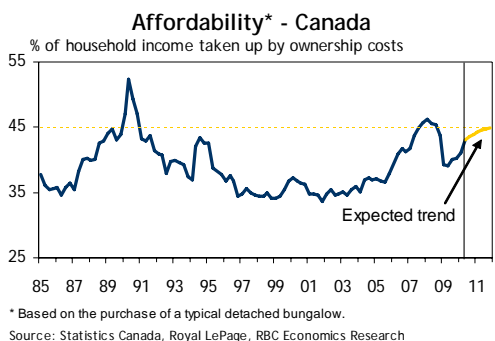
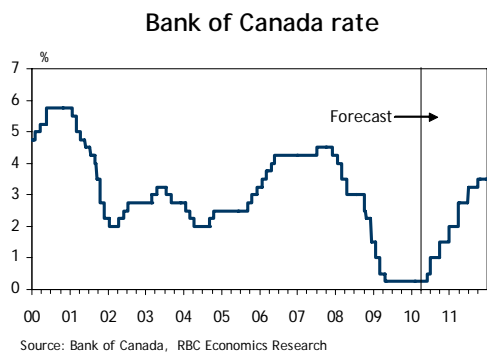
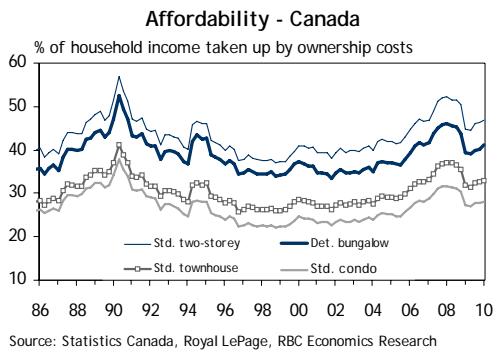


Market overview



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

HOUSING TRENDS AND AFFORDABILITY

May 2010

Affordability erodes again in the first quarter of 2010

Canada's housing markets started 2010 the same way they ended 2009: firing on all cylinders. While a boon to sellers, the resulting strong home price increases, however, have hurt housing affordability across the country. At the national level, RBC affordability measures rose for the third consecutive quarter, moving up between 0.4 and 0.9 percentage points, depending on the housing type (a rise in the measure represents a deterioration in affordability). A small decline in the average-mortgage rate that prevailed during the first quarter and further gains in household income provided minor offsetting effects. The cumulative rise in the measures since the middle of last year has reversed roughly one-quarter of the improvement in affordability that took place during most of 2008 and the first half of 2009. Overall in Canada, RBC measures are now moderately above their long-term average; yet they are still well below the most recent peaks reached in early 2008, suggesting that homeownership costs are starting to bite typical Canadian households but not dangerously so at this stage.

From a regional perspective, significant deterioration in affordability occurred once again in British Columbia (particularly for bungalows and two-storey homes), although the worsening trend was generalized across all provinces. Alberta was the sole exception, registering small improvements in the first quarter. RBC measures rose deteriorated quite strongly in Saskatchewan and Manitoba (for most housing types) but more modestly in Ontario, Quebec and Atlantic Canada.

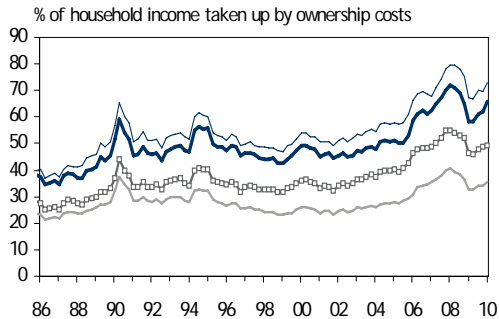
Looking ahead, further erosion in affordability is likely to take place in Canada in the coming 12 to 18 months. The main cause will be an anticipated rise in interest rates, which are currently at exceptionally low – and clearly unsustainable – levels. As the Bank of Canada moves toward 're-normalizing' its interest rate policy during the latter half of this year and in 2011, higher mortgage servicing costs will reverse much of their sharp decline last year in Canada. The five-year fixed mortgage rate (the benchmark used for the RBC affordability measures) has already initiated its upward march and climbed to its highest level since January 2009 in early May.

The resulting degree of housing *un*-affordability in Canada, however, is unlikely to exceed recent peak levels. First, we believe that the spectacular rally in housing prices in the past year will soon run its course. There is increasing evidence that supply (in both the existing and new home markets) is finally responding more forcefully to very strong demand and that local markets across the country are headed toward more balanced conditions – after having been very (and, in some cases, extremely) tight for the better part of the past year.

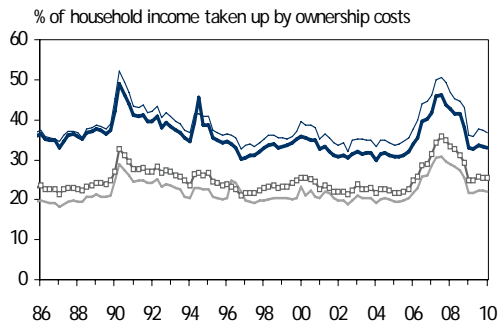
At the same time, that red-hot demand for housing is likely to cool during the second half of this year, as factors that fuelled it dissipate. The fulfillment of pent-up demand created during the recent market downturn, which brought in a wave of buyers has probably already ceased to be a driver. More recently, continued de-

RBC housing affordability measures

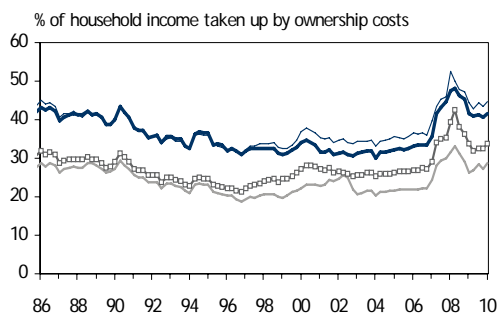
British Columbia



Alberta



Saskatchewan



Sources: Statistics Canada, Royal LePage, RBC Economics Research

mand strength has been sustained by factors that either will start reversing or are transitory in nature.

As noted above, rock-bottom interest mortgage rates – undoubtedly the rally’s most powerful driver – are set to rise in the next year and a half. Consequently, their positive effect will progressively fade. At the margin, widespread expectations of higher rates might well have caused some buyers to hurry their home-purchasing decision (to lock-in low rates), thereby bringing forward some demand that would have occurred at a later point. Also at the margin, the July 1 introduction of the HST in Ontario and British Columbia likely prompted some buyers to ‘beat’ the tax, shifting forward activity that would have taken place after July 1 in those provinces. The combination of increased supply and flat or easing demand is expected to stabilize housing prices in Canada – with outright declines possible in some markets.

Another factor contributing to keep un-affordability levels below previous peaks in the period ahead will be the effect of a recovering economy on household income. Sustained economic growth in Canada during the remainder of 2010 and 2011 is expected to support steady job creation and income gains. This should partially mitigate the effect of rising mortgage servicing costs on family budgets.

British Columbia – Unaffordable and becoming riskier

Rapid price increases are quickly undoing last year’s improvement in affordability in British Columbia. In the first quarter, RBC affordability measures surged between 0.9 and 4.0 percentage points, by far the sharpest deterioration among the provinces. In the past three quarters, the measures reversed between one-third and one-half of their sharp drop in 2008 and early 2009. B.C. housing markets have been on a tear since last summer – with resale activity fully recovering to pre-downturn levels by the end of 2009 – although some signs of slowing have emerged since the beginning of this year. Nonetheless, the strong price momentum has continued largely unaffected in recent months, returning RBC affordability measures closer to their all-time highs in early 2008. Such poor affordability levels represent an element of risk for the province’s markets.

Alberta – Bucking the trend

The Alberta housing market continued to buck the Canada-wide deteriorating trend in affordability in the first quarter. RBC affordability measures eased between 0.1 and 0.6 percentage points, the only province to show declines. This further extended the significant drop in the measures since the end of 2007, a trend that only briefly halted last summer. In contrast to most other provinces, house prices remained relatively tame in Alberta, keeping the cost of homeownership in check. In the first quarter, all RBC measures were at or below their long-term averages, suggesting that affordability remains at favourable levels.

Saskatchewan – Getting tougher on the wallet

Owning a home in Saskatchewan took a bigger chunk of household budgets in the first quarter. This more than reversed a small decline in the last three months of 2009. RBC affordability measures rose between 0.9 and 1.6 percentage points, representing some of the stronger increases in the country (although trailing far

Regional overviews

behind British Columbia). After flattening or declining marginally in previous quarters, housing prices picked up notably in the province in the first few months of this year; however, with sales slowing and the number of homes available for sale growing more recently, further price increases are unlikely to be as hefty in the near term. Despite the deterioration in the first quarter, affordability measures remain well off the peak levels of early 2008 – which were also the all-time highs in Saskatchewan.

Manitoba – Crossing the line

Manitoba's market has been a full participant in the strong housing market rally. Although resale activity recently eased a little from the super-charged levels of late last year, prices for most housing types surged ahead early in 2010. This eroded affordability in the first quarter for all but one housing type. RBC's measures climbed between 0.6 and 1.8 percentage points (for condominiums, townhouses and bungalows), with only two-storey homes remaining flat. With these latest increases, most affordability measures for the province have now moved above their long-term average. The sole exception is bungalows where the measure equalled the long-term average. The affordability situation is thus crossing the line where tensions on household budgets intensify.

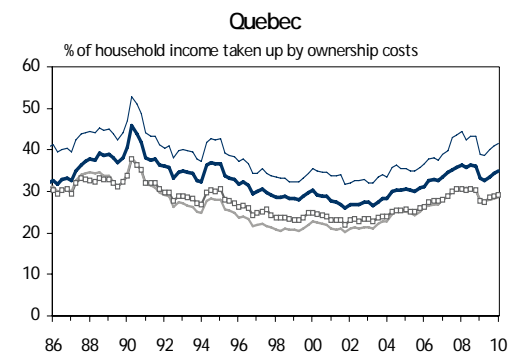
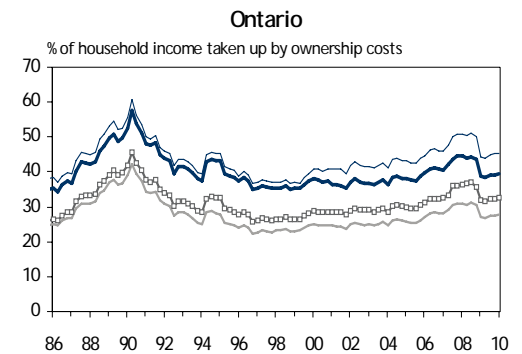
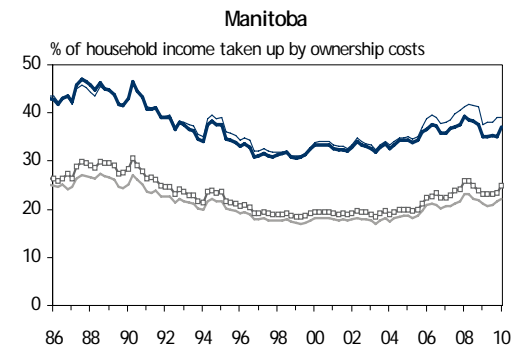
Ontario – Not letting up

The Ontario housing market recently showed few signs of letting up. In the early months of this year, resales activity remained in top gear – even reaching record highs – and, despite rapidly increasing selection for buyers, home prices continued to escalate. In fact, property values attained never before seen levels in many parts of the province. This has undermined affordability, which has been on a generally deteriorating trend since the middle of 2009. In the first quarter, RBC affordability measures rose between 0.2 and 0.4 percentage points, further reversing the significant improvement that took place in 2008 and early 2009. While still well below peak levels, most of the measures now stand above their long-term averages (except for the bungalow benchmark). This suggests that some unaffordability stress is building in Ontario.

Quebec – Bursting at the seams

The historic run in the Quebec real estate market continued largely unabated in the first few months of 2010. With red-hot local markets such as Quebec City continuing to lead the way, new marks in overall buying activity and property values have recently been set in the province. Such heated conditions, however, have further eroded affordability with RBC's measures moving higher between 0.4 and 0.5 percentage points in the first quarter. Although these increases represented mild deteriorations on their own, they came on the heels of more substantial rises (in most cases) in the two previous quarters. All Quebec affordability measures now exceed their long-term averages, having reversed between one-third and almost two-thirds of their declines in 2008 and early 2009. Any further rise in homeownership costs could have a more visible adverse effect on housing demand in the province.

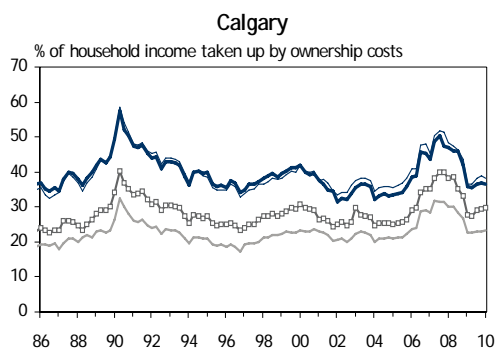
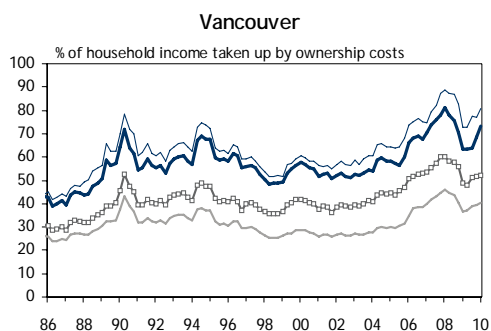
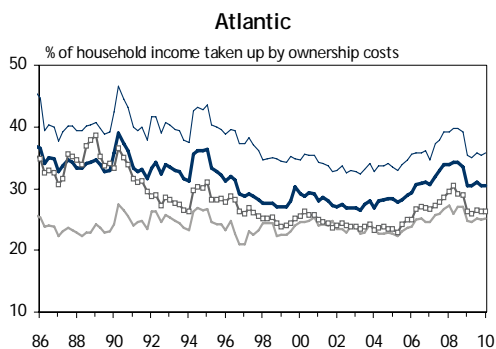
RBC housing affordability measures



— Standard two-storey — Detached bungalow
— Standard townhouse — Standard condo

Sources: Statistics Canada, Royal LePage, RBC Economics Research

RBC housing affordability measures



Sources: Statistics Canada, Royal LePage, RBC Economics Research

Atlantic – The Goldilocks market?

Atlantic Canada's housing market appears to be in that special zone: not too hot, not too cold – but just right. Demand for homes remained brisk at the start of 2010 – especially in areas such as St. John's – with resales volumes continuing to recover markedly from the 2008 downturn. Pressure on the market, however, has been largely alleviated by increased availability of homes for sale. Those broadly balanced conditions have, therefore, contained the general pace of price increases in the region. Overall, housing affordability in Atlantic Canada is among the more attractive regions in the country. RBC measures were unchanged (for a standard townhouse) or rose modestly by up to 0.4 percentage points (for a two-storey home) in the first quarter. The majority of the measures, however, were still below their long-term averages, which would indicate a little undue stress caused by homeownership costs in the region.

Metro markets

Vancouver – Gone too far?

The super-charged Greater Vancouver Area market has been at the forefront of the spectacular rally in residential real estate activity in Canada in the past year; however, there are signs that the market might have begun to react negatively to the significant deterioration in affordability since the middle of 2009. More specifically, seasonally adjusted home resales fell noticeably in the first quarter, after surging in each of the previous four. At this stage, it is unclear the extent to which the 2010 Winter Olympics and Paralympic Games disrupted activity during the period, but the weight of very poor affordability likely played a prominent role. In the first quarter, RBC affordability measures continued to surge, moving up between 0.5 and 4.8 percentage points. With the level of those measures now far above their long-term averages and inching closer to the all-time highs reached in early 2008, housing demand in Vancouver is likely to weaken further in the period ahead, taking some steam out of prices.

Calgary – All in moderation

The housing market rebound turned out to be a much more subdued affair in Calgary compared to most of the other major markets in Canada. After posting strong gains in the early stages of the rebound, resale activity has slowed considerably since the fall – likely reflecting the lack of traction in the city's job recovery. Meanwhile, home prices have maintained an upward trajectory, yet the overall pace has fallen short of the national average. In the first quarter, the increase in the costs of homeownership in Calgary was roughly equal to or slightly smaller than household income growth, leaving RBC affordability measures hovering around the zero mark – down from as much as 0.5 percentage points (two-storey home) to up as much as 0.2 percentage points (standard townhouse). Affordability continues to be attractive in the city with RBC measures near long-term averages.

Toronto – Still flying high

The Toronto market is giving few hints of being afraid of heights. Since taking flight last year, very strong demand propelled sales of existing homes to record-high altitudes in late 2009 and the early part of 2010. While sellers finally joined the aerial show in recent months – attracted by highly favourable conditions to them and, possibly, reflecting the desire to ‘beat’ the HST that will raise the costs of commissions paid by sellers starting July 1 – they are still outnumbered by buyers. Bidding wars and quick sales continue to be common. This has sustained strong upward pressure on home prices, which further ascended above earlier peaks. Consequently, affordability generally continued to erode in Toronto in the first quarter. RBC’s measures crept up between 0.3 and 0.6 percentage points for three of the four housing categories, although condos eased by 0.1 percentage point. All affordability measures now exceed their long-run averages in the Toronto market, suggesting that the dizzying flight might soon run into some turbulence.

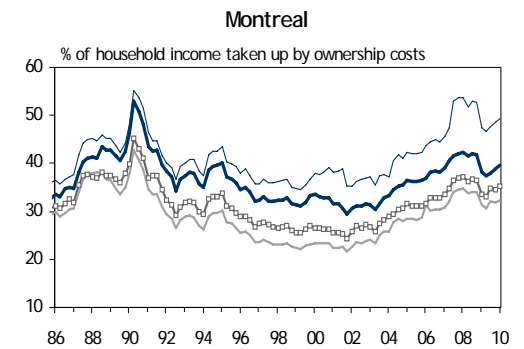
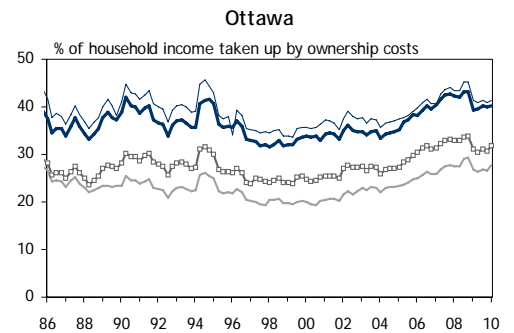
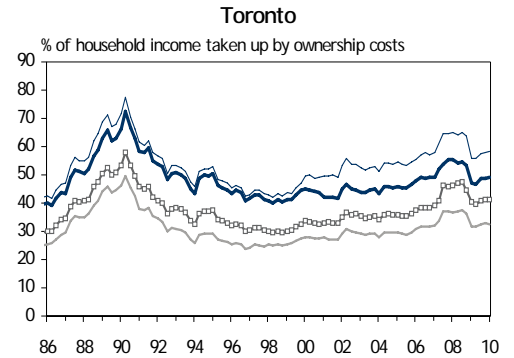
Ottawa – Charting a record-breaking path

The Ottawa area market continued to chart a record-breaking path in the first few months of 2010. Driven higher by flocking motivated buyers, home resales grew to unprecedented levels early this year. This strong demand added upward pressure on pricing, accelerating the pace of increase relative to the subdued gains recorded during second half of 2009 – despite the fact that more homes were being put up for sale. The higher prices eroded affordability in the area in the first quarter, with the RBC measures rising between 0.3 and 1.0 percentage points, which reversed most of the surprising improvement in the fourth quarter. Although demand momentum is likely to remain brisk in the very near term, the historically elevated costs of homeownership in the Ottawa area could well become a factor deterring buyers later this year. All RBC measures are above their long-term averages.

Montreal – On a winning streak

Hockey fever might cause its share of highs and lows, but as far as the Montreal housing market is concerned, the fever has squarely been on the upside so far this year. Home resales have enjoyed an impressive run since the spring of 2009, setting new all-time highs during the fall and winter. Similar to the effect of the local hockey team’s play-off prowess, the strong performance of the Montreal-area market has attracted many fans. Eager buyers do not appear to be the least put off by some notable deterioration in affordability since last summer or a persisting dearth of properties available for sale (although new listings have begun to increase more recently). In the first quarter, RBC affordability measures for Montreal rose between 0.6 and 0.9 percentage points, pushing the levels further above their long-term averages. Worsening affordability could pose a challenge to the market’s winning streak.

RBC housing affordability measures

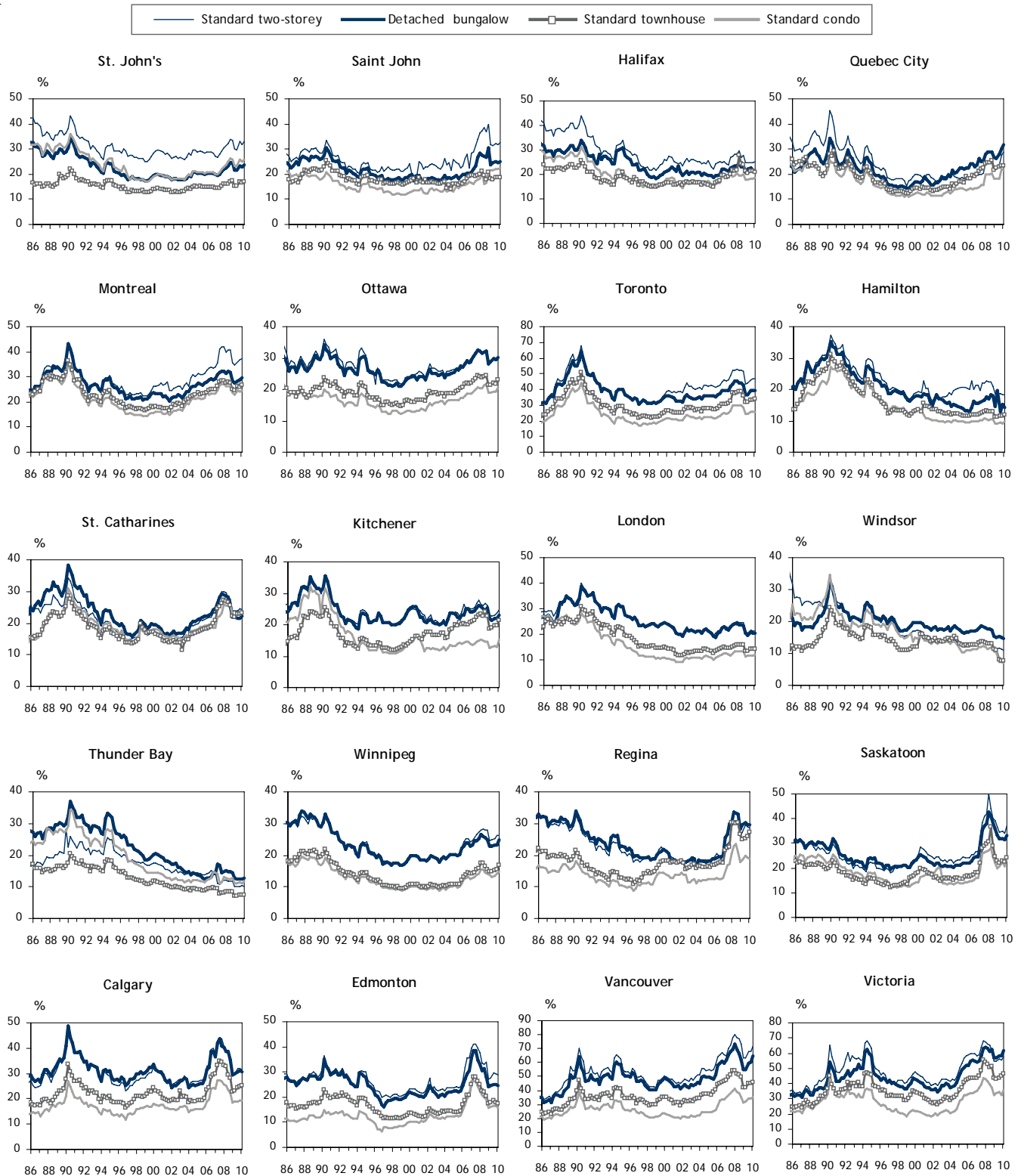


— Standard two-storey — Detached bungalow
 — Standard townhouse — Standard condo

Sources: Statistics Canada, Royal LePage, RBC Economics Research

Mortgage carrying costs by city

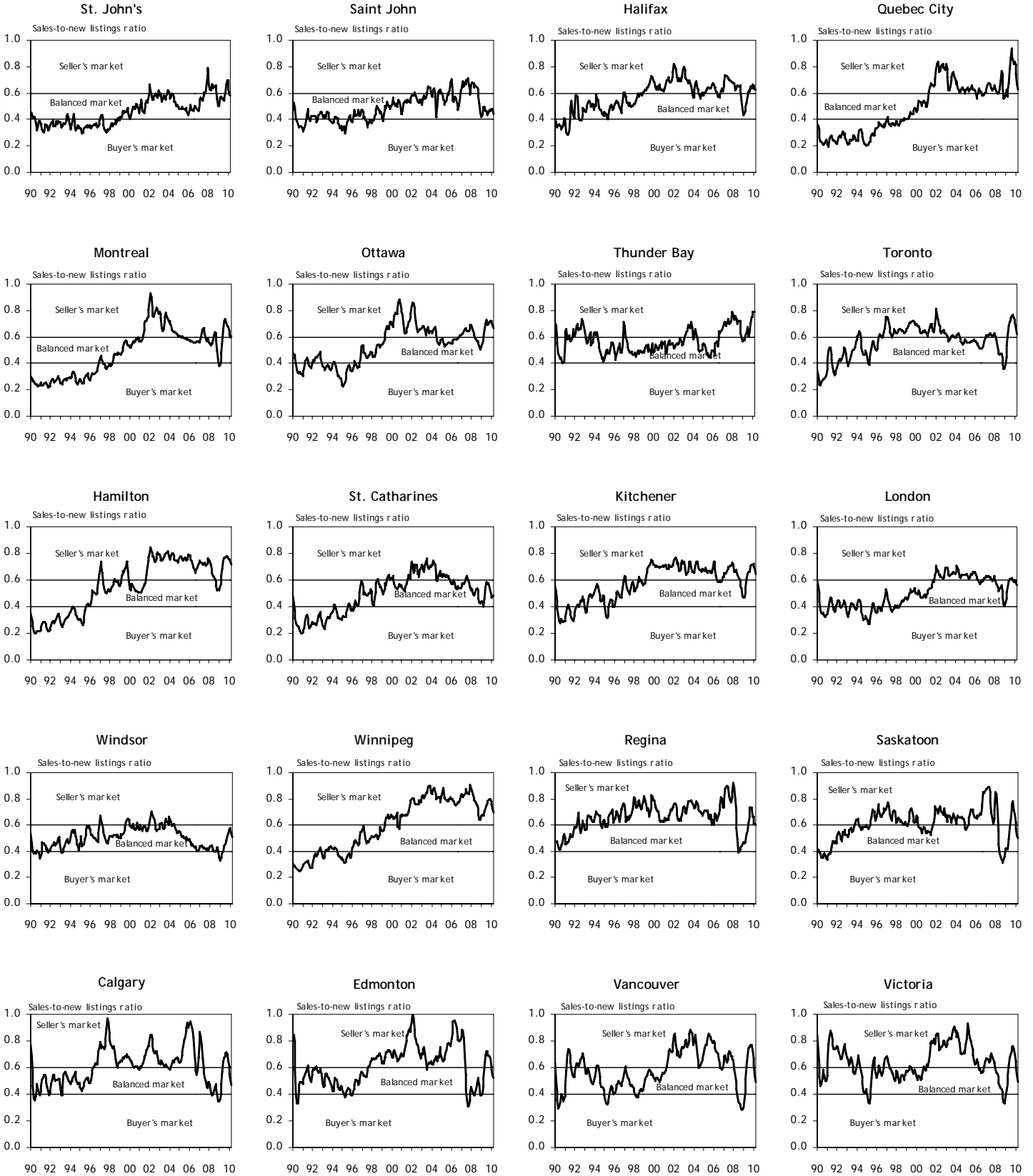
Our standard housing affordability measure captures the proportion of median pre-tax household income required to service the cost of a mortgage on an existing housing unit at going market prices, including principal and interest, property taxes and utilities; the modified measure used here includes the cost of servicing a mortgage, but excludes property taxes and utilities due to data constraints in the smaller CMAs. This measure is based on a 25% down payment and 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



Resale housing market conditions in Canada's metro cities

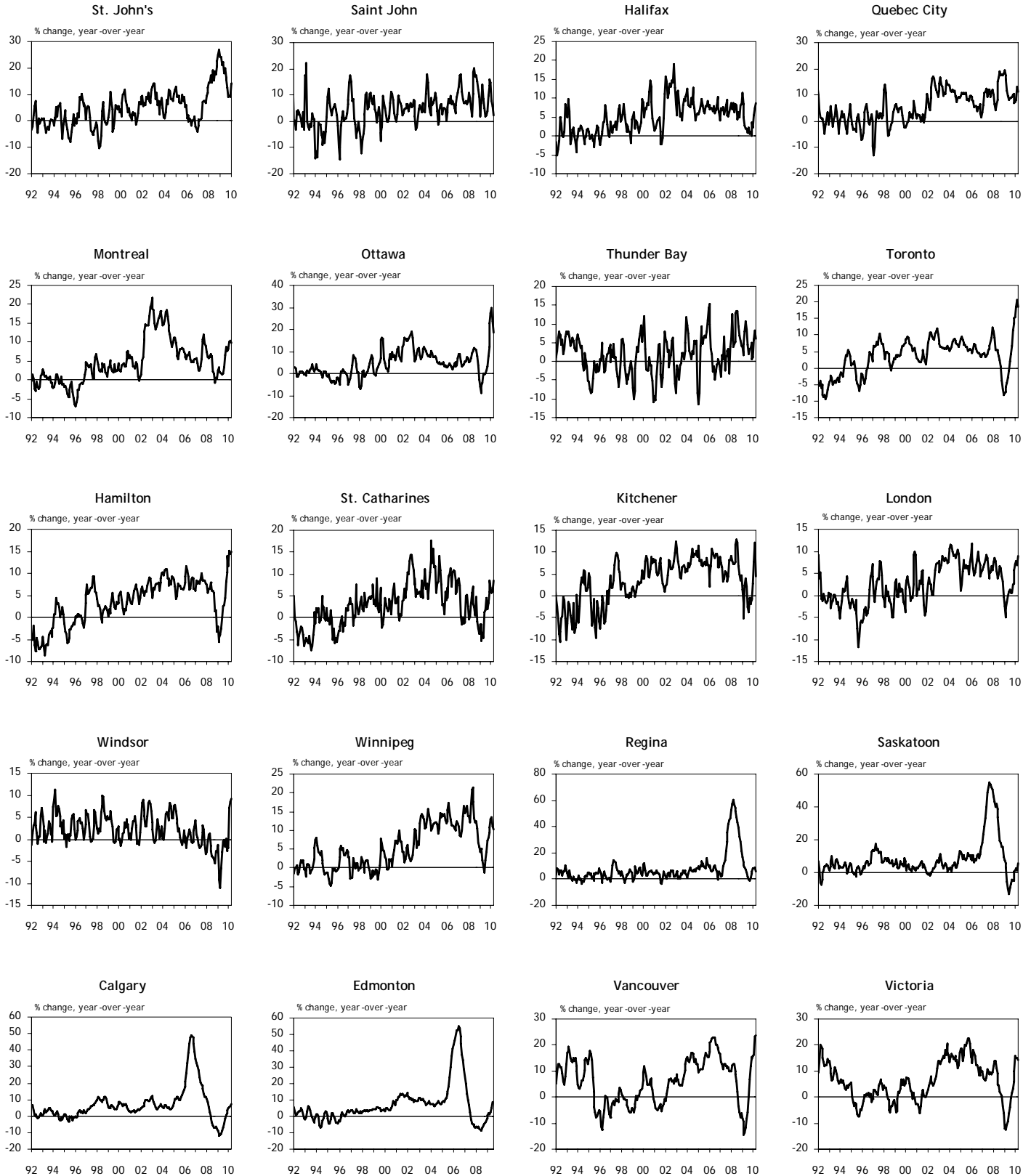


Sales-to-listings ratios are based on a three-month moving average.

Source: Canadian Real Estate Association, RBC Economics Research



House prices in Canada's metro cities



House prices are based on a three-month moving average.

Source: Canadian Real Estate Association, RBC Economics Research



Housing affordability summary tables

Detached bungalow

Region	Average Price		Qualifying Income (\$) Q1 2010	Affordability Measure			
	Q1 2010 (\$)	Y/Y % ch.		Q1 2010 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	324,600	11.2	72,200	41.1	0.9	1.8	38.9
British Columbia	562,500	18.7	112,000	66.0	4.0	7.5	49.1
Alberta	338,100	3.9	74,200	33.0	-0.4	-0.1	35.9
Saskatchewan	310,600	6.6	70,800	41.4	0.9	-0.2	36.4
Manitoba	247,300	11.9	60,500	37.0	1.8	2.0	37.0
Ontario	335,500	9.9	76,600	39.6	0.4	0.9	40.2
Quebec	215,500	10.8	50,800	34.8	0.5	1.6	32.9
Atlantic	192,600	5.7	47,300	30.5	0.1	0.1	31.5
Toronto	468,000	12.4	100,400	49.1	0.4	2.1	48.3
Montreal	258,900	9.3	59,700	39.7	0.9	1.5	36.7
Vancouver	692,500	22.4	135,300	73.4	4.8	10.2	57.1
Ottawa	355,400	11.5	82,500	40.3	0.3	1.1	36.8
Calgary	419,400	7.0	86,600	36.5	-0.3	0.8	39.4
Edmonton	311,500	4.3	70,700	32.0	-0.5	0.0	33.6

Standard two-storey

Region	Average Price		Qualifying Income (\$) Q1 2010	Affordability Measure			
	Q1 2010 (\$)	Y/Y % ch.		Q1 2010 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	367,800	11.0	82,300	46.8	0.6	1.9	43.2
British Columbia	620,600	13.4	123,900	73.0	3.2	5.7	54.3
Alberta	373,600	7.0	83,000	36.9	-0.6	0.7	38.4
Saskatchewan	328,500	9.2	76,500	44.8	1.4	0.5	37.8
Manitoba	260,500	9.4	63,800	39.0	0.0	1.5	37.9
Ontario	384,400	10.3	87,900	45.4	0.2	1.0	43.7
Quebec	255,600	13.6	60,700	41.6	0.5	2.7	38.8
Atlantic	221,200	6.5	55,500	35.7	0.4	0.2	37.9
Toronto	556,800	12.9	119,700	58.5	0.6	2.6	53.5
Montreal	324,600	9.5	74,200	49.4	0.9	2.0	41.4
Vancouver	762,900	16.1	149,200	80.9	3.8	7.9	62.3
Ottawa	351,300	8.0	84,600	41.3	0.3	0.0	39.2
Calgary	432,200	10.6	90,900	38.3	-0.5	1.7	39.8
Edmonton	367,700	8.9	83,100	37.6	-0.6	1.2	36.7

Standard townhouse

Region	Average Price		Qualifying Income (\$) Q1 2010	Affordability Measure			
	Q1 2010 (\$)	Y/Y % ch.		Q1 2010 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	260,200	9.8	58,000	33.0	0.4	1.1	30.4
British Columbia	420,100	10.5	84,000	49.5	0.9	2.9	36.8
Alberta	261,600	6.7	57,100	25.4	-0.1	0.5	25.0
Saskatchewan	252,000	8.1	57,900	33.9	1.4	0.2	27.6
Manitoba	166,300	15.3	40,600	24.8	1.3	1.8	23.0
Ontario	278,900	10.2	63,400	32.7	0.4	0.7	31.2
Quebec	177,800	10.6	42,400	29.1	0.4	1.4	27.9
Atlantic	169,000	5.2	40,800	26.3	0.0	0.0	28.5
Toronto	398,200	10.3	84,700	41.4	0.3	1.2	37.6
Montreal	230,500	10.4	52,800	35.2	0.8	1.6	31.7
Vancouver	486,400	11.2	95,900	52.0	0.5	3.3	41.9
Ottawa	271,900	11.5	65,100	31.8	1.0	0.8	27.8
Calgary	345,200	14.5	70,800	29.8	0.2	2.2	28.4
Edmonton	223,300	3.0	51,000	23.1	-0.3	-0.2	22.7

Standard condominium

Region	Average Price		Qualifying Income (\$) Q1 2010	Affordability Measure			
	Q1 2010 (\$)	Y/Y % ch.		Q1 2010 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	219,800	9.8	49,500	28.2	0.5	1.0	26.8
British Columbia	296,000	14.9	60,300	35.5	1.5	3.0	28.1
Alberta	222,600	4.6	49,200	21.9	-0.4	0.1	22.0
Saskatchewan	214,300	20.3	49,000	28.7	1.6	2.3	24.3
Manitoba	146,700	10.5	36,200	22.2	0.6	1.0	21.1
Ontario	233,000	10.1	53,800	27.8	0.4	0.6	27.7
Quebec	180,400	6.6	41,700	28.6	0.4	0.6	26.9
Atlantic	163,800	7.5	39,100	25.2	0.2	0.4	24.3
Toronto	306,300	10.5	66,800	32.7	-0.1	0.9	31.1
Montreal	214,700	8.0	48,600	32.4	0.6	1.0	29.1
Vancouver	377,400	16.4	74,700	40.5	1.1	4.0	31.7
Ottawa	243,700	12.5	56,600	27.6	1.0	0.9	23.5
Calgary	263,500	7.2	55,000	23.2	0.1	0.5	22.7
Edmonton	200,900	2.5	45,700	20.7	-0.9	-0.3	18.0

* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Economics Research

How RBC's housing affordability measures work

RBC Economics Research's housing affordability measures show the proportion of median pre-tax household income required to service the cost of mortgage payments (principal and interest), property taxes and utilities on a detached bungalow, a standard two-storey home, a standard town house and a standard condo (excluding maintenance fees).

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 town house 1,000 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 and 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 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 lie an equal number of observations.)

The housing affordability measure is based on gross household income estimates and, therefore, does not show the impact of various provincial property tax credits, which can 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).

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