

HOUSING TRENDS AND AFFORDABILITY

May 2013

Housing affordability in Canada stays in a holding pattern in the first quarter of 2013

The start of a new year did little to alter recent trends in housing affordability in Canada: owning a home at market price still took a modestly larger-than-usual share of a typical household's income, but things have not become any worse since early 2010. In fact, RBC's housing affordability measures were unchanged at the national level in the first quarter of 2013 from the previous quarter in two of three housing categories that we track. The measures for both standard two-storey homes and condominium apartments stayed at their fourth-quarter 2012 levels of 48.0% and 28.1%, respectively (a decline represents an improvement in affordability). The third category – detached bungalows – saw only a minor deterioration, rising 0.3 percentage points to 42.5%.

Affordability's main components all taking a rest

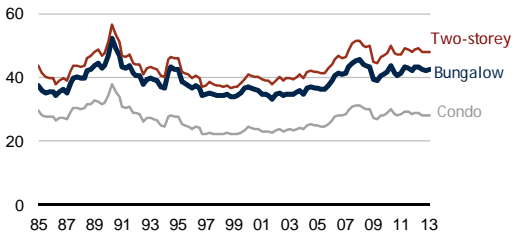
The inertia in housing affordability in the latest quarter reflected stability in all of the measures' key components: mortgage rates, home prices and household income. Mortgage rates (posted five-year fixed) were essentially flat (5.21% on average) for the third consecutive quarter. Home prices barely moved from fourth-quarter 2012 readings, only gaining (bungalows) or losing (condominium apartments) marginally or remaining unchanged (two-storey homes). For the first time since the third quarter of 2011, our estimate of median household income failed to increase from the previous quarter, remaining unchanged.

Minimal changes at the local level

There were some divergences in affordability trends across local markets but changes were minimal in most cases. Affordability measures improved most in markets in Saskatchewan (particularly for single-family homes), reversing the notable deterioration that occurred in the fourth quarter of 2012. At the other end of the scale, the Montreal-area market saw ownership costs rise markedly for two-storey homes in the first quarter of 2013, although this followed meaningful declines in the three previous quarters. The RBC measures changed by 0.8 percentage points or less in all other markets in Canada, with sometimes opposing variations across housing types within the same market. Developments in the first quarter, therefore, maintain the general cross-Canada affordability picture that has prevailed during the past few years: Vancouver continues to be, by far, the least affordable market in the country; Toronto and, to a lesser extent, Montreal show some signs that owning a single-family home is a stretch for households; and the other local markets stand within historically safe ranges.

RBC Housing Affordability Measures - Canada

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

Craig Wright

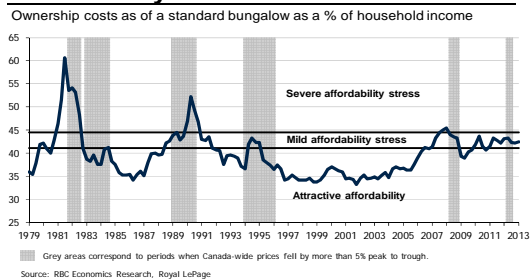
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RBC Housing Affordability Measures

Affordability "barometer" in Canada



National market somewhat stressed but not dangerously so

This holding pattern leaves Canada's overall housing market still facing somewhat higher-than-usual stress; however, recent levels of the RBC affordability measures do not suggest that the situation has become troublesome nor that a significant nation-wide price correction is imminent. Our analysis of the relationship between housing affordability and home prices since the 1970s indicates that affordability at the national level is still outside of the "danger zone". We estimate that during past housing downturns the bungalow measure typically (although not always) climbed above the 44.5% mark before prices fell by more than 5% (peak to trough) in Canada. At 42.5% in the first quarter of 2013, it remained below this critical threshold. We believe that more normal stress levels would be consistent with the national bungalow measure easing below 41%.

Affordability risks rest largely on course of future interest rates

As we indicated in past editions of *Housing Trends and Affordability*, manageable affordability levels may not persist if interest rates rise substantially. Exceptionally low mortgage rates have been the main factor preventing affordability from reaching dangerous levels in recent years; yet, we believe that the likelihood of a surge in rates is slim at this stage. A more probable economic scenario is one of continued low interest rates during the next two years; we expect the Bank of Canada to leave its overnight rate unchanged at 1% throughout 2013 and to raise it only gradually starting mid-2014. Furthermore, when interest rates do rise – and they will eventually – the increase will occur because the Canadian economy is stronger and generating more solid household income gains. This will go some way to offsetting any negative effects on affordability from rising rates.

Housing market activity appears to have stabilized at lower levels

Canada's housing market is cooler than it was just a year ago. Home resales were down 13% nationally in the first quarter of 2013 relative to the same period in 2012. There is mounting evidence, however, that activity is no longer weakening. Much of the decline in resales took place in the months following the implementation of the latest changes to government-insured mortgage insurance rules in July 2012; however, activity appears to have stabilized on a quarter-to-quarter (seasonally adjusted) basis most recently (first-quarter resales were unchanged from the fourth quarter of 2012). Home prices in Canada gave up some ground after they peaked in June 2012 but generally have held up in 2013 because demand and supply remain in balance in most of the country. As demand cooled during the past year, the supply of homes newly offered for sale also was curbed. We expect market activity to remain subdued this year although we see scope for some mild strengthening from recent quarterly levels as the effects of the changes in mortgage insurance rules dissipate. Overall, we project home resales to total almost 439,000 units in Canada in 2013, which would be down 3.2% from 2012, and home prices to ease slightly by 0.4%.

Provincial overviews

British Columbia – Unaffordability eases further

Little by little, owning a home at market price is becoming less unaffordable in British Columbia; however, the provincial market has a long way to go before the substantial stress on homebuyers in markets such as Vancouver is relieved. The first quarter of 2013 saw another small improvement with the RBC measures for the province declining in two categories (bungalows by 0.4 percentage points and two-storey homes by 1.3 percentage points), while remaining unchanged for condominium apartments. The cumulative improvement in the past year – ranging from 2.3 percentage points (condos) to 4.1 percentage points (bungalows) – has been the biggest among the provinces. Nonetheless, persisting poor affordability levels have been a prominent factor continuing to weigh on BC housing demand this year. Home resales in the first quarter fell for the fifth consecutive quarter and stood more than 30% below the 10-year average. British Columbia is the only province where prices declined year over year in all three housing types.

Alberta – Still one of Canada’s housing bright spots

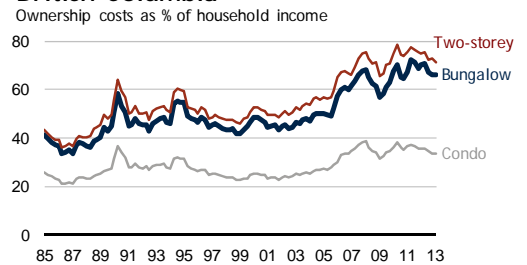
Despite slight erosion in affordability in the first quarter, Alberta’s market continues to be a bright spot in Canada. Resale activity picked up in the first quarter of this year (rising 3.7% from the fourth quarter of 2012), thereby keeping market conditions somewhat tight. Home prices rose modestly across all housing types. Higher prices are not a hindrance to Alberta homebuyers, who enjoy substantial buying power thanks to their higher income. In fact, the Alberta market remains among the most affordable in the country because of high household income in the province. In the first quarter, the RBC measures rose slightly by 0.2 percentage points across all housing types. Barring an unexpected shock to the economy, housing market activity should remain brisk in Alberta in 2013.

Saskatchewan – Modest affordability pressure persists despite improvement

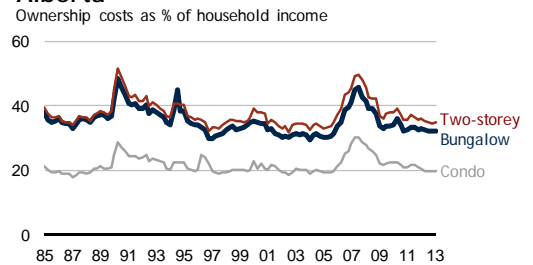
There has been a fair degree of volatility in the measurement of housing affordability in Saskatchewan during the past year. In the first quarter of 2013, RBC’s measures for the province showed the biggest improvement in Canada, although this followed noticeable deterioration in the previous quarter. Swings in home prices have been the prime reason for the volatility. In particular, substantial gains in the fourth quarter of 2012 were followed by widespread declines in the latest quarter. The RBC measures fell by 1.7 percentage points in the first quarter for two-storey homes, 1.0 percentage point for bungalows and 0.3 percentage points for condominium apartments. Affordability measures have trended sideways in the province since 2009 at levels that exert some modest pressure on homebuyers. Resale activity slowed considerably in the latter half of 2012 and the early months of 2013; however, there are signs that the market perked up this spring in markets such as Saskatoon.

RBC Housing Affordability Measures

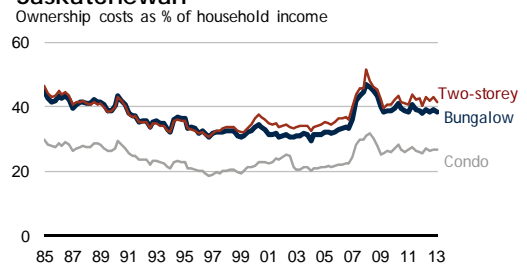
British Columbia



Alberta



Saskatchewan

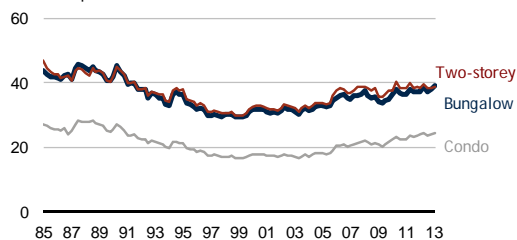


Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

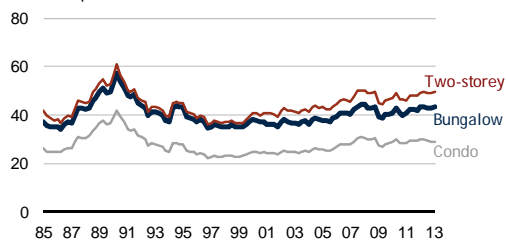
Manitoba

Ownership costs as % of household income



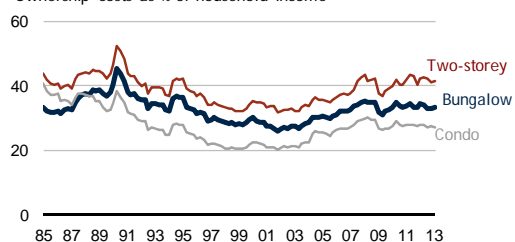
Ontario

Ownership costs as % of household income



Quebec

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

Manitoba – Second consecutive deterioration in affordability

While still not reaching dangerous levels, affordability deteriorated for the second straight quarter in Manitoba. RBC's measure rose modestly in all housing categories in the first quarter of 2013 – by 0.8 percentage points for bungalows, 0.4 percentage points for condominium apartments and 0.2 percentage points for two-storey homes. Strong price gains for most (though not all) categories in the two most recent quarters were responsible for most of the affordability erosion. The Manitoba existing home market had a record year in 2012; however, the 2013 winter was a very different story. Home resales were particularly weak in February and March (they partly rebounded in April). Part of this weakness might be attributable to the market just catching its breadth. It might also reflect the slight deteriorating trend in affordability that may be beginning to bite some homebuyers in the province.

Ontario – Maintaining course to more sustainable conditions

Developments in the Ontario housing market during the first quarter of 2013, by and large, continued recent trends. The transition from “hot-ish” to more “temperate-ish” market conditions was still in evidence with resale activity remaining subdued, demand aligning better with supply and price increases moderating further. Housing affordability extended its slight deteriorating trend for single-family homes and its stationary trend for condominium apartments. RBC's measures for bungalows and two-storey homes both rose by 0.4 percentage points in the first quarter; the measure for condominium apartments was unchanged. Following steady declines through the spring, summer and fall last year, home resales in Ontario showed signs of stabilizing in more recent months.

Quebec – Homebuyers showing significant hesitation

Quebec homebuyers became increasingly hesitant to pull the trigger on purchases during the past year. In the latest period, this hesitation led to the second-weakest first-quarter results for home resales in 10 years in the province. No doubt, the cumulative weight of uncertain economic prospects and tighter mortgage insurance rules took a toll on homebuyer confidence. What is less clear is whether housing affordability played a role. Recent trends in RBC's affordability measures for Quebec have not shown any visible deterioration; in fact, it could be argued that the trend in condo affordability improved marginally. In the first quarter of 2013, the RBC measures were a mixed bag with bungalows and two-storey homes rising slightly (by 0.4 percentage points and 0.1 percentage points, respectively), and condominium apartments declining (by 0.6 percentage points). Affordability levels, however, remain modestly worse than they have been historically for single-family homes, which may, at the margin, explain part of the hesitation.

Atlantic – No escape from the cooling

Atlantic Canada's housing market did not escape the cooling in resale activity. Home resales fell by 13% in the region between the first and last quarters of 2012. Overall activity in the region appears to have stabilized early in 2013, with first-quarter resales virtually unchanged from the fourth quarter, although the situation varied considerably across local markets, with resales in Fredericton bouncing back and those in Halifax continuing to fall. Generally, markets in the region are balanced (with Saint John and Fredericton representing exceptions) but the recent trend has been toward looser conditions. In turn, this has reduced sellers' pricing power and limited price gains, which has kept housing affordability fairly attractive in Atlantic Canada. In the first quarter, RBC's measures rose only modestly for all categories (0.6 percentage for bungalows, 0.5 percentage points for two-storey homes and 0.4 percentage points for condominium apartments), following improvements in the two previous quarters.

Major city markets

Vancouver – Near the bottom?

With home resales slumping to levels 40% below their 10-year average by the third quarter of 2012, the question for the Vancouver-area market was whether activity was on its way to test the lows reached during the 2008-09 recession (57% below the 10-year average). While developments late in 2012 and in the first quarter of 2013 may not provide the definitive answer, they suggest that the market correction that began in earnest in 2011 may be close to its bottom in terms of home resales. The dizzying slide in resales in the area steadied in the latest two quarters. However, the price correction may not be over, despite recent signs of stabilization. Buyers continue to hold the upper hand in the area and market conditions are unlikely to tighten meaningfully in the short term. Extremely poor housing affordability in the Vancouver area still weighs heavily on homebuyer demand despite recent improvement, including in the first quarter of 2013 when most of the RBC measures declined slightly.

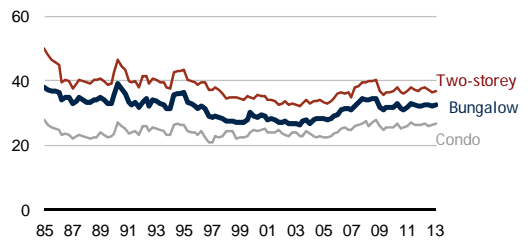
Calgary – Back on (an upward) track

The renaissance of Calgary's housing market has not been a steady process. The generally improving trend in resales was broken on occasion, including in the summer and fall of 2012. More recent statistics, however, suggest that the softness in parts of last year was indeed a temporary deviation and that the rising trend is resuming. Resales in the area ceased to decline during the first quarter of 2013 and showed month-to-month gains in the February-to-April period. The Calgary market continues to benefit from a strong provincial economy, accelerating population growth and attractive housing affordability. RBC's affordability measures for the area still compare favourably with both the historical norms in Calgary and the national average. In the first quarter of 2013, the RBC measures increased slightly (by between 0.4 percentage points and 0.8 percentage points) for all housing categories. This modest deterioration was caused by higher home prices, themselves the result of fairly tight market conditions.

RBC Housing Affordability Measures

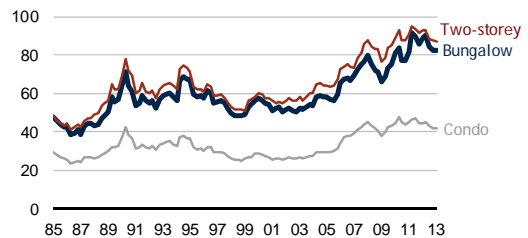
Atlantic Provinces

Ownership costs as % of household income



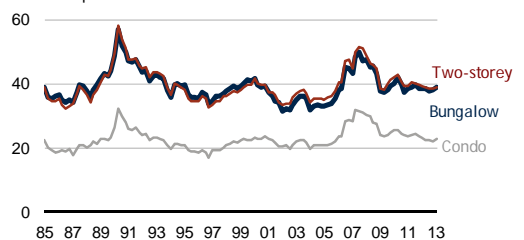
Vancouver

Ownership costs as % of household income



Calgary

Ownership costs as % of household income

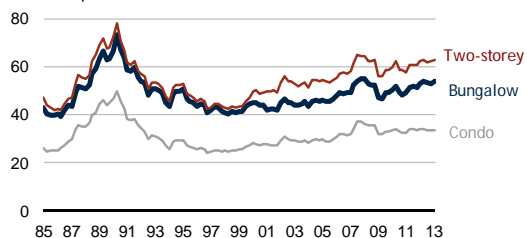


Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

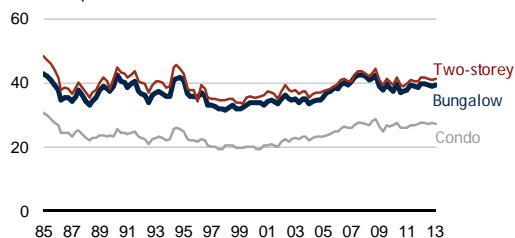
Toronto

Ownership costs as % of household income



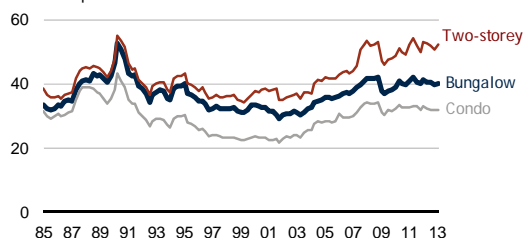
Ottawa

Ownership costs as % of household income



Montreal

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

Toronto – No market rout in the making but affordability still eroding slightly

Developments to date in 2013 should ease concerns that the cooling in activity that began last year in the Toronto-area market might morph into an all-out rout. Home resales increased modestly in the first quarter of 2013 from the fourth quarter of 2012. This rise in demand took place at a time when fewer homes were newly listed for sale, thereby tightening market conditions slightly. This tightening provided some support to home prices, which had come under some downward pressure in the latter half of 2012. The flipside of this market strengthening, however, is that it led to further modest erosion in housing affordability. RBC's affordability measures for the area rose in all categories in the first quarter of 2013: by 0.8 percentage points for bungalows, 0.3 percentage points for two-storey homes and 0.2 percentage points for condominium apartments. Owning a single-family home at today's prices in the Toronto area is a stretch for local homebuyers (the RBC measures for bungalows and two-storey homes are well above their long-term averages); however, condo ownership exerts less financial stress.

Ottawa – Market continuing to soften

The Ottawa-area market continued to soften somewhat in the early months of 2013. Home resales fell for a fifth consecutive quarter, as among other worries, buyers still appeared uncertain about public sector job prospects. Meanwhile, new listings rose for the fourth time in the past five quarters. These diverging trends between demand and supply drove down the sales-to-new-listings ratio in the area to its lowest level (0.46) since mid-1998 in the first quarter. While still indicating a balanced market, the ratio implies that buyers hold increasing sway in the price-setting process. Indeed, home prices have been at close to a standstill recently. At the margin, housing affordability may be a factor straining some Ottawa homebuyers because it remains slightly worse than it has been historically. RBC's affordability measures were little changed in the first quarter, inching higher by 0.1 percentage points for bungalows and 0.2 percentage points for two-storey homes, while easing by 0.1 percentage points for condominium apartments.

Montreal – Affordability not the best but activity slide may be over

Montreal-area activity remained significantly (almost 19%) below year-ago levels in the first quarter of 2013; however, some signs emerged in more recent months that the slide may be over. Home resales rose modestly on a month-to-month basis in both March and April, and home prices gained steadily so far this year. Nonetheless, the market still faces challenges. Among them will be the record-high number of housing units (18,000) under construction (85% are condo apartments). There is the risk that this boom could fuel a jump in the number of homes offered for sale and disturb the balance currently prevailing in the resale market. Housing affordability is not the best in the Montreal area and owning a two-storey home, in particular, would be stretching a local homebuyer's budget at current market prices. Affordability deteriorated for all categories in the first quarter, with RBC's measures rising by 1.5 percentage points for two-storey homes, 0.6 percentage points for bungalows and 0.1 percentage points for condominium apartments.

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 (\$) Q1 2013	RBC Housing Affordability Measure			
	Q1 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q1 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	366,500	0.8	1.5	77,700	42.5	0.3	-0.6	39.0
British Columbia	601,700	-0.5	-4.4	115,500	65.9	-0.4	-4.1	50.2
Alberta	362,000	1.1	4.1	75,900	32.2	0.2	-0.6	35.1
Saskatchewan	342,200	-2.3	4.1	73,500	38.1	-1.0	0.1	36.4
Manitoba	309,000	2.1	9.6	68,100	38.9	0.8	1.8	35.9
Ontario	395,800	1.6	4.1	85,500	43.5	0.4	0.4	40.4
Quebec	238,300	0.6	-0.6	53,300	33.3	0.4	-1.2	32.7
Atlantic	220,400	1.6	4.3	52,600	32.6	0.6	0.4	31.6
Toronto	556,600	2.0	4.9	113,300	53.8	0.8	0.9	48.7
Montreal	294,500	1.7	0.6	63,900	40.1	0.6	-1.0	36.8
Vancouver	786,300	0.5	-5.6	147,300	82.3	0.1	-6.3	59.8
Ottawa	389,800	0.7	0.8	88,400	39.1	0.1	-0.5	36.8
Calgary	451,800	2.5	6.8	89,500	38.7	0.8	0.2	39.1
Edmonton	330,000	-0.8	2.2	71,900	30.4	-0.2	-0.9	33.1

Standard two-storey

Region	Average Price			Qualifying Income (\$) Q1 2013	RBC Housing Affordability Measure			
	Q1 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q1 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	410,800	0.0	1.7	87,800	48.0	0.0	-0.7	43.4
British Columbia	648,400	-1.7	-3.1	125,100	71.3	-1.3	-3.6	55.4
Alberta	381,200	0.6	2.3	81,700	34.7	0.2	-1.2	37.6
Saskatchewan	363,200	-4.2	6.9	79,500	41.2	-1.7	0.9	37.8
Manitoba	302,000	-0.3	3.3	67,700	38.7	0.2	0.2	36.8
Ontario	447,800	1.2	4.1	97,200	49.5	0.4	0.5	44.1
Quebec	297,500	-0.4	1.1	66,100	41.3	0.1	-1.0	38.7
Atlantic	240,300	1.0	0.1	59,500	36.9	0.5	-0.6	37.9
Toronto	644,700	0.7	4.3	132,100	62.7	0.3	0.7	54.3
Montreal	390,600	3.5	1.4	83,100	52.1	1.5	-1.0	42.1
Vancouver	829,800	-0.4	-4.1	156,200	87.2	-0.6	-5.5	65.1
Ottawa	397,400	0.5	0.9	92,500	41.0	0.2	-0.4	39.1
Calgary	439,800	1.2	5.2	89,700	38.8	0.4	-0.4	39.6
Edmonton	370,800	0.5	-0.2	81,300	34.4	0.2	-1.7	36.3

Standard condominium

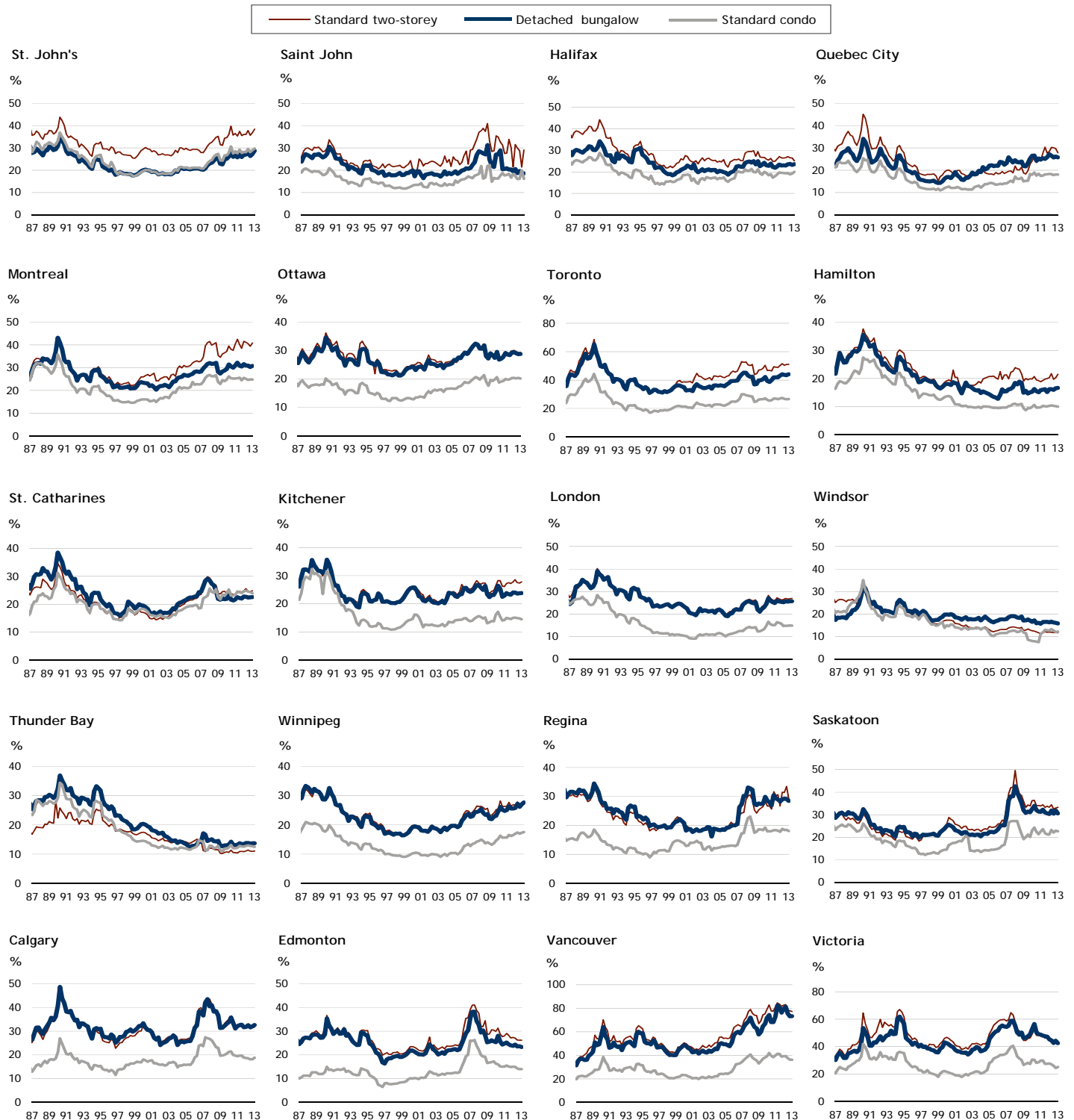
Region	Average Price			Qualifying Income (\$) Q1 2013	RBC Housing Affordability Measure			
	Q1 2013 (\$)	Q/Q % ch.	Y/Y % ch.		Q1 2013 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	236,900	-0.3	0.0	51,300	28.1	0.0	-0.7	27.0
British Columbia	295,500	0.6	-5.1	58,700	33.4	0.0	-2.3	28.4
Alberta	217,300	1.9	2.4	46,700	19.8	0.2	-0.7	21.6
Saskatchewan	238,000	-0.4	8.1	51,200	26.5	-0.3	0.8	24.3
Manitoba	195,800	1.1	5.5	42,700	24.4	0.4	0.5	21.3
Ontario	259,000	0.1	0.3	57,300	29.2	0.0	-0.5	27.7
Quebec	195,800	-3.6	-0.6	43,200	27.0	-0.6	-0.9	27.5
Atlantic	187,000	1.4	5.7	43,400	26.9	0.4	0.6	24.4
Toronto	336,000	1.0	1.1	70,600	33.5	0.2	-0.5	31.4
Montreal	237,100	-0.1	0.3	50,900	32.0	0.1	-0.8	29.4
Vancouver	388,100	-0.2	-5.5	74,500	41.6	-0.2	-3.1	32.9
Ottawa	273,400	-0.4	1.9	61,500	27.2	-0.1	-0.2	23.7
Calgary	260,800	4.3	5.1	53,000	22.9	0.8	-0.3	22.6
Edmonton	198,800	0.8	-2.6	44,000	18.6	0.1	-1.4	18.0

* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Economics Research

Mortgage carrying costs by city

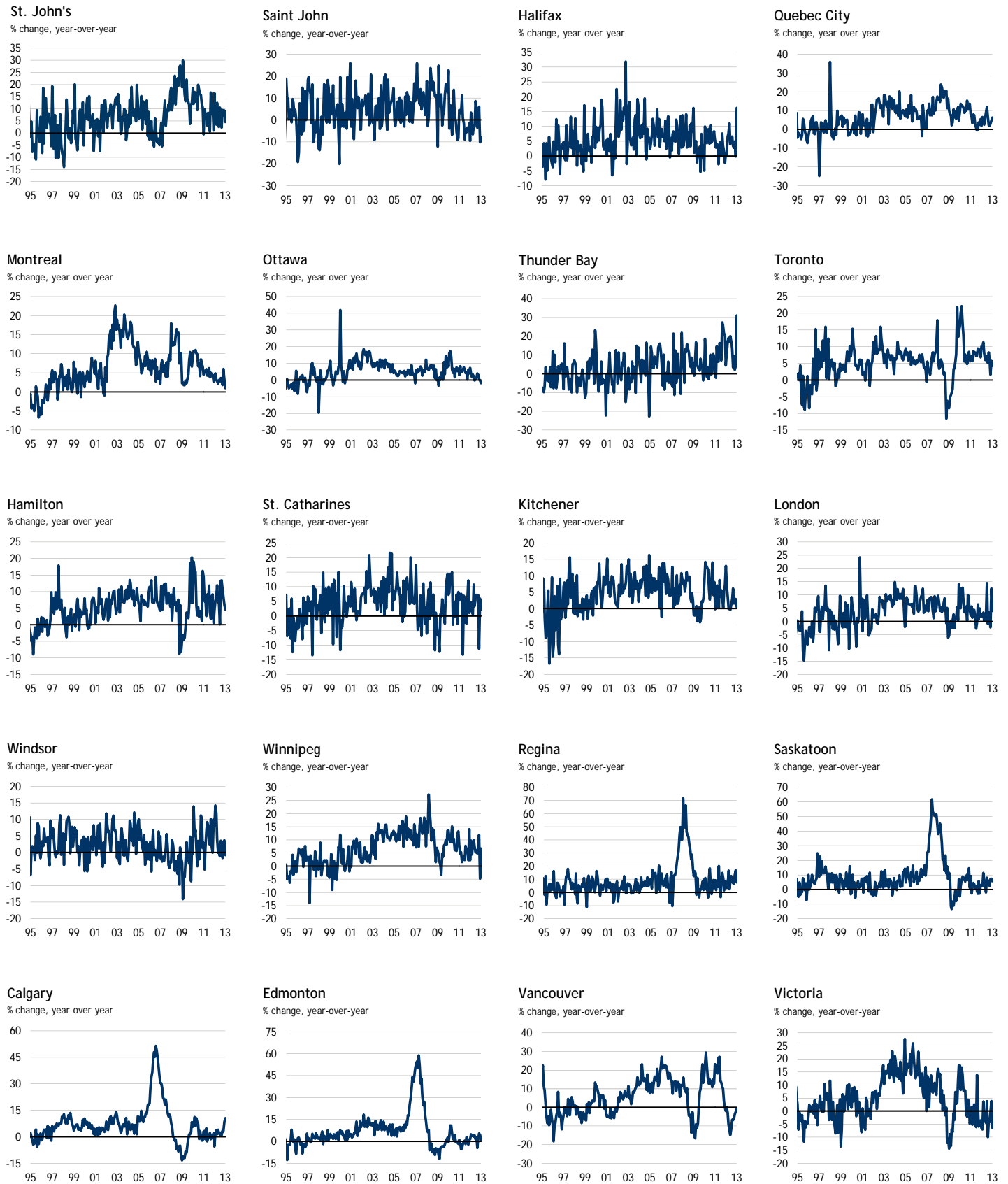
Our standard RBC Housing Affordability Measure captures the proportion of median pre-tax household income required to service the cost of a mortgage on an existing housing unit at going market prices, including principal and interest, property taxes and utilities; the modified measure used here includes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



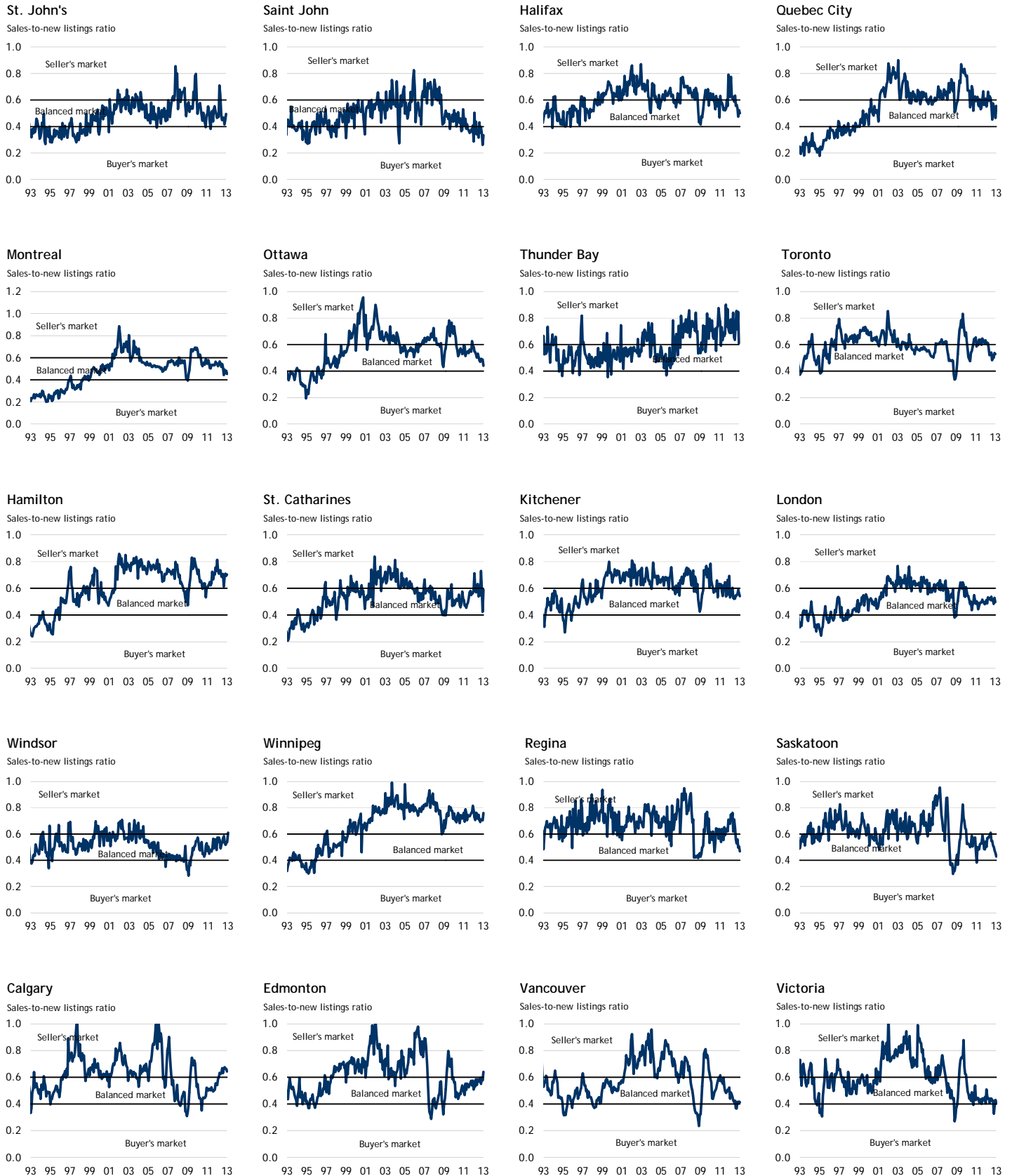
Average price of homes sold on the MLS system



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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