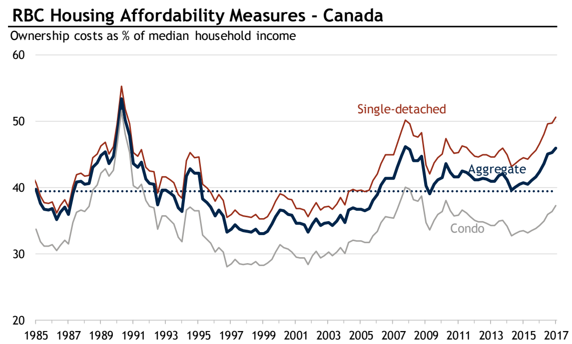
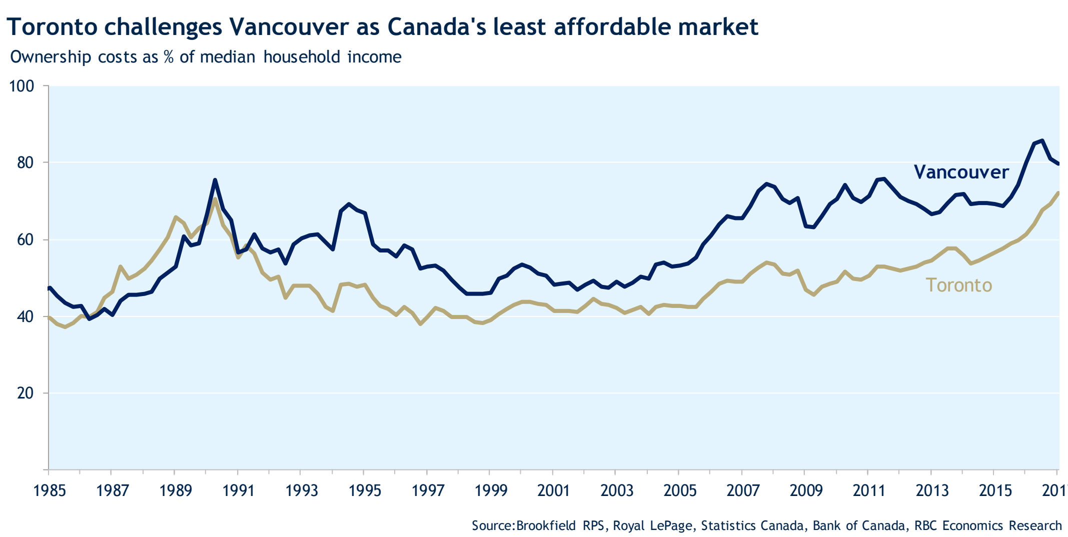
HOUSING TRENDS AND AFFORDABILITY

June 2017

Spike in Toronto home prices squeezed housing affordability in Canada in the first quarter of 2017

- Toronto challenged Vancouver as Canada's least affordable market in the first quarter of 2017.
- RBC's aggregate affordability measure for the Toronto area deteriorated to its worst level ever whereas Vancouver-area buyers saw further relief last quarter.
- Runaway home prices in Toronto and its surrounding region moved the national affordability needle to worrisome levels. RBC's measure for Canada increased to its second-highest level since 1990.
- Outside Ontario and British Columbia, affordability trends improved marginally in most Prairie markets and deteriorated slightly in most markets in Quebec and the Atlantic provinces in the past year.
- Some affordability relief may be on its way to Ontario. The province's Fair Housing Plan announced on April 20 cooled home resale activity considerably in the Greater Toronto Area this spring.





Toronto is the bigger story…

A typical Canadian household would have spent a troubling 45.9% of its income to cover the ownership costs for an average home bought in the first quarter of 2017. Only once since 1990 have households had to spend this much on ownership costs. This clearly underscores the degree to which rapidly rising prices have squeezed housing affordability in Canada over the past year. But the bigger story has been Toronto. Housing affordability in Canada's most populated area has evaporated at a disturbing pace. RBC's aggregate affordability measure for the area surged by more than one-third since 2014 with most of this increase occurring in the past four quarters (a rise in the measure represents a deterioration in affordability). In the process, the measure skyrocketed to its highest level on record. And it is closing in on Vancouver as the least affordable market in Canada, which is very concerning. Affordability stress—long an issue in the single-detached segment—has spread to Toronto's condo segment. As the cooling in the Vancouver market that started last fall continued, Toronto clearly emerged as the main source of deterioration in the national affordability measure.

…as its overheating spilled into surrounding regions

Toronto was not alone in undermining the national picture. Several other markets in southern Ontario also contributed with a wave of

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buyers coming from the core (Toronto) in search of housing that is more affordable. This influx of buyers drove prices up considerably in markets such as Hamilton, St. Catharines and Kitchener-Waterloo.

Vancouver sees further improvement from severe strain

A similar phenomenon has taken place in British Columbia where out-of-reach affordability levels in the Vancouver area drove many buyers toward markets such as Victoria. This movement—also fueled by these other markets not being subject to a foreign buyer tax—effectively transferred some of Vancouver's heat. Victoria, for example, has seen a serious deterioration in affordability last year and in the first quarter of this year. The good news is that the series of policy measures introduced last year to cool Vancouver's market have had a positive effect. Homeownership costs have come down for a second-consecutive time in the Vancouver area.

Affordability trends are little changed across other regions of Canada

Conditions were little changed for the most part in markets outside of Ontario and British Columbia in the first quarter. Affordability trends generally remained subdued, showing slight improvement in many Prairie markets and marginal deterioration in most of Quebec and the Atlantic region. Calgary is an exception in the West where affordability eroded modestly in the past year. And St. John's is an exception in the East where ownership costs have declined from a year ago. Overall, we find little evidence of undue affordability stress across these markets. At the margin, affordability may be a little stretched in Montreal and Quebec City based on their RBC measures exceeding long-run averages but we see nothing that concerns us much. RBC measures are quite close to long-term averages in virtually all markets outside Ontario and British Columbia.

Ontario's Fair Housing Plan to bring some relief?

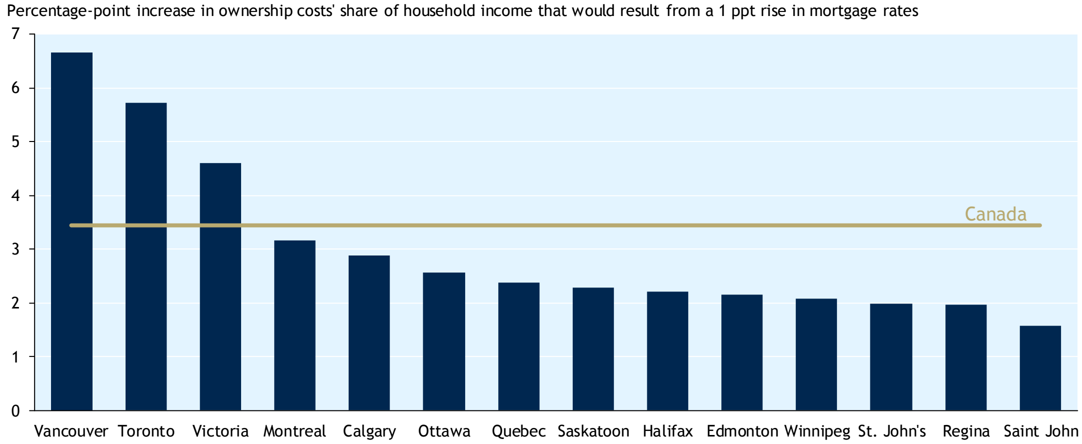
The disturbing upward spiraling of ownership costs in the GTA and other southern Ontario markets substantially raised the region's—and arguably the entire province's—vulnerability to an unexpected shock. So we felt it was prudent on the part of the Ontario government to introduce a series of 16 measures on April 20 designed to cool the market. Initial reaction to Ontario's Fair Housing Plan has been swift. Home listings surged and home resales declined sharply in April and May. The GTA swung dramatically from a super-tight seller's market to the fringe of a buyer's market in just two months. The shift in price expectations prompted by this swing has opened a window for prices to moderate that may bring some affordability relief to the region.

Bank of Canada to raise interest rates sooner than later?

Interest rates—a key determinant of ownership costs—have played a secondary role in shaping affordability trends recently because rates have remained flat at exceptionally low levels. Local prices and, in some cases, swings in household income have been the primary drivers. This could change. Recent speeches by Bank of Canada officials hinted that the central bank may increase the overnight rate sooner rather than later. The start of a rate hike cycle could weigh on housing affordability significantly depending on the magnitude and pace of rate increases. Monetary policy therefore could pose a growing risk for Canada's housing market with the most vulnerable local markets being those where home homeownership costs take the biggest chunk of a household's income.

Ownership costs in Canada's expensive cities are the most sensitive to a rise in interest rates

Percentage-point increase in ownership costs' share of household income that would result from a 1 ppt rise in mortgage rates



Source: Brookfield RPS, Statistics Canada, RBC Economics Research

British Columbia

Victoria – Affordability still getting worse

After Toronto, it was Victoria that saw the most significant erosion of housing affordability among major Canadian markets in the past year. This was the case again in the first quarter. RBC's aggregate measure rose 1.1 percentage points to a seven-year high of 56.7% in the latest period. Contrary to Vancouver, price pressure intensified in Victoria through the fall and the initial months of 2017. The main factor exerting this pressure has been a dearth of homes for sale. New listings plummeted by close to 20% in the first quarter keeping demand-supply conditions heavily in favour of sellers. Eroding affordability and a lack of choice, however, have discouraged buyers. Resales are down almost 30% since their all-time peak reached last spring. There are signs that Victoria's market will become balanced in the months ahead. More sellers listed their properties this spring, which should provide increased options for buyers and moderate price increases.

Vancouver area – Make that two quarters of affordability relief in a row

After exploding since the middle of 2015 to unheard-of levels last summer, RBC's aggregate affordability measure for the Vancouver area fell for a second-straight time in the first quarter. The measure dropped by 1.2 percentage points to 79.7%—still the highest in Canada. No doubt this still constitutes a major impediment to becoming a homeowner in the area. Extremely strained affordability and a series of policy measures last year —including the implementation of a tax on homes purchased by foreign investors—cooled homebuyer demand considerably up until and including this winter. Prices declined on a month-over-month basis last fall and early this year as market participants adjusted to the new policies. This moderate price correction was the main factor behind the affordability relief that we saw in the past two quarters. Unfortunately, the scope for further relief is limited. Vancouver's market heated up again this spring and sellers have regained some pricing power. Vancouver prices, in fact, were back at record-high levels in most market segments in May.

Alberta

Calgary – Good and bad factors affecting affordability

The share of household income needed to cover homeownership costs has been on the rose in Calgary in recent quarters. And that's partly for good reasons. Calgary's market is in the early stages of recovering from its slump and this has translated into a modest firming of prices in the area. So the increase in homeownership costs is a sign of a healthier market. But there was another not-so-good factor that also contributed—a decline in household income. The provincial recession has taken a heavy toll on Calgarians and household income continued to suffer early this year. RBC's aggregate measure for the area rose by 0.8 percentage point in the first quarter to 39.6%. This was the third consecutive quarterly increase. Yet, the level of affordability remains historically favourable to Calgary buyers. RBC's measure was still below its long-run average in the first quarter. We expect household income to strengthen in Calgary once the provincial economy is on a stronger footing.

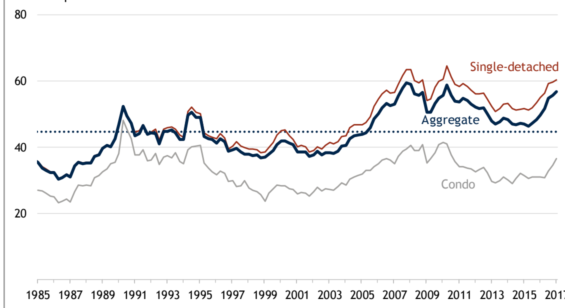
Edmonton – Still broadly affordable

Owning a home at market price also continued to be historically affordable in Edmonton. Ownership costs rose slightly in the first quarter but not by much, as property appreciation was very modest. Household income has been quite resilient in Edmonton in the past year—in contrast to the situation in Calgary. And this has partly muted the effect of rising homeownership costs. RBC's

RBC Housing Affordability Measures

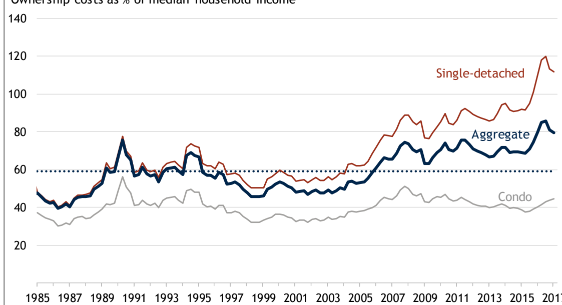
Victoria

Ownership costs as % of median household income



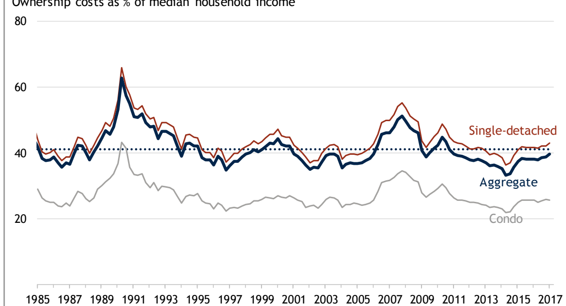
Vancouver Area

Ownership costs as % of median household income



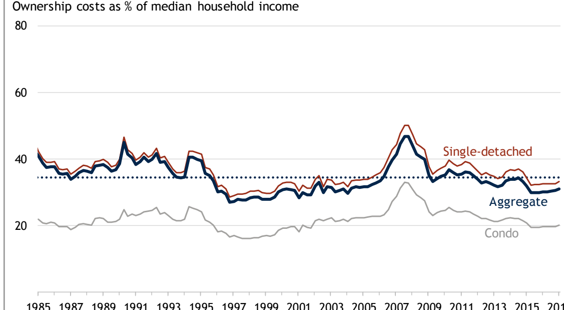
Calgary

Ownership costs as % of median household income



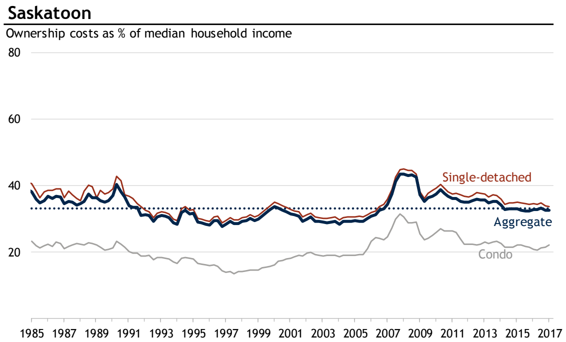
Edmonton

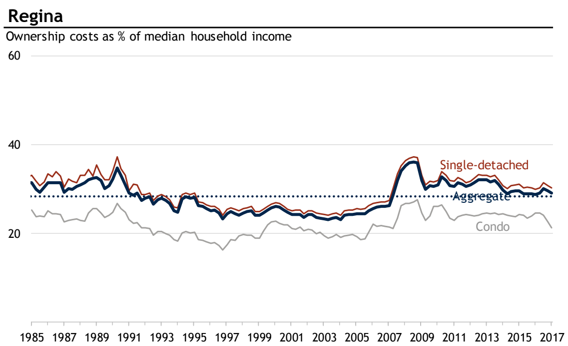
Ownership costs as % of median household income

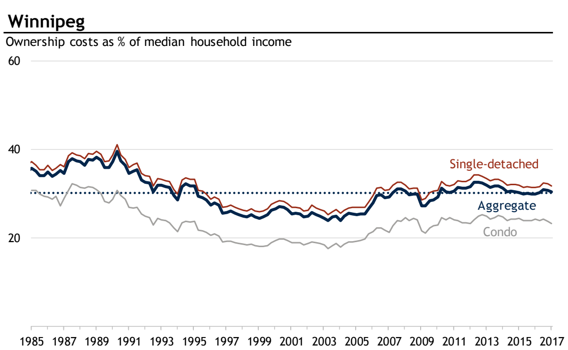


Source: Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures







Source: Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage, RBC Economics Research

aggregate measure inched higher by 0.5 percentage points to 31.0% last quarter. This level compared to a long-run average of 34.4%. Facing little affordability constraints, buyers became more active in the first quarter. Home resales climbed by more than 17% from a year ago. Stronger activity tightened demand-supply conditions only modestly, however. These conditions remained in balance. We don't expect the strong rate of increase in resales in the first quarter to be sustained. Edmonton's stubbornly high unemployment rate is likely to impede the full restoration of confidence.

Saskatchewan

Saskatoon – Good affordability standing not enough to spur buyers

Buyers are in command of the Saskatoon's housing market. The main issue is that there have been fewer and fewer of them since 2014. Their decline is not due to poor affordability. Housing affordability in fact has improved steadily and compares well relative to historical norms. The reason is a lacklustre economy. Saskatoon's unemployment rate surged above 8% this year for the first time in decades. Confidence is weak. And the rate of population growth has slowed significantly. Also tilting the scale in favour of buyers is a supply glut. New listings have been strong in the past couple of years and properties for sale haven't been moving much, resulting in a large inventory of homes for sale. Part of this inventory increase can also be traced to an earlier construction boom which brought a lot of condo units to market. RBC's aggregate affordability measure inched slightly lower by 0.1 percentage point in the first quarter to 32.5%.

Regina – Market conditions are soft but there's scope for a firming

Affordability is on a slightly improving trajectory in Regina. RBC's aggregate measure for the area fell for a second-consecutive time by 0.4 percentage points to 29.1% in the first quarter. The decline primarily reflected a weakening in prices. Demand-supply conditions in the market deteriorated considerably in the initial months of 2017. Home resales were the softest in more than eight years. New listings, on the other hand, rose by 6% from a year ago. This provided buyers with a lot of options and sway over prices. There is scope for a firming of the market in the period ahead. An easing in Regina's unemployment rate this spring bodes well for a rebound in resales.

Manitoba

Winnipeg – Slightly improving affordability trend persists

Home resale activity picked up slightly in Winnipeg in the first quarter. But sellers came out in greater force than buyers for the second straight quarter. With more choice before them, buyers used the opportunity to gain some price concessions from sellers. And the slight drop in prices that resulted from this was the main factor leading to an improvement in housing affordability in the opening months of this year. RBC's aggregate affordability measure edged lower by 0.4 percentage points to 30.4%. This extended the modestly improving trend in place since 2012. The latest reading of the measure was effectively at par with the long-run average—corresponding to a neutral stance. The Winnipeg market recorded its strongest year ever in 2016 with home resales totaling almost 12,900 units. The outlook remains positive this year.

Ontario

Toronto area – Well outside rational limits… and our comfort zone

Toronto's frenzied housing market further decoupled from fundamentals in the first quarter. It became a battleground for desperate buyers willing to do whatever it took—and pay whatever price—to purchase one of the very few properties put up for sale by high-expecting sellers. These highly combustible conditions propelled Toronto's sky-high prices right into the stratosphere. Runaway prices, in turn, pummelled housing affordability to a never-before-seen level in the area. RBC's aggregate measure jumped by a further 2.7 percentage points in the first quarter to 72.0%. This is the closest it has been to Vancouver's measure in 14 years. And this surpassed the previous peak of 70.6% in Toronto reached in 1990. Afterward the market fell into a deep and prolonged slump. Clearly, the Toronto-area market became alarmingly vulnerable to an unexpected shock last quarter. Ontario's Fair Housing Plan announced on April 20 to address such concern was a prudent move. While its impact on affordability in the GTA may take up to two or three quarters to be felt, our view is that it bring some sanity back to the market—at least for a period of time. We would be extremely concerned if it didn't.

Ottawa – Sanity prevails

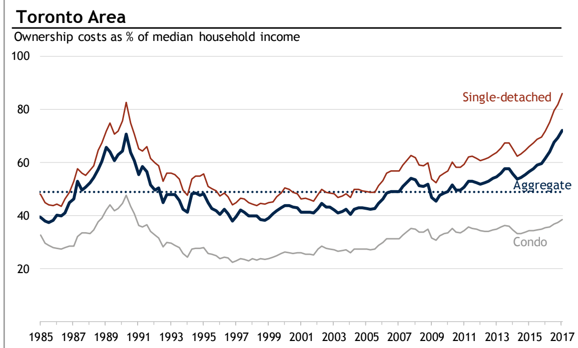
The Ottawa-area market so far has escaped the craze sweeping the GTA and other southern Ontario markets. The National Capital area in fact has shown quite healthy signs lately for the most part. Resale activity has been solid and price increases have been moderate. A decline in new listings only recently began to tip the scale slightly in favour of sellers when setting prices. Housing affordability has remained under control—despite deteriorating modestly in the past year. RBC's aggregate measure stood at 37.7% in the first quarter, up a slight 0.3 percentage points from the previous quarter and by 1.7 percentage points from a year ago. The level is a little above its long-run average of 34.8%, which suggests some moderate degree of stress. But it compares advantageously to Toronto's measure (72.0%). Such favourable comparison with Toronto may attract migrants into the Ottawa area. Home resales set a new record high of 15,800 units last year. The outlook remains bright this year.

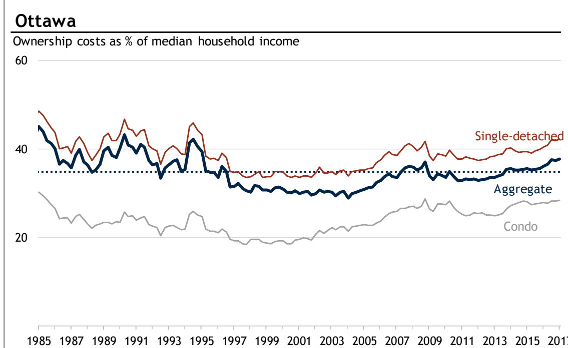
Quebec

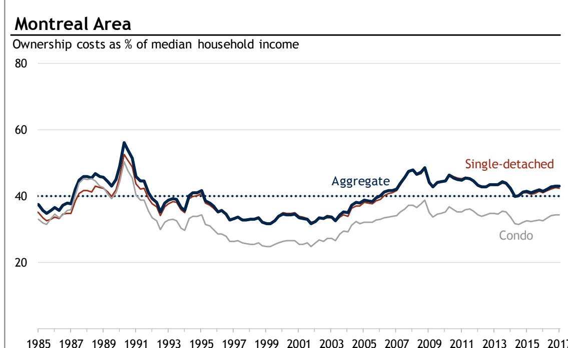
Montreal area – A stronger economy benefits the housing market

A stronger economy and vigorous labour market have had clear benefits for Montreal's housing market in the past year. These factors boosted demand for housing, helped reduce the inventory of unsold homes and put prices on a slightly higher track. A minor flip side of firmer property appreciation, however, has been that households in the region have needed to allocate a little more of their income to cover ownership costs. RBC's aggregate measure for the area has trended upwardly—but gently—since last year. In the first quarter, the measure stood at 43.0%, or 1.6 percentage points above its year-ago level. It is also stood above its long-run average of 40.0%, which is a potential sign of affordability stress. The improved economic backdrop may provide some assistance on that front, however. Household income grew a little stronger in the first quarter. And this helped to trim the measure by 0.1 percentage points for the first time in four quarters. We see some scope for further income growth in the period ahead.

RBC Housing Affordability Measures







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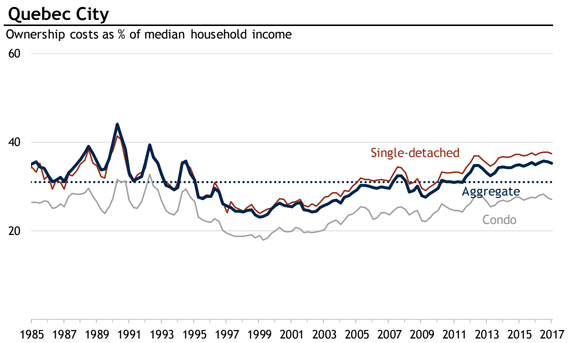
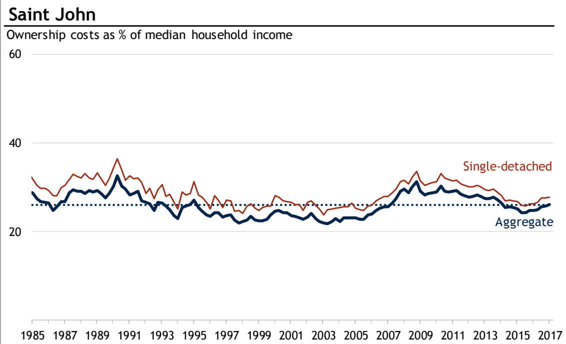
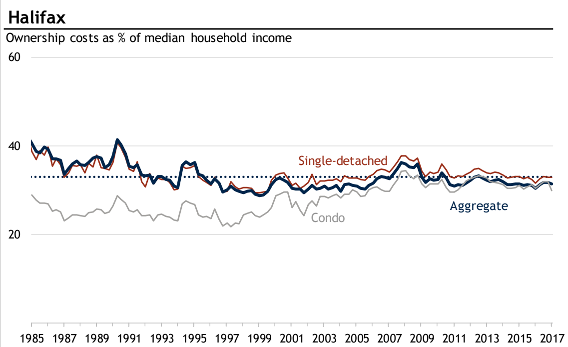
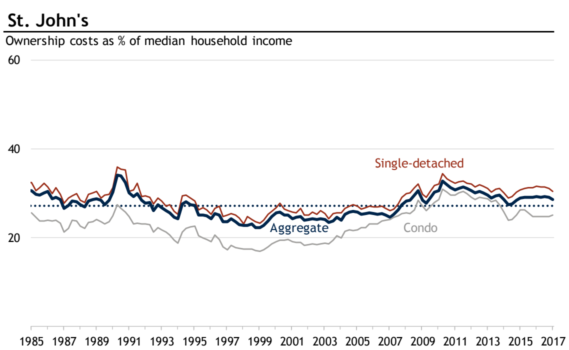
RBC Housing Affordability Measures









Source: Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage, RBC Economics Research

Quebec City – Trend still deteriorating but affordability improved in Q1

Housing affordability improved in the Quebec City area in the first quarter. RBC's aggregate measure fell 0.4 percentage points to 35.2%. A modest softening in prices contributed to lower ownership costs, as the Quebec City market remained abundantly supplied, thereby handing much pricing power to buyers. Still, developments in the first quarter reversed only a part of the affordability deterioration that has taken place over the past several years. RBC's measure departed from historical norms in 2012 and rose to a nine-year high at the end of 2016—although recent levels have been far from extreme. Affordability issues may have been a factor holding back buyers last year. But this was not evident in the first quarter. Home resales rose by a solid 5% from a year ago. We expect demand-supply conditions to firm up in the period ahead with a stronger economy spurring buyers and inventories being drawn down further.

Atlantic Canada

Saint John – On an upswing

The upswing in Saint John's housing market that began in 2015 was in full force in the first quarter of this year. Home resales jumped 27% above year-ago levels to a nine-year high. Brisk activity tightened demand-supply conditions and bumped up prices. Saint John recorded the strongest price increases among the markets that we track in the Atlantic region. This caused affordability to erode. RBC's aggregate measure for the area rose for a seventh-consecutive time by 0.3 percentage points in the first quarter. However, it remains much more affordable to own a home in Saint John than in any major city in Canada. At 26.0%, RBC's measure for Saint John was still the lowest among the 14 markets in our coverage. We expect low ownership costs to continue to motivate buyers. A recent drop in the area's unemployment rate to a seven-year low is likely to provide further motivation.

Halifax – Affordability not budging much—still fine

The balance between demand and supply continued to tighten in the Halifax market in the first quarter. But it wasn't because more buyers were stirring the pot. On the contrary, home resales fell 9% relative to a year ago. It was because fewer sellers listed their properties. A lot fewer. New listings plunged by 15%. Despite a lower inventory of homes for sale, prices eased in the first quarter. This was the main factor contributing to a slight improvement in affordability. RBC's aggregate measure edged lower by 0.2% to 31.5%. Yet this decline was too small to alter the flat trend in place since 2014. Affordability still compares favourably to historical norms in Halifax.

St. John's – Ownership costs are coming down but Newfoundlanders have bigger fish to fry

After remaining generally static since 2014, housing affordability improved in the first quarter in St. John's. But not many buyers may care at this point because their focus is on the poor state of the provincial economy. St. John's unemployment rate surged to a 13-year high of 9.8% at the end of last year. And the angst and uncertainty this has created no doubt has ranked higher on buyers' minds than a modest break on affordability. RBC's aggregate measure fell by 0.6 percentage points last quarter to 28.6%. This was the lowest level since the fourth quarter of 2014. Buyers have been unimpressed, however. Home resales remained depressed in the first quarter near a 10-year low. Supply is overflowing. Prices face substantial downward pressure and we see little in our (grim) economic outlook for the province that could change that in the near term.

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 based on the average market price for single-family detached homes and condo apartments, as well as for an overall aggregate of all housing types in a given market.

Current home prices are sourced from Brookfield RPS, and established from sales prices from monthly transactions, which are filtered to remove extreme values and other outliers.

The aggregate of all categories includes information on prices for housing styles not covered in this report (semi-detached, row houses, townhouses and plexes) in addition to prices for single-family detached homes and condominium apartments. In general, single-family detached homes and condo apartments represent the bulk of the owned housing stock across Canadian markets.

The affordability 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 14 major urban markets in Canada and a national composite. 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 home. 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.

Summary tables

Aggregate of all categories

Market	Price			RBC Housing Affordability Measure			
	Q1 2017 ($)	Q/Q % ch.	Y/Y % ch.	Q1 2017 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada	477,300	2.2	11.3	**45.9**	0.7	3.5	39.5
Victoria	704,000	2.8	18.3	**56.7**	1.1	7.0	44.6
Vancouver area	999,300	-1.1	1.4	**79.7**	-1.2	-0.4	59.3
Calgary	489,800	1.5	2.8	**39.6**	0.8	1.4	41.1
Edmonton	407,900	0.8	1.3	**31.0**	0.5	0.9	34.4
Saskatoon	376,300	-0.1	0.0	**32.5**	-0.1	-0.2	33.2
Regina	333,500	-0.9	3.4	**29.1**	-0.4	0.4	28.3
Winnipeg	293,500	-0.3	3.8	**30.4**	-0.4	0.6	30.2
Toronto area	826,300	5.0	22.8	**72.0**	2.7	10.6	48.9
Ottawa	388,700	1.4	7.9	**37.7**	0.3	1.7	34.8
Montreal area	395,400	0.9	5.9	**43.0**	-0.1	1.6	40.0
Quebec City	295,000	-0.4	2.2	**35.2**	-0.4	0.3	30.9
Saint John	217,900	1.1	8.5	**26.0**	0.3	1.3	25.9
Halifax	301,800	-0.7	2.9	**31.5**	-0.2	1.0	33.0
St. John's	315,800	-2.0	-0.9	**28.6**	-0.6	-0.7	27.2

Single-family detached

Market	Price			RBC Housing Affordability Measure			
	Q1 2017 ($)	Q/Q % ch.	Y/Y % ch.	Q1 2017 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada	523,300	2.4	11.6	**50.6**	0.9	4.0	42.1
Victoria	747,700	2.3	13.5	**60.4**	0.8	5.5	47.0
Vancouver area	1,431,100	-1.0	3.5	**111.8**	-1.6	1.6	68.5
Calgary	532,100	1.6	2.3	**43.1**	0.9	1.4	44.0
Edmonton	433,200	0.5	-0.5	**33.2**	0.5	0.6	36.5
Saskatoon	381,100	-0.6	-2.0	**33.7**	-0.3	-0.8	34.8
Regina	337,200	-0.7	3.1	**30.3**	-0.4	0.3	29.4
Winnipeg	298,600	-0.4	2.8	**31.8**	-0.4	0.4	31.6
Toronto area	991,200	6.1	25.1	**85.8**	4.1	13.9	56.3
Ottawa	432,000	1.6	7.7	**42.3**	0.4	1.8	38.8
Montreal area	376,200	0.8	5.8	**42.4**	-0.1	1.5	39.1
Quebec City	305,600	-0.3	2.7	**37.5**	-0.3	0.5	31.8
Saint John	226,800	0.2	9.9	**27.8**	0.2	1.5	28.6
Halifax	307,300	-0.4	3.7	**32.8**	-0.2	1.2	33.6
St. John's	328,500	-2.6	-3.2	**30.4**	-0.7	-1.2	28.7

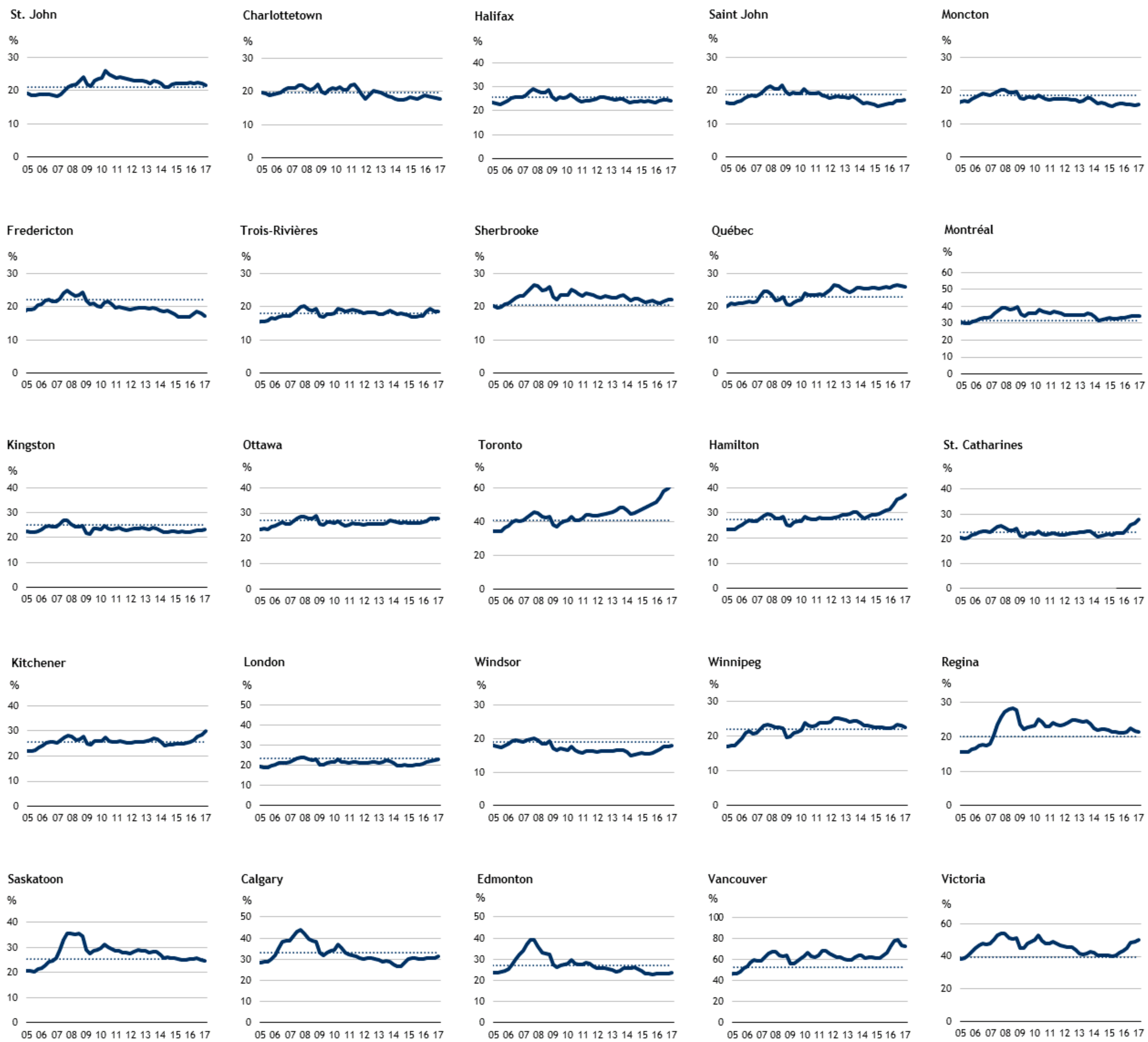
Condominium apartment

Market	Price			RBC Housing Affordability Measure			
	Q1 2017 ($)	Q/Q % ch.	Y/Y % ch.	Q1 2017 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada	394,800	3.1	11.4	**37.2**	0.8	2.9	34.3
Victoria	440,200	7.6	24.1	**36.6**	2.0	5.6	32.4
Vancouver area	532,000	2.6	13.5	**44.4**	0.7	4.0	39.9
Calgary	295,100	-2.1	-2.1	**25.6**	-0.2	0.0	27.1
Edmonton	243,800	0.3	-0.9	**20.0**	0.3	0.3	21.9
Saskatoon	248,700	3.8	9.8	**22.1**	0.6	1.4	20.7
Regina	241,000	-7.4	-16.5	**21.2**	-1.4	-3.4	22.2
Winnipeg	226,300	-1.8	-4.0	**23.2**	-0.6	-1.0	23.4
Toronto area	418,100	4.4	13.3	**38.6**	1.3	3.3	31.0
Ottawa	305,100	1.4	3.7	**28.4**	0.2	0.4	23.8
Montreal area	321,500	0.8	8.3	**34.3**	-0.1	1.8	33.2
Quebec City	239,200	-0.5	0.1	**27.2**	-0.3	-0.2	24.5
Saint John	n/a	n/a	n/a	**n/a**	n/a	n/a	n/a
Halifax	306,500	-7.2	-2.8	**30.0**	-2.0	-0.5	27.8
St. John's	290,100	1.9	4.1	**25.1**	0.3	0.4	23.1

Source: Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage, RBC Economics Research

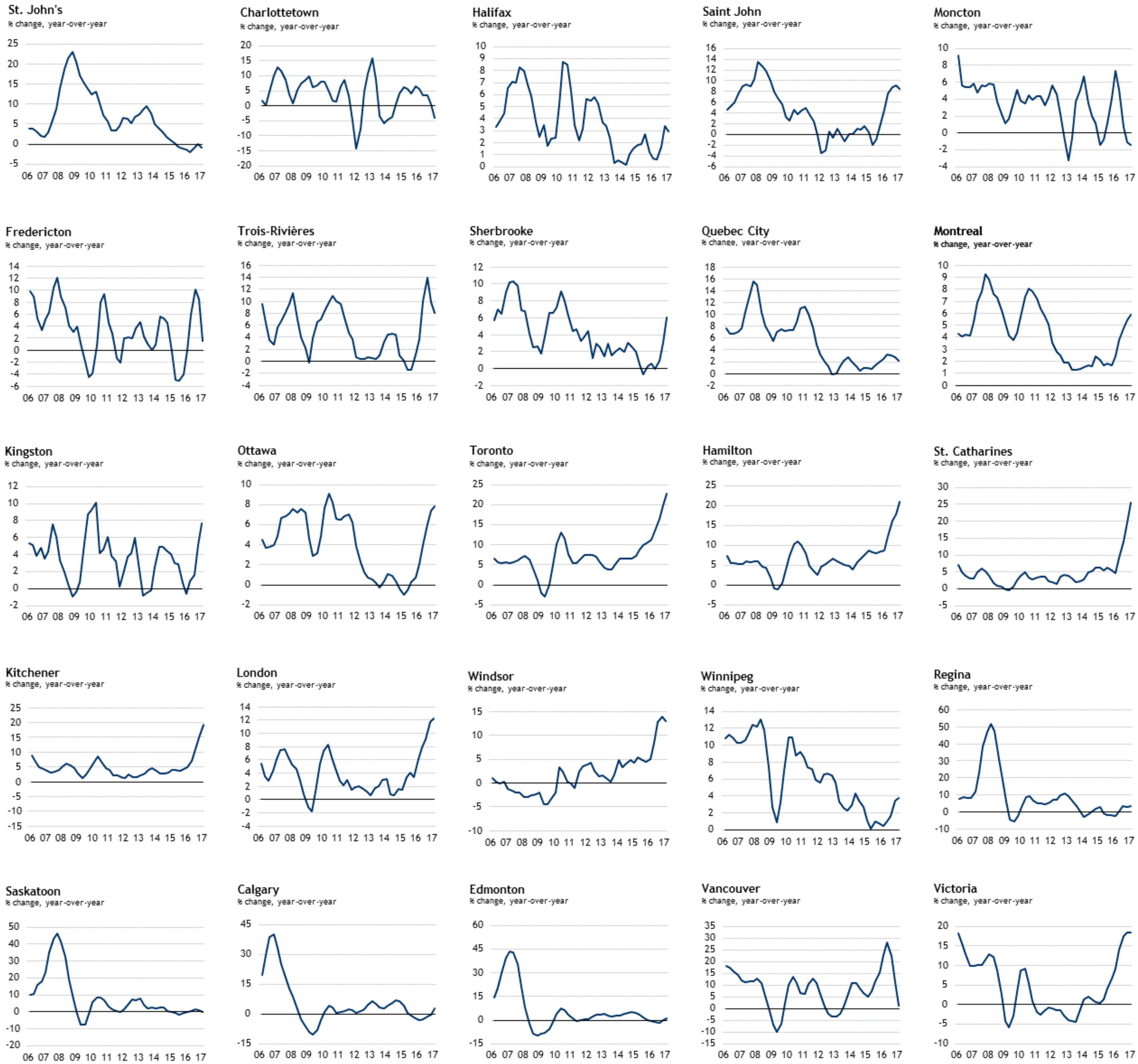
Mortgage carrying costs by city

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 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.



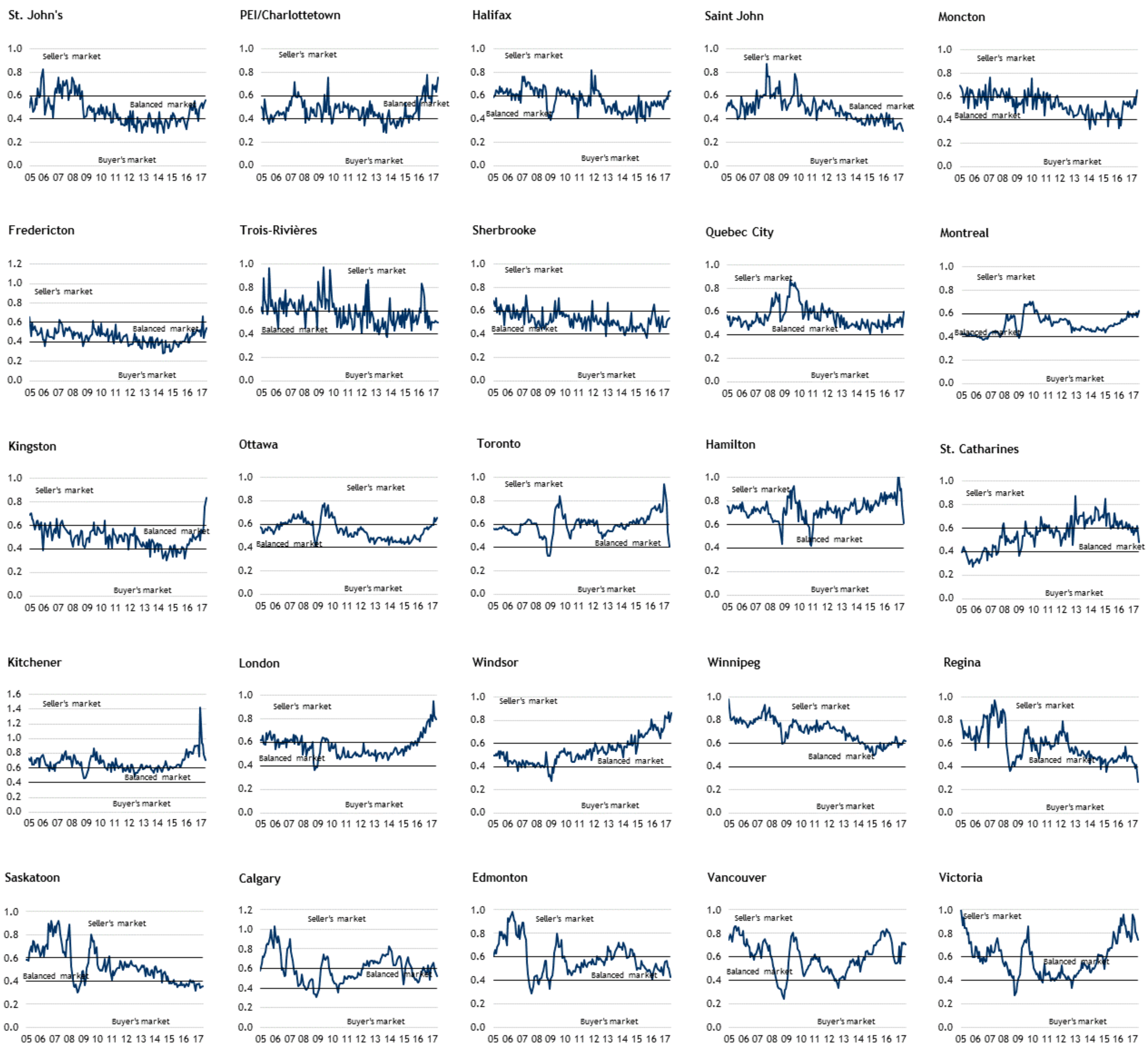
The dashed line represents the long-term average for the market.
Source: Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage, RBC Economics Research

Aggregate home price



Source: Brookfield RPS, RBC Economics Research

Home sales-to-new listings ratio



Source: Canadian Real Estate Association, RBC Economics Research