HOUSING MARKET ASSESSMENT
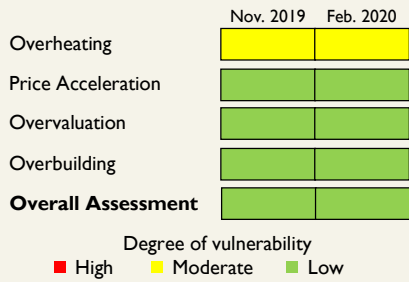## Montréal CMA

Date Released: First Quarter 2020

Canada

CMHC ♦ SCHL

Highlights

Results Overview
Montréal CMA

	Nov. 2019	Feb. 2020
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 in the third quarter of 2019.[1]

- Evidence of overvaluation remained weak, as housing prices stayed in sync with fundamental economic and demographic factors.

- The Montréal resale market continued to show evidence of overheating, given the narrow gap between sales and new listings. This put pressure on prices, but evidence of price growth acceleration remained weak.

- 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 imbalances in the housing market; 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 housing market fundamentals[3]. Overbuilding is flagged when the rental apartment vacancy rate and/or inventory of newly built and unsold housing units are significantly above normal levels.

The HMA combines the results from a technical framework with insights gained through CMHC's market

analysts' knowledge of local market conditions. These insights allow 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.

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[1] Results are based on data as of the end of September 2019 (the annual rental apartment vacancy rates are from October 2019) and local market intelligence up to the end of December 2019.

[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 detected on the Montréal housing market

In the third quarter of 2019, evidence of overheating in the Montréal CMA persisted, given that the seasonally adjusted sales-to-new listings ratio remained above the threshold for problematic conditions[4] (see figure 1).

The gap between demand, represented by sales, and new supply, represented by new listings, has therefore increasingly tightened. More specifically, from July to September 2019, the ratio between these two variables increased, as sales grew rapidly, while new listings decreased slightly.

In addition, the active listings-to-sales ratio,[5] another market indicator, continued to decrease,[6] thereby also showing that the Montréal resale market has been tightening and becoming increasingly favourable to sellers.[7] In the third quarter of 2019, this tightening could be observed in the single-family, condominium and plex (rental properties with two to five units) segments. Market conditions have favoured sellers of single-family dwellings and plexes for close to three years, and sellers of condominiums for a little over one year.

For single-family dwellings, the active listings-to-sales ratio decreased in almost all the major sectors[8] of the metropolitan area, and market conditions therefore became even more favourable to sellers than they were in the previous quarter.[9] This was more pronounced in certain areas 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 area of Montréal, as well as in areas[10] of Le Sud-Ouest, Saint-Laurent, Rosemont, Villeray, Notre-Dame-de-Grâce–Montréal West and Mercier–Hochelaga-Maisonneuve. In the suburbs, areas such as Chomedey–Laval-des-Rapides–Pont-Viau, Fabreville, Boisbriand–Sainte-Thérèse, the southwestern part of the South Shore, Candiac–La Prairie, Brossard–Saint-Lambert, Vieux-Longueuil, Saint-Hubert, Boucherville–Saint-Bruno, Sainte-Julie–Varennes, Vaudreuil-Dorion and Saint-Jean-sur-Richelieu[11] were in the same situation.

Lukas Jasmin-Tucci
Economist

"For over two years now, the degree of overall vulnerability has remained low for the Montréal CMA housing market. The strength of the fundamentals has supported the price levels observed on the market. However, the Montréal resale market continues to show evidence of overheating, a result of significant tightening between new listings and sales."

Figure 1
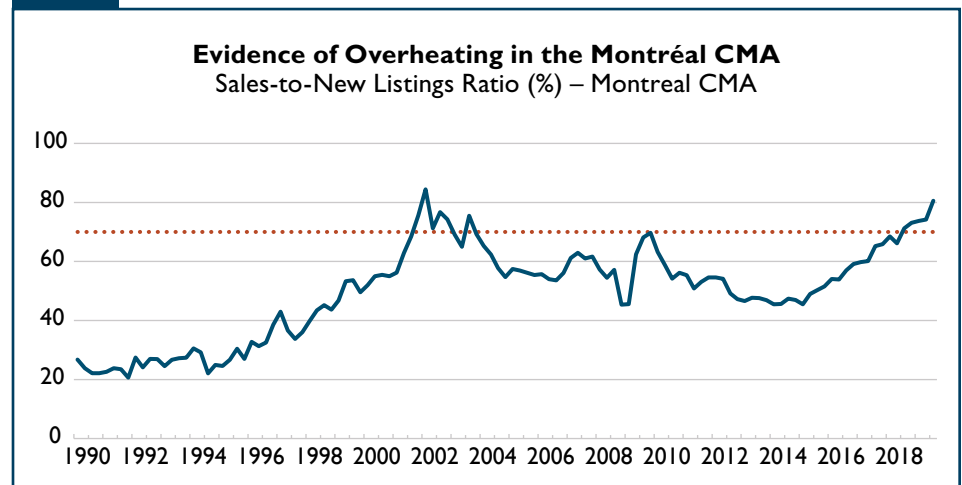
Evidence of Overheating in the Montréal CMA
Sales-to-New Listings Ratio (%) – Montreal CMA

Sources: Quebec Professional Association of Real Estate Brokers (QPAREB) through the Centris® system, seasonally adjusted data by CMHC
Last data point: 2019 Q3.

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[4] This threshold is set at 70%.

[5] While the sales-to-new listings ratio reflects 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] 12-month moving average.

[7] In a sellers' market, the ratio is below eight sellers (or active listings) per buyer (or Centris® sales). In a balanced market, the ratio is between eight and ten sellers per buyer; and, in a buyers' market, this ratio is above ten 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.

[8] The major sectors are the Island of Montréal, Laval, the North Shore, the South Shore, Vaudreuil-Soulanges and Saint-Jean-sur-Richelieu.

[9] Average of the last 12 months, thus October 2018 to September 2019, compared to July 2018 to June 2019.

[10] Boroughs or parts of boroughs.

[11] Saint-Jean-sur-Richelieu area before mergers with Saint-Luc, Saint-Athanase and Iberville.

As with single-family dwellings, condominiums saw their market conditions tighten in the large sectors of the CMA, with sellers getting the edge in all of them. Less than six months ago, market conditions were still balanced in Saint-Jean-sur-Richelieu and on the North Shore.

The Island of Montréal stood out, as market conditions for condominiums heavily favoured sellers[12] in certain areas, including Le Sud-Ouest, Saint-Laurent, Ahuntsic, Plateau-Mont-Royal, Rosemont, Villeray and Mercier–Hochelaga-Maisonneuve. In the suburbs, the Saint-Hubert, Boucherville–Saint-Bruno, Vaudreuil-Dorion and Île-Perrot areas also stood out for the same reason.

Evidence of price growth acceleration was weak

Evidence of price acceleration in the Montréal CMA remained weak in the third quarter of 2019. The average Centris® price of existing homes rose by 5.4% compared to the third quarter of 2018. Despite the tightening between supply and demand on the resale market, price growth was stable and remained under the threshold past which evidence of price acceleration would be problematic (see figure 2).

It should be noted, however, that price growth varied by market segment and sector of the Montréal metropolitan area. In the single-family segment, the average price in the Greater Montréal area rose by 2.8% in the third quarter of 2019 compared to the third quarter of 2018. In the large geographic sectors, the South Shore posted the strongest growth in the average price for the period July to September 2019, at 7.5% (compared to the third quarter of 2018). Growth on the Island of Montréal was 4.1%, the lowest in two years for this sector.

Figure 2
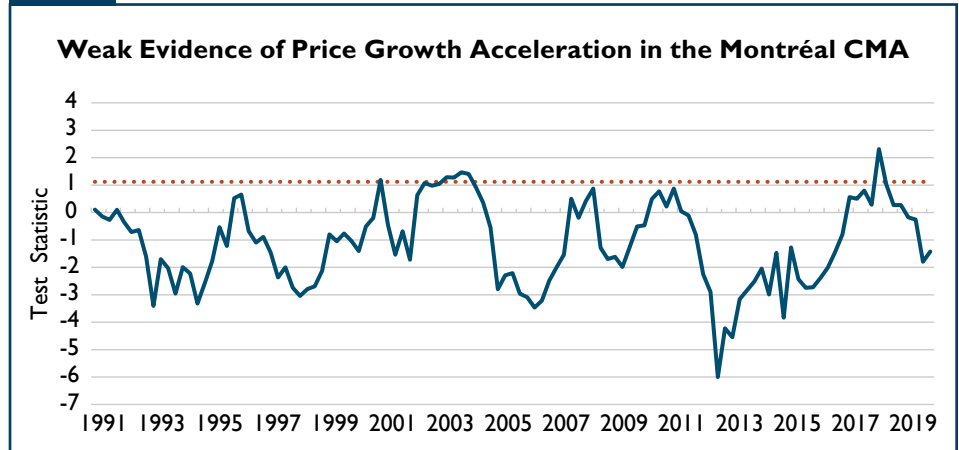
Weak Evidence of Price Growth Acceleration in the Montréal CMA

Sources: Quebec Professional Association of Real Estate Brokers (QPAREB) through the Centris® system, CMHC calculations
Last data point: 2019 Q3.

The Greater Montréal condominium segment, meanwhile, posted, in the third quarter of 2019, the highest growth in the average price (+5.7%) in two years. Just like for single-family dwellings, it was on the South Shore where the strongest growth in the average price was recorded (+9.1%). This sector has been a sellers' market for over a year.

Despite a slowdown, the Island of Montréal remained the sector of the CMA with the second-highest level of growth in the average price (+7.7%). Growth was stronger than in recent quarters on the North Shore, as well (+6.8%), which has been a sellers' market for the past two quarters. In Laval, growth was more modest (+3.9%).

Based on our forecast, even though weaker job growth over the next few quarters could temper resale market activity, the overall economic outlook remains favourable to housing demand, and the market will continue to tighten. The price growth acceleration indicator will therefore continue to be monitored over the coming months.

Evidence of overvaluation remained weak

In the third quarter of 2019, the HMA model did not detect any significant imbalance between real house prices[13] and the price levels dictated by housing market fundamentals, such as personal disposable income and population (see figure 3). The economic and demographic indicators remained at levels justifying the prices recorded on the Montréal housing market. As a result, the HMA revealed no significant evidence of overvaluation.

A more detailed analysis revealed that most fundamentals remained at levels supporting housing demand in the third quarter of 2019. The population aged 25 to 34 continued to grow (+1.5% compared to the same quarter in 2018), and real personal disposable income per capita, which has registered substantial gains since 2015, increased slightly in the third quarter of 2019 (+0.6%). Finally, the real five-year fixed mortgage rate (adjusted for inflation) remained at a historically low level.

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[12] Situation in which there are fewer than four sellers per buyer.
[13] Observed prices adjusted for inflation.

Real house prices (adjusted for inflation)[14] all increased. Statistics Canada's New Housing Price Index (NHPI),[15] the average Centris® price[16] and the Teranet-National Bank House Price Index™ rose by 2.1%, 3.2% and 3.7%, respectively, compared to the third quarter of 2018.

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.[17] 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 2019, both overbuilding indicators, namely, the inventory of completed and unsold units per 10,000 population and the vacancy rate for conventional rental apartments, suggested weak evidence of overbuilding (see figures 4 and 5).

The inventory of completed and unsold housing units per 10,000 population remained relatively low in the third quarter of 2019, reaching 4.9 units, compared to 4.1 in the previous quarter. Despite this small increase, caused by a slight gain in the inventory of unsold new units, the number of unsold units in the Montréal CMA had not been this low in about eight years.
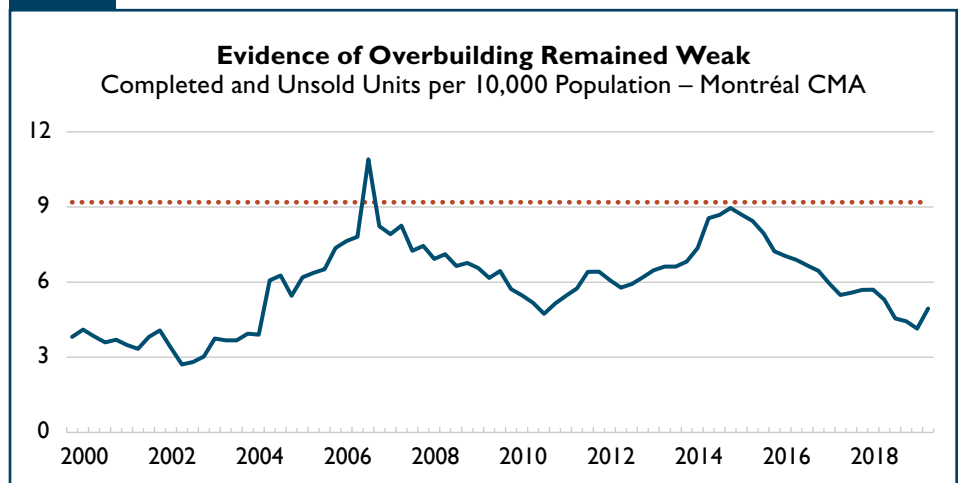
Figure 3
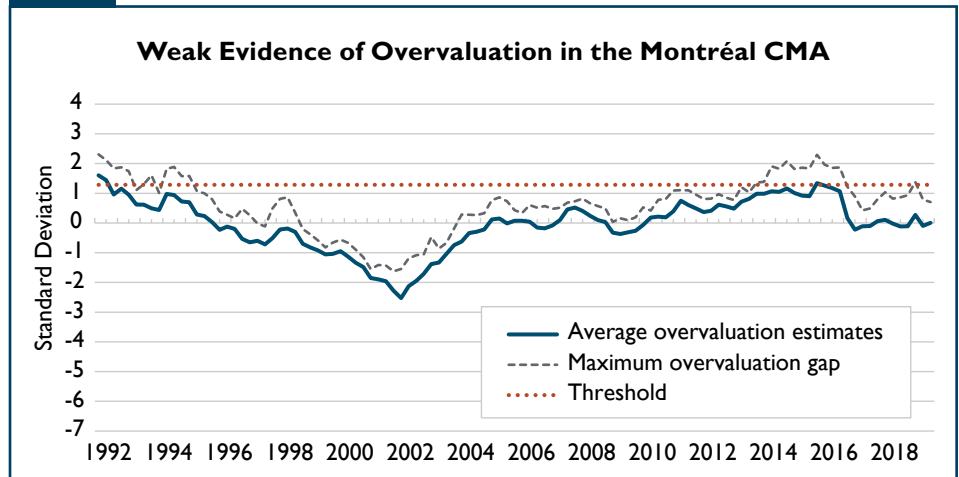
Weak Evidence of Overvaluation in the Montréal CMA

Sources: Quebec Professional Association of Real Estate Brokers (QPAREB) through the Centris® system, Statistics Canada, Teranet and National Bank, CMHC calculations
Last data point: 2019 Q3.
Note: The average estimate of overvaluation is the average gap between actual house prices and their fundamental level estimated from a group of selected models. These include demand, supply, hybrid, and affordability models. There are five models in total, each of which is estimated using four measures of house prices to generate twenty unique estimates of overvaluation. The selection of models is conducted with a set of cointegration tests, and the selected models are estimated with Dynamic Seemingly Unrelated Regression (DSUR). 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 1.285 for a confidence level of 90%. Overvaluation is signaled when overvaluation estimates lie above the threshold.

Figure 4

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

Sources: Statistics Canada and CMHC
Last data point: 2019 Q3.

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

[15] Source: Statistics Canada.

[16] Source: Quebec Professional Association of Real Estate Brokers (QPAREB), through the Centris® system.

[17] 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, these buyers accounted for less than 2% of all residential transactions in the Montréal CMA since the start of 2019 (sources: JLR; CMHC, calculations). In addition, 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 increase in demand, combined with the slowdown in condominium starts in recent years,[18] allowed the inventory of unsold new condominiums to remain relatively low. Despite a slight rebound in condominium construction in 2017, 2018 also ended with a decline in housing starts of this type. This is the third time this has happened in four years. Moreover, the data for 2019 shows that condominium starts should again be limited on the whole this year. Given the strong demand and the rather moderate pace of condominium construction, evidence of overbuilding should remain weak over the coming quarters.

Meanwhile, the vacancy rate for conventional rental apartments registered a third straight annual decrease. According to the Rental Market Survey, it fell from 3.9% in 2016 to 2.8% in 2017, then to 1.9% in 2018 and to 1.5% in 2019. This decline stems from 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 rose sharply between 2017 and 2018,[19] particularly in the category of non-permanent residents. The data for the province of Quebec for the first months of 2019 also suggests that net migration will remain high, which will once again contribute to rental housing demand.

Figure 5

Vacancy Rate Fell to 1.5% in 2019
Vacancy Rate (%) – Montréal CMA
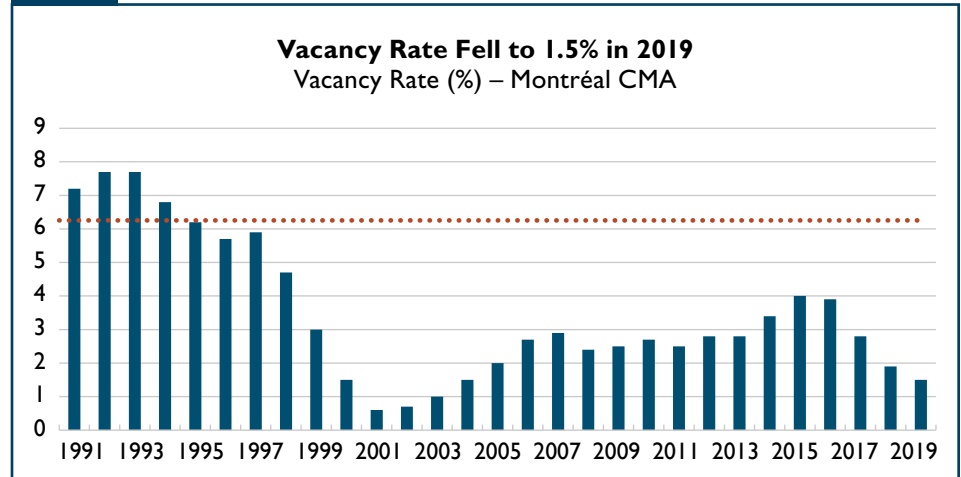
Source: CMHC
Last data point: October 2019

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 2018 and 2019 editions of our Rental Market Survey, around 8,500 units were added to the rental stock.[20] This was around 1,000 more than the year before and far exceeded the annual average from the past few years.

The 2019 data also shows that conventional rental starts are higher than last year, when they were already at a 30-year peak. We will therefore have to wait and see if the vast majority of these new units find tenants in 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.

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[18] Condominium starts averaged at 8,250 units annually from 2015 to 2018, compared to about 11,000 from 2011 to 2014.

[19] According to estimates based on data from Statistics Canada and the Institut de la statistique du Québec, net migration in the Montréal CMA reached 52,000 people in 2018; this was about 20,000 people more than in 2017 and a record for the area.

[20] From July 2018 to June 2019. Only buildings that were open in June 2019 are included in the 2019 Survey.

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 each assessed with a single indicator. Colour scales for these factors vary between green and yellow only. Overvaluation and overbuilding are assessed with 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.

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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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