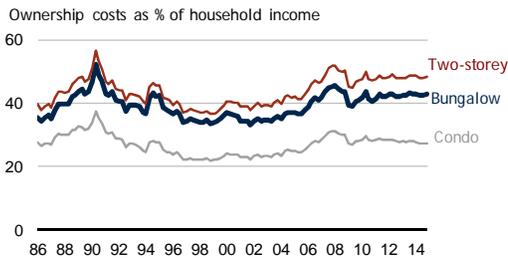


HOUSING TRENDS AND AFFORDABILITY

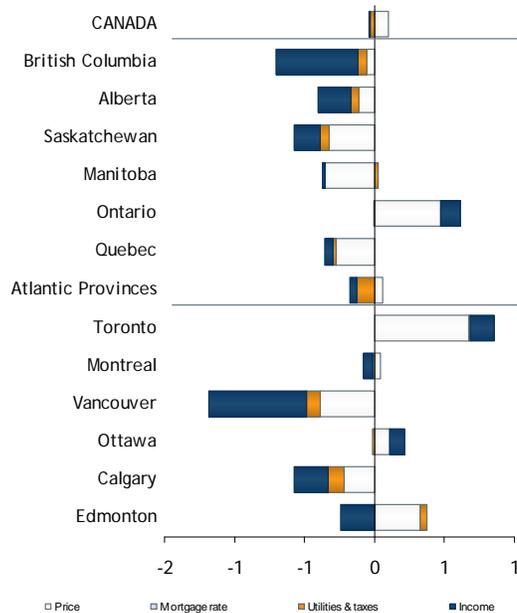
March 2015

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

Craig Wright

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

Robert Hogue

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

Slight deterioration in Q4 housing affordability in Canada masked diverging paths locally

Solid home price increases in Ontario were a main factor contributing to a slight erosion of housing affordability in Canada in the fourth quarter of 2014. Higher home prices in Ontario (mainly Toronto) across all categories, and in specific segments of other provincial markets (including British Columbia and Saskatchewan), boosted what the monthly costs of owning a home would be, at current market values, by more than household income rose last quarter. The effects of plunging oil prices on affordability were still modest and largely isolated to Calgary during the period in question; however, more substantial consequences (although still contained geographically) are likely to emerge in the coming quarters. Interest rates played a neutral role for affordability for the second straight quarter, as posted mortgage rates remained unchanged. At the national level, RBC's affordability measures edged higher relative the third quarter of 2014 in two of three housing categories: by 0.1 percentage points to 42.7% for detached bungalows and 0.2 percentage points to 48.1% for two-storey homes (an increase represents deterioration in affordability). The measure for condominium apartments was unchanged at 27.4%.

Toronto market stood out

Developments in the Ontario market stood out in the fourth quarter with RBC's affordability measures for Toronto deteriorating noticeably in single-family home segments. This local market continued to see robust demand driving up prices, although gains in the condo segments were comparatively subdued. Ontario's economy stands to benefit overall from sharply lower oil prices and the attendant monetary policy response, which is expected to keep a strong bid on markets such as Toronto. While there was some deterioration in housing affordability in certain segments of markets outside Ontario (e.g., two-storey homes in Edmonton and condos in Vancouver), the majority of local markets in Canada saw affordability improve in the latest period. This was the case for all segments in Calgary, bungalows in Vancouver, and condos in Montreal.

Medium-term trends still predominantly flat

The fourth-quarter increases in RBC's measures for the single-detached categories at the national level came on the heels of similar, modest rises in the previous quarter; nonetheless, trends since 2010 remain essentially flat thanks to a well-entrenched pattern of periods of modest deterioration succeeding periods of improvement. The medium-term trend for the condo measure also remains flat overall in Canada—the measure has been stuck at 27.4% since the second quarter of 2014. At the local level, however, the Toronto-area market has displayed deteriorating affordability trends. These contrast with more benign trends in markets such as Saskatchewan, and segments of Quebec and Atlantic Canada.

No undue affordability-related stress in most regions of Canada

The steady rise of ownership costs during the past several years has height-

ened affordability pressures in the Toronto area, particularly for single-family homes. Toronto is one of two markets where affordability is unambiguously poorer than longer-term norms. The other market of course is Vancouver, which continues to show the most stretched affordability measures in Canada by far—despite the fact that the area’s measures have stabilized (or slightly improved in the case of condos) during the past couple of years. RBC’s measures remain close to historical averages in virtually all other markets in the country, thereby suggesting that, generally speaking, affordability is not exerting undue stress on homebuyer demand across most of Canada.

Home resale activity cooled in the late stages of 2014

After showing surprising strength during the spring, summer, and early fall, home resale activity cooled noticeably in Canada at the end of 2014. Home resales fell 5.6% between November and December, representing the steepest monthly decline in four and a half years. The start of 2015 saw more of the same with resales receding by a further 3.1% in January. This new bout of weakness can be largely attributed to the sharp drop in oil prices since June 2014, which has undermined confidence in oil-producing provinces. Declines in Alberta and Saskatchewan accounted for the bulk of the recent drop in home resales nationwide in December 2014 and January 2015. Despite the significant headwinds, home prices overall continued to rise in Canada, although this mainly reflected solid advances in British Columbia (mainly Vancouver) and Ontario (mainly Toronto). Demand-supply conditions recently swung sharply in favour of buyers in Calgary, following a prolonged period of nearly three years of favouring sellers. Demand-supply conditions remained generally balanced in other local markets in Canada, with the exception of Vancouver where sellers hold the upper hand in setting prices.

Recent cut in interest rates likely to help affordability in the near term

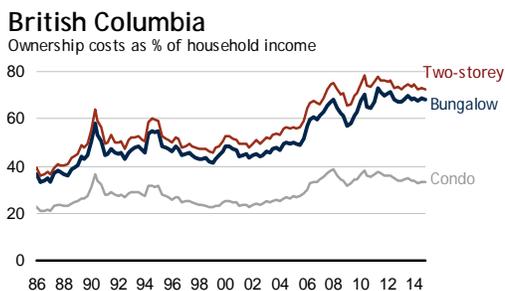
On January 21, 2015, the Bank of Canada surprised financial markets by cutting its overnight rate by 25 basis points to 0.75%. This move triggered reductions in both fixed- and variable-mortgage rates, which are likely to help improve housing affordability in the near term. With only limited upward pressure on prices at best in most local markets, we expect the positive effects of lower interest rates to flow through to affordability largely unimpeded. That being said, Vancouver and Toronto may well continue to be exceptions given their current strength. By 2016, however, we expect that the Bank of Canada will reverse its ‘insurance cuts’ and begin to normalize its monetary policy. Any rise in interest rates would threaten to erode housing affordability and weigh on homebuyer demand in Canada.

Provincial overviews

British Columbia – Small improvement in affordability keeps resale market humming

Housing affordability improved a little in all categories in British Columbia in the fourth quarter of 2014. RBC’s measures eased between 0.1 and 0.7 percentage points. The improvement primarily reflected stronger household income arising from brighter economic prospects in the province. Home price increases were generally contained (or prices eased marginally in the case bungalows), which contributed to reverse some slight deterioration in affordability

RBC Housing Affordability Measures



Source: Statistics Canada, Royal LePage, RBC Economics Research

that occurred in the third quarter. Nonetheless, affordability remained poor in the province due to the persistence of extreme levels of ‘unaffordability’ in segments of the Vancouver market. Provincial home resale activity continued to advance in the fourth quarter, albeit at a slower pace than in the two previous quarters. Results were uneven across local markets, with gains in areas such as Vancouver, Fraser Valley, and Kamloops contrasting with declines in Victoria, Kootenay, and Okanagan.

Alberta – The centre of attention

The Alberta housing market became the centre of attention, with developments since late 2014 clearly pointing toward a significant loss of confidence, no doubt resulting from the plunge in oil prices. After holding up remarkably well during the summer and early fall, home resales have plummeted back to back in December 2014 and January 2015, falling by 35% cumulatively in the province. As further evidence of shaken confidence, the number of sellers has surged, such that demand-supply conditions have loosened considerably in the province (although they remain balanced overall due to a strong starting point). While this has not (yet) translated into widespread price declines, the earlier rapid pace of appreciation in the province moderated substantially in the fourth quarter (in fact, there was even a small drop recorded in the bungalow segment). Housing affordability was mainly unchanged in Alberta in the latest period and continued to be fairly attractive from a historical perspective and compared to other provinces. RBC’s measures were stable for two-storey homes and condo apartments; however, the measure for bungalows eased by 0.4 percentage points.

Saskatchewan – Affordability not the overriding factor driving the market presently

Developments in Saskatchewan’s housing market also came into sharp focus recently due to the plunge in oil prices. Similar to Alberta, there is evidence that confidence has taken a hit since the late stages of 2014. Home resales fell by 4.6% in the fourth quarter and by a more substantial month-to-month rate of 19% in January 2015. Such declines occurred at a time when the provincial market was already well supplied, thereby resulting in a demand-supply equation heavily favouring buyers by early 2015. This was the case in both of the biggest local markets in the province (Regina and Saskatoon), where prices had been under downward pressure even prior to the fourth quarter. Housing affordability improved in most categories for the fifth consecutive quarter in the fourth quarter of 2014. RBC’s measures fell by 0.6 percentage points for both bungalows and two-storey homes. The measure for condo apartments was the exception, however, as it rose by 0.6 percentage points—although its value (24.9%) was still lower than it was a year earlier.

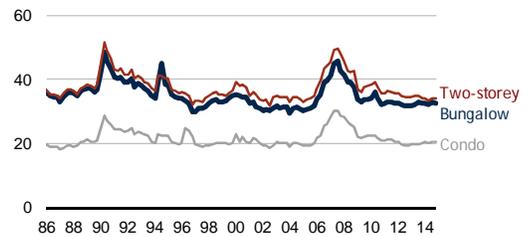
Manitoba – More affordable but market still contending with plentiful supply

It became more affordable to buy a home in Manitoba in the fourth quarter of 2014, much as has been the case during the past year. RBC’s measures fell in all housing categories in the latest period with declines ranging between 0.1 and 0.4 percentage points relative to the third quarter. Cumulative declines since the fourth quarter of 2013 (that range between 1.3 and 2.2 percentage points) have been among the larger ones recorded in the country.

RBC Housing Affordability Measures

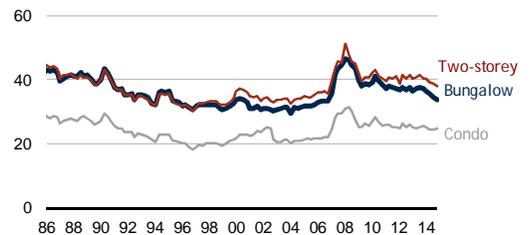
Alberta

Ownership costs as % of household income



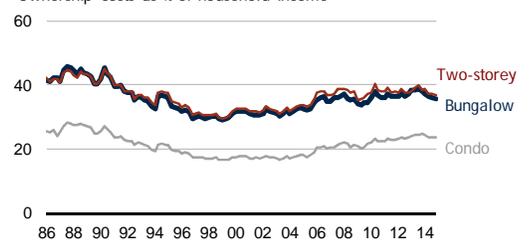
Saskatchewan

Ownership costs as % of household income



Manitoba

Ownership costs as % of household income

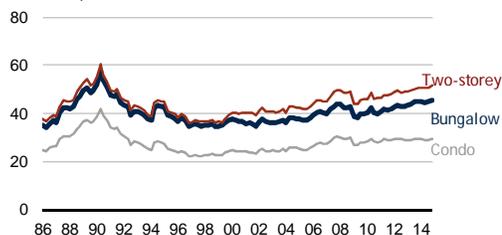


Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

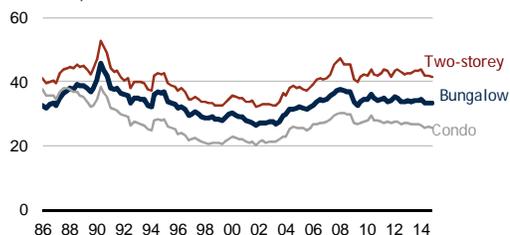
Ontario

Ownership costs as % of household income



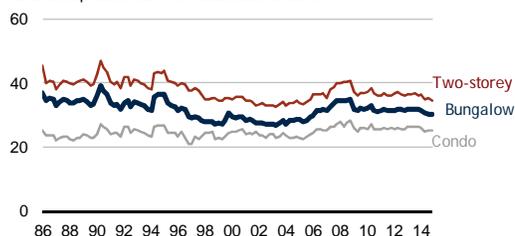
Quebec

Ownership costs as % of household income



Atlantic Provinces

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

A key contributing factor for the improvement in affordability has been the softness in the pricing environment in the province. In fact, home prices fell slightly in all categories in the fourth quarter. The provincial market has contended with a substantial increase in the supply of homes available for sale in the past year (new listings were up 12% year over year in the fourth quarter); the effect of which was exacerbated in the fourth quarter by a substantial 5.0% drop in home resales. Demand-supply conditions (as measured by the sales-to-new listings ratio) loosened to their weakest level in more than 16 years in the province. This largely reflected the situation in Winnipeg where the earlier completions of a wave of new units caused absorption issues.

Ontario – Affordability erosion a side effect of market vigour

Ontario's housing market bucked the generally improving trend in affordability across Canada in the fourth quarter. RBC's measures for the province rose in all categories: by 1.0 percentage point to 51.5% for two-storey homes, 0.6 percentage points to 45.3% for bungalows, and 0.2 percentage points to 29.2% for condo apartments. The contrast with developments in the majority of other provinces highlights the fact that key local markets (mainly the Toronto area) continue to display substantial vigour. Home resales in the province remained at moderately elevated levels from a historical point of view in the latter part of 2014, despite a decline in December (and another easing in January 2015). Upward price pressures built up during the spring and fall last year because of a strong rebound in resales but also due to comparatively limited growth in the number of homes available for sale, which gave sellers more control over pricing. While demand-supply conditions eased somewhat in the fourth quarter, they continue to underpin some of the stronger rates of price increases in the country.

Quebec – Broad-based improvement in affordability continues

Fairly steady improvement in housing affordability took place last year in Quebec, including in the fourth quarter when RBC's measures declined in all categories. The measures fell by 0.6 percentage points for two-storey homes (to 41.3%) and by 0.4 percentage points for both bungalows (to 33.1%) and condo apartments (to 25.6%) in the latest period. Homebuyers now enjoy the most affordable conditions in the province in more than five years for single-family homes and almost 10 years for condos. The better affordability picture is the upside of otherwise predominantly soft market conditions in Quebec, however. While home resale activity picked up during the second half of last year, it remained 4.1% below the 10-year average. Perhaps contributing more to the softness is the elevated number of homes available for sale in the province, particularly in the condo segment. Greater availability has given buyers more weight in setting prices, which has led to quarterly declines in all categories—with the more significant change occurring for condos.

Atlantic – Advantageous affordability position keeps on looking better

The share of income that a household would spend to own a home at market value in the Atlantic region has long been among the lower in the country. For the most part, that share shrunk a little in the fourth quarter, as it did during much of the past year. RBC's affordability measures fell for both the two-storey and bungalow segments (by 0.5 and 0.1 percentage points, respectively), while edging upward only marginally by 0.1 percentage point for the condo apartment segment. An improving trend in affordability has emerged

since the end of 2013, coinciding with a period of soft market activity and historically elevated inventory levels that significantly contained price increases. In fact, conditions in markets such as Fredericton, Saint John, PEI, Newfoundland, and until not that long ago, Moncton, have been more favourable to buyers, which have led to some weakening in prices in the past year. Nonetheless, there were signs that activity picked up somewhat in a few markets during the second half of last year, including Moncton and Saint John.

Major city markets

Vancouver – Still the least affordable market, but resales are firmly on an upswing

Developments regarding housing affordability were mixed in the Vancouver area in the fourth quarter. RBC's measures fell quite noticeably by 1.2 percentage points in the bungalow segment, rose modestly by 0.2 percentage points in the condo segment, and stayed unchanged in the two-storey home segment. Levels of affordability, however, remained unambiguously poor in the area, with RBC's measures far exceeding readings in any other Canadian market and Vancouver's own elevated historical norms. Despite extremely stretched affordability conditions facing homebuyers, the area's housing market found renewed vigour in 2014 with resales reaching close to a three-year high by the fourth quarter. The supply of homes for sale, meanwhile, did not gather as much momentum as resales, such that the demand-supply equation favoured sellers during the second half of last year. Unsurprisingly, this situation heated home prices in the area to the point that Vancouver reclaimed a spot among Canada's markets exhibiting the fastest-rising price increases (alongside Toronto and, until very recently, Calgary and Edmonton).

Calgary – Sharp drop in confidence superseding affordability considerations

Housing affordability improved for the second time in the past three quarters in the Calgary area in the fourth quarter; however, this development received little consideration from homebuyers who exited the market en masse by December (and continued to do so in January). After showing impressive resilience in the face of plunging oil prices since last summer, market confidence gave in to a wave of cutbacks announced by the oil industry and collapsed as winter rolled in. Large increases in new listings in October and November provided early signs of nervousness on the part of sellers, but it was the 26% (month-to-month) freefall in home resales in December that delivered compelling proof that the unease had spread to all participants. A further 24% monthly drop in resales in January confirmed that this turn of events was no fluke. In these circumstances, demand-supply conditions swung swiftly in favour of buyers and set the stage for some weakening in prices in the area. RBC's affordability measures fell in all categories between 0.2 and 0.6 percentage points in the fourth quarter.

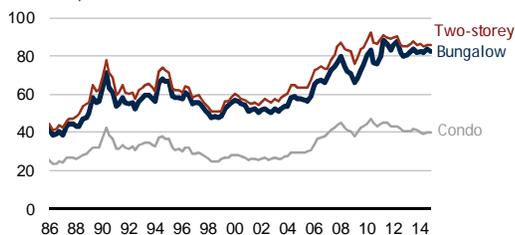
Toronto – Motivated homebuyers unfazed as affordability slips further

Despite an easing in the closing months of 2014, home resale activity in the Toronto area remained quite brisk in the fourth quarter. Actual homebuyer demand likely was even stronger than resale numbers would suggest, because limited new listings quite possibly restrained activity in the past year. Demand-

RBC Housing Affordability Measures

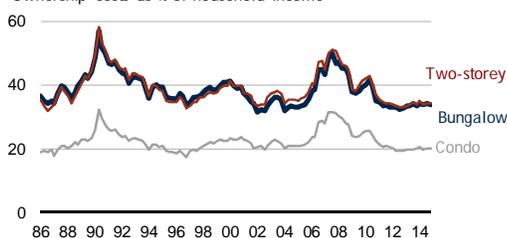
Vancouver

Ownership costs as % of household income



Calgary

Ownership costs as % of household income

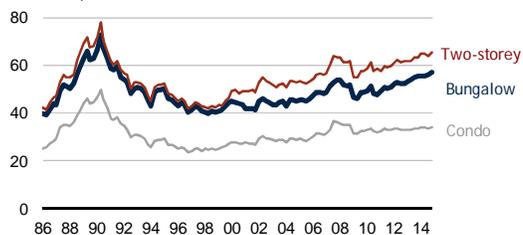


Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

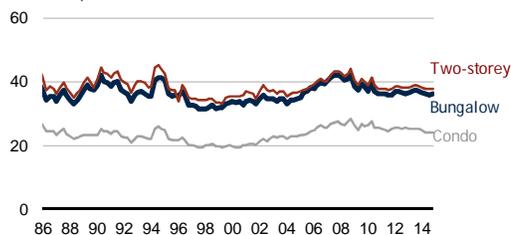
Toronto

Ownership costs as % of household income



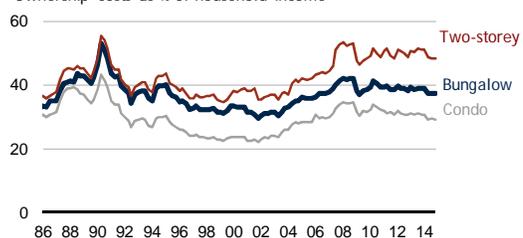
Ottawa

Ownership costs as % of household income



Montreal

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

supply conditions in the area swung in favour of sellers in late summer and during most of the fall, which resulted in an acceleration of price increases. Although demand-supply conditions let up a little in the fourth quarter, price momentum remained solid, particularly in the single-family home segment. This contributed to raise the ownership bar ever higher and further deterioration in affordability. RBC's measures climbed in all categories—between 0.3 and 1.8 percentage points—thereby extending long-standing deteriorating trends in the area. Current affordability levels appear quite stretched relative to historical norms for single-family homes, although less so for condo apartments.

Ottawa – Slight affordability deterioration just temporary?

Some of the concerns that arose in the Ottawa area amid a slowdown in resale activity late in 2013 and in the early part of 2014 have eased more recently in light of a rebound in resales during the second half of last year. Other concerns persist, however. Steady increases in the number of homes available for sale since 2010 have brought plentiful supply to the local market, which stood at historically high levels at the end of 2014. Despite minor tightening in the past two quarters, demand-supply conditions—as gauged by the sales-to-new listings ratio—still hold near their loosest state since 1998 in the area. The effect on prices has been clearly restraining, particularly in the condo segment where outright declines have been registered during part of 2014. That being said, there were modest price increases across all housing categories in the fourth quarter that contributed to a slight deterioration in affordability. RBC's measures edged higher in all segments by 0.1 to 0.2 percentage points. Given the prevailing challenging market conditions, further deterioration would be unlikely in the near term.

Montreal – Improving affordability trend taking a pause

RBC's affordability measures for the Montreal area were little changed in the fourth quarter compared to the third quarter; however, this followed substantial improvement earlier last year. In fact, despite flat readings for the bungalow and condo segments, and only a modest decline of 0.2 percentage points for the two-storey home segment, fourth-quarter levels in the area were the most improved compared to year-ago levels among Canada's biggest metropolitan markets. Much of this development was owed to weakness in prices, especially during the first half of 2014. Price increases have been subdued at best in the past year, weighed down by supply reaching elevated levels, particularly in the condo segment. More recent results show that resale activity picked up during the second half of last year from deeply depressed levels. In the fourth quarter, home resales were 1.2% higher than they were a year earlier; however, they were still 20% below the 10-year average for the period.

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 (\$) Q4 2014	RBC Housing Affordability Measure			
	Q4 2014 (\$)	Q/Q % ch.	Y/Y % ch.		Q4 2014 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	402,700	0.3	6.3	81,800	42.7	0.1	-0.3	39.2
British Columbia	668,300	-0.1	7.7	123,100	68.0	-0.7	0.0	51.1
Alberta	410,800	-0.4	7.9	82,700	32.4	-0.4	-0.1	35.0
Saskatchewan	337,600	-1.2	-4.0	71,100	33.7	-0.6	-3.5	36.1
Manitoba	309,200	-1.3	0.2	66,500	35.6	-0.4	-2.2	35.8
Ontario	441,800	1.4	7.7	90,700	45.3	0.6	0.5	40.3
Quebec	257,600	-1.1	3.0	55,500	33.1	-0.4	-1.1	33.3
Atlantic	223,900	0.3	1.4	51,900	30.1	-0.1	-1.6	31.8
Toronto	634,000	1.5	9.3	122,600	56.8	0.8	1.4	48.7
Montreal	304,100	0.1	2.1	64,100	37.3	0.0	-1.5	36.9
Vancouver	879,700	-0.5	9.0	158,300	82.4	-1.2	0.9	60.7
Ottawa	406,000	0.4	2.4	89,300	36.0	0.2	-0.9	36.3
Calgary	511,900	-0.8	9.2	97,500	33.7	-0.6	0.2	38.3
Edmonton	386,400	1.3	9.8	79,800	33.5	0.1	0.3	33.3

Standard two-storey

Region	Average Price			Qualifying Income (\$) Q4 2014	RBC Housing Affordability Measure			
	Q4 2014 (\$)	Q/Q % ch.	Y/Y % ch.		Q4 2014 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	449,900	0.8	6.0	92,200	48.1	0.2	-0.5	43.7
British Columbia	707,700	0.7	6.1	131,300	72.5	-0.3	-1.0	56.3
Alberta	417,000	1.1	6.9	86,600	33.9	0.0	-0.3	37.5
Saskatchewan	377,000	-1.1	0.4	80,100	38.0	-0.6	-2.4	37.6
Manitoba	318,300	-1.6	2.5	68,900	36.9	-0.4	-1.5	36.7
Ontario	499,600	2.2	8.8	103,100	51.5	1.0	1.1	44.0
Quebec	324,300	-1.5	0.7	69,300	41.3	-0.6	-2.2	39.9
Atlantic	248,900	-1.3	2.3	59,600	34.6	-0.5	-1.5	38.0
Toronto	725,600	3.0	10.3	141,500	65.6	1.8	2.2	54.3
Montreal	399,900	-0.3	0.2	82,700	48.1	-0.2	-2.8	42.6
Vancouver	906,400	1.1	7.2	164,400	85.6	0.0	-0.3	65.8
Ottawa	413,800	0.3	2.5	93,600	37.7	0.1	-0.8	38.5
Calgary	500,300	0.1	8.5	98,200	33.9	-0.4	0.0	38.8
Edmonton	410,000	2.1	10.8	86,400	36.3	0.4	0.5	36.5

Standard condominium

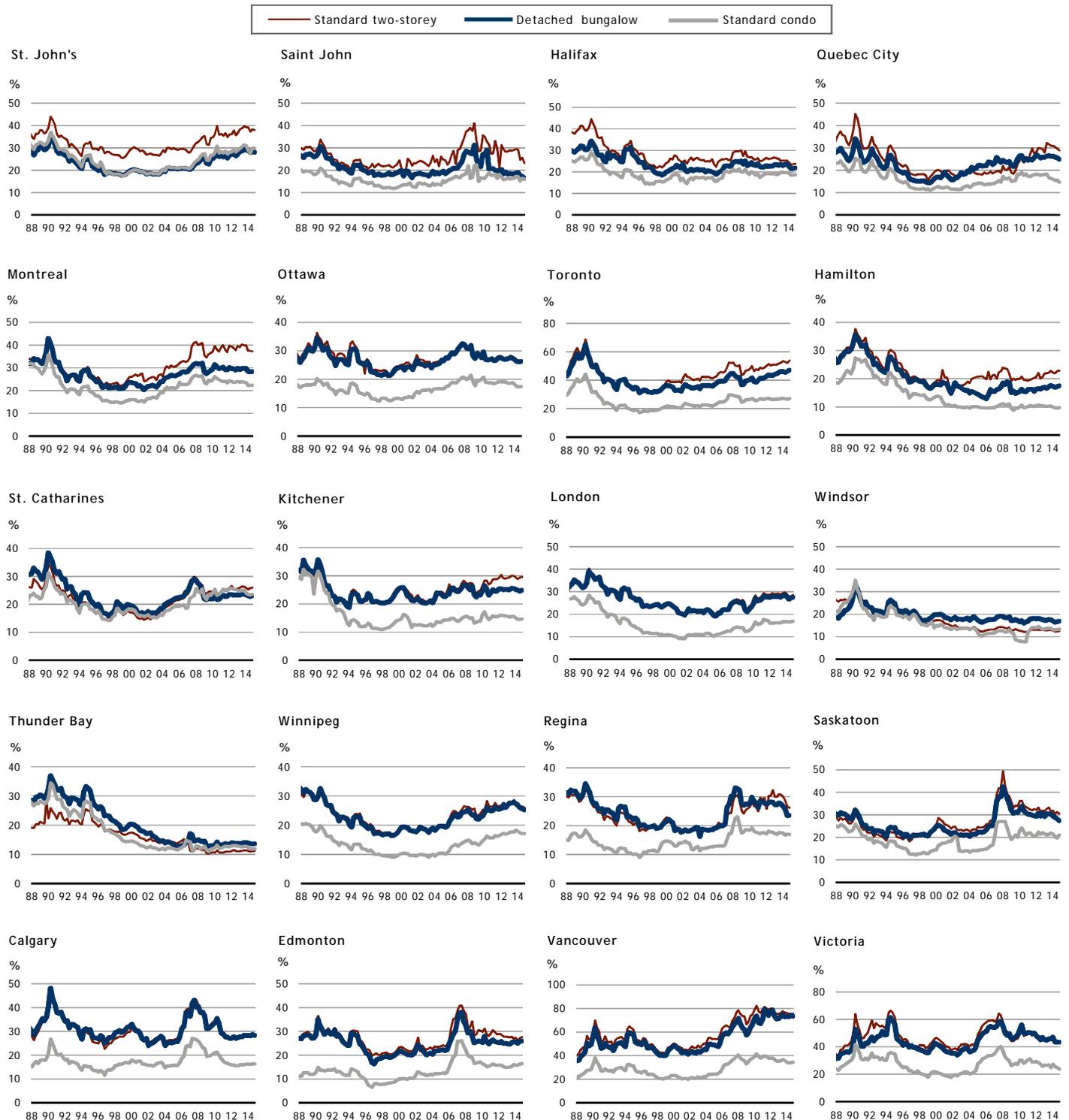
Region	Average Price			Qualifying Income (\$) Q4 2014	RBC Housing Affordability Measure			
	Q4 2014 (\$)	Q/Q % ch.	Y/Y % ch.		Q4 2014 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	251,200	0.3	4.4	52,500	27.4	0.0	-0.6	27.0
British Columbia	312,500	0.9	4.7	60,000	33.1	-0.1	-0.8	28.6
Alberta	253,900	1.3	11.5	52,200	20.4	0.0	0.4	21.5
Saskatchewan	252,700	4.2	4.6	52,400	24.9	0.6	-0.7	24.2
Manitoba	209,300	-0.4	0.8	43,900	23.5	-0.1	-1.3	21.4
Ontario	274,600	0.5	4.1	58,400	29.2	0.2	-0.3	27.6
Quebec	199,100	-1.9	2.0	42,900	25.6	-0.4	-1.0	27.6
Atlantic	192,600	1.0	1.6	43,200	25.1	0.1	-1.3	24.6
Toronto	362,600	0.4	6.3	73,100	33.9	0.3	0.2	31.2
Montreal	239,700	0.2	1.1	50,200	29.2	0.0	-1.5	29.5
Vancouver	412,500	1.6	4.4	76,600	39.9	0.2	-1.0	33.1
Ottawa	269,600	0.3	-0.6	59,700	24.1	0.1	-1.1	23.5
Calgary	294,900	0.2	9.3	57,800	20.0	-0.2	0.2	22.2
Edmonton	244,000	1.4	10.8	50,700	21.3	0.1	0.3	18.3

* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Economics Research

Mortgage carrying costs by city

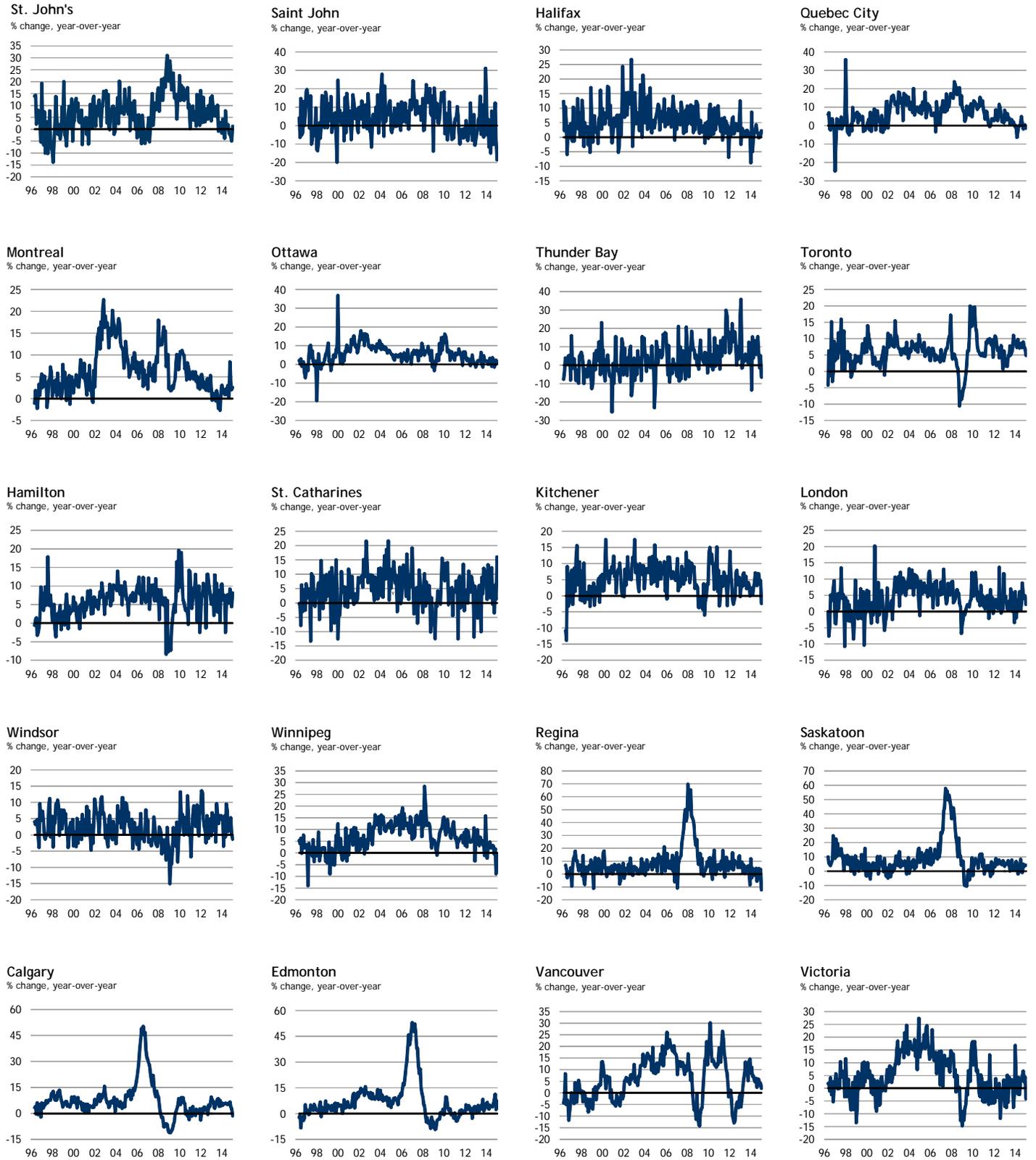
Our standard RBC Housing Affordability Measure captures the proportion of median pre-tax household income required to service the cost of a mortgage on an existing housing unit at going market prices, including principal and interest, property taxes and utilities; the modified measure used here includes 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



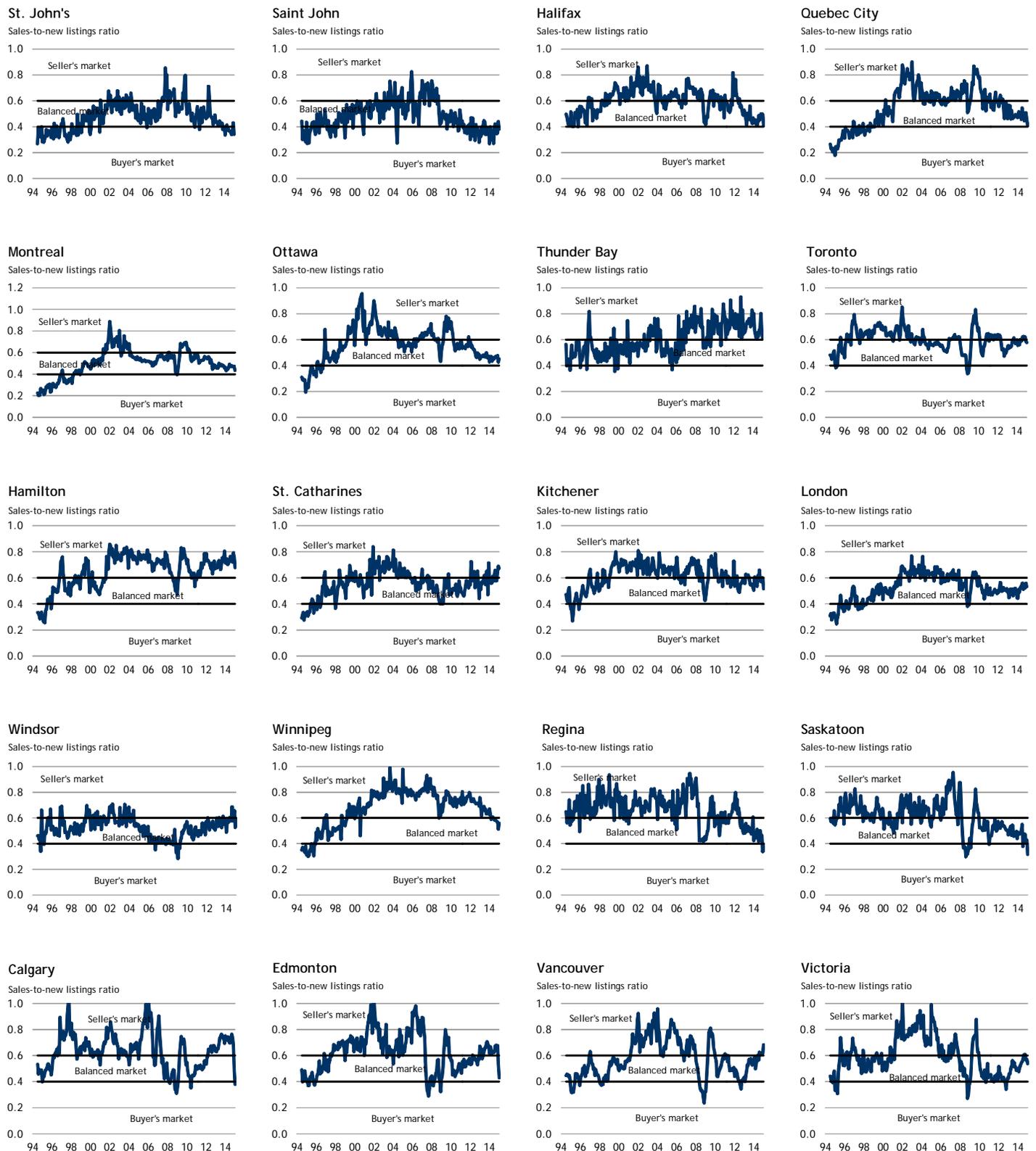
Average price of homes sold on the MLS system



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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