Housing affordability tensions intensified in Canada’s hot markets in Q2/16

- Rapidly escalating homeownership costs in the Vancouver and Toronto areas continued to squeeze housing affordability at the national level in the second quarter of 2016.
- RBC’s aggregate affordability measure for Canada rose the most in six years—by 1.2 percentage points to 42.8%—in the second quarter, thereby extending the recent streak to five straight quarterly rises (an increase represents deterioration in affordability). Single-detached homes led the climb (up 1.4 percentage to 47.8%), followed by condo apartments (up 0.4 percentage points to 34.4%).
- The aggregate measure for the Vancouver area soared by 6.1 percentage points to a new record high of 90.3%. Back-to-back surges in the first and second quarter of 2016 marked the biggest deterioration in affordability during a six-month period in the area in 26 years.
- The aggregate measure for the Toronto area jumped by 2.1 percentage points to 60.2%, primarily reflecting further escalation in single-detached home ownership costs. The level of Toronto’s aggregate measure was the highest since the third quarter of 1990.
- Housing affordability in other major Canadian cities generally eroded modestly in the latest period. Calgary, Saint John, and St. John’s bucked the trend as RBC’s measures eased slightly in these markets.
- The outlook for affordability across Canada calls for more of the same in the near term—intense pressure in Vancouver and Toronto contrasting with very relaxed conditions in Calgary and normal conditions in most other markets.
- Signs of cooling have emerged in the Vancouver and, tentatively, Toronto markets in recent months. If sustained, such cooling might bring some affordability relief later this year or in 2017.

Focus on Vancouver and Toronto—again
Another quarter, another batch of housing data highlighting the stark divergences across local markets in Canada, yet it is the situation in Canada’s ‘hot markets’—Vancouver and Toronto—that continue to dominate the national conversation about housing. Soaring prices in Vancouver and, to a lesser extent, Toronto fuel genuine concerns about overheating in these markets. Already stretched housing affordability deteriorated significantly in the second quarter, especially in the Vancouver area where property values have ballooned by more than 30% in the past year (including an outsized 9.1% gain in the second quarter). Undoubtedly, the Vancouver and Toronto markets get some heat from favourable economic fundamentals—including low interest rates and solid job growth—and limited supply of single-detached homes; however, robust local fundamentals, alone, cannot justify the full extent of the price escalation in Vancouver. Over-exuberant price expectations likely also have played a prominent role in propelling values on a parabolic trajectory in Vancouver.

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

Robert Hogue
Senior Economist
(416) 974-6192
robert.hogue@rbc.com
New BC tax could signal a shift in the province’s housing policy...

After four rounds of housing policy tightening (and several other tweaks to regulation) at the federal level since 2008, it was the BC government’s turn on August 2, 2016, to address housing market risks by introducing a 15% tax on home purchases by foreign nationals in Metro Vancouver. The new tax was the BC government’s most significant action to date—following the start of data collection on foreign ownership and the end of self-regulation in the real estate industry in June—and may be perceived as signalling a shift in provincial housing policy toward actively cooling things down in the Vancouver area. Home resales in the area were already on a downward track prior to the announcement and could easily fall markedly further in the near term if any perceived policy shift triggers a sharp downgrading of future price expectations and suppresses speculative activity.

...but not necessarily in the rest of Canada

Given a unique set of dynamics at play in the Vancouver-area market, the new tax in BC is unlikely to be replicated in other provinces. The situation in Toronto, while also concerning for single-detached home affordability, remains less extreme than in Vancouver, especially for condo apartments—a comparatively more affordable ownership option. Thus, policymakers have room to consider less-instantaneous courses of action in Toronto such as addressing obstacles to boosting the supply of new low-rise housing.

Affordability close to historical norms in most local markets

Outside of the Vancouver and Toronto areas, housing affordability generally eroded only modestly in the second quarter of 2016, thereby remaining close to historical norms in the majority of local markets. Calgary continued to be an exception where RBC’s affordability measure was well below the long-term average for the area. Halifax also stood out for its attractive affordability level. On the other hand, rapidly rising prices during the past year drove Victoria’s affordability somewhat off track, with the level of the measure reaching a four-year-high in the latest period.

Affordability picture to remain divided but some relief in sight

Looking ahead, we expect housing affordability to remain divided across Canada between highly stressed conditions in Vancouver and Toronto, and relatively neutral conditions in the majority of other markets. With that said, signs of cooling resale activity have emerged in Vancouver and, more tentatively, Toronto that we believe will slow the pace of property appreciation by year-end 2016 in both markets. This is unlikely to help near-term affordability given current demand-supply tightness; however, some relief could come by late 2016 or early 2017.

British Columbia

Victoria – Topping out?

Victoria is the other market in British Columbia outside Vancouver that experienced a substantial housing rally and solid price gains in the past year. The drawback of course has been that local housing affordability eroded after reaching a nine-year best at the start of 2015. In the second quarter of 2016, RBC’s aggregate measure for the area rose, by a sizable 1.6 percentage points to 51.4%, for the fifth consecutive time. This level exceeded the long-term average of 43.8% quite significantly, which suggests to us the presence of greater than usual affordability stress. This stress may have been a factor behind a decline in home resales at the end of spring 2016—they fell by more than 10% between April and June—potentially a sign that this market has topped out. On the other hand, part or all of this decline could be reversed in the coming months if the new tax on foreign buyers in Metro Vancouver results in increased foreign investor interest in the Victoria market.
Vancouver – In uncharted territory
The seemingly unstoppable ascent of Vancouver home prices took the area’s affordability measures deeper into uncharted territory in 2016. RBC’s aggregate measure rose sharply by 6.1 percentage points in the second quarter, on the heels of an even larger increase of 6.6 percentage points in the first quarter. In the past year, the measure has surged by a massive 18.3 percentage points to an astounding 90.3%—a record high. The measure for single-detached homes skyrocketed by 28.9 percentage points during the same interval to 126.8%. Clearly, owning a single-detached property at current prices in Vancouver is a luxury that very few locals can afford. The new 15% tax on purchases by foreign nationals introduced on August 2, 2016, by the BC government visibly aimed at reducing foreign buyers’ interest in the Vancouver market. Perhaps more importantly, the tax may be a signal that the provincial government is now intent on engineering a cooldown of the market. Area home resales had already dropped by more than 20% (from their all-time peak in February 2016) prior to the announcement of the new tax. Any shift in market expectations resulting from the tax may precipitate a further near-term weakening.

Alberta

Calgary – Local demographics under pressure
Despite signs of a modest recovery in home resale activity—albeit from a historically low base—Calgary’s housing market continued to struggle amid plentiful supply of homes available for sale, declining prices, and softening demographics fundamentals. Recently released civic census statistics provided clear evidence of the toll exerted by the provincial recession on local demographics by showing that more people left Calgary in the 12 months ending April 2016 than moved into the area. This was the first net outflow recorded since 2010 and only the second such occurrence in the past quarter century. The challenges facing the market overshadowed further improvement in housing affordability in the area. RBC’s aggregate measures eased by 0.3 percentage points in the second quarter to 33.0%, still well below the long-term average of 40.4% for the area. Both the single-detached and condo segments registered small improvements. While unlikely to be a primary consideration for buyers at this point, attractive housing affordability conditions could play a much more stimulative role once the provincial economy turns a corner and confidence returns.

Edmonton – Neutral affordability picture not changing much
Housing affordability remained at neutral levels in Edmonton in the second quarter, which was unchanged from the first quarter. In fact, not only did RBC’s aggregate measure stand still at 35.1% in the latest period, but also it was only slightly higher (up 0.9 percentage points) than its year-ago level—a testament to the stability of affordability conditions in the area in the past year. There were only marginal changes recorded by the single-detached and condo segments in the second quarter. Home resales this spring have recovered some of the ground lost in the previous half-year (rising nearly 14% in the second quarter); however, the recovery appears to have stalled in the summer months. Weakening labour market trends may be to blame.

Saskatchewan

Saskatoon – Supply-side retreat launches rebalancing process
The highlight in Saskatoon’s housing market in the latest quarter was a second-consecutive decline in the number of homes available for sale. Earlier plentiful inventories—especially for condo apartments—relative to demand

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applied downward pressure on local prices last year and the early part of this year. The easing in existing home supply and stabilizing of resale activity (following a steady slide since mid-2014) in the second quarter, however, helped to boost prices slightly during spring and summer. Meanwhile, households’ incomes have remained under pressure in the face of a persistently challenging economic landscape; therefore, they have not compensated for this increase in ownership costs. Housing affordability eroded slightly as a result in the second quarter with RBC’s aggregate measure for Saskatoon rising by 0.5 percentage points to 32.6%. Despite this small deterioration, affordability still does not appear to be an issue in the area since the measure remained well within historical norms. A bigger issue at this point is the local job market where the jobless rate reached a multi-year high recently in the face of weakness in the provincial energy and non-energy mining sectors.

**Regina – Treading water**

Housing affordability trends for the most part continue to be stationary near long-term averages in Regina. In the second quarter, RBC’s aggregate measure inched 0.5 percentage points higher to 28.6%; however, this followed declines of 0.4 and 0.3 percentage points in previous two quarters, thereby leaving the level of the measure little changed from a year ago. Home resale activity also has trended mostly sideways in the past year, although the demand-supply balance tightened up slightly because the number of homes available for sale has declined. Such conditions have sustained a modest firming in prices during the first half of 2016.

**Manitoba**

**Winnipeg – Strong demand, strong supply, stationary affordability**

Winnipeg’s housing market continued to be vibrant in the second quarter as it nearly sustained the record-high levels of home resale activity achieved in the first quarter. Despite vigorous demand, price increases remained subdued because there were still many properties offered for sale, although inventory has shrunk somewhat this year. This was the case in the second quarter when new listings fell by 5.1% from the first quarter. In all, housing affordability conditions changed very little in the past year, including the latest period, and are at neutral levels. RBC’s aggregate measure edged 0.2 percentage points higher in the second quarter to 29.5%—very close to the 29.9% long-term average.

**Ontario**

**Toronto – Still booming but some moderation on the horizon?**

Second-quarter statistics confirmed that the housing boom was still in full swing in the Toronto area this spring with home resales setting yet new record highs and prices continuing to rise at accelerating rates. By all appearances, rapidly deteriorating affordability had no restraining effect on supercharged demand. RBC’s aggregate affordability measure for the area increased the most in five years—by 2.1 percentage points—to the most stressed level (60.2%) in the past quarter century. Once again, the single-detached segment accounted for the lion’s share of deterioration, while condo apartments eroded more modestly on a relative basis. The Toronto-area market remains very tight with demand far exceeding supply, especially in the single-detached segment. With that said, there may be tentative signs that the market has topped out. Recent monthly figures have shown that home resales have re-

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Source: Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage, RBC Economics Research
treated somewhat since hitting a peak in May and that new listings have begun to rise again this summer after falling steadily during the first half of 2016. If these signs are sustained in coming months, then there may be some moderation in the pace of price increases in store later this year or early next year.

**Ottawa – Market roars back, costing some affordability points**

A slowdown in Ottawa-area home resales at the start of 2016 was short-lived. Activity roared back in the second quarter, when resales jumped by 12.4% to their second-highest quarterly tally on record (on a seasonally adjusted basis). Equally noteworthy was the fact that the number of homes for sale continued to fall. Elevated inventories—especially of condo apartments—have been a thorn in the side of Ottawa’s market for the better part of the last two years following a wave of condo completions in 2014 and the first half of 2015. With fewer new units completed recently, however, those for-sale inventories have been drawn down to more reasonable levels, thereby resulting in a tighter demand-supply balance and increasing support for prices. Against this backdrop, housing affordability deteriorated modestly in the second quarter, yet it remained close to historical average. RBC’s aggregate measure rose by 0.5 percentage points to 35.2% in the second quarter.

**Quebec**

**Montreal – Affordability levels not budging much**

The cost of homeownership has not budged that much as a share of household income in the past two years in the Montreal area. Such stability reflects both limited price increases and continued modest gains in household income that took place during this period. This remained the case in the second quarter of 2016 when RBC’s aggregate affordability measure rose modestly by 0.6 percentage points to 39.4%—still within the narrow 38–40% band of the last two years. At this level, affordability is unlikely to be a major restraining factor for homebuyers in the area given that it is only slightly above the long-term average of 38.2%. After gathering increasing momentum since spring 2015, the Montreal-area market has lost a little bit of steam this spring when the pace of home resales slowed down somewhat, yet activity remained stronger than it was a year ago. Despite this lull, the demand-supply equation tightened a tad because of a decline in the inventory of homes for sale. For some time, the market has contended with lofty levels of condos for sale following a wave of new condo completions in 2014 and early 2015. Further inventory drawdown is likely in the period ahead.

**Quebec City – Buyers calling the shots**

Quebec City’s housing market has been rather stagnant during the first half of 2016 with stubbornly high inventories, slow sales growth compared to a year ago, and very limited price advances at best. In the second quarter, buyers were still comfortably in the driver’s seat with plenty of options to choose from and a lot of time to make up their minds (for instance, the average number of days on the market for a condo apartment was 170), and neither were buyers pressed by any fear that affordability might slip away. RBC’s measures have trended sideways for most of the past four years. The second quarter saw a continuation of this flat trend despite rising by 0.4 percentage points—the quarterly rise reversed earlier declines. At 34.0%, the latest reading of the aggregate measure perhaps signalled some degree of affordability stress given that it was above its long-term average of 30.1%; however, any such stress is unlikely to be severe at this stage. To be sure, high inventories...
Atlantic Canada

Saint John – Housing affordability leader

Saint John continues to lead major Canadian markets in terms of housing affordability. RBC’s affordability measures for the area were still the lowest (i.e., home ownership is the most affordable) in the second quarter among the cities that we track in Canada. Saint John’s aggregate measure stood at 24.3% in the latest period—down slightly by 0.2 percentage points from the first quarter—which was well below the national average of 42.8%. Such an attractive affordability position may have spurred buyers into action. After lingering at historically weak levels since 2010, home resales in the area began to rebound last year; however, they really took off in the second quarter of this year when they jumped by almost 14%. This was the second-largest quarterly gain in the past 10 years. Recent monthly resales figures show that activity was not quite as strong this summer, although the upward trend remained intact.

Halifax – A pause in the improving affordability trend

There was a pause in Halifax’s multi-year improving affordability trends in the second quarter of 2016. RBC’s aggregate measure rose by 0.8 percentage points to 29.6%, which represented only the third increase in the past three years in this market. The rise in the latest period was smaller than declines in previous quarters such that the measure still stood below both its level a year ago and long-term average. In short, home ownership continued to be quite affordable in the Halifax area, yet buyers remain hesitant. Home resales have been soft for the past three years and unable to gather any meaningful momentum. Resales were essentially flat in the second quarter after showing a promising gain at the start of this year. Nonetheless, the demand-supply balance firmed up this year due to a significant drop in homes offered for sales. New listings fell by 8.5% during the first half of 2016. Such firming in market conditions has lent some (albeit still-modest) support for prices since spring.

St. John’s – Coping with a tough situation

Home prices continue to be under downward pressure in St. John’s amid a difficult economic backdrop—largely resulting from weak oil prices—that undermines confidence and generates substantial uncertainty for buyers and sellers alike. Notwithstanding monthly volatility, the trend in home resales has held up surprisingly well so far this year considering the circumstances; however, consistently high inventories of homes for sale pose the biggest challenge at this point. Plentiful supply relative to demand continued to tip the scale in favour of buyers. A small decline in prices was the main factor behind an improvement in housing affordability in the second quarter. RBC’s aggregate measure edged lower by 0.2 percentage points to 26.2%. This latest easing in the measure—the fourth in the past six quarters—extended the downward trend that has prevailed since 2011 in the area.
### 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 based on the average market price for single-family detached homes and condo apartments, as well as for an overall aggregate of all housing types in a given market.

Current home prices are sourced from Brookfield RPS, and established from sales prices from monthly transactions, which are filtered to remove extreme values and other outliers.

The aggregate of all categories includes information on prices for housing styles not covered in this report (semi-detached, row houses, townhouses and pentes) in addition to prices for single-family detached homes and condominium apartments. In general, single-family detached homes and condo apartments represent the bulk of the owned housing stock across Canadian markets.

The affordability 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 14 major urban markets in Canada and a national composite. 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 home. 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.

### Summary tables

#### Aggregate of all categories

<table>
<thead>
<tr>
<th>Market</th>
<th>Q2 2016 ($)</th>
<th>Price Q/Q % ch.</th>
<th>Y/Y % ch.</th>
<th>Y/Y Avg. since '85 (%)</th>
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#### Single-family detached

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Source: Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage, RBC Economics Research
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 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.
Aggregate home price

Source: Brookfield RPS, RBC Economics Research
Home sales–to–new listings ratio

Source: Canadian Real Estate Association, RBC Economics Research

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