HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

Montréal CMA

Date Released: First Quarter 2019

Canada

CMHC SCHL

Highlights

Results Overview
Montréal CMA

	Oct. 2018	Feb. 2019
Overheating		
Price Acceleration		
Overvaluation		
Overbuilding		
Overall Assessment		

Degree of vulnerability
■ High ■ Moderate ■ Low

- 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 third quarter of 2018.[1]
- Evidence of overvaluation remained weak, with house prices having stayed in line with economic and demographic fundamentals.
- There is now evidence of overheating on the horizon on the Montréal resale market, given the narrow gap between supply and demand. This is putting pressure on prices, but evidence of price growth acceleration still remains weak for the moment.
- 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 from a historical standpoint.

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 and contribute to an orderly adjustment of housing market imbalances.

The HMA is an analytical framework that provides a comprehensive view of housing market vulnerabilities. It should be noted that it intends to identify short-term imbalances in the housing market. As such, it is not aimed at being a framework to identify long-term fundamental affordability challenges. It considers four main factors: overheating, price acceleration, overvaluation and overbuilding. Overheating is detected when sales greatly outpace new listings in the market for existing homes. Price acceleration is signaled when the growth rate of house prices increases rapidly. Overvaluation indicates that house prices are elevated compared to price levels supported by personal disposable income, population, interest rates, and other fundamentals[3]. Overbuilding is flagged when the rental apartment vacancy rate and/or inventory of newly built and unsold housing units are higher than normal.

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.

Colour codes indicate the degree of market vulnerability. The HMA is a comprehensive framework that considers both the intensity (magnitude) and the persistence of signals of imbalances. Generally, low intensity and persistence are associated with low evidence of vulnerability. As the number of intense and persistent signals increases, the associated degree of vulnerability becomes higher.

[1] Results are based on data as of the end of September 2018 (the annual rental apartment vacancy rates are from October 2018) and local market intelligence up to the end of December 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.

[3] Other fundamental factors include mortgage-borrowing capacity of households, required minimum down payment, and labor productivity.

In Detail

Evidence of overheating remains weak, but maybe not for long

In the third quarter of 2018, evidence of overheating remained weak, even though the seasonally adjusted sales-to-new listings ratio reached 71.2% (see figure 1), or just above the threshold for problematic conditions.[4] Should this again be the case over the coming quarters, evidence of overheating would then become moderate on the Montréal resale market, given the narrow gap between demand, represented by sales, and supply, represented by new listings. This indicator will therefore continue to be monitored in our upcoming publications.

More specifically, from July to September 2018, the sales-to-new listings ratio increased, given the growth in sales and the decline in new listings. The decrease in the ratio recorded in the previous quarter was therefore only a one-time drop, and the latest figures effectively confirmed the general market tightening trend that has been observed for the past few years now.

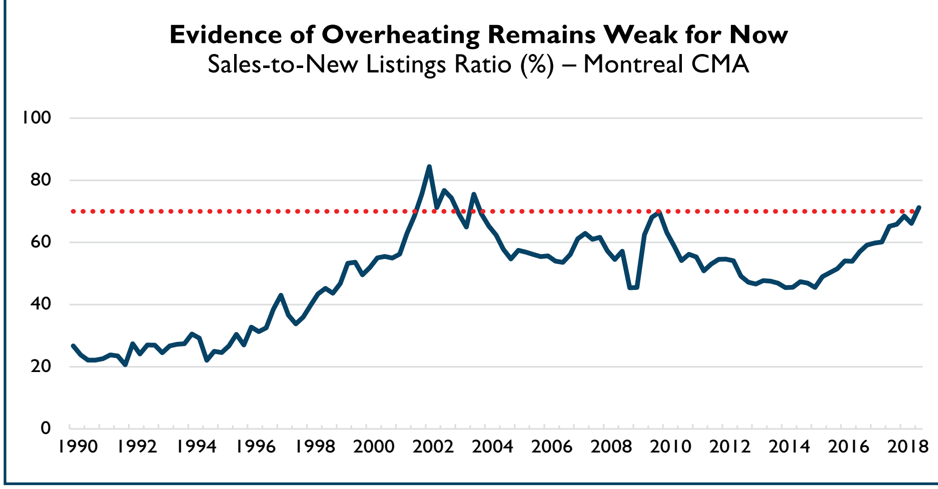
As well, the active listings-to-sales ratio,[5] another market indicator, continued to decrease, thereby also showing that the Montréal resale market has been tightening and increasingly favourable to sellers.[6] The tighter conditions could in fact be observed in all market segments. For single-family houses and plexes (rental properties with two to five units), market conditions have favoured sellers for over a year,[7] while this became the case only much more recently for condominiums.

For single-family homes, the active listings-to-sales ratios decreased in almost all the large sectors[8] of the metropolitan area, and market conditions therefore became even more favourable to sellers than in the previous quarter.[9] This was more marked in certain sectors of the CMA, where there were fewer than four sellers 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. In the suburbs, sectors such as Brossard–Saint-Lambert,

Francis Cortellino
Economist

"For two years now, the degree of vulnerability of the Montréal CMA housing market has remained low. The strength of the fundamentals supported the price levels observed on the market. However, there is now evidence of overheating on the horizon, given the current significant tightening of the resale market."

Figure 1



Sources: Quebec Federation of Real Estate Boards (QFREB) through the Centris® system, seasonally adjusted data by CMHC
Last data point: 2018 Q3

4 This threshold is set at 70%.

5 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.

6 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.

7 See footnote 6.

8 Island of Montréal, Laval, North Shore, South Shore, Vaudreuil-Soulanges and Saint-Jean-sur-Richelieu.

9 October 2017 to September 2018, compared to July 2017 to June 2018.

Le Vieux-Longueuil, Saint-Hubert, Île-Perrot and Vaudreuil-Dorion were in the same situation.

Just like for single-family houses, condominiums saw their market conditions tighten in the large sectors of the CMA. The Island of Montréal, the South Shore and Vaudreuil-Soulanges had sellers' markets for condominiums, while conditions were more balanced in Laval. In fact, only the North Shore and Saint-Jean-sur-Richelieu still had conditions favouring buyers. However, given the pace of sales and listings, these two markets should become balanced in 2019.

The Island of Montréal stood out, as in certain sectors, market conditions for condominiums heavily favoured sellers,[10] including Le Sud-Ouest, Le Plateau-Mont-Royal and Rosemont.

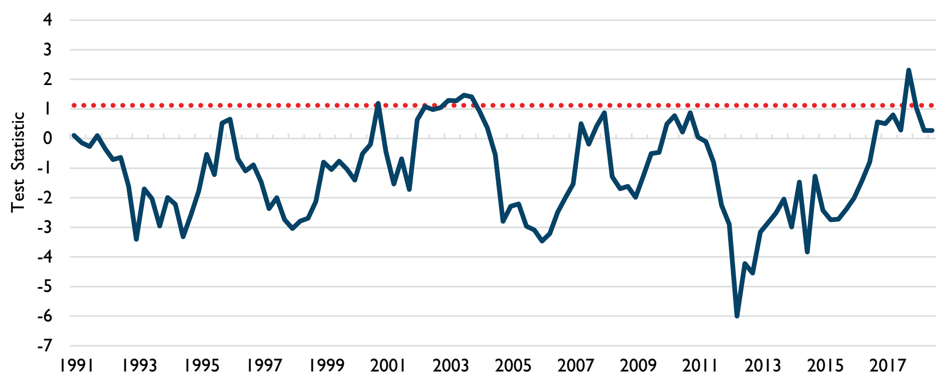
Evidence of price growth acceleration was weak

Evidence of price growth acceleration remained weak in the third quarter of 2018 (see figure 2). However, the tightening of the resale market in recent months has maintained pressure on prices.

In the third quarter of 2018, the average Centris® price rose by about 6.5% over the third quarter of 2017, an increase that was relatively comparable to the rises registered in the previous quarters (between 5.0% and 6.6%). 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.

Figure 2

Weak Evidence of Price Growth Acceleration in the Montréal CMA



Sources: QFREB through the Centris® system, CMHC calculations
Last data point: 2018 Q3

The average price of single-family homes in the Montréal CMA registered an increase of 6.0% in the third quarter of 2018, a rise that was smaller than the gain recorded in the third quarter of 2017.

In all large sectors of the Montréal CMA, except for those located in the southern part,[11] the gains in the average prices were greater than those observed in the same quarter a year earlier.

Certain sectors on the Island of Montréal still stood out with relatively significant gains in their average prices for single-family homes (over 15%), such as Notre-Dame-de-Grâce–Montréal West and Côte-des-Neiges–Côte-Saint-Luc.

In the condominium segment, the growth in the average price in the Greater Montréal area was more significant in the third quarter of 2018 (+5.3%) than in the third quarter of 2017 (-0.4%). By large geographic sector, larger increases were recorded on the Island of Montréal, on the South Shore and in Vaudreuil-Soulanges. On the Island, certain zones posted greater gains in their average prices, including Le Sud-Ouest, Saint-Laurent, Ville-Marie, Notre-Dame-de-Grâce–Montréal West and Côte-des-Neiges–Côte-Saint-Luc.

On the North Shore and in Laval, two sectors where condominium market conditions do not yet favour sellers, the average prices in the third quarter of 2018 were down or stable relative to a year earlier.

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

[10] With fewer than five sellers per buyer.

[11] South Shore, Saint-Jean-sur-Richelieu and Vaudreuil-Soulanges.

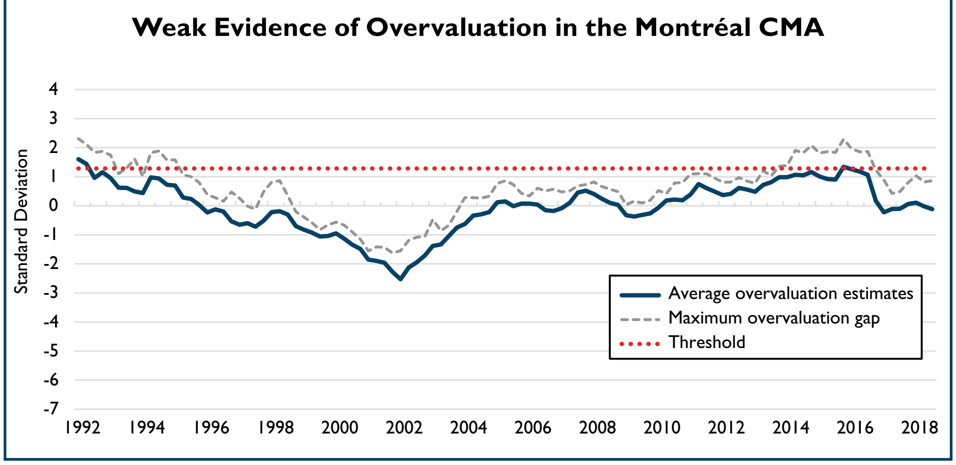
Evidence of overvaluation remained weak

In the third 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 3). 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 third quarter. The population aged 25 to 34 continued to grow (+1.5% over the same quarter in 2017). As for real personal disposable income per capita, albeit stagnant in the third 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) still remained at a historically low level.

As for real house prices (adjusted for inflation),[13] they all increased. Statistics Canada's New Housing Price Index (NHPI),[14] the average Centris® price[15] and the Teranet–National Bank House Price Index™ rose by 0.7%, 4.3% and 2.8%, respectively, compared to the third quarter of 2017.

Figure 3



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.

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.[16] Reflecting this, the overvaluation analysis showed little difference between real house prices and the prices dictated by the fundamentals.

Evidence of overbuilding remained negligible

In the third 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 4 and 5).

[12] Observed prices adjusted for inflation.

[13] Several different price indicators are used in order to get a more comprehensive market assessment.

[14] Source: Statistics Canada.

[15] Source: Quebec Federation of Real Estate Boards, through the Centris® system.

[16] 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.

The inventory of completed and unsold housing units per 10,000 population remained relatively low in the third quarter of 2018, reaching 5.5 units, compared to 5.9 in the previous quarter. The increase in demand, combined with the marked slowdown in condominium starts in 2015 and 2016,[17] allowed the inventory of unsold new condominiums to fall and remain relatively low.

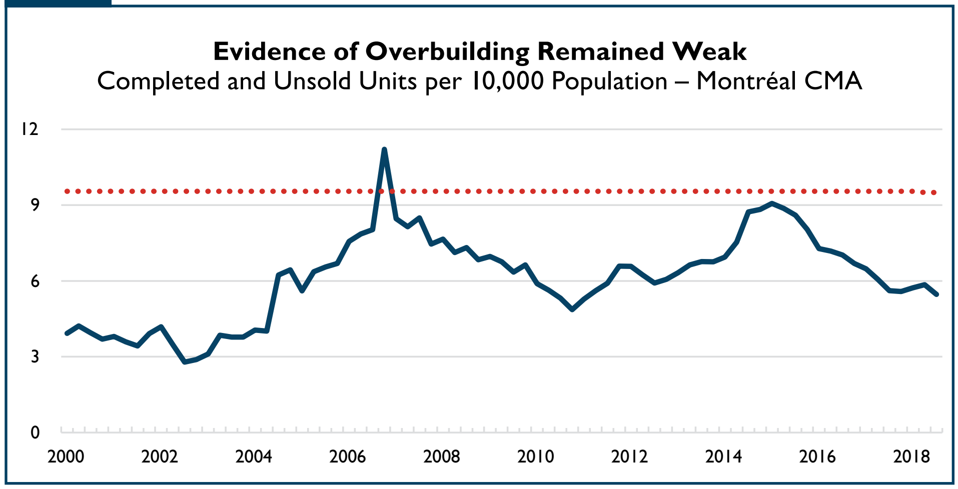
Although the number of new condominiums did rise slightly in 2017, the year 2018 also ended with a decline in starts of this type, for the third time in four years. Given the strong demand and this rather moderate pace of condominium construction, evidence of overbuilding should remain weak over the coming quarters.

The vacancy rate for conventional rental units, for its part, registered a second straight annual decrease. According to the Rental Market Survey, it fell from 3.9% in 2016 to 2.8% in 2017 and then to 1.9% in 2018. The reason for the decline: an increase in conventional rental housing demand driven, more specifically, by a marked upswing in net migration. Indeed, net international migration in the Montréal area[18] rose sharply between 2017 and 2018, particularly in the category of non-permanent residents.

What's more, this decrease in the vacancy rate occurred in a context where the supply of new rental units also increased significantly. In fact, between the 2017 and 2018 editions of our Rental Market Survey, around 7,500 units were added to the rental housing stock.[19] This was about 3,000 more than the year before and far exceeded the annual average from 2011 to 2014 (approximately 1,600 units).

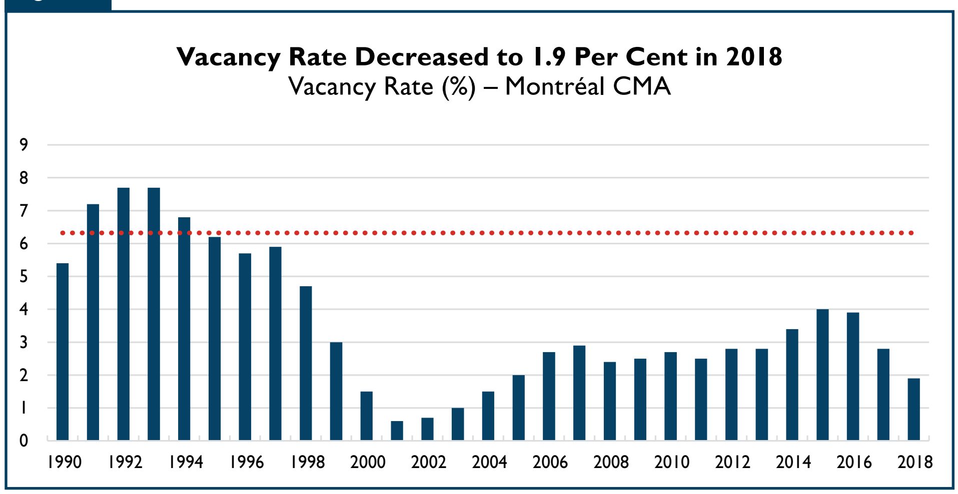
In 2018, over 10,000 conventional rental apartments[20] were in fact started, a 30-year record. We will therefore have to wait and see if the vast majority of these new units find tenants in the next few quarters. If not, the result would be upward pressure on the vacancy rate. Preliminary estimates indicate that this increase would, however, not be sufficient to change our assessment of weak evidence of overbuilding.

Figure 4



Sources: Statistics Canada and CMHC
Last data point: 2018 Q3

Figure 5



Source: CMHC
Last data point: October 2018

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

[18] The latest data are for the province of Quebec, not the Montréal CMA. Still, given the significant weight of the Montréal CMA in the migration data for the province, the provincial data probably apply to the metropolitan area as well.

[19] From July 2017 to June 2018. Only the structures that were open in June 2018 were included in the 2018 Survey.

[20] These units exclude apartments in seniors' residences.

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. 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 in the existing home market; (2) sustained acceleration in house prices meaning that the rate of increase in prices is itself increasing; (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 the intensity (magnitude) and the persistence of signals. 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 number, intensity, 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 recent 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 in the resale market. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions. 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.

Acceleration in House Prices

House price acceleration occurs when the growth rate in house prices continuously increases. Acceleration in house prices over an extended period would lead prices to unsustainable levels, hence increasing housing market vulnerability. To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating growth in 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—based on economic theory—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 apartment vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current levels and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. Overheating and price acceleration are measured by single indicator. Colour scales for these factors vary between green and yellow only. Overvaluation and overbuilding are measured by multiple indicators. Their colour scales, as well as the colour scale for the overall assessment, change among green, yellow and red to reflect different degrees of imbalances.

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: 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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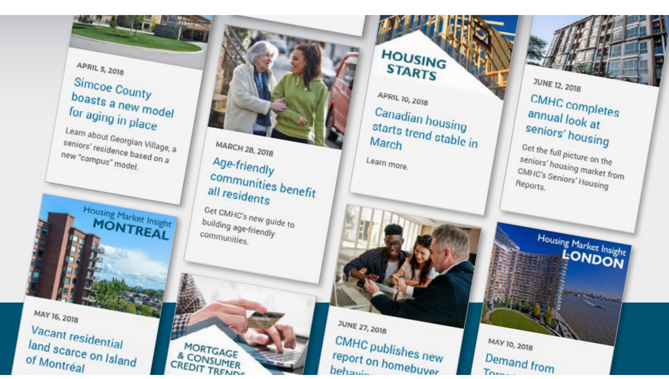

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