



# Current Analysis

Current Analysis reports address current economic issues of importance to RBC Financial Group and its clients.

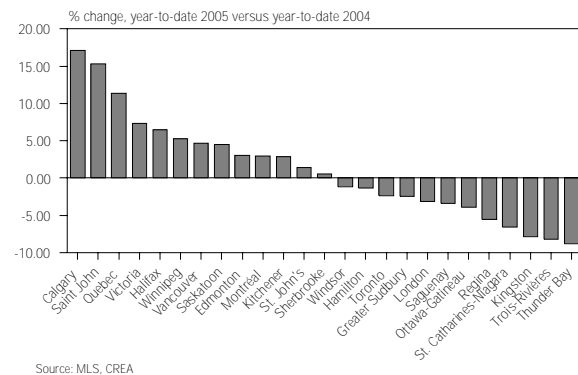
## Canadian city housing markets

September 2005

The current housing boom has been under way since about 2001. It started earlier in some markets like Toronto and, in others, like Montreal, it started a bit later. Mid-way through 2005, the boom in sales was still going strong in many cities but has started to run out of steam in others. Activity has also shifted from single-family homes to condos and townhouses and has become concentrated in a few major cities.

Chart 1 ranks growth in year-to-date average MLS home sales in 2005 compared to a year earlier. Sales have continued to climb from 2004 levels in 13 census metropolitan areas (CMAs), while sales are running at a slower rate than a year ago in 12. Of the 12 CMAs reporting lower sales levels in 2005, 75% are in Ontario. Two are Quebec cities with high unemployment rates and only one, Regina, is in western Canada. (Data for Abbotsford and Oshawa were not available at time of writing.)

Chart 1  
MLS sales by CMA



The real estate boom continues unabated in most of western Canada. Notably, several Quebec and maritime cities are also seeing stronger sales this year than last. Calgary leads, but is followed closely by Saint John. High energy prices have breathed renewed life into New Brunswick's energy sector. In third place, Quebec City is enjoying healthy sales levels. Halifax, Montreal and St. John's are also up on the year. In Ontario, only Kitchener is on the plus side.

### Future path of house prices

Canadians have increasingly come to view real estate as a solid and attractive investment. For this to be true, house prices have to continue to rise at a healthy pace. Although it is beyond our scope here to forecast city-level house prices, one way of making inferences about the possible future path of house prices in any particular CMA is to analyze its local market demand

and supply conditions (per capita housing starts and home resales) relative to their long-term trends (see charts for each of the 27 census metropolitan areas on page 4).

The longer a region sits below its long-run average sales or starts level, the more likely it is that pent-up activity will build up to be released when conditions are right. Conversely, sales and starts activity is unlikely to remain above long-run average levels in perpetuity. In 23 of Canada's census metropolitan areas, per capita home sales exceed their long-run averages — 17 of them by more than 10%. Only in Halifax, Saskatoon, Thunder Bay and Regina are per capita sales below their long-run average. Unit sales are above their average by the greatest margin in Saguenay, Sherbrooke and Montreal and below in Saskatoon, Thunder Bay and Regina.

Per capita starts are below their long-run average level in 10 cities. Starts are above their average by the greatest margin in Edmonton, Regina, Montreal and St. John's and below by the greatest margin in Saguenay, Thunder Bay, Abbotsford and Sudbury.

Chart 2

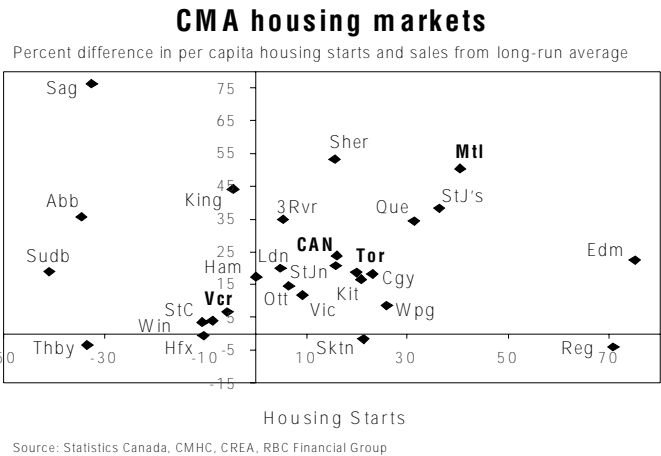


Chart 2 compares the latest data to each city’s long run-average. Each of the four quadrants produces different implications for city housing markets. In the bottom right quadrant, starts are above average, while sales are below average. This would imply rising housing supply and relatively slower demand, leading to weak price appreciation. Regina and Saskatoon are in this quadrant. Unemployment rates in both cities are in the mid-4% range and starts are up about 50% year-over-year, while unit sales are down 1-5% from last year. Annual price growth of 6.6% in Saskatoon and 11.8% in Regina is likely to weaken.

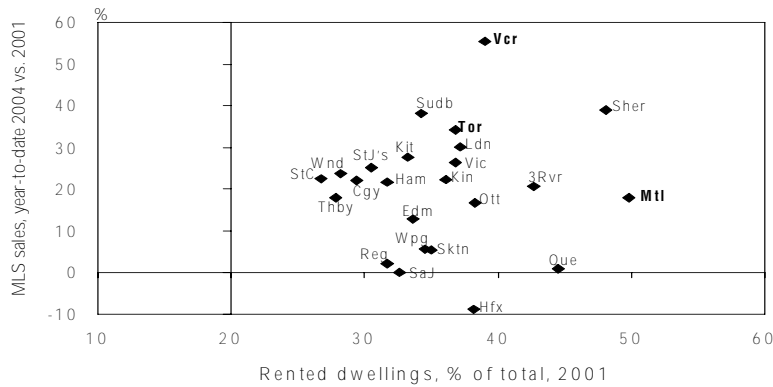
Most of Canada’s CMAs are in the top-right quadrant, with both sales and starts above long-run levels. This is to be expected given the housing boom of the past few years. Edmonton has seen strong sales but very strong starts way above trend, suggesting that growth there could slow. Activity is at less extreme levels in Calgary. Toronto is close to the national average. Montreal and Sherbrooke both stand out with starts and sales well above long-run averages. However a pent-up demand story is at work there as those markets make up for weak activity in the 1990s.

In the bottom left, both unit sales and starts are below historical levels. This indicates a slow growing or even structurally challenged housing market. Halifax and Thunder Bay are in this quadrant. Halifax’s housing market has slowed significantly from above-average levels of activity two years ago. Thunder Bay faces difficult conditions. Slow population growth and challenges in the forestry sector have put downward pressure on growth and incomes. Starts and sales are down year-over-year, although price growth is only slightly below the past year’s 8% national average.

Cities in the top left quadrant are expected to post the fastest growth in the near-term because sales are above average but starts are below average. Saguenay, Sudbury and Abbotsford are standouts here. Saguenay per capita sales have been on an upward trend since 1990, while per capita starts have been falling, creating supply constraints. The region has been losing population since 1999 (explaining the dearth of new construction), but low interest rates have spurred more demand relative to supply, pushing prices up more than 10% in the past year. Sudbury’s population growth has been close to zero, with little new construction and weak prices.

Chart 3

### CMA rental shares



Source: Statistics Canada, CMHC, CREA, RBC Financial Group

Abbotsford has seen very strong population growth and even stronger demand, while new construction has been weaker than population growth due to a lack of available new space. Vancouver, too, is in this quadrant. Despite a booming housing market, Vancouver’s sales and starts trends are not alarming compared to the mid-1990s. Total housing starts have been very strong but so has population growth. As a result, starts appear weak on a per capita basis. Strong construction and price growth should continue.

### The first-time buyer effect

Another way of assessing the staying power of the current housing boom is to look at the underlying reasons that sales took off so strongly in the first place. One popular explanation has highlighted the first-time buyer phenomenon as the source of an unknown, but potentially large, percentage of home sales in the past few years. As interest rates were hitting generational lows, many first-time buyers found it easier to move from the rental market into homeownership.

However, as Chart 3 shows, there appears to be little correlation between the share of renters in 2001 and the subsequent pace of home sales from the start of the current boom in 2001 to its peak in the first half of 2004. For first-time buyers to have been a significant driver of the market, we should see a correlation between a higher share of rented dwellings than home sales when interest rates decline. This correlation should be stronger in cities with relatively more renters. Unfortunately, a clear relationship does not exist. Some cities had a relatively high proportion of renters in 2001 as the housing boom got under way, yet did not show much stronger sales activity than other cities with a low proportion of renters.

Quebec cities have a significantly higher share of renters than average, but not all have seen strong housing markets in the last four years. Vancouver has an average rental share and a very strong market; Halifax has an average rental share and a weak resale market. Some Ontario cities like St. Catharines and Windsor have seen strong markets with relatively few renters. Similarly, there is little correlation between the difference in rental costs and homeownership costs and the strength of the resale market from 2001 to 2004. In conclusion, while first-time buyers make for an interesting story, it is unlikely that their presence alone was a key driver of city-level housing market sales activity.

# Per capita city-level housing starts and unit sales

