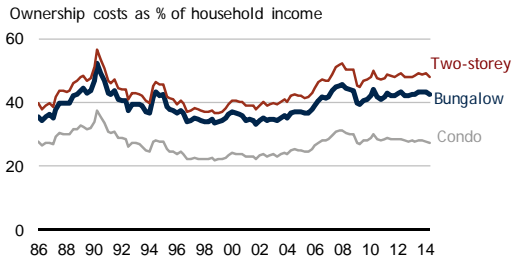


HOUSING TRENDS AND AFFORDABILITY

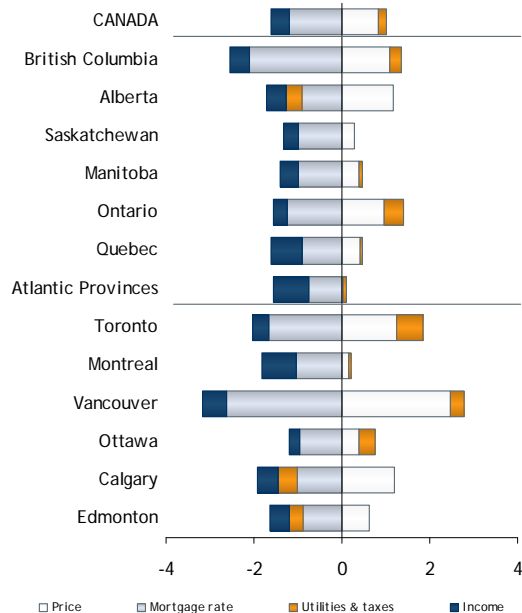
August 2014

RBC Housing Affordability Measures - Canada



Factors contributing to the change in the RBC affordability measure

Percentage point change from a quarter ago (detached bungalow)



Source: Statistics Canada, Royal LePage, RBC Economics Research

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Lower mortgage rates made home ownership more affordable in Canada in the second quarter of 2014

The strong rebound in housing activity this spring in Canada can be attributed to the helping hand of mortgage rate declines. Fixed mortgage rates (posted) fell the most in almost four years in the second quarter of 2014, which led to widespread improvement in housing affordability across the country. Owning a home became more affordable in virtually all provincial and major local markets despite increasing prices. In fact, even areas, such as Calgary, Toronto, and Vancouver, that saw solid price gains during the second quarter enjoyed improved affordability. At the national level, RBC's affordability measures fell for all housing types (a decrease represents an improvement in affordability). The measures declined by 0.9 percentage points from the first quarter of 2014 to 48.0% for two-storey homes, by 0.6 percentage points to 42.5% for detached bungalows, and by 0.4 percentage points to 27.4% for condominium apartments.

Buyers in Montreal and the Prairie and Atlantic regions get bigger break

At the local level, homebuyers in the Montreal area benefited from some of the more significant drops in ownership costs in Canada in the second quarter, with buyers in markets in Saskatchewan, Manitoba, and the Atlantic region also enjoying notable declines. The breaks homebuyers received generally were more sizeable for single-family homes since affordability of higher-priced properties is more sensitive to interest rates.

Flat affordability trends still the norm, except in Toronto where they show steady erosion

Despite the latest improvement, affordability levels in Canada remain little changed from where they were a year ago. The predominant pattern in RBC's measures in recent years has been alternating periods of improvement and deterioration keeping overall trends fairly stable at levels that suggest persistent, albeit moderate, affordability-related pressures. Such continued to be the case in the second quarter of 2014 for the most part, although the Toronto-area market increasingly stood out with steadily eroding trends (primarily for single-family homes).

Any affordability pressures are generally contained, except in Vancouver and Toronto

Across the country, Vancouver remains the local market with the poorest affordability levels, reflecting prevailing sky-high prices—especially for single-family homes. Toronto is Canada's other market where affordability appears to be somewhat stretched—also mainly for single-family homes. Virtually all other markets remain reasonably close to historical norms, thereby suggesting generally contained affordability-related pressures at this stage. There may be segments of certain markets (e.g., two-storey homes in Montreal) that look mildly excessive relative to long-run averages; however, these are minor ex-

ceptions. Condos continue to be the more affordable ownership option in every market, which largely explains the popularity of this type of housing in Canada in the past many years.

Lower mortgage rates gave the market extra energy this spring

While housing activity was expected to rebound naturally from weather-induced weakness this winter, the drops in mortgage rates and resulting improvement in affordability this spring gave the market extra energy. Home resales picked up solidly in May and June, contributing to a 9.4% quarterly advance in the second quarter, the strongest gain in nearly four years in Canada. Unadjusted for seasonal factors, resales in the second quarter of 2014 were the second-best ever (the peak was recorded in the second quarter of 2007). The resurgence of activity was broadly based across the country and included strong increases in Toronto, Calgary, and Vancouver. Montreal continued to buck the trend, however, as conditions remained soft in that market. Almost as important as the general uptick in homebuyer demand in Canada was the fact that home sellers came out from the sidelines. New listings surged by 8.0% in the second quarter in Canada, following three consecutive quarterly declines. Greater availability of properties for sale helped unclog markets such as Toronto, which were hampered by a lack of 'quality' listings earlier this year. The concomitant rise of new listings and sales kept the majority of local markets in balanced territory this spring and price increases generally subdued. Particularly strong housing demand in Calgary and still-narrow selection of single-family homes offered for sale in Toronto, however, left sellers in the driver's seat in these markets. Calgary and Toronto posted the strongest price advances in Canada so far this year.

Rising interest rates to erode housing affordability

Recent statistics on Canada's housing market indicate that upward momentum is being sustained at this point, and that any slowdown in activity will have to wait a little longer. We continue to expect, however, that the market will transition to lower resale levels and that the rate of price increases will moderate in 2015. We believe that the current historically low levels of interest rates in Canada are not sustainable and that longer-term rates will begin to rise later this year in anticipation of a return to tightening mode by the Bank of Canada in 2015. While continued growth in household income will provide some offset, we expect rising rates to erode housing affordability across Canada and weigh on homebuyer demand. The effect will be gradual and unlikely to unhinge either overall affordability or the market, thereby leading to a cooling of activity as opposed to a US-style crash. Please see our *Canadian Housing Forecast* [report](#) published August 20, 2014 for a more detailed discussion of our outlook for housing to 2015.

Provincial overviews

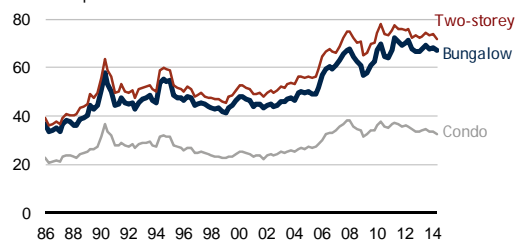
British Columbia – Affordability improves, yet still historically strained

Housing activity was quite brisk in British Columbia in the second quarter. Home resales (unadjusted for seasonality) rose to a five-year high, while the pace of new listings picked up sufficiently to keep the demand-supply equation in balance. Price pressures remained in check overall, although there was a slight divergence between the single-family home segments (showing relative-

RBC Housing Affordability Measures

British Columbia

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

ly stronger price gains) and condo segment (more subdued gains). Housing affordability improved broadly, with two housing categories (two-storey homes and condos) even reaching their most attractive levels since late 2009. RBC's affordability measures fell for all housing types in the second quarter. The drop, in fact, was fairly significant for two-storey homes (2.0 percentage points). The other measures declined by 1.3 percentage points for detached bungalow and by 0.9 percentage points for condo apartments. While BC homebuyers will welcome the improvement in affordability, owning a home at market price in an area such as Vancouver continues to be very difficult for an average household to afford.

Alberta – Good times keep on rolling

Alberta's housing market was still on a roll in the second quarter. Home resales increased for the fifth time in the past six quarters, registering their fastest quarterly advance in nearly four years. Second-quarter resales were the second-best on record (unadjusted for seasonality) in the province. The good news for homebuyers was that the supply of homes for sale finally increased meaningfully. New listings jumped by 12% in the second quarter (relative to the first) to a multi-year high. This long-awaited supply response helped ease some, albeit not all, of the ongoing market tensions. Alberta has been a sellers' market since the latter part of 2012, which led to rapid price increases in areas such as Calgary in the past year, yet escalating prices largely have been taken in stride by homebuyers. Solid growth in household income provided substantial offset, such that affordability continued to be attractive. Affordability improved modestly in the second quarter, with RBC's measures for Alberta easing between 0.2 and 0.9 percentage points.

Saskatchewan – Convincing snapback from this winter's slowdown

With the poor weather that hampered activity this winter out of the way, the Saskatchewan housing market rebounded strongly in the second quarter. Home resales jumped to a new record-high level in the province (based on data unadjusted for seasonality), which more than made up for weakness in the first quarter. Year to date, the market appears to be on pace to match its strongest annual result of 13,900 units sold that was set in 2012. Much of the second-quarter gain took place in Saskatoon, a market that has been flying ever higher since 2011. Saskatchewan homebuyers continue to face little undue affordability pressure at this point. RBC's measures remain close to their long-term averages. In the second quarter, they fell across all housing categories, declining by 1.3 percentage point for two-storey homes, by 1.0 percentage point for detached bungalows, and by 0.8 percentage points for condo apartments.

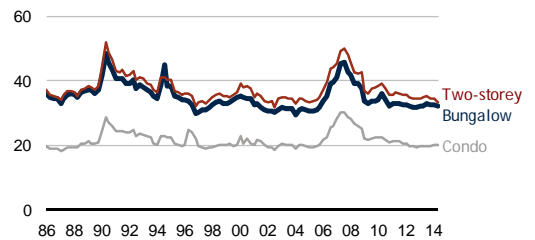
Manitoba – Growing supply of homes for sale the main story

Home resales in Manitoba bounced back as expected in the second quarter from the slowdown caused by frigid temperatures in the first quarter; however, the bigger story was a surge of homes being offered for sale. New listings—which have been on a steady upward trend for some time—jumped in the latest quarter to levels almost 14% above where they were a year ago. The increase coincided with a wave of completions of new housing units in

RBC Housing Affordability Measures

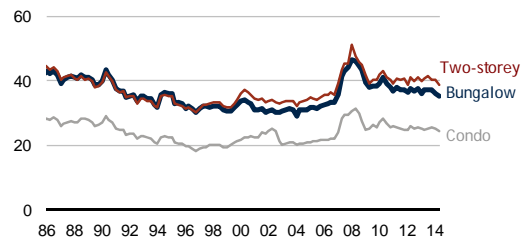
Alberta

Ownership costs as % of household income



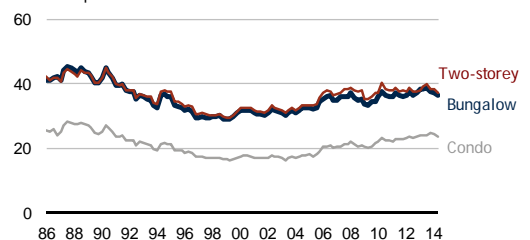
Saskatchewan

Ownership costs as % of household income



Manitoba

Ownership costs as % of household income

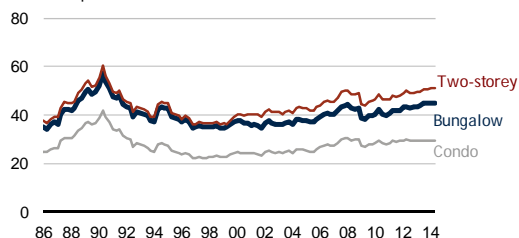


Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

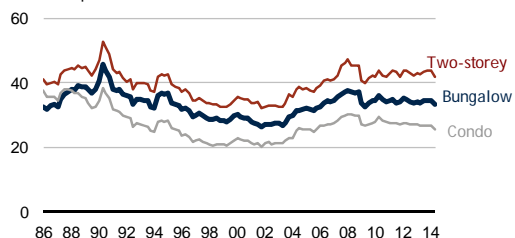
Ontario

Ownership costs as % of household income



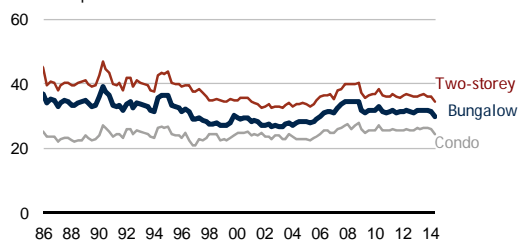
Quebec

Ownership costs as % of household income



Atlantic Provinces

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

the Winnipeg area (which represents between 85% and 90% of the Manitoba market) in the past year. It also far exceeded a 2.6% increase in resales. This is the latest such divergence that resulted in a notable loosening of demand-supply conditions since the end of 2012 and, more recently, limited price advances. Housing affordability continues to play a predominantly neutral role for homebuyer demand in the province. RBC's measures for Manitoba remain close to historical norms. They fell between 0.5 and 1.5 percentage points in the second quarter.

Ontario – Homebuyers undisturbed by affordability strains

Housing affordability changed very little in Ontario in the second quarter. At the margin, owning a home became slightly easier in the province; however, this was insufficient to reverse ongoing (mildly) deteriorating affordability trends. Ownership costs have come under mounting pressure in recent years in markets such as Toronto where property values keep on moving upward. The latest readings of RBC's measures continue to suggest that affordability may be moderately strained in the province—although this primarily reflects the situation in Toronto. Still, Ontario homebuyers do not appear to be overly disturbed by any affordability issues at this point. Home resales picked up smartly in the second quarter in the province, thereby suggesting that the decline in the first quarter indeed had more to do with unusually poor winter weather than any underlying weakness. That being said, lower mortgage rates no doubt provided an extra push. Lower rates were the main factor contributing to marginal declines in RBC's measures in the second quarter, which edged lower by 0.1 and 0.2 percentage points.

Quebec – Improved affordability helps stem the slide

The slide in Quebec's housing market activity since early 2012 stabilized in the second quarter of 2014. Home resales rose slightly by 0.8% from the first quarter, following declines in six of the previous eight quarters. While this small increase represented an encouraging development, the level was, nonetheless, the weakest for a second quarter since 2006, thereby indicating that resale activity still remains rather weak in the province. Moreover, the provincial market faces a rising supply of homes up for sale, particularly in the condo segment, which ultimately further contributed to keep a lid on price increases. Buyers in the province are in an attractive position. Not only do they have plenty of options from which to choose, owning a home has become the most affordable in years. Housing affordability, therefore, should not constitute a major obstacle to homeownership in the province. In the second quarter, RBC's affordability measures improved for all housing types, declining between 0.9 and 1.8 percentage points.

Atlantic – Facing challenging times despite attractive affordability

Housing affordability improved quite noticeably across Atlantic Canada in the second quarter. The combination of lower mortgage rates and very subdued price pressures generated some of the bigger drops in RBC's measures in the country. The measures fell by 1.6 percentage points for two-storey homes, by 1.5 percentage points for detached bungalows, and by 1.4 percentage points for condo apartments. Despite generally attractive affordability, housing mar-

kets are going through challenging times in the Atlantic region this year. For the most part, demand is weak reflecting sluggish provincial economies, slumping job markets, and unfavourable demographic trends. While home resales rose slightly in the second quarter from their first-quarter levels (on a seasonally adjusted basis) in the region, they remained close to their 10-year lows. Activity was especially depressed in the Halifax area, Fredericton, and to a lesser extent, Moncton during the first half of this year—although things picked up a little in more recent months. Buyers are in the driver's seat in these markets.

Major city markets

Vancouver – Homebuyers welcome lower mortgage rates

One noteworthy aspect of higher-priced housing markets is that affordability benefits disproportionately from a fall in mortgage rates relative to lower-priced markets (if everything else remains constant). Such was the case in the second quarter when affordability improved across the board in the Vancouver area despite prices recording some of the faster increases among Canada's major markets. RBC's measures fell from 0.3 percentage points to 1.3 percentage points. This (generally modest) improvement in affordability may have been among the factors contributing to a quarterly rise of 8.7% in home resales in the second quarter; however, the effect no doubt was limited given that affordability levels remains poor in the area. All RBC measures continue to be well above historical averages, thereby suggesting that affordability still stresses homebuyers in Vancouver. This likely explains in large part why home resales continued to be more than 6% below the 10-year average.

Calgary – Activity soaring but affordability still well under control

A surge in home resales in the second quarter clearly confirmed that Calgary's housing market is soaring: resales set a new record high for this period of the year, rising almost 29% above the 10-year average. Such results are not entirely surprising considering how strongly underlying housing demand is being supported by the booming provincial economy, rapid population growth, and still-attractive affordability. Home prices continue to climb rapidly in the area—in fact, their rate of increase has been the fastest in Canada in the past year; however, the effect on homebuyers' ability to own a home has been fully neutralized by solid income gains and the recent drops in mortgage rates. The latest readings on housing affordability in Calgary still compare favourably relative to historical norms in the area. In the second quarter, RBC's measures edged lower for all housing types, moving downward between 0.5 and 1.0 percentage points. A gush of new listings in the second quarter may help ease the current market tightness and moderate price gains going forward.

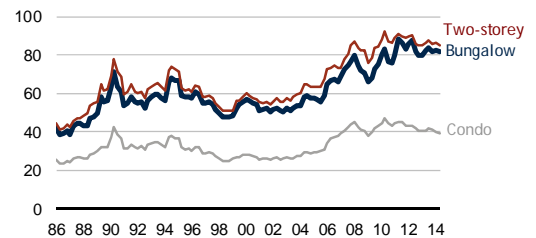
Toronto – Seller's market persists despite rise in listings

A double-digit increase in homes newly listed for sales between the first and second quarters was a welcomed development in the Toronto-area market. Drops in listings were partly to blame for declines in resale activity in the two previous quarters and, perhaps more importantly, for a tightening in demand-supply conditions in the area. The 10.2% quarterly rise in new listings helped

RBC Housing Affordability Measures

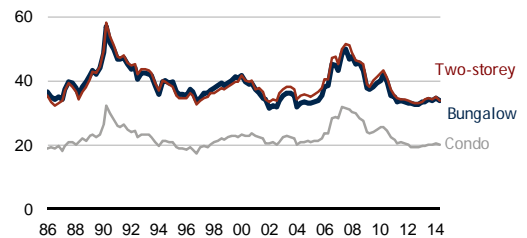
Vancouver

Ownership costs as % of household income



Calgary

Ownership costs as % of household income

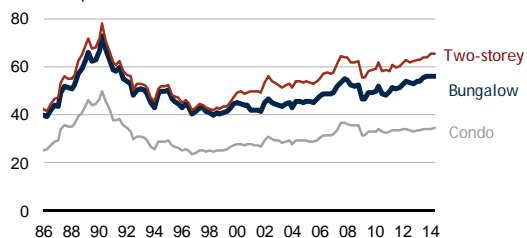


Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

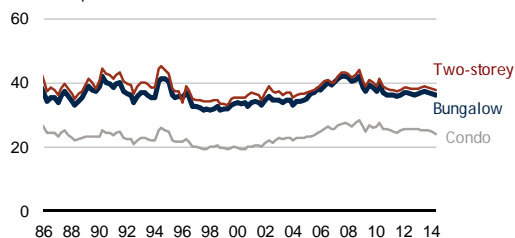
Toronto

Ownership costs as % of household income



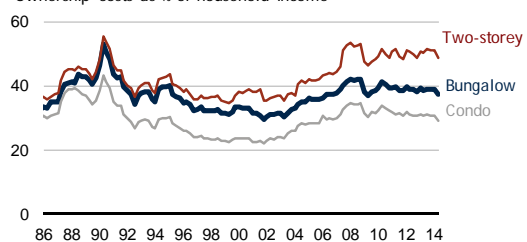
Ottawa

Ownership costs as % of household income



Montreal

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

home resales surge to their second-highest second-quarter results on record. What this rise was unable to achieve, however, was greater balance between demand and supply. Conditions continued to favour sellers and accordingly sustain a strong bid on property values. Developments in the latest quarter did virtually nothing to stem the steady erosion in housing affordability since 2009 in the area. In fact, Toronto was the only major market showing some deterioration in the second quarter—RBC’s measure for condos rose slightly by 0.1 percentage points (the measure was unchanged for two-storey home, and fell by 0.2 percentage points for detached bungalows). Affordability still appears to be strained in the area, particularly for the single-family home segments.

Ottawa – Demand begins to pick up; supply remains plentiful

The Ottawa-area market showed signs in the second quarter that demand was finally picking up following two consecutive quarters of declining sales, yet overall market conditions remained quite weak in the area. There were still plenty of properties available for sale relative to demand. In fact, new listings continued to outpace resales, thereby causing the ratio of sales to new listings to fall to its lowest level since 1997 and handing over increased pricing power to buyers. Home price advances, accordingly, have been very limited this year in the area. There was even evidence of declines in the condo segment. Housing affordability does not appear to be an obstacle to homebuyers at this stage. RBC’s measures continue to be close to the area’s historical norms. The measures fell modestly for all categories in the second quarter, declining between 0.4 and 0.6 percentage points.

Montreal – Still soft but a turnaround might be in the works

The Montreal-area market continued to be soft in the second quarter. The number of homes sold was the lowest for this period of the year since 2000, coming in more than 17% below the 10-year average. Muted demand prevailed amid growing availability of properties available for sale, especially of condominium apartments. Selling times consequently have risen substantially in the area, which have given buyers increasing sway in setting prices. Condo prices stalled in the second quarter, while prices for single-family homes rose only modestly at best. The upside of this absence of upward price pressure has been that lower mortgage rates provided greater affordability relief in the Montreal area than in any other major market in Canada in the latest period. RBC’s affordability measures fell noticeably across all housing type, dropping between 1.4 and 2.6 percentage points. Such improvement might sow the seeds for a revival in activity during the second half of 2014. Indeed, there were early signs that resales started to move upward during the summer months.

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 2014	RBC Housing Affordability Measure			
	Q2 2014 (\$)	Q/Q % ch.	Y/Y % ch.		Q2 2014 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	395,900	2.5	5.7	80,800	42.5	-0.6	0.0	39.2
British Columbia	650,000	1.9	5.0	120,100	67.0	-1.3	-0.6	50.7
Alberta	396,900	4.8	7.5	80,500	31.9	-0.6	-0.3	35.1
Saskatchewan	352,500	1.0	0.2	72,700	35.1	-1.0	-1.9	36.0
Manitoba	314,600	1.4	1.1	67,200	36.3	-0.9	-1.9	35.7
Ontario	430,300	2.8	7.0	89,200	44.7	-0.2	1.0	40.3
Quebec	259,000	1.7	4.4	55,800	33.4	-1.1	-0.3	33.3
Atlantic	220,400	0.2	-0.7	51,400	29.7	-1.5	-1.9	31.7
Toronto	614,400	2.8	8.1	120,300	55.9	-0.2	1.8	48.8
Montreal	303,000	0.6	2.6	64,000	37.3	-1.6	-1.0	36.9
Vancouver	861,400	3.5	5.5	155,500	81.8	-0.3	-0.3	60.3
Ottawa	403,000	1.5	1.3	88,800	36.0	-0.4	-0.7	36.4
Calgary	501,200	4.4	9.5	95,900	33.6	-0.8	0.3	38.5
Edmonton	353,500	2.6	6.1	74,500	31.7	-1.1	-1.0	33.3

Standard two-storey

Region	Average Price			Qualifying Income (\$) Q2 2014	RBC Housing Affordability Measure			
	Q2 2014 (\$)	Q/Q % ch.	Y/Y % ch.		Q2 2014 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	443,600	1.8	5.0	91,300	48.0	-0.9	-0.2	43.7
British Columbia	693,300	0.7	4.4	129,000	72.0	-2.0	-0.9	55.9
Alberta	401,400	3.6	3.3	84,100	33.4	-0.9	-1.4	37.6
Saskatchewan	385,800	0.5	1.4	80,600	38.9	-1.3	-1.6	37.4
Manitoba	318,200	-0.4	0.5	68,600	37.0	-1.5	-2.1	36.6
Ontario	486,700	2.7	7.2	101,500	50.9	-0.1	1.4	44.0
Quebec	329,100	0.7	3.4	70,200	41.9	-1.8	-0.8	39.9
Atlantic	249,400	0.6	0.8	59,700	34.5	-1.6	-1.8	37.9
Toronto	712,300	3.0	9.1	140,300	65.3	0.0	2.7	54.4
Montreal	401,900	-0.4	1.7	83,100	48.4	-2.6	-1.6	42.5
Vancouver	888,200	2.2	4.4	161,600	85.0	-1.3	-1.1	65.4
Ottawa	408,500	0.9	0.8	92,800	37.6	-0.5	-0.8	38.6
Calgary	489,600	3.6	7.9	96,600	33.9	-1.0	0.0	39.0
Edmonton	386,800	0.3	3.8	82,600	35.2	-1.8	-1.7	36.5

Standard condominium

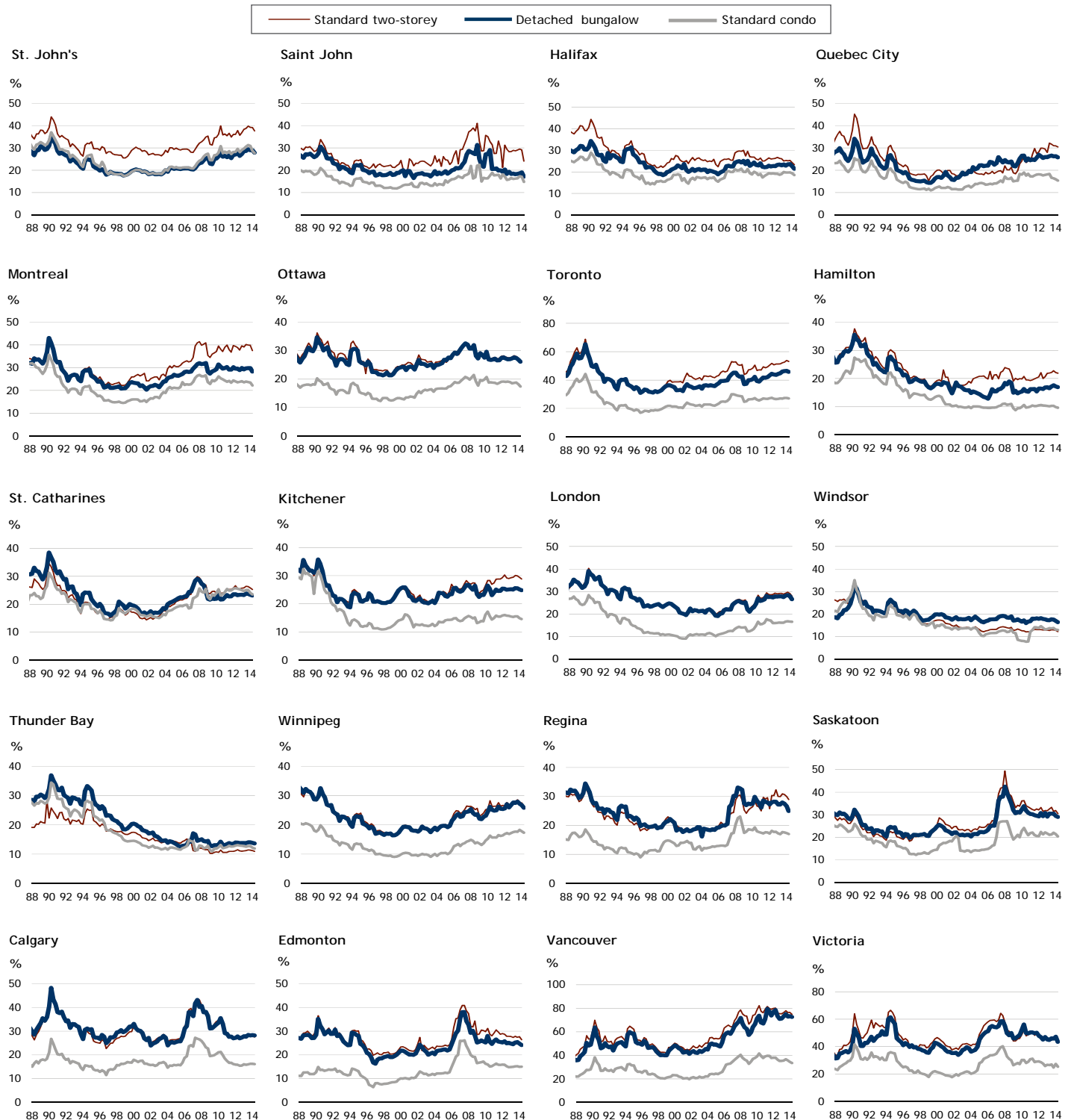
Region	Average Price			Qualifying Income (\$) Q2 2014	RBC Housing Affordability Measure			
	Q2 2014 (\$)	Q/Q % ch.	Y/Y % ch.		Q2 2014 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	248,100	2.3	3.5	52,100	27.4	-0.4	-0.4	27.0
British Columbia	302,500	0.3	0.8	58,400	32.6	-0.9	-1.3	28.4
Alberta	244,900	6.6	11.7	50,700	20.1	-0.2	0.4	21.6
Saskatchewan	244,200	0.5	4.7	50,500	24.4	-0.8	-0.4	24.0
Manitoba	210,600	2.1	5.3	43,900	23.7	-0.5	-0.5	21.3
Ontario	273,200	2.6	3.9	58,400	29.3	-0.1	0.1	27.6
Quebec	199,600	2.0	1.0	43,000	25.7	-0.9	-0.9	27.7
Atlantic	187,300	-0.4	-0.7	42,400	24.5	-1.4	-1.6	24.5
Toronto	362,800	3.1	5.6	73,700	34.3	0.1	0.6	31.3
Montreal	237,900	0.0	-0.1	50,000	29.1	-1.4	-1.4	29.5
Vancouver	397,100	1.4	0.3	74,200	39.0	-0.8	-1.8	32.9
Ottawa	268,200	-0.4	-0.7	59,500	24.1	-0.6	-0.8	23.5
Calgary	286,400	4.3	9.3	56,500	19.8	-0.5	0.2	22.3
Edmonton	220,100	5.4	7.8	46,800	20.0	-0.2	-0.3	18.2

* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Economics Research

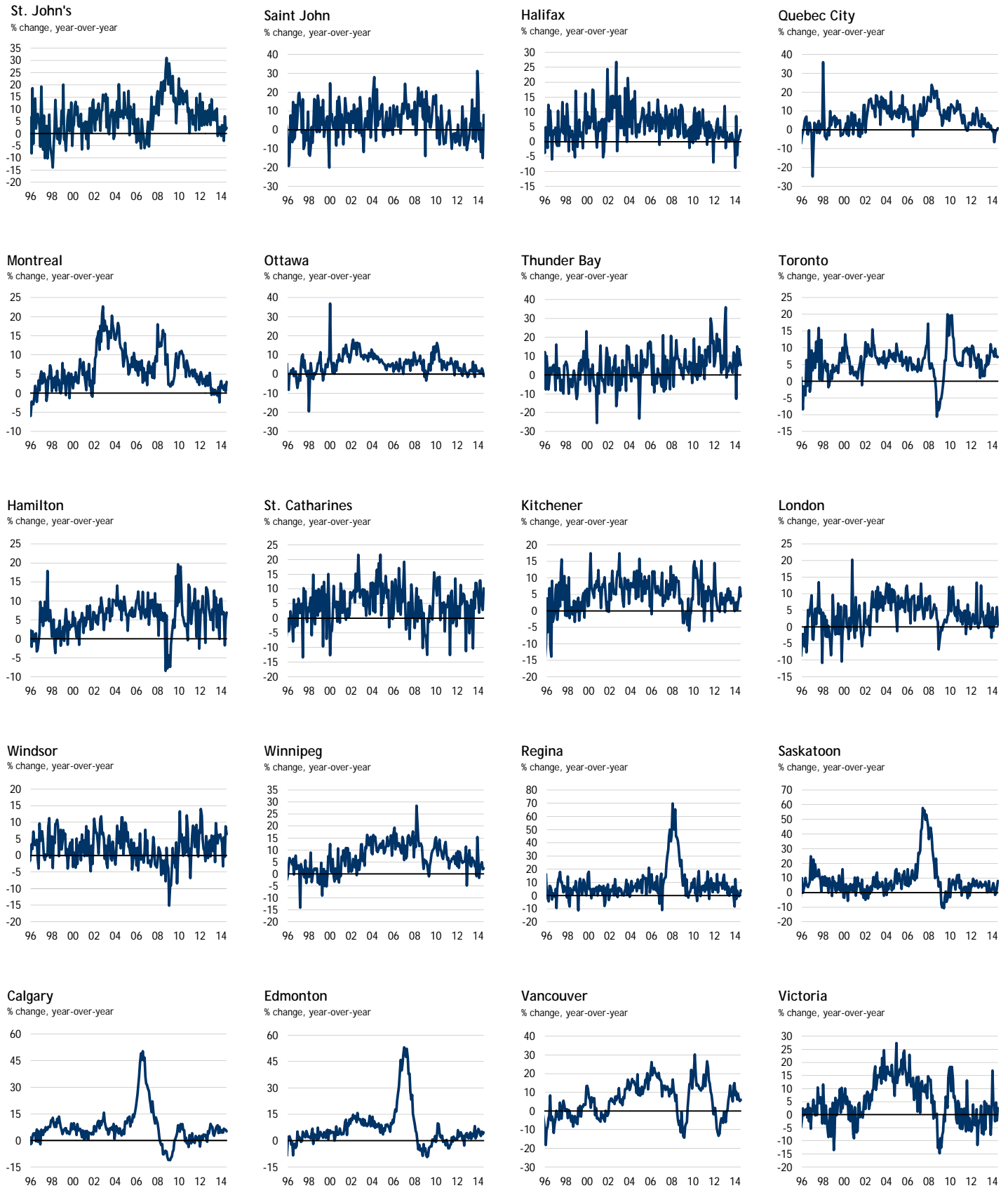
Mortgage carrying costs by city

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

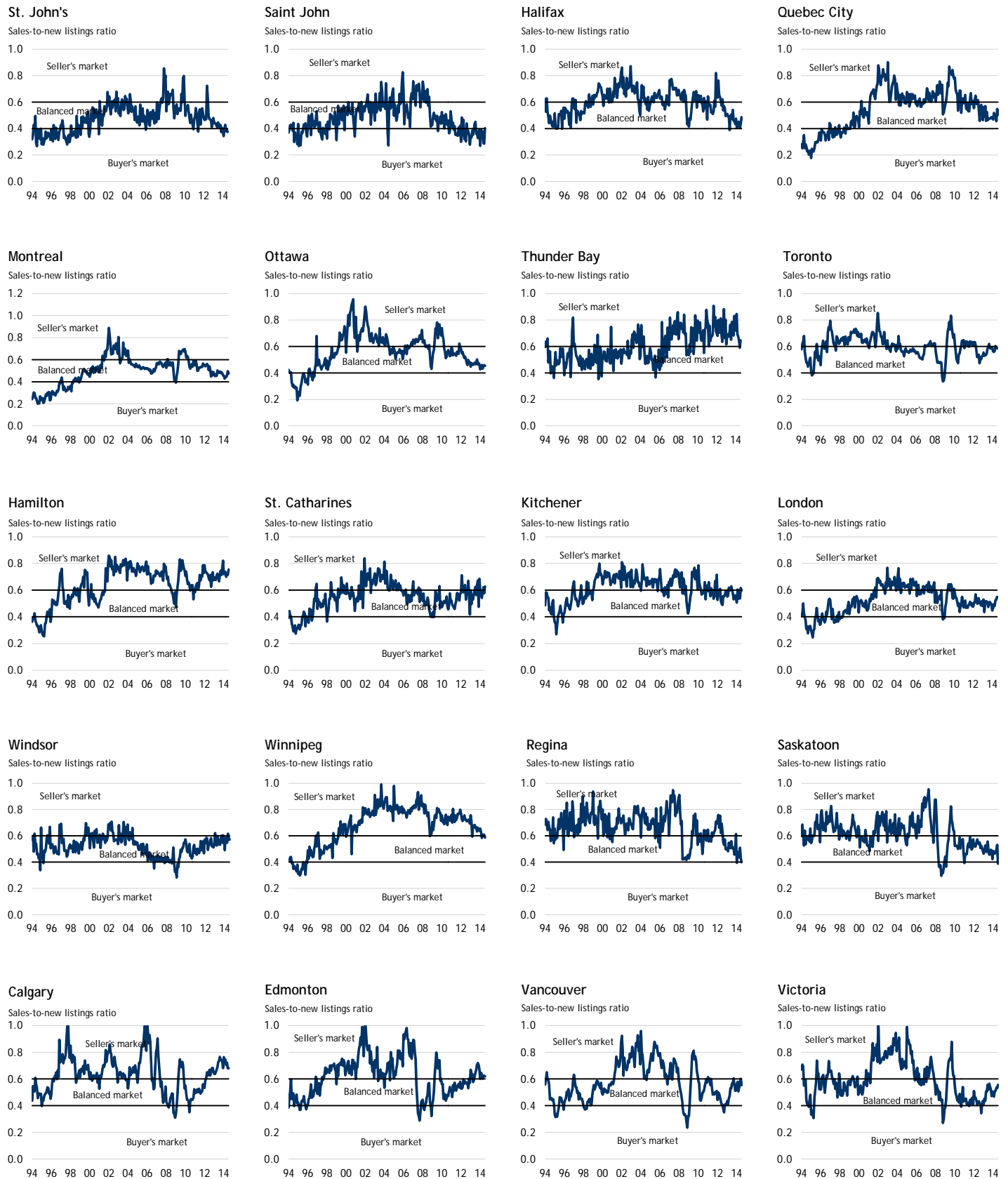
Average price of homes sold on the MLS system



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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