

## HOUSING TRENDS AND AFFORDABILITY

November 2013

### Housing affordability erodes across all regions of Canada in the third quarter of 2013

Renewed vigour in most of Canada's housing markets since spring and a rise in mortgage rates this summer set the stage for a second consecutive quarterly reduction in housing affordability in the third quarter of 2013. Stronger resale activity by mid-year contributed to heat up home prices by a few degrees, primarily in single-family home categories. At the same time, bond yields rose in tandem with a similar trend in the US that reflected the anticipation that the US Federal Reserve would begin tapering its bond buying program. This translated into the first notable increase in mortgage rates in Canada since the second quarter of 2011. Rises in home prices and mortgage rates consequently boosted the costs of owning a home at market value, more so than what could be offset by household income gains. Still, the lessening of affordability that resulted from this combination of factors was mild overall and did not pose any immediate threat to the general health of the housing market. In the third quarter of 2013, RBC's housing affordability measures rose modestly for all housing types in Canada relative to the second quarter (an increase represents a deterioration in affordability), although once again, most of the erosion took place in single-family home segments of the market. RBC's measures moved up by 0.7 percentage points to 43.3% for the detached-bungalow benchmark and by 0.6 percentage points to 48.9% for two-storey homes, while the measure for condominium apartments edged up by only 0.1 percentage points to 28.0%.

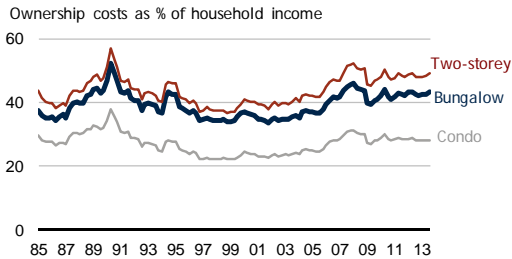
#### Single-family home cost premium widens further

Developments in the third quarter further underscored the divergence in trends between the single-family home and condominium apartment segments that emerged in recent years. With prices for bungalows and two-storey homes continuing to outpace those of condo apartments, the ownership cost premium for single-family homes reached near-record levels relative to condo apartments in the third quarter. The difference between RBC's two-storey home and condo apartment measures at the national level, for instance, was the second-widest registered since the mid-1980s. Even though affordability of all housing categories remains within manageable levels overall in Canada, single-family homes represent more of a stretch for homebuyers than they have historically, whereas condo apartment affordability is closer to its historical norm.

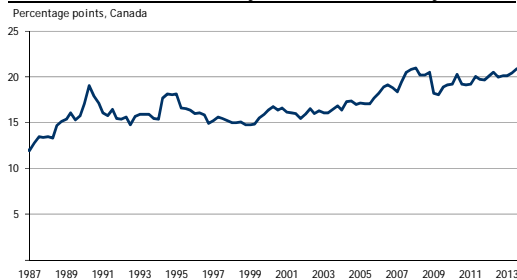
#### Two-tiered affordability conditions in Toronto, Montreal and Vancouver

The emergence of two-tiered affordability conditions nationally mainly reflects the situation in Canada's three-largest markets. Strong demand for, relative to the supply of, single-family homes in desirable locations in Toronto, Montreal, and Vancouver, in the past several years, generally applied consistently more upward pressure on prices for these categories than for condos, which represented the fastest-growing source of new housing units. In effect, single-family homes have become more of a luxury in these top markets that proportionally

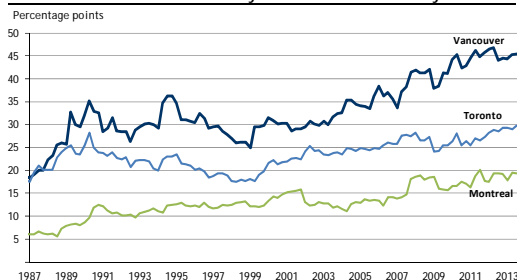
#### RBC Housing Affordability Measures - Canada



#### Differential between two-storey and condo affordability measures



#### Differential between two-storey and condo affordability measures



Source: Statistics Canada, Royal LePage, RBC Economics Research

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fewer households can afford. Because of their growing availability, condos remain much more within reach for typical households who are looking to own. Outside of Toronto, Montreal, and Vancouver, affordability is generally in line with historical norms for all housing categories.

#### **The deterioration in affordability in the third quarter was widespread across the country**

There was no real divergence among Canada's top-three and other markets in the way affordability evolved in the third quarter of 2013; however, virtually all markets across the country showed modest deterioration, with Vancouver experiencing more pronounced slippage than elsewhere for the second consecutive quarter. Furthermore, all markets saw most of the deterioration occur in the single-family home categories. In fact, condo apartment affordability levels in the Manitoba, Quebec, and Atlantic regions remained unchanged from the second quarter.

#### **Vancouver and Alberta at opposite ends of the affordability spectrum**

Across the country, housing affordability continues to be the poorest, by far, in the Vancouver area, where the latest RBC measures are significantly above their long-term average. At the other end of the spectrum, affordability in Alberta and the Atlantic region still looked reasonably attractive for the most part in the third quarter.

#### **Homebuyers unperturbed by any affordability issues at this point**

Varying affordability levels in Canada did not appear to be much of a factor in differentiating local home resale activity in the latest period. Vancouver-area resales grew at the strongest rate in the country (although from historically weak levels) in the third quarter, with Toronto (Canada's second-most expensive market) also posting a notable gain. Overall in Canada, home resales increased by a solid 6.0% in the third quarter, following a slightly stronger 6.3% advance in the second quarter, thereby indicating that recent affordability levels (and the back-to-back quarterly deteriorations) generally did not stand in the way of homebuyers stepping into the fray in this country. That being said, we believe that part of the resale strength this summer reflected the unwinding of earlier restraint associated with the tightening of mortgage insurance rules last year and a rush by some homebuyers to lock-in lower mortgage rates this summer. A 3.2% monthly resale decline nationwide in October suggests that some of the recent activity may have been borrowed from future months. We expect home resales to stabilize near the current not-too-hot and not-too-cold levels, although some further modest pullback may occur in the near term.

#### **Sharply rising interest rates would pose a threat**

Going forward, affordability could become a deterrent for homebuyers in this country if it were to deteriorate much further due to, for example, a surge in interest rates. Exceptionally low mortgage rates have been a key factor preventing affordability from reaching harmful levels in recent years. Nonetheless, we view the risk of sharply rising interest rates as moderate at this point. We expect the Bank of Canada to leave its overnight rate unchanged in 2014 and bond yields—the main driver of fixed mortgage rates—to drift gently upward throughout the year ahead of what is likely to be a gradual pace of policy tightening by both the US and Canadian central banks.

## Provincial overviews

### British Columbia – Market activity recovers; affordability recedes

Home resales in British Columbia rebounded strongly for the second straight time in the third quarter of 2013 despite housing affordability further reversing earlier improvements. Resale gains of 13.6% and 15.1% in the second and third quarters, respectively, largely restored provincial market activity to levels that prevailed prior to late 2011, before the most recent downturn began. The return of firmer market conditions propped home prices up in the province, which in turn, contributed to eroding housing affordability. RBC's affordability measures rose across the board for the second consecutive quarter in the third quarter, thereby clawing back the progress made during the second half of 2012 and the first quarter of 2013. In the latest period, RBC's measures increased by 1.5 percentage points to 69.2% for bungalows, 1.2 percentage points to 74.1% for two-storey homes, and 0.8 percentage points to 34.7% for condo apartments.

### Alberta – Affordability erodes modestly but remains attractive

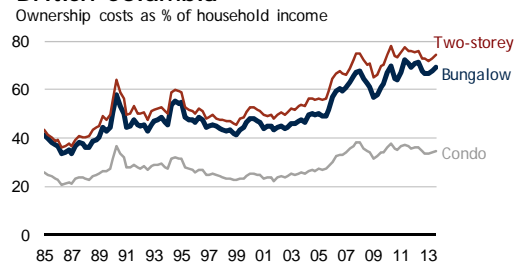
Housing affordability eroded in Alberta for the third consecutive quarter in the third quarter; however, this erosion was quite modest and did not undermine the province's attractive affordability position. RBC's measures rose by 0.6 percentage points to 32.5% for detached bungalows, 0.2 percentage points to 34.6% for two-storey homes, and 0.1 percentage points to 19.6% for condo apartments. All measures continued to be below both their long-term and national averages. Favourable affordability levels, therefore, continue to be positive for homebuyer demand in the province, which is propelled by a strong provincial economy and rapidly rising population. Alberta home resales revved up by 7.8% in the third quarter, which was the fastest pace in nearly three years. Strong market momentum is likely to persist in the year ahead given the province's very bright economic prospects.

### Saskatchewan – Affordability picture still reasonably positive

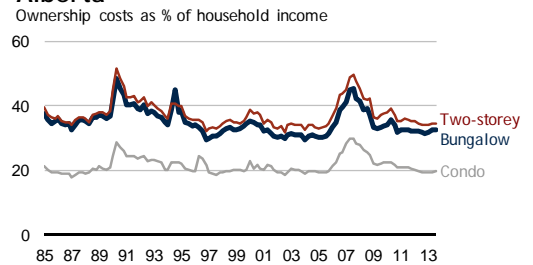
The third quarter was largely uneventful in Saskatchewan's housing market. As elsewhere in the country, there was some loss of affordability across all housing types; however, this loss was generally slight and did not really alter the overall, reasonably positive picture. Home resales were mostly flat at historically high levels, and prices continued to rise at modest rates in the province. The costs of owning a home at current market prices edged higher as a share of household income by 0.6 percentage points to 41.3% for two-storey homes, 0.2 percentage points for condo apartments to 25.1%, and 0.1 percentage points to 37.2% for detached bungalows. Housing affordability has trended mostly sideways in Saskatchewan since 2009 at levels generally close to historical norms, thereby suggesting that affordability likely plays a predominantly neutral effect on home-buying decisions. The province's strong labour market and population growth, no doubt, are the more powerful factors fuelling homebuyer demand, and we expect them to continue to do so in the near term.

## RBC Housing Affordability Measures

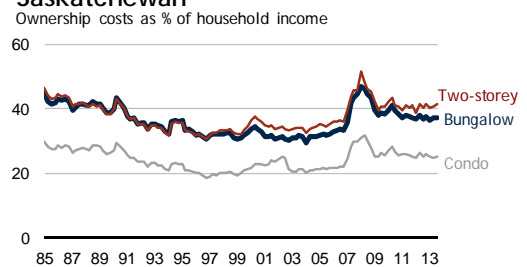
### British Columbia



### Alberta



### Saskatchewan

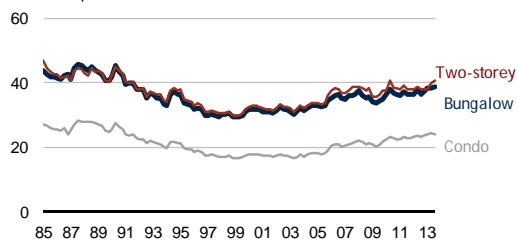


Source: Statistics Canada, Royal LePage, RBC Economics Research

## RBC Housing Affordability Measures

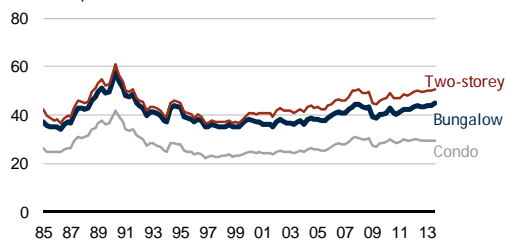
### Manitoba

Ownership costs as % of household income



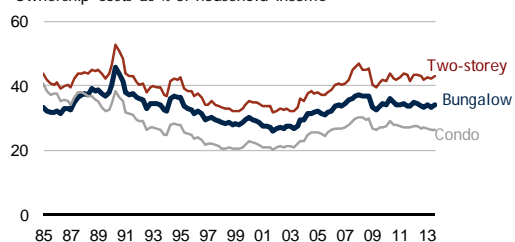
### Ontario

Ownership costs as % of household income



### Quebec

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

### Manitoba – Mirrored developments at the national level

Housing affordability developments in Manitoba largely mirrored those at the national level in the third quarter. RBC's measures for the province increased by almost the same magnitude as the Canadian measures for single-family home categories (0.6 percentage points for both detached bungalows and two-storey homes), while the measure for condo apartments remained unchanged in Manitoba compared to a marginal rise of 0.1 percentage points in Canada overall. Homeownership costs as a share of household income, therefore, continue to be lower in Manitoba than in the rest of the country. On the other hand, the share is still modestly higher than it has been on average in the province since the mid-1980s. This would suggest that Manitoba homebuyers may be presently facing some greater than usual affordability-related stress. Any such, stress did not hold resale activity back in the past two quarters, however, as home resales advanced by 5.9% and 1.2% in the second and third quarters, respectively. The Winnipeg market, in particular, bounced back vigorously from a soft patch at the start of this year.

### Ontario – Single-family homes less affordable; condos still within reach

Ontario saw further modest erosion of its housing affordability position in the third quarter, concentrated once again in the single-family home segments of the market. RBC's measures for bungalows and two-storey homes have drifted higher in the past four years, reaching levels that imply the presence of some affordability-induced stress in these categories but likely still far from extreme or dangerous at this point. The trend in the measure for condo apartments, however, has been much flatter, thereby indicating that condo ownership remains well within reach for most homebuyers in the province. In the third quarter, RBC's measures rose by 0.9 percentage points to 44.9% for bungalows and 0.7 percentage points to 50.6% for two-storey homes, while the increase for condo apartments was more subdued at just 0.2 percentage points to 29.6%. Ontario's resale market largely ignored the erosion of affordability and continued to rebound in the third quarter. Market psychology shifted back to a more upbeat tone this summer, which contributed to a slight acceleration in home price increases.

### Quebec – Reversing most of the earlier affordability improvement

The small improvement in affordability that took place in the second quarter in Quebec was reversed for the most part in the third quarter. The earlier drops in RBC's measures gave way to modest increases for single-family homes in the latest period with two-storey homes rising by 0.6 percentage points to 42.9% and bungalows by 0.5 percentage points to 33.9%. After the second-quarter decline of 0.4 percentage points in the condo apartment measure, the level remained unchanged at 26.4% in the third quarter. Despite diverging affordability trends across housing categories during the past three years in the province—two-storey homes deteriorated slightly, bungalows stayed mostly flat, and condo apartments improved slightly—current affordability levels are generally in line with historical norms in Quebec. This lends some support for provincial homebuyer demand, which continues to rebuild (Quebec home resales rose by 1.5% in the third quarter), although at a less vigorous pace than in other parts of the country. Lacklustre labour market conditions and uncertain economic prospects in the province may be weighing on homebuyer confidence.

## Atlantic – Very manageable affordability not enough to invigorate housing market

When it comes to housing affordability, matters tend to change only slowly in Atlantic Canada. That is a good thing when affordability is within a very manageable range and compares well to the rest of the country, as it has been for the past few years. Once again, RBC's measures for the region showed little movement in the third quarter, edging higher by 0.5 percentage points to 36.7% for two-storey homes and by 0.2 percentage points to 31.7% for bungalows, and remaining unchanged at 26.1% for condo apartments. While owning a home at current market prices is quite manageable budget-wise in the region, housing market activity remains rather sluggish so far this year. On a year-to-date basis, home resales were down nearly 10% during the first three quarters of 2013. Homebuyer demand likely is being dragged down by a stagnant labour market, fragile consumer confidence, and weak demographics in many parts of the region. Resales in markets such as Halifax and Fredericton remain well below year-ago levels.

## Major city markets

### Vancouver – As market crash fears fade, unaffordability concerns resurface

Concerns of a painful market crash in the Vancouver area dissipated in the past two quarters as home resales took off again, surging by nearly 42% since reaching a four-year low in the first quarter. As impressive as this rebound was, third-quarter resales were still about 5% shy of the 10-year average in the area and by no means suggested that the market was on the verge of overheating. A 10% monthly drop in October, in fact, hinted that the rebound may have mostly run its course by now and that activity may soon stabilize at lower than average levels. Buyers' return to the market since spring rebalanced the equation with sellers, which contributed to sending prices on an upward course, following a year of decline. The flipside is that higher prices took a further toll on an already poor affordability situation in the area. In the third quarter, RBC's measures for Vancouver rose the most among all major markets in Canada, moving up by 2.0 percentage points to 84.2% for bungalows, 1.4 percentage points to 87.4% for two-storey homes, and 1.1 percentage points to 41.9% for condo apartments. These levels are uncomfortably high and likely purport substantial market stress.

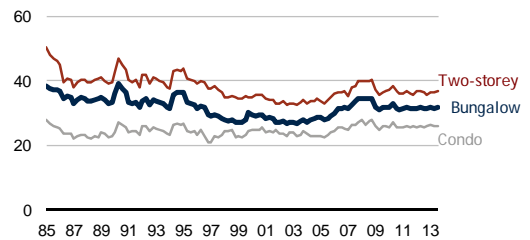
### Calgary – Homebuyer demand supercharged by booming economy

Modest deterioration in housing affordability in the Calgary area in the third quarter is likely to be taken in stride by local homebuyers, because they still benefit from some of the lower ownership costs as a share of household income in Canada. RBC's measures increased for all housing categories in the area in the latest period—rising between 0.2 percentage points and 0.7 percentage points—however, levels continue to be below the national and historical averages. Favourable affordability conditions primarily reflect high household income in Calgary rather than low home prices given that home prices in the area are among the more expensive in the country. While affordability is constructive for homebuyer demand, the more powerful factors driving it, no doubt, are Calgary's hot labour market and fast-rising population, both supercharged by a booming provincial economy. Home resales surged to their highest level in six years in the area. The fact that this occurred despite the worst

## RBC Housing Affordability Measures

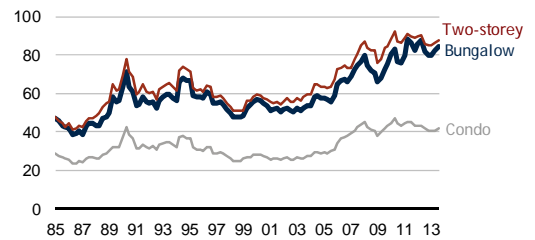
### Atlantic Provinces

Ownership costs as % of household income



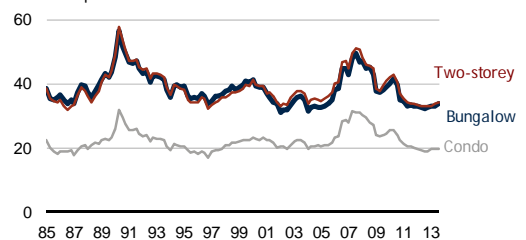
### Vancouver

Ownership costs as % of household income



### Calgary

Ownership costs as % of household income



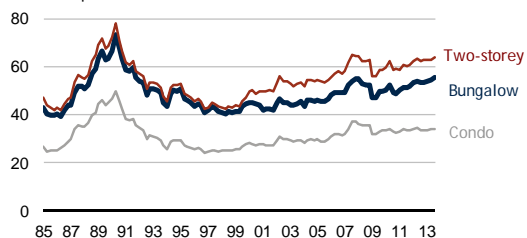
Source: Statistics Canada, Royal LePage, RBC Economics Research



## RBC Housing Affordability Measures

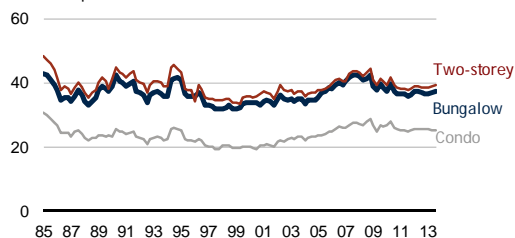
### Toronto

Ownership costs as % of household income



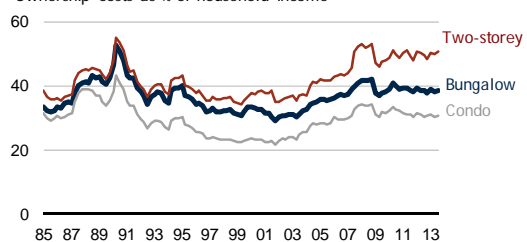
### Ottawa

Ownership costs as % of household income



### Montreal

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

floods in memory at the end of June is quite telling of the market's strength at this stage.

### Toronto – Back on track

The Toronto-area market is back on track, as the significant cooling in activity that took place in the latter half of 2012 was effectively fully reversed by the third quarter of 2013. A strong 18% cumulative gain in home resales in the past three quarters (including a 9.3% advance in the third quarter) occurred despite housing affordability continuing to appear a little stretched—particularly for single-family homes. The share of household income needed to cover the costs of owning a home at current market prices in the Toronto area (55.6% for bungalows, 63.7% for two-storey homes, and 33.8% for condo apartments) continues to exceed historical norms quite noticeably for bungalows and two-storey homes, albeit much less so for condo apartments. In the third quarter, that share increased further for the single-family home categories (by between 0.8 percentage points and 1.3 percentage points); however, it diminished marginally (by 0.1 percentage points) for condo apartments. While stretched affordability may have had little restraining effect on homebuyer demand so far this year, it could well act as a force that keeps Toronto home resales from reaching heated levels in the period ahead.

### Ottawa – All in moderation

Recent developments in the Ottawa-area market show that forward momentum is being sustained but remains fairly modest. Home resales grew for the second straight quarter in the third quarter; however, at 1.8%, the rate of growth both was slower than the 2.9% registered in the second quarter and lagged the 6.0% pace at the national level. With demand-supply conditions generally in balance but somewhat looser than they were a year ago, home price increases have been quite subdued—or slightly negative in the case of condo apartments. Changes to Ottawa-area housing affordability were similarly incremental in the third quarter. RBC's measures edged higher by 0.4 percentage points for both bungalows and two-storey homes, and by just 0.1 percentage points for condo apartments. Affordability levels continue to be at, or close to, long-run averages in the area, thereby implying little undue stress on local homebuyers at this stage.

### Montreal – Recovery remains incomplete; condo listings on the rise

The Montreal-area market continues to rebound from its downturn in the latter half of last year; however, its recovery is still far from complete. Moderate back-to-back quarterly gains in home resales in the second and third quarters of 2013 (3.8% and 3.2%, respectively, or just a little over half of the rates recorded at the national level) only partially reversed the earlier drops, such that in the latest period the number of homes that exchanged hands still stood more than 16% below the 10-year average in the area. At the same time, the number of properties available for sale also is on the rise, particularly for condos, which have posted the fastest increase in listings in the past year. Plentiful condo availability led to slight price declines in this category in the third quarter. Affordability, or any lack thereof, does not appear to be a major impediment at this point in general, although owning a two-storey home at current prices is somewhat of a stretch for many area households. RBC's measures rose slightly between 0.2 percentage points and 0.9 percentage points in the third quarter.

## 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 (\$) Q3 2013	RBC Housing Affordability Measure			
	Q3 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q3 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	380,000	1.3	4.1	80,700	43.3	0.7	1.0	39.2
British Columbia	627,700	1.2	2.7	120,700	69.2	1.5	1.5	50.3
Alberta	375,500	1.7	4.9	79,200	32.5	0.6	0.9	34.9
Saskatchewan	353,200	0.3	3.2	75,700	37.2	0.1	0.3	36.2
Manitoba	313,200	0.7	7.0	69,400	38.8	0.6	2.2	35.9
Ontario	408,600	1.6	5.1	88,600	44.9	0.9	1.4	40.5
Quebec	250,100	0.9	3.1	55,600	33.9	0.5	0.3	33.1
Atlantic	222,900	0.5	1.9	53,000	31.7	0.2	0.2	31.7
Toronto	578,600	1.8	5.8	118,200	55.6	1.3	2.1	48.9
Montreal	295,900	0.2	0.6	64,500	38.3	0.3	-0.2	36.6
Vancouver	830,100	1.3	3.1	155,800	84.2	2.0	2.2	59.7
Ottawa	399,700	0.5	2.3	91,000	37.3	0.4	0.5	36.7
Calgary	465,400	1.6	7.2	92,800	33.7	0.7	1.6	38.3
Edmonton	340,000	2.0	3.0	74,500	32.9	0.5	0.5	33.1

### Standard two-storey

Region	Average Price			Qualifying Income (\$) Q3 2013	RBC Housing Affordability Measure			
	Q3 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q3 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	425,600	0.7	3.4	91,100	48.9	0.6	0.8	43.7
British Columbia	667,200	0.4	2.3	129,200	74.1	1.2	1.5	55.5
Alberta	390,200	0.4	3.1	84,400	34.6	0.2	0.5	37.4
Saskatchewan	387,600	1.9	5.5	84,000	41.3	0.6	1.1	37.7
Manitoba	327,900	0.6	8.6	72,700	40.6	0.6	2.8	36.8
Ontario	457,100	0.7	4.1	99,900	50.6	0.7	1.3	44.3
Quebec	320,100	0.6	2.1	70,300	42.9	0.6	0.1	39.5
Atlantic	251,100	1.5	2.4	61,300	36.7	0.5	0.4	38.0
Toronto	655,800	0.5	3.7	135,400	63.7	0.8	1.5	54.5
Montreal	400,600	1.3	3.9	85,200	50.6	0.9	1.1	42.0
Vancouver	855,000	0.5	2.3	161,700	87.4	1.4	1.7	64.9
Ottawa	407,800	0.6	2.4	95,400	39.0	0.4	0.5	39.0
Calgary	457,500	0.8	6.0	93,800	34.0	0.4	1.2	38.7
Edmonton	374,500	0.5	1.6	83,000	36.6	0.0	0.1	36.3

### Standard condominium

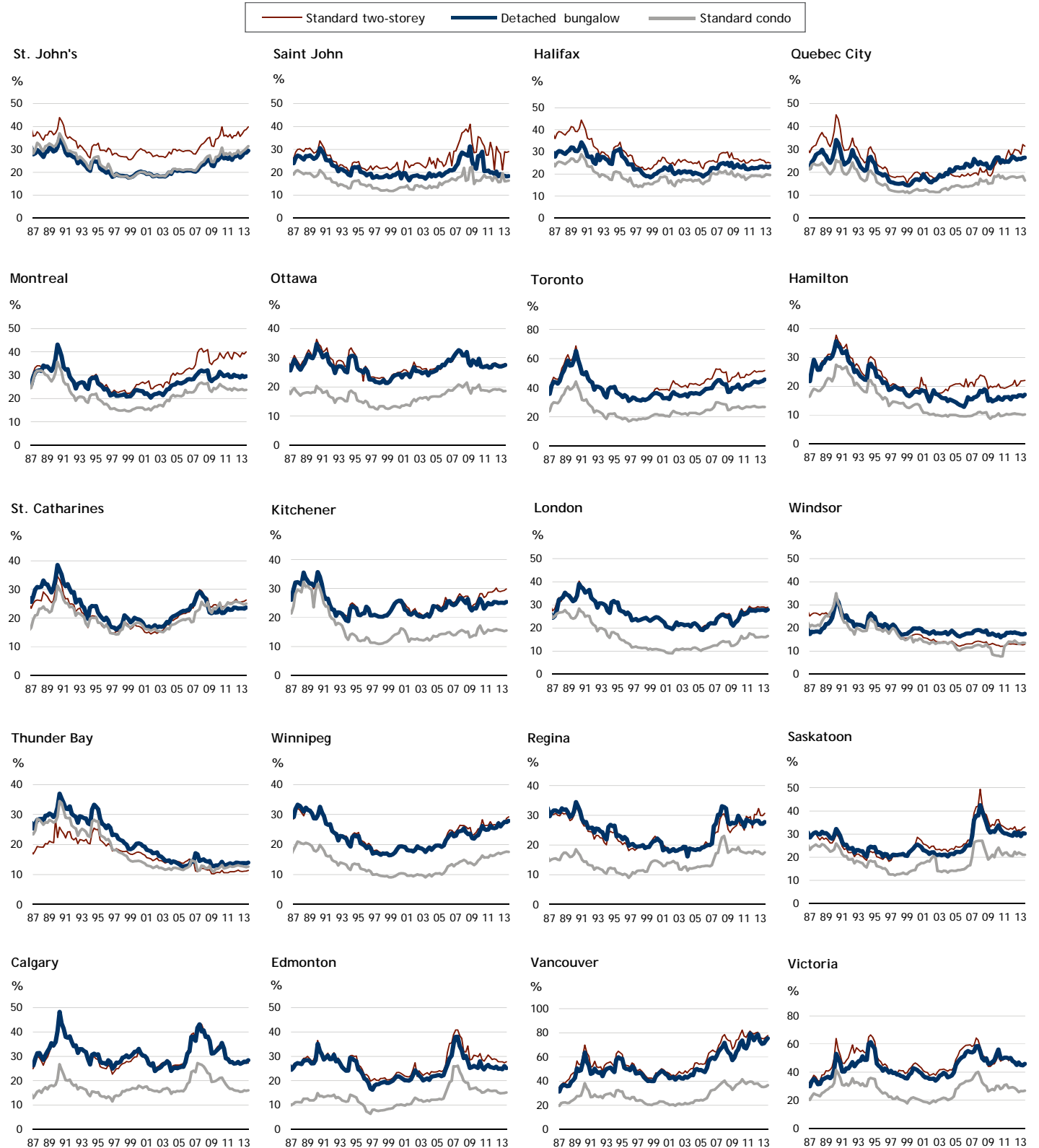
Region	Average Price			Qualifying Income (\$) Q3 2013	RBC Housing Affordability Measure			
	Q3 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q3 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	239,400	-0.2	1.0	52,200	28.0	0.1	-0.1	27.0
British Columbia	304,100	1.4	0.2	60,600	34.7	0.8	0.0	28.3
Alberta	218,800	-0.2	2.5	47,700	19.6	0.1	0.2	21.4
Saskatchewan	236,400	1.4	1.0	51,200	25.1	0.2	-0.2	24.2
Manitoba	196,700	-1.6	3.7	43,200	24.2	0.0	0.9	21.3
Ontario	262,000	-0.4	0.5	58,400	29.6	0.2	-0.1	27.8
Quebec	195,600	-1.1	0.5	43,400	26.4	0.0	-0.3	27.5
Atlantic	188,600	-0.1	4.9	43,700	26.1	0.0	0.7	24.5
Toronto	339,500	-1.2	1.4	72,000	33.8	-0.1	0.2	31.5
Montreal	237,700	-0.2	1.7	51,300	30.5	0.2	0.1	29.3
Vancouver	402,800	1.8	0.8	77,500	41.9	1.1	0.3	32.7
Ottawa	269,700	-0.2	-1.1	61,600	25.2	0.1	-0.3	23.7
Calgary	263,100	0.4	5.6	54,100	19.6	0.2	0.6	22.2
Edmonton	204,400	0.1	1.9	45,600	20.1	0.0	0.1	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

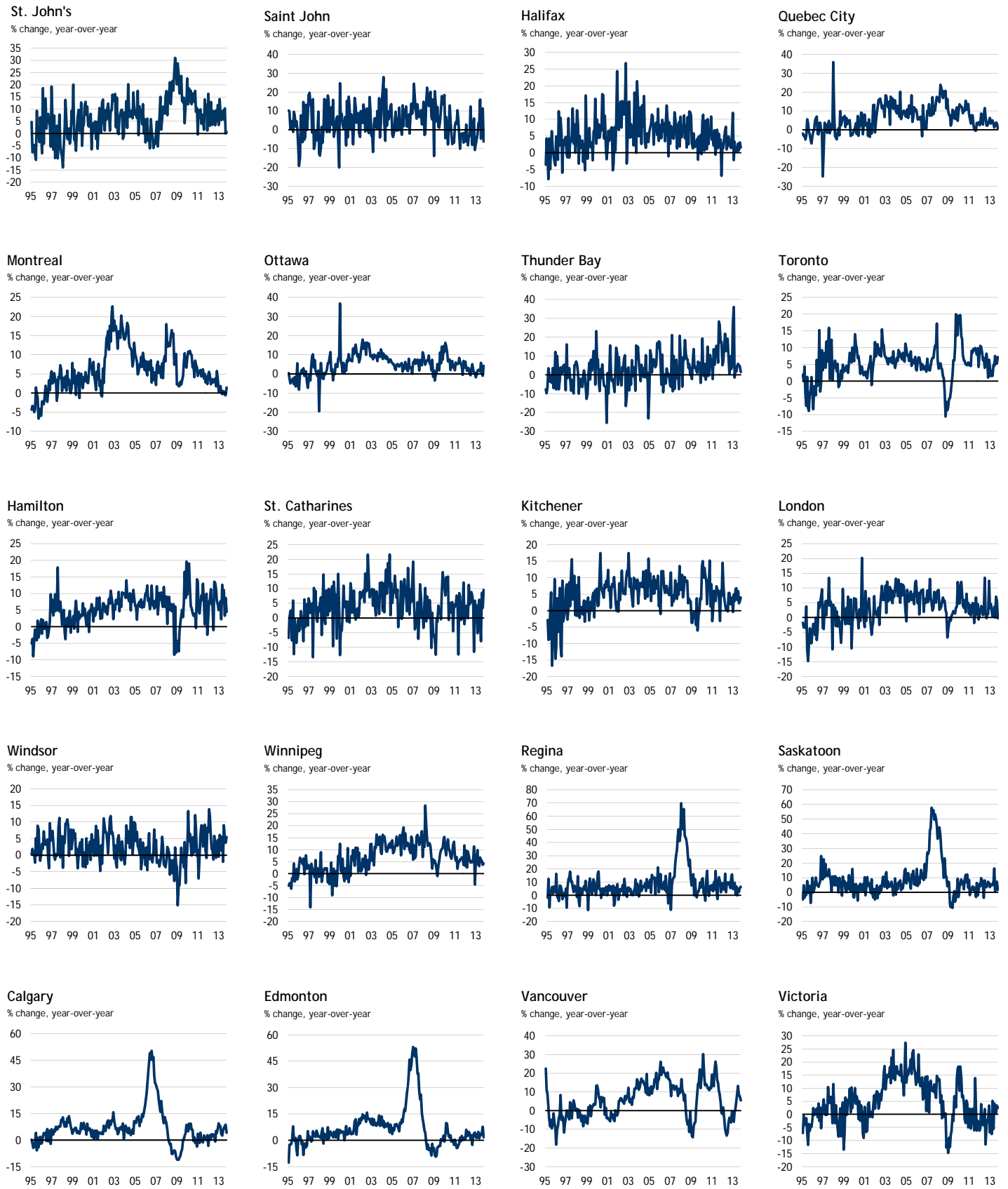


Source: Statistics Canada, Royal LePage, RBC Economics Research





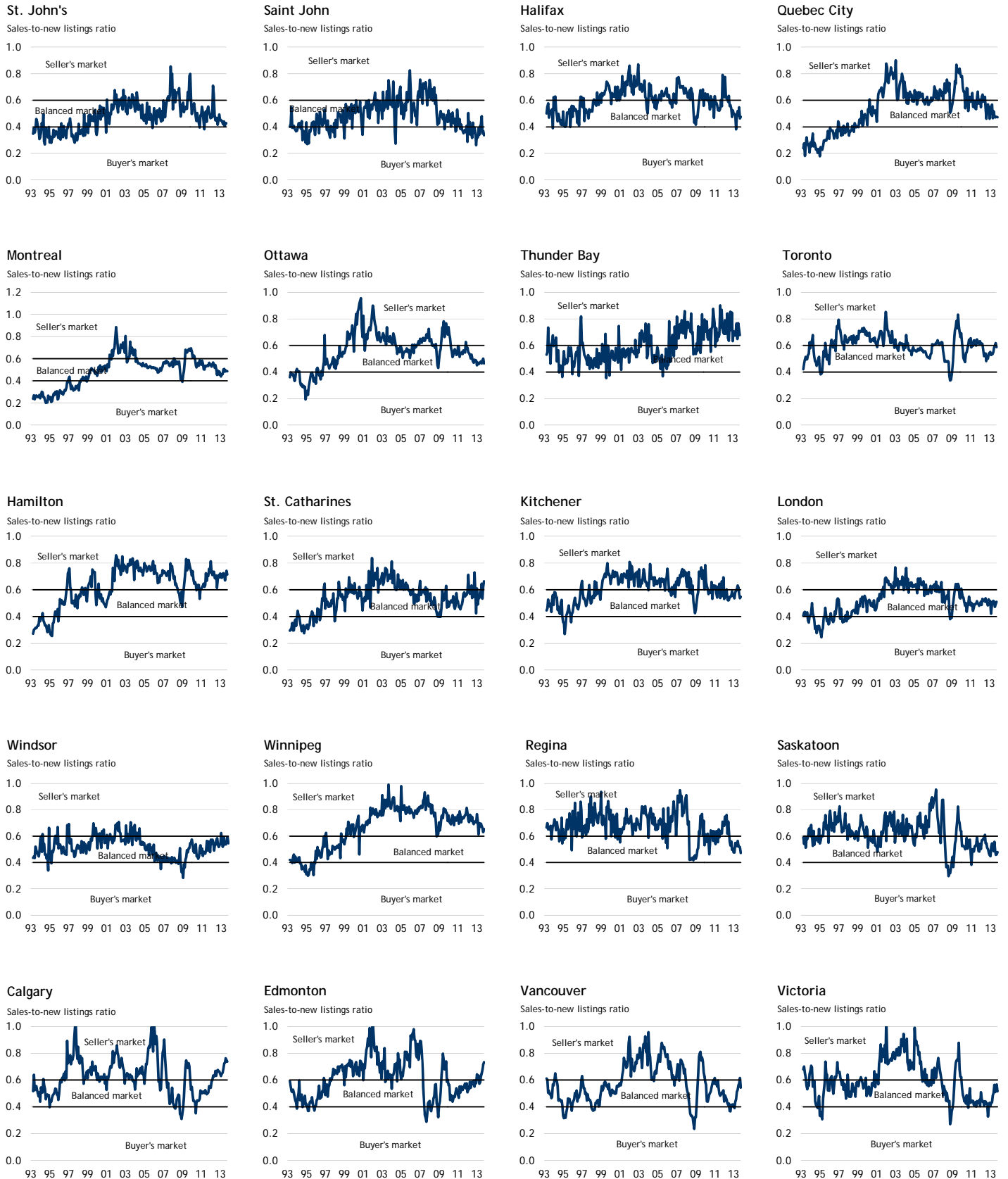
# Average price of homes sold on the MLS system



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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