

HOUSING TRENDS AND AFFORDABILITY

August 2013

Housing affordability in Canada deteriorates marginally in the second quarter of 2013

The recent upswing in the Canadian housing market brought with it some mild erosion in housing affordability in the second quarter of 2013. Successive month-to-month advances in home resales and housing starts this spring seemingly marked an end to the cooling of activity that took place in the second half of last year and the early months of 2013, and tightened demand-supply conditions just enough to support a modest acceleration in quarterly home price increases. For single-family homes, the rate of property appreciation in the second quarter was sufficient to wear down their affordability a little. RBC's housing affordability measures at the national level rose by 0.3 percentage points to 42.7% for the detached-bungalow benchmark and by 0.4 percentage points to 48.4% for two-storey homes. The appreciation of condominium apartments was comparatively more subdued, however, and had no effect on the corresponding RBC measure, which remained unchanged at 27.9%.

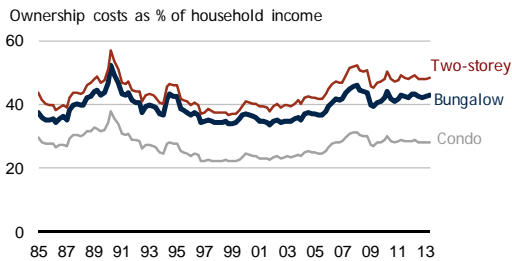
Diverging affordability conditions between single-family home and condo segments...

Last quarter's divergence between the single-family home and condominium apartment segments was not a new development. Relatively tighter demand-supply conditions for single-family homes in past years generally applied consistently more upward pressure on homeownership costs for single-family homes than for condos. The cumulative effects of these pressures have been affordability levels degrading below historical norms for bungalows and, especially, two-storey homes, while staying roughly on par for condominium apartments.

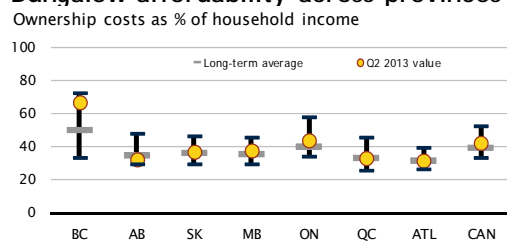
...reflecting the situation in Toronto, Montreal, and Vancouver

Such two-tiered affordability conditions nationally mainly reflect the situation in Canada's three-largest markets. In Toronto, Montreal, and Vancouver, it has become somewhat of a stretch (compared to averages since the mid-1980s) for typical households to own a single-family home, while condo ownership remains much more within reach—although less so in Vancouver where condo affordability remains quite poor. Outside of these three markets, there are few signs elsewhere in Canada that affordability of any type of housing causes any undue stress for homebuyers at this stage.

RBC Housing Affordability Measures - Canada

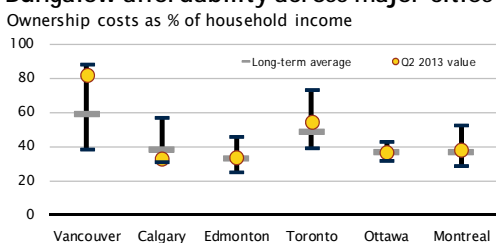


Bungalow affordability across provinces



Note: the top of each scale is the all-time high; the bottom, the all-time low.

Bungalow affordability across major cities



Note: the top of each scale is the all-time high; the bottom, the all-time low.

Source: Statistics Canada, Royal LePage, RBC Economics Research

Craig Wright

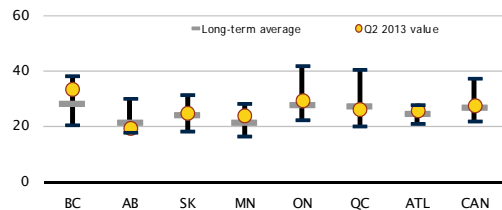
Chief Economist
(416) 974-7457
craig.wright@rbc.com

Robert Hogue

Senior Economist
(416) 974-6192
robert.hogue@rbc.com

Condo affordability across provinces

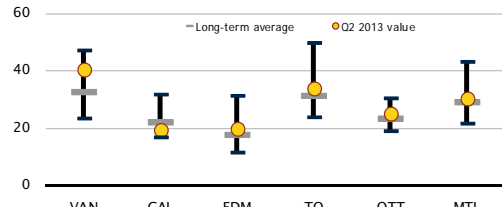
Ownership costs as % of household income



Note: the top of each scale is the all-time high; the bottom, the all-time low.

Condo affordability across major cities

Ownership costs as % of household income

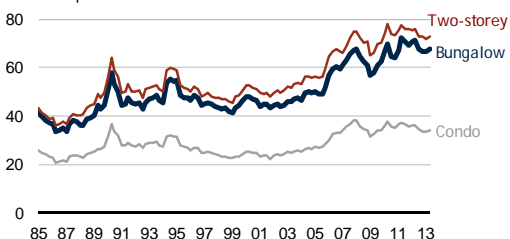


Note: the top of each scale is the all-time high; the bottom, the all-time low.

RBC Housing Affordability Measures

British Columbia

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

Majority of local markets saw modest deterioration in affordability in the second quarter

In the second quarter of 2013, most local markets saw some deterioration in affordability, with Vancouver showing noticeable slippage in the bungalow and two-storey home segments (following four quarters of nearly continuous improvement). The erosion in other markets was generally modest (except perhaps in Edmonton where the RBC measure for bungalow jumped 1.8 percentage points). There were a few markets that experienced some improvement in affordability, however, including Montreal (all housing types), the Atlantic region (bungalows and condos), Manitoba (bungalows), and Ottawa and Calgary (condos).

Affordability not currently a hindrance for homebuyers...

With Canada's housing market showing signs of regaining some strength in recent months—home resales increased by 6.4% in the second quarter—current affordability levels do not appear to get in the way of homebuyers becoming more active. We believe that the latest changes to National Housing Act Mortgage-backed Securities (NHA MBS) guarantees announced by the Canada Mortgage and Housing Corporation (CMHC) on August 1 will have a marginal effect on housing demand and that, barring another turn of the housing-policy screw by the federal government, home resales will stabilize near the recent not-too-hot, not-too-cold levels in the near term.

...but could become so if interest rates increase substantially

The main risk, as we have noted in past editions of *Housing Trends and Affordability*, is that manageable affordability levels may not persist if interest rates rise substantially. Exceptionally low mortgage rates have been the main factor preventing affordability from reaching dangerous levels in recent years, yet we believe that the likelihood of a surge in rates is slim at this stage. A more probable economic scenario is one of continued low interest rates in the short term; we expect the Bank of Canada to leave its overnight rate unchanged at 1% throughout the remainder of 2013 and to raise it only gradually starting in mid-2014. Although bond yields have already started to rise in recent months in anticipation of a reduction of monetary stimulus in the US, we expect future increases to be moderate in the face of what is likely to be a gradual pace of policy tightening by both the US and Canadian central banks.

Provincial overviews

British Columbia – One-step back on the way to healthier affordability levels

After seeing notable progress toward a lesser degree of unaffordability during the previous three quarters, the BC market took one-step back in the second quarter of 2013 when some deterioration occurred in the single-family home segments. RBC's affordability measures rose by 1.1 percentage points for bun-

galows and by 0.8 percentage points for two-storey homes (to 67.6% and 72.8%, respectively). Condo affordability was little changed in the period—the RBC measure inched up by only 0.1 percentage points (to 33.8%). This latest setback on the way to healthier affordability levels in the provincial market took place amid a pick-up of resale activity since early spring following a nearly two-year long cooling stretch. Second-quarter home resales rebounded by 13.6% from a historically low level in the first quarter—they remained 19% weaker than the 10-year average. Home prices in the province are still lower than they were a year ago; however, they went up on a quarterly basis in the second quarter.

Alberta – Homeownership remains quite affordable

Owning a home at market price continues to be quite affordable for Alberta homebuyers despite some increases in ownership costs in the past two quarters. RBC's measures for all housing types still stood below their long-term averages in the second quarter thereby indicating that affordability levels remained historically attractive in Alberta. Nonetheless, the measures edged higher for all three housing categories for the second time in the second quarter largely as a reflection of the market kicking into higher gear since spring. Stronger price gains, especially for single-family homes, in the province have led to RBC's measures rising by 0.7 percentage points for bungalows and 0.4 percentage points for two-storey homes in the second quarter. RBC's measures for condominium apartments rose by a smaller 0.1 percentage points. While the floods in the southern portion of the province likely cause some disruptions in market activity this summer, Alberta's strong economy will continue to support further growth in the housing sector into 2014.

Saskatchewan – Seesaw affordability pattern endures

Housing affordability in Saskatchewan in the second quarter of 2013 continued to display the seesaw pattern that has been characteristic of that market in recent years. RBC's measures for single-family homes rose modestly in the latest period (by 0.9 percentage points for bungalows and 0.5 percentage points for two-storey homes), largely offsetting declines in the first quarter, while the measure for condominium apartments inched lower (by 0.3 percentage points) and further reversed increases that occurred in late 2012. Alternating increases and declines from quarter to quarter generated a fairly flat trend in affordability since 2009, thereby maintaining affordability levels close to historical averages in the province. With little affordability pressure restraining them, Saskatchewan homebuyers sprung into action in the second quarter, boosting home resales by nearly 14% relative to the first quarter. Notable gains were registered in both Saskatoon and Regina. The province's strong labour market and population growth should continue to support housing demand in the short term.

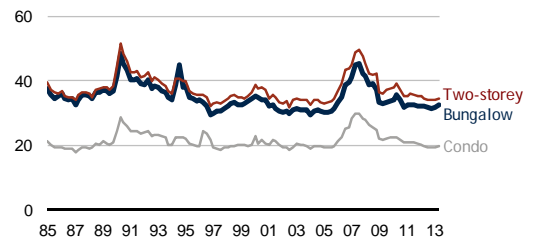
Manitoba – Mixed bag

Housing affordability developments in Manitoba were a mixed bag in the second quarter. RBC's measure for two-storey homes rose noticeably (by 1.8

RBC Housing Affordability Measures

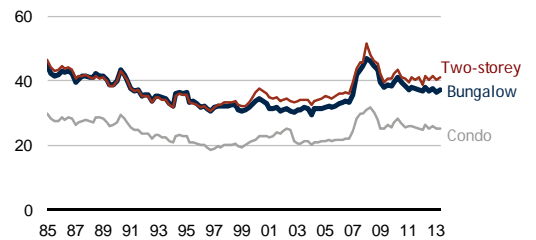
Alberta

Ownership costs as % of household income



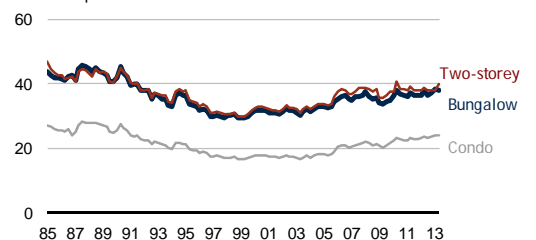
Saskatchewan

Ownership costs as % of household income



Manitoba

Ownership costs as % of household income

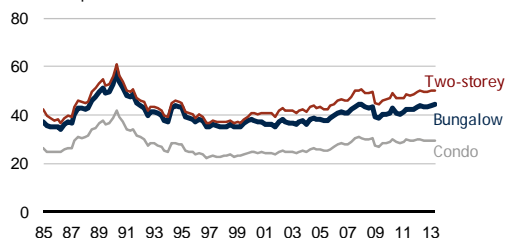


Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

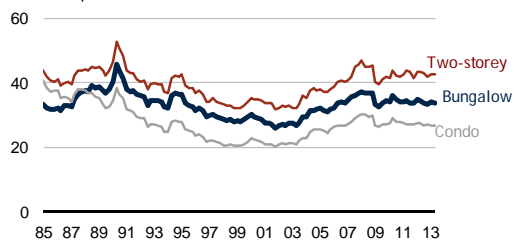
Ontario

Ownership costs as % of household income



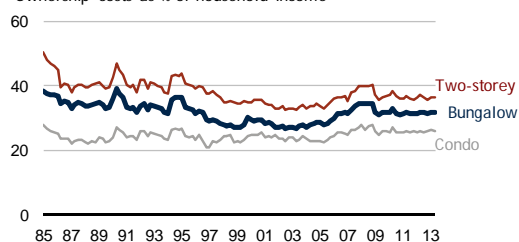
Quebec

Ownership costs as % of household income



Atlantic Provinces

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

percentage points), but the changes to the measures for bungalows and condominium apartments were much more tempered—down slightly by 0.2 percentage points in the case of bungalows and up a little by 0.2 percentage points in the case of condos. Generally, housing affordability is modestly poorer than it has been on average since the mid-1980s in Manitoba and may be exerting some mild stress on homebuyers. There was little evidence of any deleterious effect on market activity in the second quarter, however, as home resales rebounded by 5.6% from the first quarter. The spring season was quite brisk in markets such as Winnipeg, which saw resales return above the 10-year average in June following a particularly weak winter.

Ontario – Affordability little changed; still pinching a bit

There was little change in housing affordability in Ontario in the second quarter. RBC's measures for both bungalows and two-storey homes edged higher by just 0.2 percentage points relative to their first-quarter values, while the measure for condominium apartments stayed flat. The affordability situation in the province, therefore, continues to show somewhat greater tensions than there have been on average historically—primarily in single-family home segments—but any such tensions still remain far from levels that would clearly spell trouble for the provincial market. Indeed, Ontario homebuyers did not appear troubled in recent months as they increasingly re-entered the market after moving to the sidelines for the better part of the past year. With steady month-to-month gains in home resales since March and demand-supply conditions firming up lately (although still within balanced territory), market psychology is shifting back to a more upbeat tone in Ontario. This is contributing to the rate of home price increases stabilizing or even picking up a little this summer after a year-long period of deceleration.

Quebec – Bucking the trend

The Quebec market bucked the provincial trend in enjoying broad-based improvement in affordability in the second quarter. RBC's affordability measures for the province fell for both bungalows (down 0.5 percentage points) and condominium apartments (down 0.4 percentage points) with the measure for two-storey homes remaining unchanged. Current affordability levels are mostly in line with historical norms in Quebec (only the two-storey home measure appears slightly above normal), which suggests that owning a home at market price should not pose any undue burden on homebuyers at this stage. Nonetheless, resale activity in the province, while rebounding from four-year lows reached earlier this year, has yet to display the same vigour as in other parts of the country this spring and summer. Quebec home resales rose by a fairly subdued rate of 3.7% in the second quarter, which was almost half the pace at the national level. Lacklustre labour market conditions and uncertain economic prospects in the province may be weighing on homebuyer confidence.

Atlantic – Affordability stuck at neutral levels

Housing affordability remained mostly stationary at neutral levels in the sec-

ond quarter in the Atlantic Canada region. RBC's measures moved very little in all categories: bungalows and condominium apartments edged down by 0.1 percentage points and 0.2 percentage points, respectively; while two-storey homes edged up by 0.1 percentage points. Levels of affordability, consequently, continued to stay close to historical norms in the region, which unlikely posed any unusual constraint on home buying. Other factors such as a stagnant labour market and fragile consumer confidence in many parts of the region, however, continued to weigh on housing activity this spring and early summer. Home resales rose by just 1.1% in the second quarter from a two-year low in the first quarter. Activity in markets such as Halifax and Fredericton remained fairly weak lately. On the other hand, markets such as Saint John showed signs of renewed vigour.

Major city markets

Vancouver – Market rebounding smartly

After showing signs of stabilizing earlier this year—indicating a possible end to a nearly two-year slide—the Vancouver-area market rebounded smartly in more recent months. Home resales surged 14% in the second quarter and climbed a further 11% between June and July. These latest developments strongly suggest that the market correction has run its course in the area and that the risk of a catastrophic outcome has greatly diminished. This turnaround in market conditions supported some strengthening in prices during the past several months—although Vancouver prices have yet to move above year-ago levels. The downside of successive month-to-month appreciation, however, was that it took somewhat of a toll on affordability, which remains by far the poorest in Canada. In the second quarter, higher prices across all housing types (relative to the first quarter) were the main factor causing broadly based deterioration in affordability in the Vancouver area. RBC's measures rose quite noticeably for single-family homes—by 2.2 percentage points for bungalows and by 1.1 percentage points for two-storey homes—while the rise in the condo measure (0.3 percentage points) was comparatively milder.

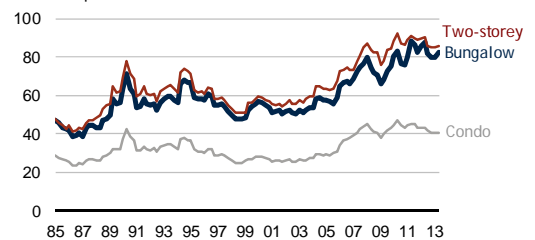
Calgary – Forging ahead despite flood adversity

A strong provincial economy, solid labour market, fast-rising population, and attractive affordability continue to fuel demand for Calgary housing. Not even the worst floods in memory at the end of June appear to have slowed the market's progression. Monthly resale activity increased for six straight months, including in June (rising 1.1% month over month) and July (up 3.1%). On a quarterly basis, home resales in the area posted their second-strongest gain (12%) in four years in the second quarter. While prices recently embarked on a more steeply upward trajectory, the effect of faster-rising prices has yet to undermine affordability in any material way. In fact, affordability levels in Calgary continue to be among the better in Canada. In the second quarter, RBC's measures showed little movement, remaining unchanged for bungalows, rising modestly by 0.5 percentage points for two-storey homes, and edging lower by 0.2 percentage points for condominium apartments.

RBC Housing Affordability Measures

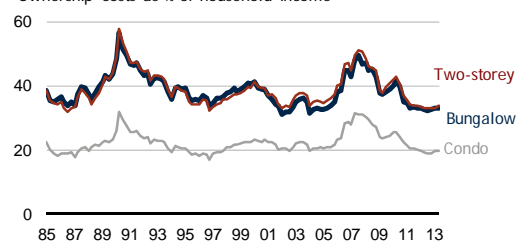
Vancouver

Ownership costs as % of household income



Calgary

Ownership costs as % of household income

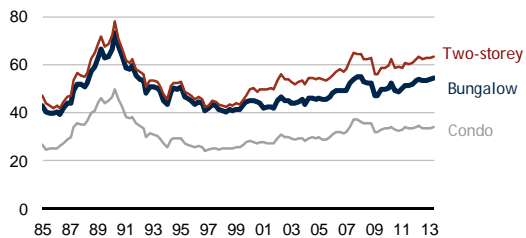


Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

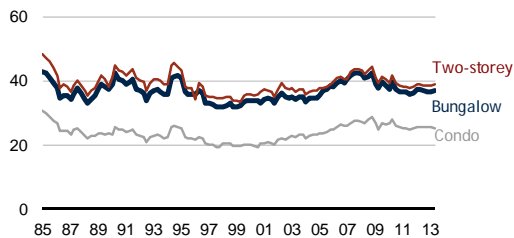
Toronto

Ownership costs as % of household income



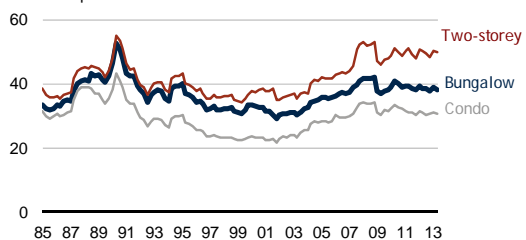
Ottawa

Ownership costs as % of household income



Montreal

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

Toronto – Healthy comeback underway

Despite affordability that appears a little stretched—particularly for single-family homes—home-buying activity in the Toronto-area market staged a healthy comeback so far this year. Home resales rose back to back in the first and second quarters of 2013 for a cumulative gain of 8.1% since the last quarter of 2012. The July results showed a further advance of 4% from June. This upswing in housing demand more likely reflected the lessening of the negative effects from new mortgage insurance rules introduced in July 2012 than any favourable change in affordability. In the second quarter of 2013, housing affordability in the area was at very similar levels to those prevailing a year ago—still moderately worse than historical norms. During the past year, RBC’s affordability measures largely trended sideways in all categories, including in the latest period when the measures increased only slightly by 0.2 percentage points to 0.5 percentage points. The continued presence of some affordability stress in the market (especially for single-family homes) is likely to prevent Toronto home resales from reaching heated levels.

Ottawa – Average performance all over

‘Average’ seems to best describe most aspects of the Ottawa-area market these days. Home resales essentially matched the 10-year average for the area in the second quarter, when they rose 2.9% following a year-long cooling down period. Home prices increased at essentially the same rate as the average for Canada for most housing types in the latest quarter. This meant that housing affordability also eroded by roughly the same (small) magnitude as occurred nationally in the second quarter—with the exception of the condominium apartment category, where affordability slightly improved in Ottawa while remaining flat overall in Canada. RBC’s measures for Ottawa rose by 0.5 percentage points for both the bungalow and two-storey home categories, while condos eased by 0.3 percentage points. And the latest affordability levels in the Ottawa-area market were basically at par with their long-run averages. One of the few developments sticking out, however, has been the steady rise in the number of homes newly listed for sales during the past year. This contributed to some loosening in demand-supply conditions.

Montreal – Market vigour still lagging

The Montreal-area market is a participant to the broad-based upswing in resale activity since the spring around the country; however, it has yet to display quite the same vigour as most other major markets. While home resales rose in the area in the second quarter, the level of activity remained nearly 14% below the 10-year average. Many Montreal would-be homebuyers likely are still hesitant to enter the market at this juncture, unsure of their job situation—the unemployment rate rose above 8% this spring. Affordability may be an issue for some homebuyers, although the numbers suggest that any unusual tensions are mostly isolated to the two-storey home segment of the market. RBC’s measure for this housing category is materially above its long-run average. This is not the case for the measures for the other categories, which remain only slightly above historical norms and unlikely to exert any undue stress. In the second quarter, RBC’s measures fell modestly for all housing types in the Montreal area—falling between 0.5 percentage points and 0.7 percentage points.

How the RBC Housing Affordability Measures work

The RBC Housing Affordability Measures show the proportion of median pre-tax household income that would be required to service the cost of mortgage payments (principal and interest), property taxes, and utilities on a detached bungalow, a standard two-storey home and a standard condo (excluding maintenance fees) at the going market prices.

The qualifier 'standard' is meant to distinguish between an average dwelling and an 'executive' or 'luxury' version. In terms of square footage, a standard condo has an inside floor area of 900 square feet, a bungalow 1,200 square feet, and a standard two-storey 1,500 square feet.

The measures are based on a 25% down payment, a 25-year mortgage loan at a five-year fixed rate, and are estimated on a quarterly basis for each province and for Montreal, Toronto, Ottawa, Calgary, Edmonton, and Vancouver-metropolitan areas. The measures use household income rather than family income to account for the growing number of unattached individuals in the housing market. The measure is based on quarterly estimates of this annual income, created by annualizing and weighting average weekly earnings by province and by urban area. (Median household income is used instead of the arithmetic mean to avoid distortions caused by extreme values at either end of the income distribution scale. The median represents the value below and above which lays an equal number of observations.)

The RBC Housing Affordability Measure is based on gross household income estimates and, therefore, does not show the effect of various provincial property-tax credits, which could alter relative levels of affordability.

The higher the measure, the more difficult it is to afford a house. For example, an affordability measure of 50% means that home ownership costs, including mortgage payments, utilities, and property taxes take up 50% of a typical household's pre-tax income.

Qualifying income is the minimum annual income used by lenders to measure the ability of a borrower to make mortgage payments. Typically, no more than 32% of a borrower's gross annual income should go to 'mortgage expenses'—principal, interest, property taxes, and heating costs (plus maintenance fees for condos).

Summary tables

Detached bungalow

Region	Average Price			Qualifying Income (\$) Q2 2013	RBC Housing Affordability Measure			
	Q2 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q2 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	375,700	2.1	2.2	79,000	42.7	0.3	-0.6	39.1
British Columbia	620,300	3.1	-2.3	118,100	67.6	1.1	-3.7	50.1
Alberta	375,800	3.8	6.1	78,600	32.4	0.7	0.4	34.9
Saskatchewan	351,900	2.8	4.3	74,700	37.2	0.9	-0.6	36.2
Manitoba	311,100	0.7	4.4	68,300	38.1	-0.2	0.3	35.8
Ontario	402,100	1.6	3.8	86,200	44.1	0.2	0.3	40.5
Quebec	248,000	0.8	1.2	54,700	33.5	-0.5	-1.1	33.1
Atlantic	221,900	1.5	2.9	52,500	31.6	-0.1	-0.2	31.7
Toronto	568,200	2.1	4.2	114,700	54.5	0.5	0.6	48.8
Montreal	295,500	0.4	2.7	63,800	38.1	-0.7	-0.5	36.6
Vancouver	819,500	4.2	-3.2	152,100	82.1	2.2	-5.4	59.5
Ottawa	397,800	2.0	1.9	89,600	37.1	0.5	0.0	36.7
Calgary	457,900	1.3	5.9	90,600	33.0	0.0	0.3	38.4
Edmonton	354,100	7.3	7.2	76,700	34.0	1.8	1.0	33.1

Standard two-storey

Region	Average Price			Qualifying Income (\$) Q2 2013	RBC Housing Affordability Measure			
	Q2 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q2 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	422,800	2.1	1.8	89,500	48.4	0.4	-0.8	43.6
British Columbia	664,200	2.4	-0.9	127,100	72.8	0.8	-3.0	55.3
Alberta	388,800	2.0	3.4	83,500	34.5	0.4	-0.1	37.4
Saskatchewan	380,500	1.5	4.2	82,000	40.8	0.5	-0.6	37.6
Manitoba	325,800	7.9	7.1	71,500	39.9	1.8	1.1	36.8
Ontario	453,900	1.5	2.4	97,800	50.1	0.2	-0.2	44.2
Quebec	318,200	2.4	2.2	69,300	42.5	0.0	-1.0	39.5
Atlantic	247,400	2.6	0.7	60,300	36.3	0.1	-0.8	38.0
Toronto	652,700	1.2	2.6	132,800	63.1	0.2	-0.1	54.4
Montreal	395,200	1.2	3.3	83,500	49.9	-0.5	-0.4	41.9
Vancouver	851,200	2.6	-1.7	159,000	85.8	1.1	-4.3	64.7
Ottawa	405,200	2.0	1.8	93,800	38.8	0.5	0.0	39.0
Calgary	453,800	3.2	6.7	92,200	33.6	0.5	0.6	38.8
Edmonton	372,600	0.5	1.2	82,600	36.6	0.1	-0.4	36.3

Standard condominium

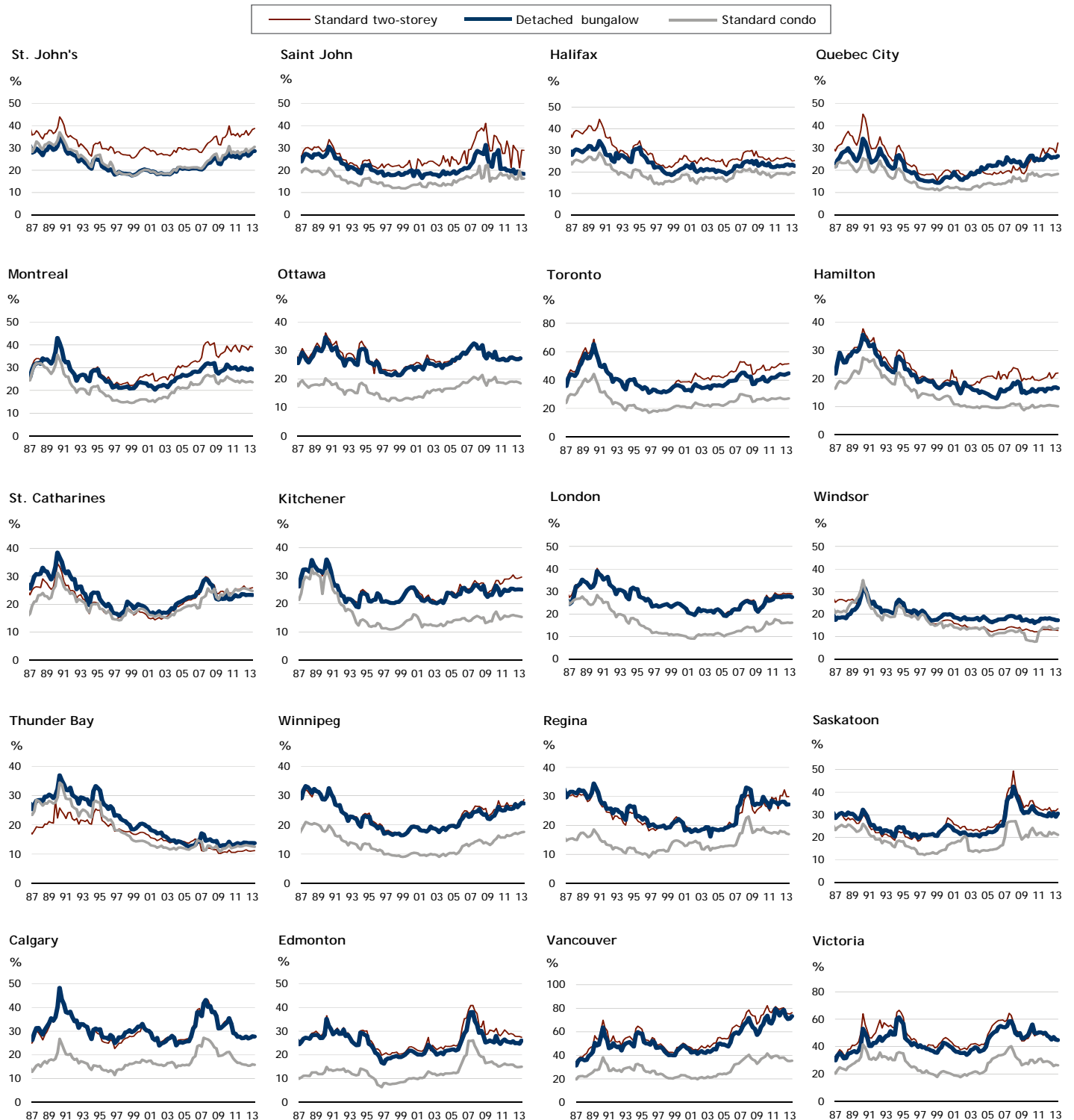
Region	Average Price			Qualifying Income (\$) Q2 2013	RBC Housing Affordability Measure			
	Q2 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q2 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	239,800	1.1	0.5	51,700	27.9	0.0	-0.8	27.0
British Columbia	300,000	1.5	-3.1	59,100	33.8	0.1	-2.1	28.3
Alberta	219,300	0.9	3.4	47,400	19.6	0.1	0.0	21.5
Saskatchewan	233,200	-2.0	-0.5	50,100	25.0	-0.3	-1.3	24.2
Manitoba	200,000	2.1	5.4	43,300	24.2	0.2	0.4	21.3
Ontario	263,000	1.2	0.4	57,700	29.5	0.0	-0.6	27.8
Quebec	197,700	0.9	0.9	43,300	26.5	-0.4	-0.9	27.5
Atlantic	188,700	0.9	4.8	43,400	26.1	-0.2	0.2	24.5
Toronto	343,500	2.2	1.5	71,500	34.0	0.4	-0.3	31.4
Montreal	238,300	0.5	2.2	50,900	30.4	-0.5	-0.5	29.3
Vancouver	395,800	2.0	-3.5	75,400	40.7	0.3	-2.7	32.6
Ottawa	270,200	-1.2	-0.1	60,900	25.2	-0.3	-0.4	23.6
Calgary	261,900	0.4	6.0	53,300	19.4	-0.2	0.2	22.2
Edmonton	204,200	2.7	0.6	45,500	20.2	0.5	-0.3	18.0

* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Economics Research

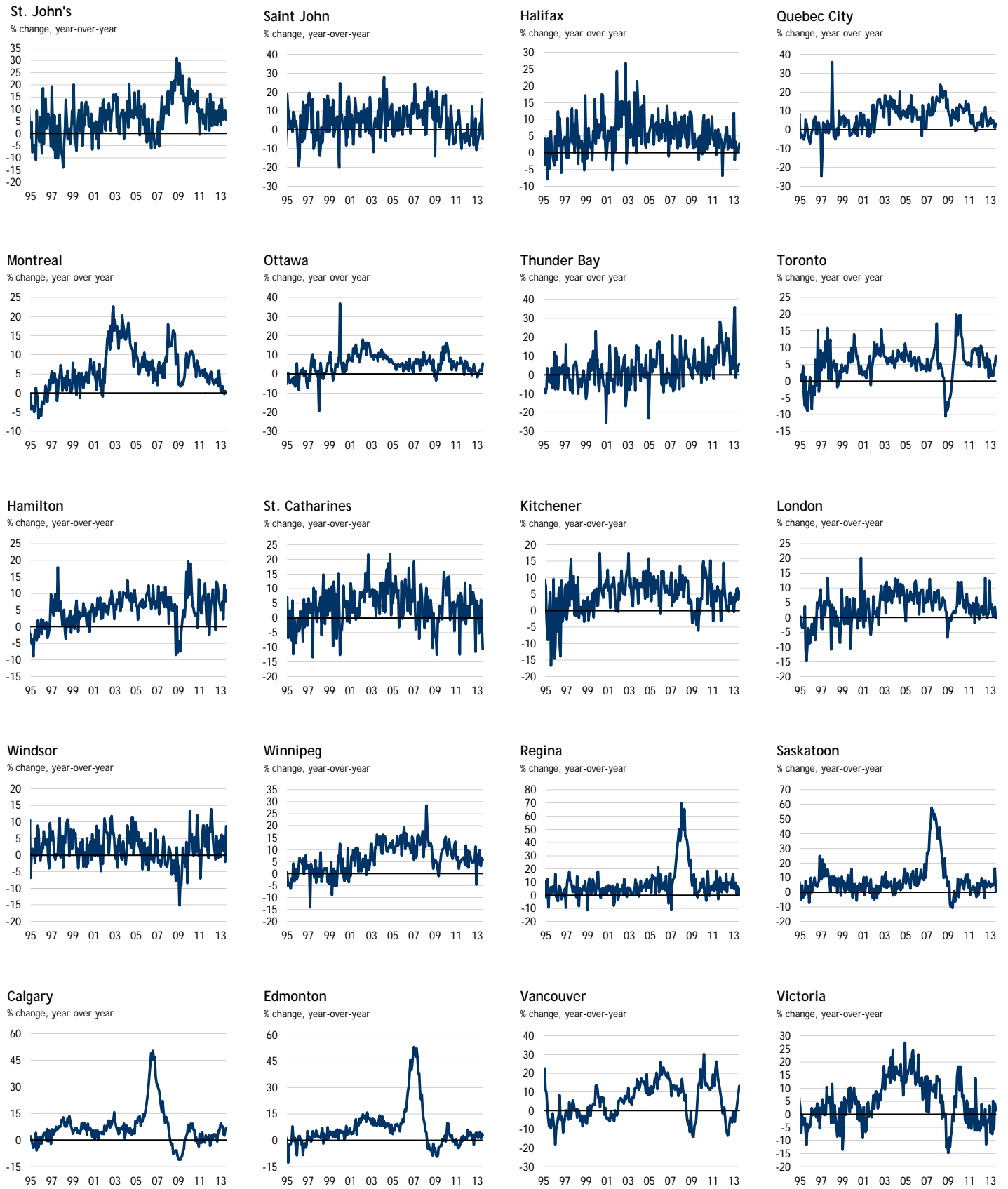
Mortgage carrying costs by city

Our standard RBC Housing Affordability Measure captures the proportion of median pre-tax household income required to service the cost of a mortgage on an existing housing unit at going market prices, including principal and interest, property taxes and utilities; the modified measure used here includes the cost of servicing a mortgage, but excludes property taxes and utilities due to data constraint in the smaller CMAs. This measure is based on a 25% down payment, a 25-year mortgage loan at a five-year fixed rate, and is estimated on a quarterly basis. The higher the measure, the more difficult it is to afford a house.



Source: Statistics Canada, Royal LePage, RBC Economics Research

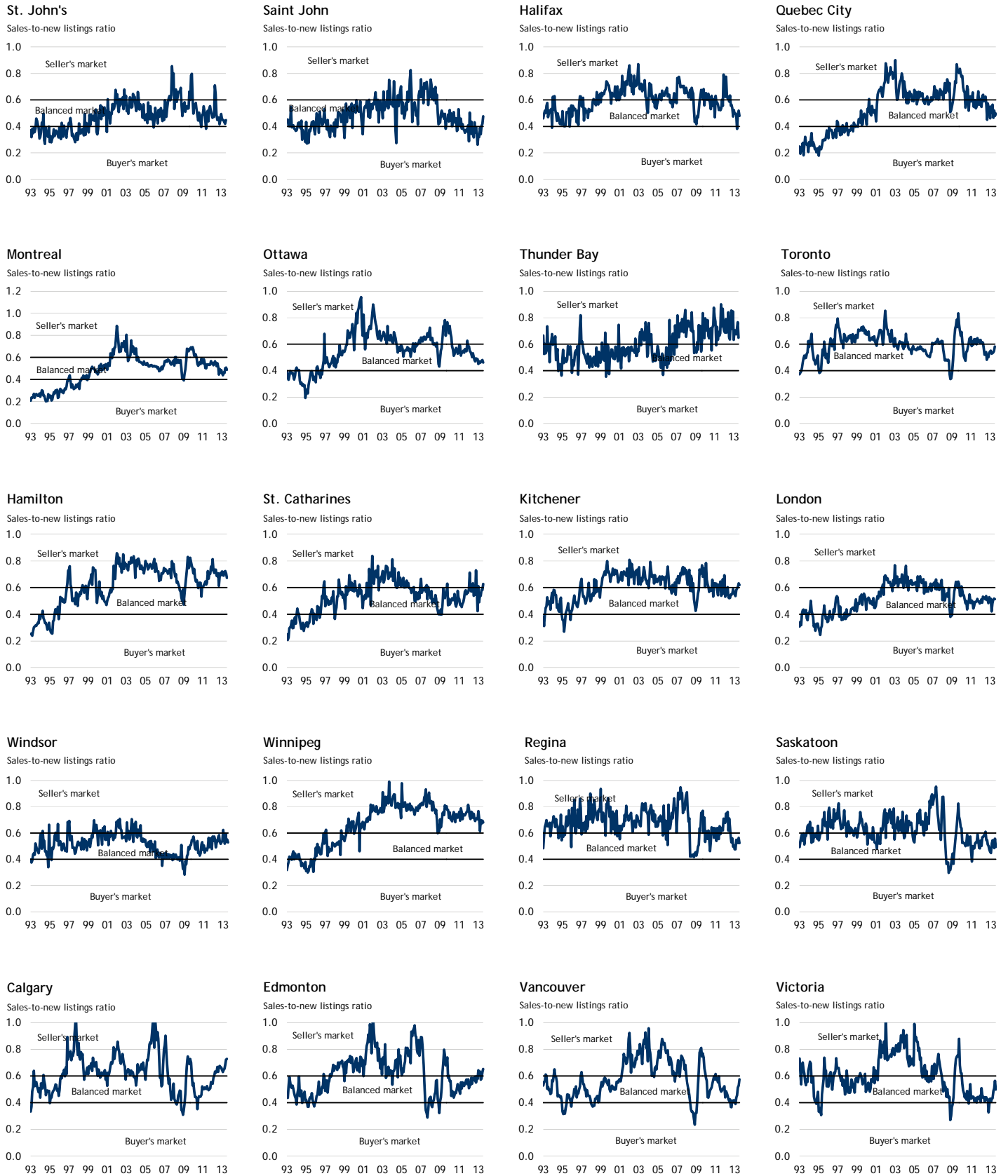
Average price of homes sold on the MLS system



Source: Canadian Real Estate Association, RBC Economics Research



Home sales-to-new listings ratio



Source: Canadian Real Estate Association, RBC Economics Research



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