

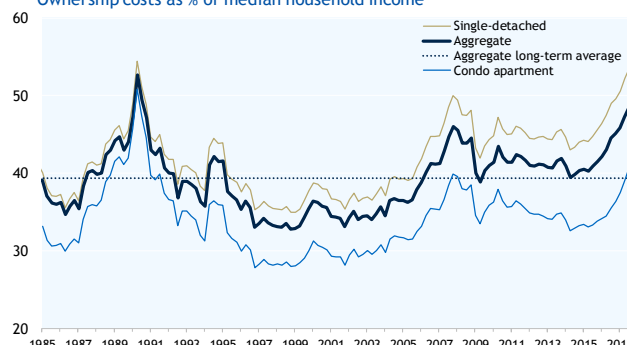
HOUSING TRENDS AND AFFORDABILITY

April 5, 2018

At last, some affordability relief for Ontario homebuyers

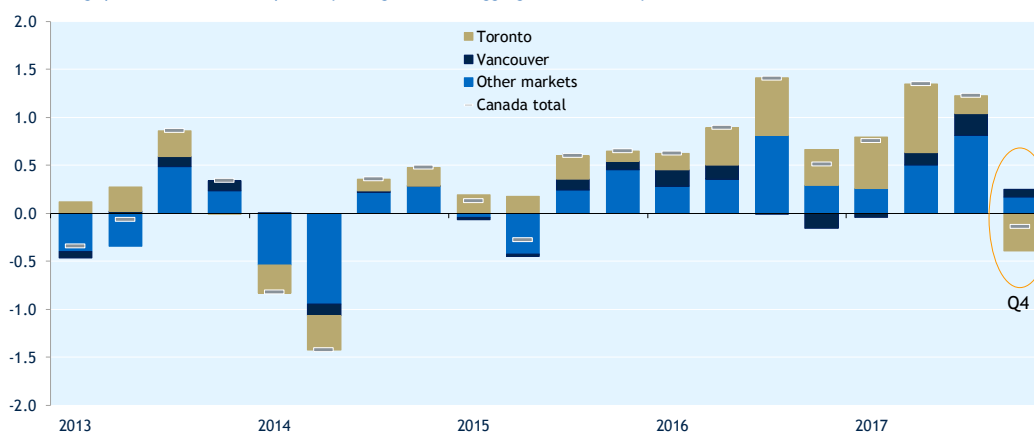
- **Long overdue improvement.** RBC's overall housing affordability measure for Canada improved in the fourth quarter of 2017 for the first time in more than two years.
- **It was mostly due to a drop in Toronto prices.** The significant cooling in the Toronto market since the introduction of Ontario's Fair Housing Plan led to a modest decline in single-detached home prices.
- **Affordability remains stretched.** That's true nationally, in Canada's long-standing 'hot spots' Toronto and Vancouver, and increasingly so in Montreal.
- **Still not an issue in the Prairies and Atlantic Canada.** Affordability levels remain close to historical norms in these regions.
- **Are we at a turning point for affordability? No.** The scope for further affordability improvement in Canada is limited in the short term. Rising interest rates will put upward pressure on home ownership costs, and recent policy measures are more likely to reduce household and market risks than provide material affordability relief.

RBC Housing Affordability Measures - Canada
Ownership costs as % of median household income



A drop in Toronto detached home prices was the main factor improving affordability in Canada

Percentage point contribution to quarterly changes in RBC's aggregate affordability measure for Canada



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

io's Fair Housing Plan in April and as earlier policy measures increasingly constrained buyers' budgets. RBC's aggregate measure dropped by 2.3 percentage points to 75.1% in the Toronto area (a decrease in the measure represents an improvement in affordability). This was a sufficiently large change to move the needle at the national level where RBC's aggregate measure eased by 0.2 percentage points to 48.3% in the fourth quarter.

Yet ownership cost pressures are still intense in Toronto...

Toronto homebuyers will welcome any relief in affordability. However, it's doubtful that they will feel much of a difference. The

Cooling in Ontario's housing market brings (modest) affordability benefits

The steady and rapid deterioration in home ownership affordability over the past two years in Canada finally came to a stop in the fourth quarter. It was, for the most part, because home prices dipped in Ontario after reaching dizzying heights earlier last year. More specifically, detached home prices in the Toronto area gave back some of their out-sized gains of recent years. Demand for high-priced detached homes fell following the introduction of Ontar-



costs of owning a home at today's prices are still onerous compared to all other markets in Canada except the Vancouver area. And these costs remain very close to the highest they've ever been in the Toronto area. The drop in RBC's aggregate affordability measure in the fourth quarter rolled back only a small part of the 8.2 percentage point rise it recorded over the previous nine quarters. Condominium apartments are the more affordable housing option in the Toronto area and attracted more buyers in the past year. Unfortunately, that segment of the market saw no affordability relief in the fourth quarter.

...and British Columbia

Pressures got more intense in Canada's other affordability-stressed markets. The re-acceleration of home prices in Vancouver and continued appreciation in Victoria further increased pressure on BC homebuyers. In fact, Vancouver-area buyers experienced the most significant deterioration in RBC's aggregate affordability measure in Canada in the fourth quarter, rising by 1.8 percentage points. Victoria's measure edged 0.5 percentage points higher. RBC's measures are at their worst-ever levels in both these markets. In light of such challenging affordability trends, it wasn't a surprise to see the BC government announce further housing policy initiatives to cool the market in its 2018 budget. These initiatives included an increase in the foreign-buyer tax from 15% to 20% and the introduction of a property tax on unoccupied properties owned by non-residents (including other Canadians) in certain urban markets.

Montreal's market upswing comes at a cost: an erosion of affordability

One of the more encouraging developments in Canada's housing market in the last two years has been the vitality of markets in Montreal and Ottawa. Both benefited from a strengthening in regional economies and renewed consumer confidence. The pick-up in activity has led to a firming in prices and gradual erosion of affordability, although this is not overly concerning at this stage. RBC's measures aren't far off historical norms. Still, Montreal just saw the ninth increase in its aggregate measure in the past ten quarters. This trend is starting to take some of the shine off its reputation as an affordable market—especially for detached homes.

The Prairies and Atlantic Canada: still broadly affordable

Home ownership costs generally remained manageable for homebuyers in the rest of the country. RBC's aggregate measures stood near long-run averages in the Prairies and Atlantic Canada. That being said, a small increase in mortgage rates contributed to a slight deterioration in affordability in most markets.

This is not a turning point for affordability in Canada

It would be tempting to view the fourth quarter's affordability improvement in Canada as the start of a new, friendlier trend for homebuyers. But this is unlikely to be the case for a few key reasons. First, we expect the reprieve in the Toronto area to be short-lived. We believe that Toronto prices will bottom out sometime this spring. Second, we expect interest rates to rise further. Our view is that the Bank of Canada will hike its overnight rate to 2.25% by the first half of 2019 and we expect longer-term rates to rise in tandem. Higher interest rates have the potential to stress housing affordability markedly in Canada. We estimate that, everything else remaining constant, a 100-basis-point increase in mortgage rates would lift RBC's aggregate affordability measure for Canada by about 4 percentage points. Some of the adverse impact on affordability could be offset by household income gains, but it's unlikely that incomes would rise fast enough to provide a full offset. Third, mortgage qualifying rules are more stringent. The new rules that came into effect in January, as well as earlier rule changes, have raised the ownership bar for buyers who need a new mortgage—like the vast majority of first-time homebuyers.

British Columbia

Victoria – Increasingly unaffordable due to a dearth of sellers

The costs of home ownership reached record-high levels in Victoria as 2017 drew to a close. Home prices have been on a steady climb in the area amid tight demand-supply conditions in the past three years. Sharply deteriorating affordability—Victoria recorded the second-largest rise in RBC’s aggregate affordability measure in Canada in the past year—has priced buyers out of the market. Home resales fell by 15.6% in the area in 2017. But it’s a relative lack of sellers that’s keeping the market so tight. It seems that sky-high prices aren’t enough to convince would-be sellers to put their properties up for sale. RBC’s aggregate affordability measure rose again in the fourth quarter by 0.5 percentage points to 61.6%.

Vancouver area – Soaring prices prompt further policy intervention

The re-acceleration of home prices since the middle of last year put housing affordability back at the top of the list of concerns in the Vancouver area. RBC’s aggregate measure jumped by 1.8 percentage points in the fourth quarter. This came on the heels of even larger increases in the previous two quarters. The unfortunate outcome for local homebuyers is that they are now challenged by **the worst affordability levels ever recorded anywhere in Canada**. The costs of owning a home at today’s prices would have represented an astounding 85.2% of a typical household’s income in the fourth quarter. The worrying trend prompted the BC government to impose new and expanded initiatives to cool the market down. The 2018 provincial budget announced that the government will raise the foreign-buyer tax from 15% to 20%, expand it beyond Metro Vancouver to a number of other local markets, and introduce a property tax on unoccupied properties owned by non-residents (including other Canadians) in certain urban markets. A main objective is to increase housing supply by ‘unlocking’ units that sit empty most of the year.

Alberta

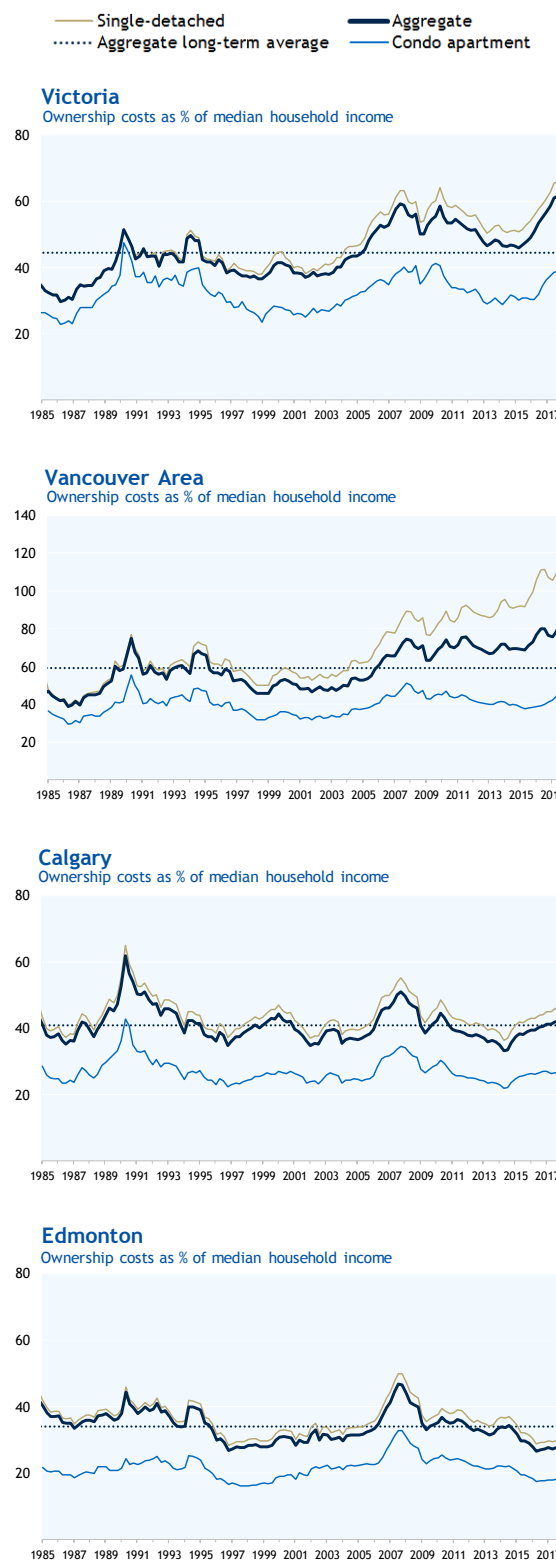
Calgary – Market recovery drives gradual rise in ownership costs

Home ownership costs are on a modest upward trend in the Calgary area but that isn’t necessarily a bad sign. Costs are rising in large part because market conditions are improving. Slowly—and unevenly—but surely. Home resales rose by 6.0% in 2017, representing the first increase in three years. This contributed to put a slight bid on home prices in the area. Yet it’s unlikely that affordability poses problems to homebuyers. RBC’s aggregate affordability measure remains close to its long-run average of 41.0%. The measure rose marginally in the fourth quarter by 0.1 percentage points to 42.1%. We expect the market to continue to recover in the year ahead alongside a provincial economy that’s on the mend.

Edmonton – No complaints here about affordability

Affordability isn’t really an issue for Edmonton homebuyers. RBC’s aggregate measure for the area, at 27.7% in the fourth quarter, is **among the most attractive in the country**. The trend has been quite flat in the past couple of years, reflecting the fact that prices have changed little overall over that period. Yet buyers haven’t been overly eager to jump in. Home resales rose just 0.5% in 2017. There was a late-surge of activity ahead of the new mortgage

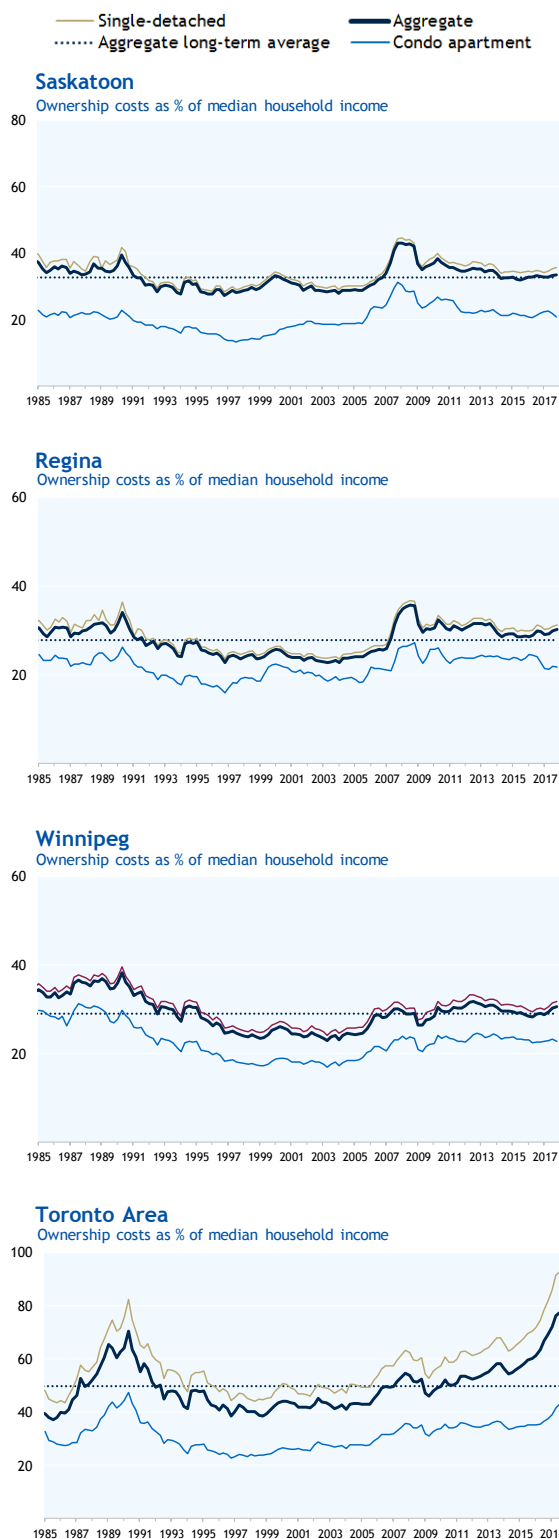
RBC Housing Affordability Measures



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



RBC Housing Affordability Measures



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

stress test that came into effect on January 1 but it has since been largely reversed. We expect the market to improve this year. A recent decline in Edmonton's unemployment rate bodes well for demand to pick up.

Saskatchewan

Saskatoon – Slow-moving trends all-round

Housing affordability has been stuck in neutral for the past three years in Saskatoon and this continued to be the case in the fourth quarter. RBC's aggregate measure for the area rose only slightly by 0.2 percentage points to 33.4%—just a stone's throw from the long-term average of 32.7%. Buyers remain unimpressed. Home resales fell for a third straight year by 4.5% in 2017. A challenging provincial economy and sluggish local job market weighed significantly on buyers' minds in recent years. The good news is that Saskatoon's unemployment rate finally began to dip in the fall after reaching a decades-high in mid-2017. If sustained, the improvement in the labour market should bolster homebuyer demand and set the stage for a long-awaited turnaround in the local housing market. Any recovery is bound to be gradual because high inventories will take time to absorb.

Regina – Still soft

Similar conditions and challenges prevail in Regina. Home resale activity was soft in 2017 despite housing affordability remaining close to a neutral point. In fact, Regina didn't even see the late-year surge of activity that occurred in most markets across Canada ahead of the new mortgage stress test in January. Buyers continue to be in the driver's seat which keeps a lid on price increases. RBC's aggregate affordability measure rose by 0.3 percentage points to 30.2% in the fourth quarter, although this followed declines earlier last year. Compared to a year ago, the measure was up by only 0.5 percentage points.

Manitoba

Winnipeg – Market stays busy

The Winnipeg market didn't have quite as strong a finish to 2017 as we expected but still managed to record its second-best year ever last year in terms of sales. Until very recently, sellers were in a position of strength and drove prices higher at an accelerating rate. The trend moderated somewhat in the latter stages of 2017, however, as demand eased and the supply of homes for sale crept up. Earlier price strength put affordability on a modestly deteriorating trend. RBC's aggregate measure for the area increased 1.5 percentage points in the past year, including a 0.4 percentage-point rise in the fourth quarter. Yet at 30.6%, the measure isn't worryingly above its long-run average of 29.1%. This suggests to us that affordability is unlikely to be a significant deterrent for buyers at this stage. It's also unlikely to become an issue in the near term given that the market is in balance and price increases are on a moderating path.

Ontario

Toronto area – Finally some affordability relief but does it matter much?

After 13-straight quarters of deterioration, housing affordability finally improved in the Toronto area in the fourth quarter. RBC's aggregate measure for the area fell by 2.3 percentage points. Should we pop the champagne? Not



unless you think allocating 75.1% of a household's income to cover ownership costs is acceptable. That's what a typical Toronto-area household would need to allocate if it were to buy an average home today at today's prices and interest rates. Even buying a condo, the more affordable housing option, would require a 43.1% share—still prohibitive for many. A significant cooling in the market post-Fair Housing Plan provided relief in the fourth quarter. The cooling brought the market back into balance and reduced the intense upward price pressure that prevailed previously, although almost all of that easing was concentrated in the higher-priced detached home segment. The condo segment didn't get any affordability relief in the fourth quarter. The bad news is that we don't expect the dip in RBC's aggregate measure to be the start of a new, buyer-friendly trend in the Toronto area. We expect home prices to bottom out sometime this spring.

Ottawa – Still in good shape

Ottawa's housing market is in good shape with resale activity and prices trending higher. Demand-supply conditions are firm, supported by solid economic and demographic backdrops. Sellers are in command for the most part. Housing affordability is on a slightly eroding path but remains at a manageable level. Certainly, buyers have shown few signs that affordability is an issue for them. Ottawa home resales set a new record-high last year, rising almost 11% from 2016. RBC's aggregate measure eased marginally by 0.1 percentage points to 36.1% in the fourth quarter.

Quebec

Montreal area – Gradual erosion of affordability not a big deal so far

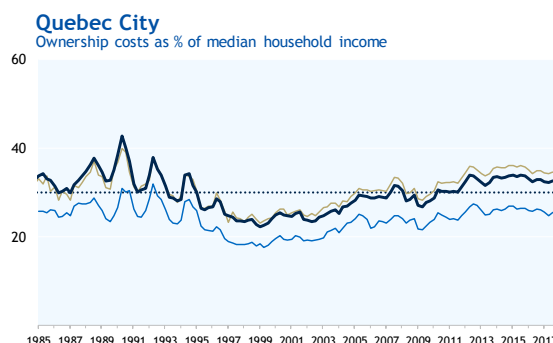
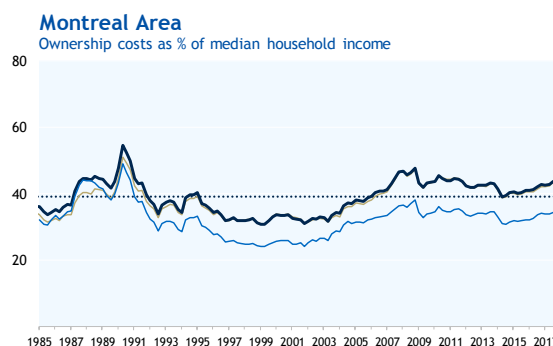
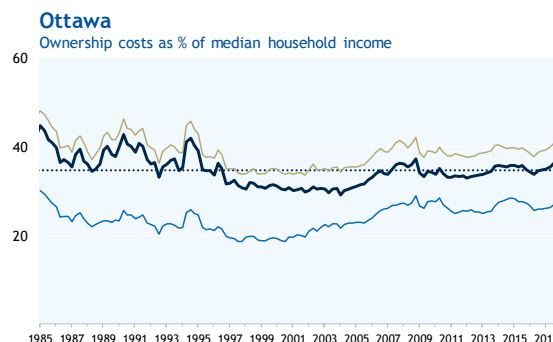
Montreal's housing market is on an impressive run. It just recorded its second-strongest year ever in 2017. Home resales rose by 8% from 2016 and prices climbed between 3% and 7% depending on the housing category. Sellers hold the upper hand in the detached-home segment and are slowly gaining power in the condo segment. Housing affordability eroded steadily since 2015 though this hasn't dampened buyers' enthusiasm. Quite the contrary, buyers have become increasingly bullish thanks to a thriving regional economy and strong labour market. RBC's aggregate affordability measure inched higher by 0.4 percentage points to 44.1% in the fourth quarter. This was the ninth increase in the past 10 quarters, and the highest level since the third quarter of 2011. As with other markets across Canada, tighter mortgage lending rules and the spectre of higher interest rates will generate some headwinds in 2018. Still, we don't expect the buzz about Montreal's housing market to quiet down much.

Quebec City – Buyers are in the driver's seat

Quebec City's housing market also is on a multi-year upswing although it lost some momentum in the latter stages of 2017. The final tally for 2017 showed a fourth-straight annual increase of 2% in home resales in the area. Yet activity was flat on a year-over-year basis in the fourth quarter. This slowdown kept buyers in the driver's seat in all housing categories. Buyers have plenty of options to choose from and use this advantage to resist price increases. In fact, prices changed little overall in the past year. The main exceptions are for lower-priced properties where demand exceeds supply. This is because affordability hurdles at the more expensive price points divert homebuyers to-

RBC Housing Affordability Measures

— Single-detached — Aggregate
 Aggregate long-term average — Condo apartment



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

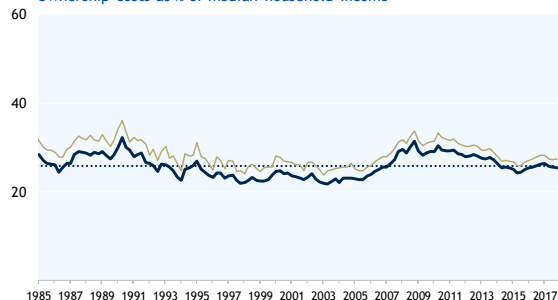


RBC Housing Affordability Measures

— Single-detached — Aggregate
 Aggregate long-term average — Condo apartment

Saint John

Ownership costs as % of median household income



ward the lower end of the market. Soft aggregate prices, therefore, have more to do with the mismatch between demand and supply than outright slumping demand. There's been little change in housing affordability in the past year and a half in Quebec City. RBC's aggregate measure inched higher by 0.1 percentage points to 32.7% in the fourth quarter.

Atlantic Canada

Saint John – Positive signs continue to emerge

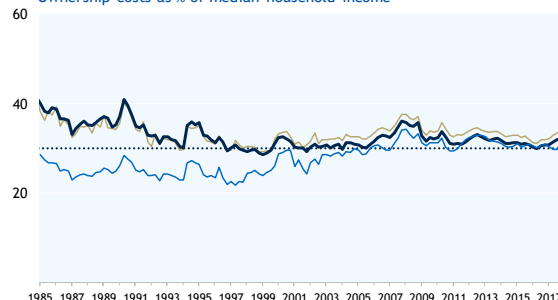
Things are looking up for Saint John's housing market. Home resales reached a nine-year high in 2017 and prices began to firm up over the second half of year. Demand-supply conditions are balanced. The area's unemployment rate fell since last spring and population growth picked up in the past couple of years. Housing affordability isn't a problem. Quite the opposite, it's the most attractive in among the markets that we track. RBC's aggregate measure was 25.4% in the fourth quarter—the lowest on our list. The measure eased for a third-straight time by 0.1 percentage points in the latest period.

Halifax – Confidence in the market is rising despite some affordability erosion

Housing affordability deteriorated modestly since the first quarter of 2017 in the Halifax area but this shouldn't be a worry. At 32.3% in the fourth quarter, RBC's aggregate measure remained quite attractive. It was still below its long-run average of 32.7% and the national mark of 48.3% in the quarter. Certainly buyers have demonstrated increasing confidence in the market. Home resales climbed to their highest level in five years in the Halifax area last year. This tightened up demand-supply conditions to the point that sellers gained a fair degree of pricing power by the end of the year. A recent spike in the area's employment and drop in its jobless rate, if sustained, bode well for further gains in 2018.

Halifax

Ownership costs as % of median household income

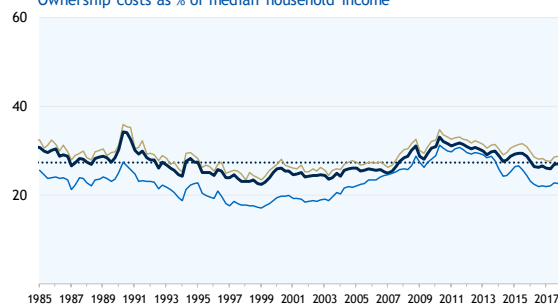


St. John's – Tough challenges remain

St. John's is a buyer's market. Still it's difficult to motivate buyers to jump in when the provincial economy is so unsettled and job prospects are uncertain. Home resales dropped to an 11-year low in the area in 2017. Prices remained generally flat for the third-straight year. Housing affordability is not an issue because it compares favourably to historical norms. RBC's aggregate measure was 27.1% in the fourth quarter, below the long-run average of 27.3%. The good news is that home resale activity regained some momentum over the second half of last year—coinciding with the area's unemployment rate easing from a 13-year high. This could be a sign that the worst might be behind us for the market. Yet rapidly slowing population growth—including for people of prime-buying age—is a reminder that tough challenges lie ahead.

St. John's

Ownership costs as % of median household income



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

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 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

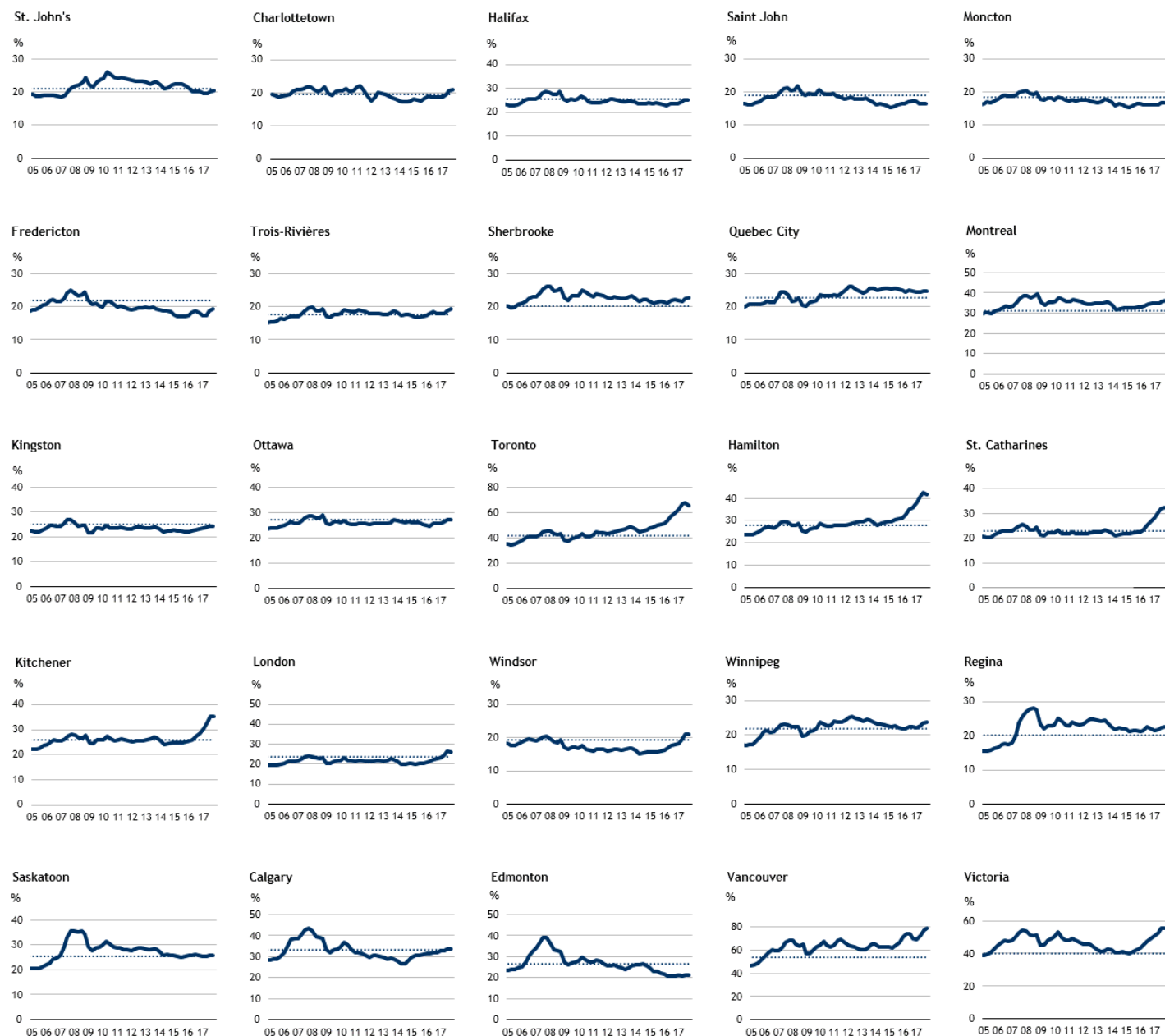
Aggregate of all categories							
Market	Price			RBC Housing Affordability Measure			
	Q4 2017 (\$)	Q/Q % ch.	Y/Y % ch.	Q4 2017 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada	507,800	-0.4	8.5	48.3	-0.2	3.2	39.4
Victoria	773,200	0.5	12.5	61.6	0.5	6.5	44.5
Vancouver area	1,129,800	2.0	11.7	85.2	1.8	8.7	59.3
Calgary	500,700	0.0	3.8	42.1	0.1	1.6	41.0
Edmonton	408,200	-0.3	1.0	27.7	0.1	0.5	33.9
Saskatoon	373,700	0.1	-0.5	33.4	0.2	0.4	32.7
Regina	337,400	0.6	0.4	30.2	0.3	0.5	27.8
Winnipeg	311,200	0.2	5.5	30.6	0.4	1.5	29.1
Toronto area	866,300	-3.0	9.8	75.1	-2.3	6.0	49.7
Ottawa	403,800	0.2	5.6	36.1	-0.1	1.3	34.7
Montreal area	411,400	1.3	4.9	44.1	0.4	1.4	39.1
Quebec City	295,000	0.5	0.1	32.7	0.1	-0.3	29.9
Saint John	199,800	-0.1	-5.7	25.4	-0.1	-0.9	25.9
Halifax	320,000	-0.4	5.2	32.3	0.3	1.6	32.7
St. John's	322,100	1.3	-0.2	27.1	0.2	0.6	27.3

Single-family detached							
Market	Price			RBC Housing Affordability Measure			
	Q4 2017 (\$)	Q/Q % ch.	Y/Y % ch.	Q4 2017 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada	557,600	-0.5	8.9	53.3	-0.2	3.7	42.0
Victoria	827,200	0.6	12.5	66.0	0.6	7.0	46.9
Vancouver area	1,570,200	1.6	8.6	116.5	2.1	9.3	69.0
Calgary	548,700	0.3	4.6	46.2	0.3	2.1	43.9
Edmonton	434,600	-0.7	0.9	29.7	0.0	0.5	36.0
Saskatoon	391,800	0.5	2.1	35.6	0.3	1.1	34.2
Regina	338,700	0.6	0.0	31.2	0.2	0.3	28.9
Winnipeg	315,800	0.1	5.0	31.8	0.4	1.5	30.4
Toronto area	1,039,900	-3.3	11.1	89.6	-3.0	8.1	57.3
Ottawa	451,600	0.3	6.4	40.7	-0.1	1.7	38.7
Montreal area	399,400	2.0	6.9	44.0	0.6	1.9	38.1
Quebec City	302,700	-0.1	-0.3	34.5	-0.1	-0.4	30.7
Saint John	210,500	1.0	-5.6	27.4	0.1	-0.9	28.5
Halifax	326,400	-0.8	5.3	33.7	0.3	1.7	33.3
St. John's	336,100	1.5	-0.5	28.8	0.2	0.6	28.8

Condominium apartment							
Market	Price			RBC Housing Affordability Measure			
	Q4 2017 (\$)	Q/Q % ch.	Y/Y % ch.	Q4 2017 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada	443,100	1.0	15.3	41.1	0.3	4.7	34.1
Victoria	472,500	0.3	14.6	38.8	0.3	4.5	32.2
Vancouver area	626,200	3.1	20.2	48.9	1.5	7.7	39.6
Calgary	289,600	-1.8	-4.6	26.4	-0.3	-0.7	27.0
Edmonton	246,600	-1.4	1.2	18.0	-0.1	0.3	21.6
Saskatoon	220,700	-6.5	-8.2	20.9	-0.9	-1.0	20.4
Regina	239,500	-2.0	-8.2	21.7	-0.2	-1.1	21.8
Winnipeg	232,400	-3.7	-0.3	22.8	-0.4	0.2	22.6
Toronto area	479,100	0.6	19.1	43.1	0.1	5.8	31.4
Ottawa	302,900	-2.3	2.2	26.4	-0.5	0.4	23.8
Montreal area	326,700	0.9	2.4	34.6	0.2	0.4	32.4
Quebec City	245,100	2.1	-0.1	25.9	0.4	-0.2	23.9
Saint John	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Halifax	331,900	5.3	0.4	31.5	1.8	0.5	27.7
St. John's	278,300	-0.1	0.1	22.6	-0.1	0.5	23.1

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

Aggregate home price

St. John's

% change, year-over-year



Charlottetown

% change, year-over-year



Halifax

% change, year-over-year



Saint John

% change, year-over-year



Moncton

% change, year-over-year



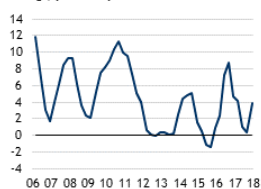
Fredericton

% change, year-over-year



Trois-Rivières

% change, year-over-year



Sherbrooke

% change, year-over-year



Quebec City

% change, year-over-year



Montreal

% change, year-over-year



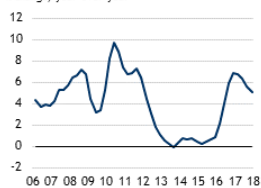
Kingston

% change, year-over-year



Ottawa

% change, year-over-year



Toronto

% change, year-over-year



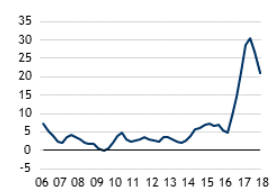
Hamilton

% change, year-over-year



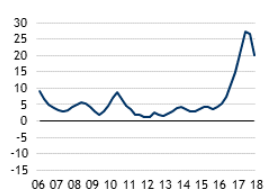
St. Catharines

% change, year-over-year



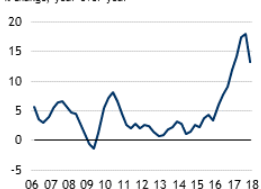
Kitchener

% change, year-over-year



London

% change, year-over-year



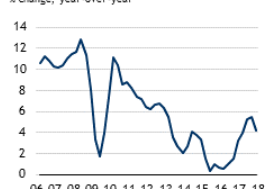
Windsor

% change, year-over-year



Winnipeg

% change, year-over-year



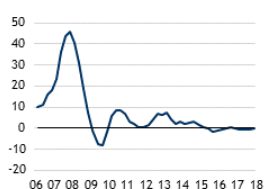
Regina

% change, year-over-year



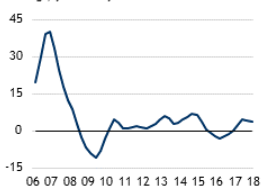
Saskatoon

% change, year-over-year



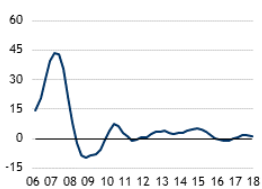
Calgary

% change, year-over-year



Edmonton

% change, year-over-year



Vancouver

% change, year-over-year



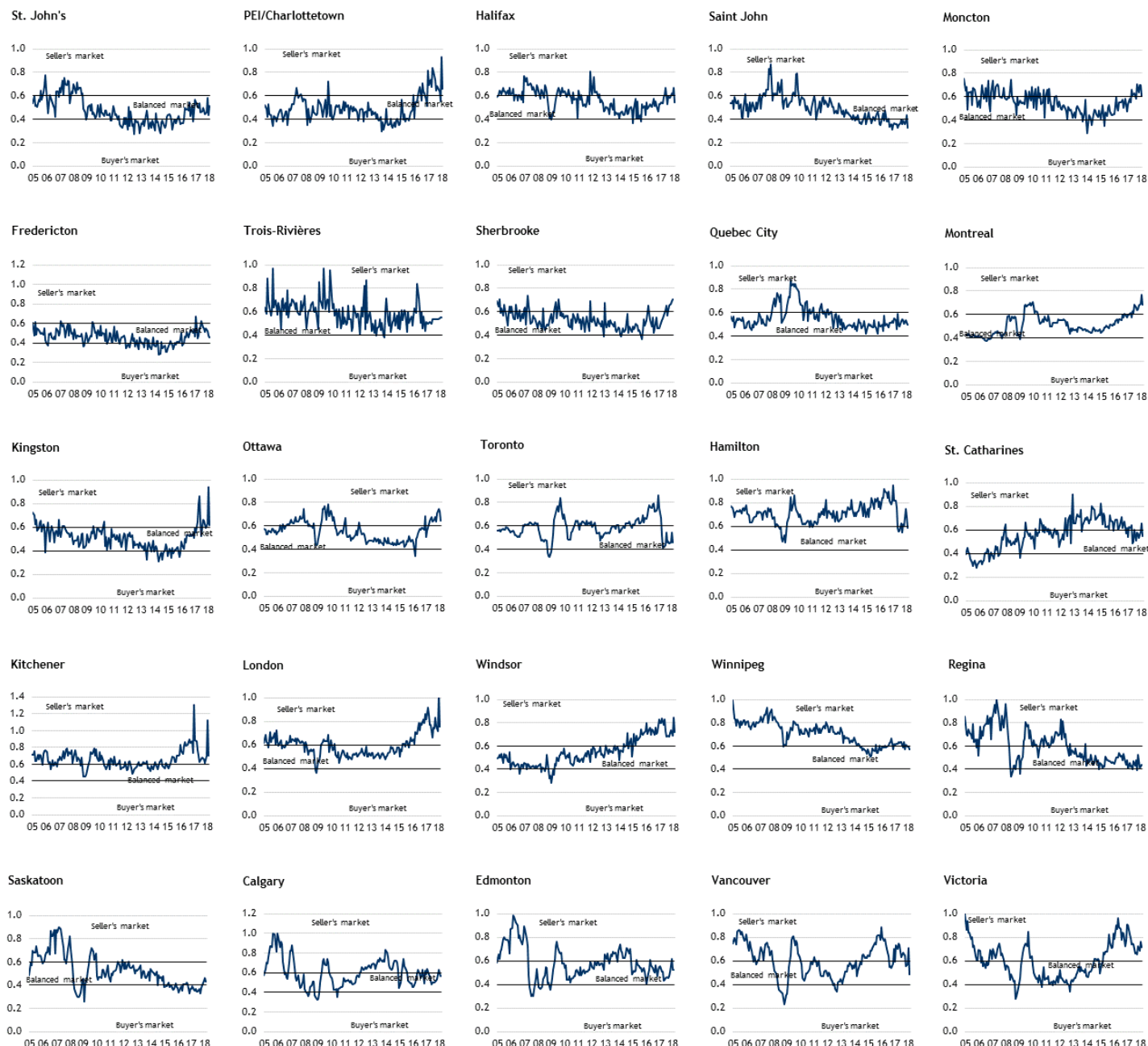
Victoria

% change, year-over-year



Source: RPS, RBC Economics Research

Home sales-to-new listings ratio



Source: Canadian Real Estate Association, RBC Economics Research

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