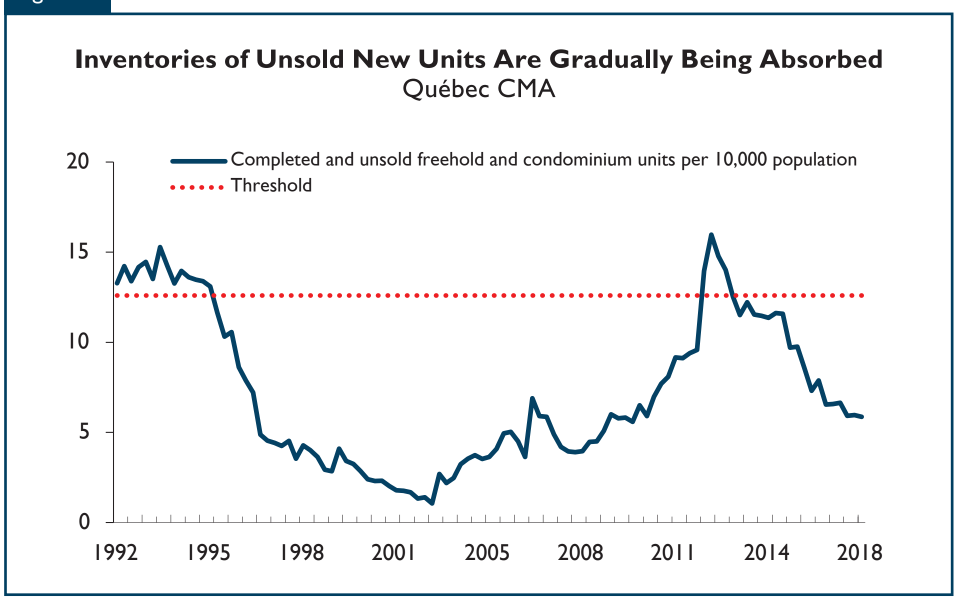
In the first quarter of 2018, the two indicators used to assess imbalances in the growth in housing supply were below the thresholds for overbuilding. These two indicators are completed and unsold freehold and condominium units per 10,000 population and the vacancy rate for conventional rental housing.

Figure 5



Sources: QFREB, Statistics Canada, Teranet and National Bank of Canada, CMHC calculations.
Last data point: First quarter 2018.
Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. Baseline models 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.

Figure 6



Source: CMHC. Last data point: First quarter 2018.

After reaching a high point in 2012, the inventory of unsold new homes was gradually absorbed in the Québec area (see figure 6). This inventory was largely composed of condominium units. The rebalancing was supported by the slowdown in the construction of dwellings of this type in the last few years. Evidence of overbuilding in this market therefore weakened and remained weak in the first quarter of 2018.

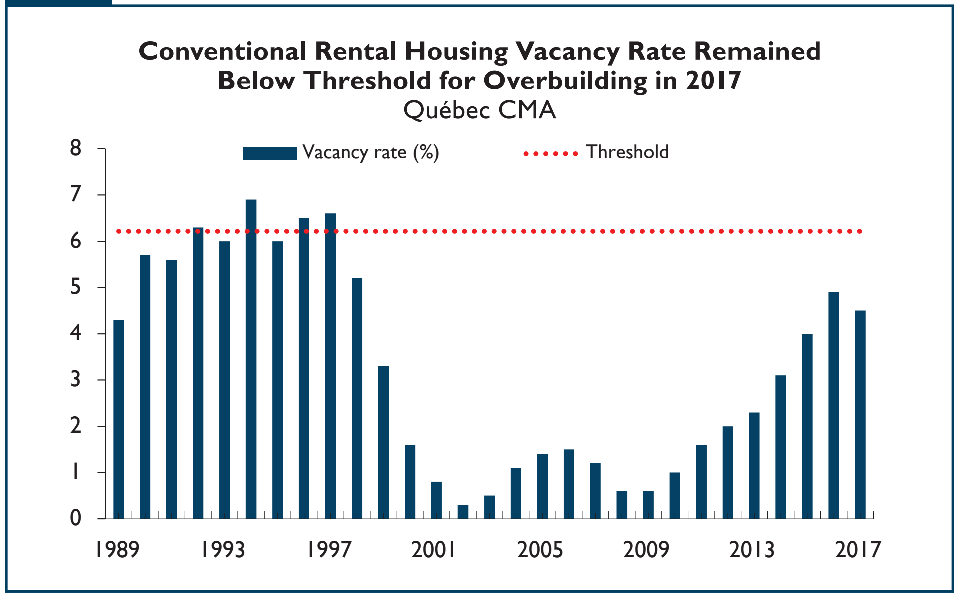
Based on the analytical framework, evidence of overbuilding was also weak in the rental market. According to the latest measure taken in October 2017, the vacancy rate for conventional rental housing in the Québec area stood at 4.5%, which is below the threshold for overbuilding (see figure 7)[8]. Still, this rate has risen significantly in recent years, partly as a result of a strong increase in supply.

In fact, the recent trend in housing supply in the area continues to raise some concerns.

The condominium segment stood out in 2017, with nearly 1,200 new units started. Additionally, as previously mentioned, the number of units available on the resale market was relatively high. As a result, some caution remains warranted relative to the condominium market.

As for the rental market, just over 2,200 conventional rental units have been completed in the Québec metropolitan area since the vacancy rate was last measured[9]. And, at the end of May 2018, there were still about 2,500 units under construction. These are historically high levels in

Figure 7



Source: CMHC Rental Market Survey. Last data point: 2017.

the area. The rapid growth in supply is therefore bound to continue over the coming months.

It remains to be seen if demand will be sufficient to absorb all these units in the short or medium term. Even though employment growth, rising net migration and the aging population are favourable to the rental market in the Québec CMA, housing supply may well outpace demand. In fact, in the seniors' housing segment, where construction has also been very active for the past year, the vacancy rate rose by 2.6 percentage points between 2017 and 2018, reaching 7.6%[10].

Even with the weak evidence of overbuilding in the first quarter of 2018, caution remains warranted relative to the rental market, where significant or persistent imbalances could appear. The pace of rental housing starts in the area must continue to be monitored.

[8] CMHC Rental Market Survey, October 2016 and October 2017.

[9] CMHC Rental Market Survey, October 2017, units completed between July 2017 and May 2018. The units completed between July 2017 and September 2017 had been completed at the time of the October survey but were not included in the survey universe as they had been on the market for less than three months.

[10] CMHC Seniors' Housing Survey, 2017 and 2018.

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.

* 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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