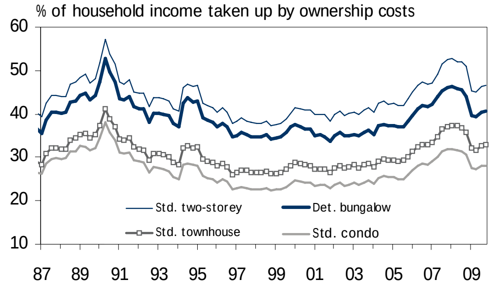
Market overview

Affordability - Canada

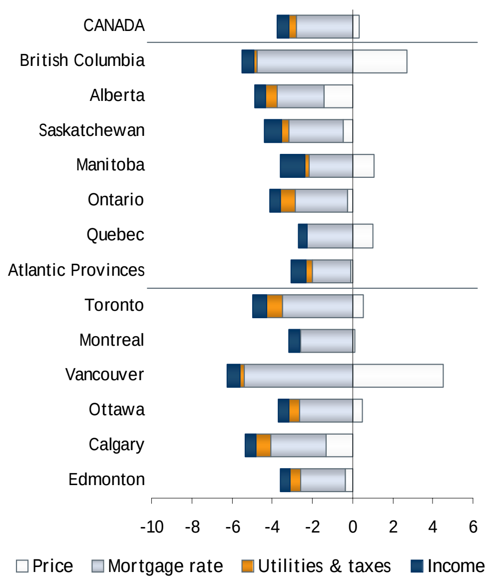
% of household income taken up by ownership costs



Source: Statistics Canada, Royal LePage, RBC Economics Research

Factors contributing to the change in affordability

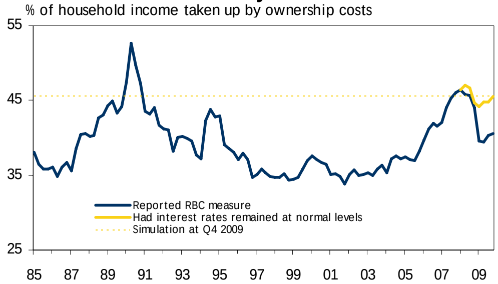
Percentage point change from a year ago (detached bungalow)



Source: Statistics Canada, Royal LePage, RBC Economics Research

Affordability* - Canada

% of household income taken up by ownership costs



* Based on the purchase of a typical detached bungalow.

Source: Statistics Canada, Royal LePage, RBC Economics Research

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HOUSING TRENDS AND AFFORDABILITY

March 2010

Affordability erodes mildly in fourth quarter

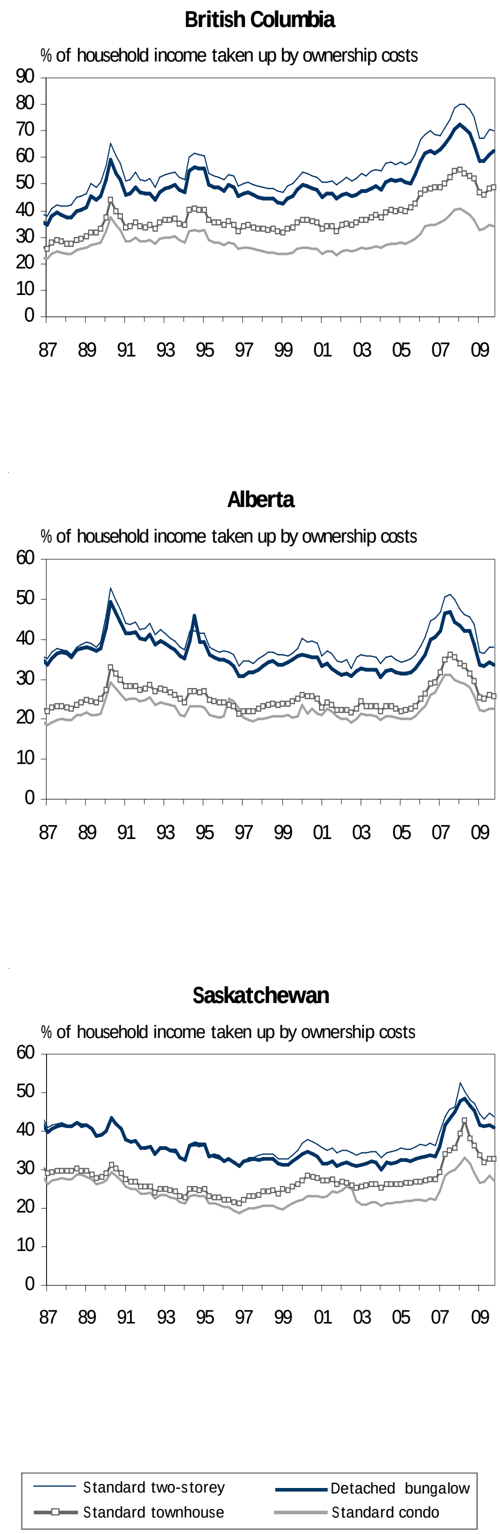
Red-hot home resale activity and strong price rises across Canada made it more difficult to own a home for a typical household in the fourth quarter of 2009; however, concerns that housing affordability would come off the rails did not materialize. RBC's affordability measures generally eroded only modestly in the closing months of 2009. At the national level, the measures increased between 0.1 and 0.3 percentage points, depending on the housing type (a rise in the measure represents a deterioration in affordability). These fairly small increases contrasted with much larger ones registered in the third quarter, when a rise in mortgage rates exacerbated the effect of strong housing price increases. Except for detached bungalows, the pace of price appreciation was steady or moderated slightly in the fourth quarter of 2009. The effect on affordability was further tempered by a small decline in mortgage rates and continued gains in household income.

There were notably divergent swings at the provincial level. Affordability deteriorated significantly in British Columbia (particularly for bungalows and townhouses) and Quebec (two-storey homes and bungalows). Levels in British Columbia are now causing some worries. In Manitoba, most RBC measures rose moderately. At the same time, there was a further, substantial improvement in Saskatchewan and, to a lesser extent, Alberta (for most housing types). The Atlantic region also had some modest improvement. In Ontario, affordability was either flat or eroded marginally.

While the broad affordability picture at the national level did not fall apart in the fourth quarter of 2009, it, nonetheless, has become abundantly clear that it is once again set on an eroding path. One reason is the effect of the uptrend in prices, which is likely to continue to raise the bar on homeownership costs. Prices are bid higher due to very tight supply of available properties relative to demand – the latter fuelled by exceptionally low interest rates. Brisk demand is likely to be sustained in the near term by anticipation of an interest rate hiking campaign by the Bank of Canada – to start mid-year according to our forecast – enticing buyers to jump into the game to lock in lower rates. In Ontario and British Columbia, demand for housing should also receive a further boost this spring from buyers rushing in 'to beat' the implementation of the HST on July 1, 2010 – which will increase the transaction costs associated with a home purchase. Most affected will be new, high-priced housing, where the tax will apply to the purchase price and not be fully offset by rebates.

Potentially acting to restrain near-term demand will be the changes, which are aimed at preventing a market bubble from forming in Canada, announced in mid-February by federal Finance Minister, Jim Flaherty. These changes set stricter qualifying criteria for variable rate mortgages, lower upper limits on mortgage refinancing and higher down payment requirements for properties purchased as investments. While the precise market effect is unknown at this point, the new rules (kicking in on April 19, 2010) could exert some moderating influence on activity, at least at the margin.

RBC housing affordability measures



Sources: Statistics Canada, Royal LePage, RBC Economics Research

The other key reason to expect further deterioration in affordability going forward is the anticipated rise in interest rates. The significant drop in mortgage rates since late 2008 contributed to most of the improvement in affordability in the past year – accounting for three-quarters to four-fifths of the year-over-year decline in RBC measures in the fourth quarter of 2009 at the national level. Had rates remained at 'normal' levels (defined as long-term average real rates reflated by the current core inflation rate), RBC measures would be very close to the recent cyclical peaks reached in the first half of 2008 – i.e., the poorest levels since the early 1990s. The eventual reversal of such abnormally low mortgage rates, thus, will put some stress on affordability levels. The extent of the deterioration will depend on the speed at which rates will rise. On that score, the pace of increase should be fairly steady throughout 2010 and 2011, helping to alleviate concerns of an imminent derailing of housing affordability in Canada. We believe that the most probable scenario is for a gradual deterioration through the interest rate's 're-normalization' period.

British Columbia — Heat returns...melting away affordability

The heat is back on for the B.C. housing market and is undoing some of the significant improvement in affordability that took place during most of 2008 and early 2009. The combination of surging demand and, until recently, scarce supply of homes available for sale has led to substantial price increases in the province's large urban centres in the past two quarters, making it less affordable to own a home in the province. In the fourth quarter of 2009, RBC measures rose 1.0 percentage point for detached bungalows and 0.8 percentage points for standard townhouses. The measures eased by 0.2 percentage points for both standard two-storey homes and condominiums; however, this follows particularly large increases in the third quarter of 2009. While still below their recent cyclical peaks, all RBC measures stand well above long-term averages. Such poor affordability levels represent an element of risk that could weigh heavily on markets when interest rates start rising.

Alberta — Affordability remains in check

The upside to Alberta's market recovery running behind recoveries in other regions of the country is that affordability in the province remains in check. The substantial excess supply that resulted from the housing downturn in the province has taken longer than elsewhere to clear, holding back upward price momentum during the market upturn. In turn, this has contributed to stabilized housing affordability at generally favourable levels. In the fourth quarter of 2009, all RBC affordability measures in Alberta inched slightly lower – by magnitudes ranging from -0.4 percentage points (for bungalows and townhouses) to -0.1 percentage points (for condominiums). The levels for bungalows (33.7%) and two-storey homes (37.9%) remained below their respective long-term averages, while those for townhouses (25.8%) and condominiums (22.5%) were just marginally above their respective averages.

Saskatchewan — Market gearing down a little

The big bounce in resale activity that took place during the spring and summer of 2009 in Saskatchewan showed signs of letting up late in the year, just as more properties were listed for sale. This put a damper on price increases recently, which allowed affordability to improve further in the province. In the fourth quarter of 2009, RBC measures fell between 0.1 and 1.1 percentage points (for condominiums and townhouses, respectively), in most cases extending the sharp declining trends since about the middle of 2008. Nonetheless, the cost of home-ownership remains historically high in Saskatchewan, with the unprecedented surge from late-2006 to early-2008 only partly reversed. This might not be cause for concern, however, considering that housing prices that prevailed prior to the boom were likely depressed by unfavourable migration flows, which have since turned around.

Manitoba — No undue stress apparent yet

The pace of Manitoba's market activity picked up considerably late in 2009. This added pressure on housing prices, which had been progressively building since early in 2008. For housing types, such as condominiums and two-storey homes, price gains were quite solid in the fourth quarter of 2009, causing affordability levels to erode in the province. RBC measures rose for three of the four categories that we track, with only detached bungalows (down 0.5 percentage points) showing a decline. The condominium measure moved up 0.6 percentage points, two-storey homes climbed by 0.5 percentage points and townhouses by 0.2 percentage points. Despite some deterioration last quarter, however, affordability levels remain in line with long-term averages. This suggests that the price increases to date have not put undue stress on Manitoba households. Still, the likelihood of further solid price increases in the face of continued market tightness could create greater tensions this year.

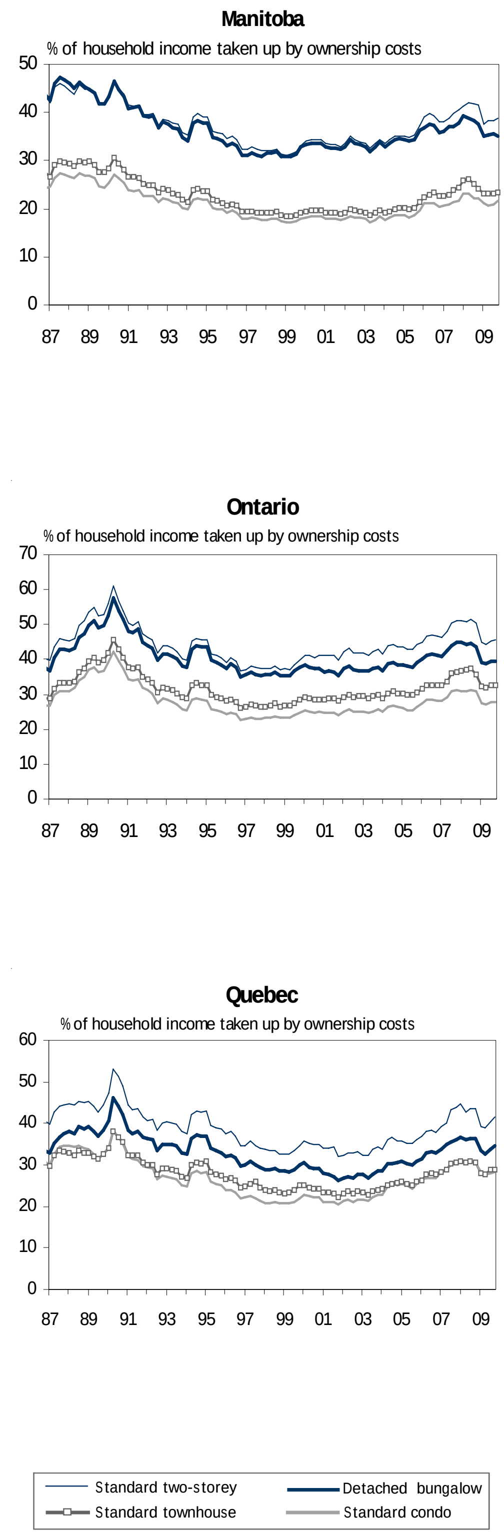
Ontario — Hot…but not overly so

The Ontario housing market has staged a remarkable turnaround in the past year. Whereas a year ago, there were concerns that the market would collapse the way the U.S. market did. More recent worries have been at the opposite end of the spectrum – that possibly excessive demand is heating things up too much. To be sure, resale activity has more than fully recovered from the losses during last year's downturn, lately reaching record levels. Prices also have rebounded to new heights for most housing categories, yet this renewed vigour has caused only moderate damage to overall housing affordability in the province. After rising for the first time in roughly a year during the third quarter of 2009, RBC measures remained stable or edged slightly higher in the fourth quarter of 2009 – with townhouses and condominiums showing no change, and bungalows and two-storey homes rising only 0.1 and 0.2 percentage points, respectively. The small decline in mortgage rates and continued growth in household income largely neutralized the effect of higher prices, keeping affordability close to long-term averages.

Quebec — Spirited rally lives on

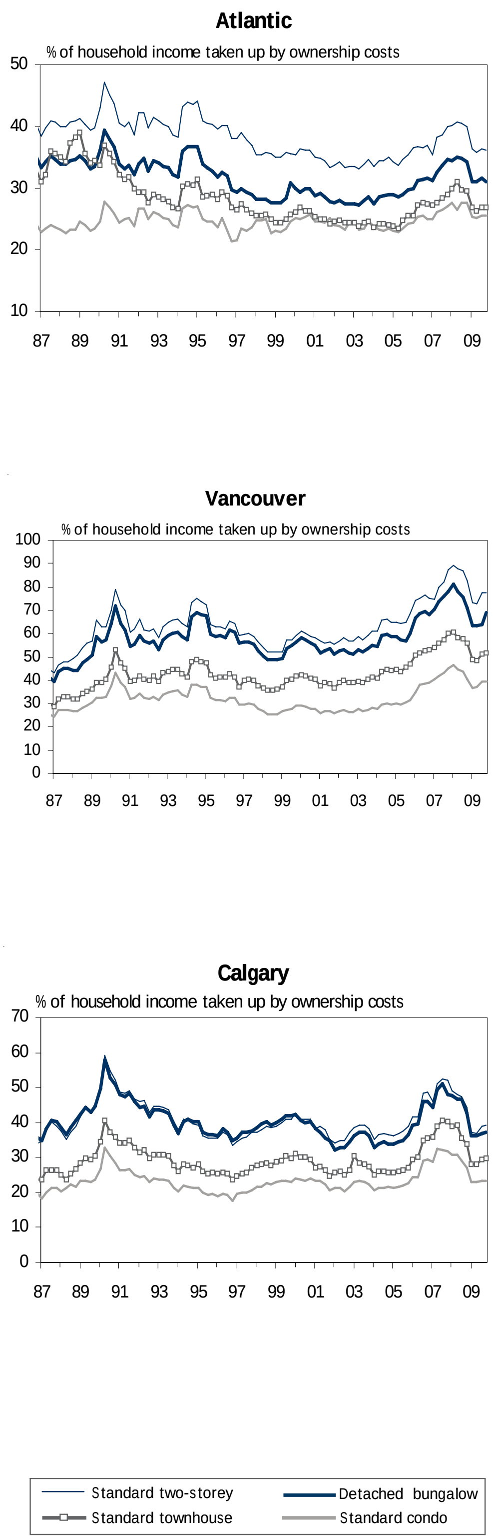
The spirited rally in resale activity in Quebec has shown few signs of running out of breath, recently surpassing all previous records and intensifying upward pressure on prices. What little ground that was lost in property values during the downturn has been easily recovered, and gains have shown some acceleration lately. Prices for most housing categories in Quebec rose substantially in the fourth quarter of 2009, causing some of the sharper deteriorations in affordability among provinces. This was particularly the case for two-storey homes and bungalows, where RBC measures rose 1.1 percentage points and 0.8 percentage points, respectively. The erosion was less pronounced for townhouses (up 0.2 percent-

RBC housing affordability measures



Sources: Statistics Canada, Royal LePage, RBC Economics Research

RBC housing affordability measures



Sources: Statistics Canada, Royal LePage, RBC Economics Research

age points) and condominiums (up 0.4 percentage points). All of the Quebec measures now exceed their long-term averages. It is interesting to note that much of the provincial market strength is found in areas such as Quebec City and other cities outside of the Montreal region.

Atlantic — Costs of homeownership still contained

In contrast with several other regions of the country, housing affordability generally improved in Atlantic Canada in the fourth quarter of 2009. RBC measures moved down in most housing categories, declining by 0.6 percentage points for bungalows, 0.3 percentage points for two-storey homes and 0.1 percentage point for condominiums. The measure for townhouses remained unchanged. Overall, housing price increases have been subdued in the region in recent months. Large markets within the region appear to be reasonably balanced or tilted slightly in favour of sellers, which is consistent with moderate price appreciation. This general tone of moderation should keep affordability at attractive levels in the region – all measures were below long-term averages in the fourth quarter of 2009, except for condominiums. In turn, this should support continued brisk activity in the resale market, especially in spots such as St. John's, which have been on a roll for some time.

Metro markets

Vancouver — Uncomfortably hot

The Greater Vancouver Area is easily Canada's hottest housing market, and the pressure is becoming increasingly uncomfortable. Resale activity in the area recently set new all-time highs, and prices have now all but fully reversed their slides during 2008 and early 2009. With prices back around record-high levels, already poor affordability has suffered further. In the fourth quarter of 2009, this was most evident in the bungalows category, where RBC measures rose by an outsized 1.4 percentage points. The measures for townhouses and condominiums also moved higher by 0.5 and 0.4 percentage points, respectively; however, two-storey homes improved marginally (down 0.1 percentage point). Affordability levels are significantly worse than long-term averages in the area, suggesting that buyers are stretching their budgets thin. This might eventually threaten the market rally, especially when other factors such as the HST and rising mortgage rates exert a greater influence.

Calgary — Bumpy road

The road to recovery in Calgary's housing market has bumps. After surging from the 14-year low reached in late 2008 to early 2009, the pace of resale activity slowed last summer and then went into reverse since the fall. Prices have maintained an upward trajectory (at least through to the end of last year) thanks to continued low availability of homes for sale providing a slight advantage to sellers; however, price gains have been relatively modest and recent levels remain well below the peaks reached in the middle of 2007. Affordability continues to be attractive in the city with RBC measures at or below long-term averages (with the exception being the townhouse category which stands a little above average). In the fourth quarter 2009, the measures rose modestly across the board, edging up by 0.1 percentage point for bungalows and condominiums, 0.3 percentage points for two-storey homes and 0.5 percentage points for townhouses.

Toronto — Full-steam ahead

The powerful rebound in the Greater Toronto Area market carries on with a full head of steam. Very strong demand continues to dominate, lifting sales of existing homes to all-time highs in recent months, yet keen buyer interest has largely failed to attract more sellers, resulting in a dearth of homes available for sale. The properties that are put on the market, however, move fast, frequently being the object of bidding wars. This has contributed to prices in the area generally reaching record-high levels. The flipside of steeper prices is an attendant erosion of affordability. All RBC measures rose for the second-straight time in the fourth quarter of 2009 – up 0.1 percentage point for bungalows and townhouses, 0.2 percentage points for condominiums and 0.3 percentage points for two-storey homes. Affordability levels have now moved above long-term averages in the area – significantly so in the case of two-storey homes – confirming that stress is starting to build in the Toronto market.

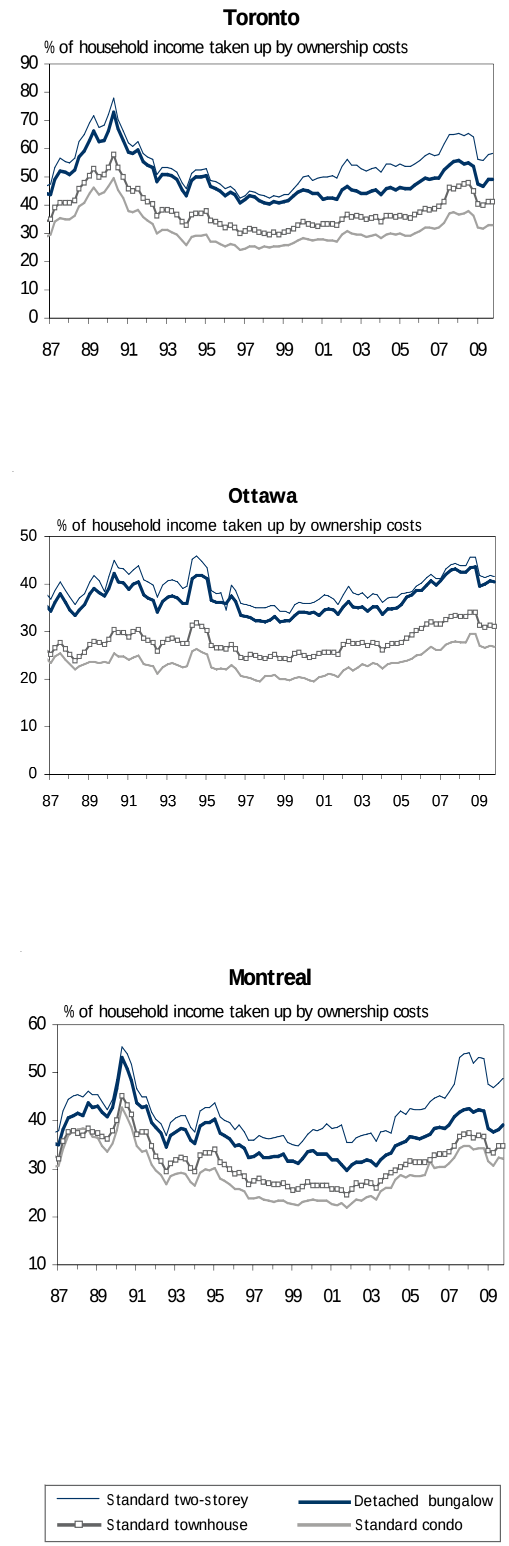
Ottawa — Best of both worlds

The Ottawa market seems to be enjoying the best of both worlds lately: experiencing strong activity and improving affordability at the same time. On one side, home resales have hovered at levels just below all-time highs in recent months, fuelled by buyers taking advantage of exceptionally low mortgage rates. On the other side, a generally restrained pace of price appreciation has contributed to slightly lower costs of homeownership in the area. In the fourth quarter of 2009, RBC measures edged down for all housing categories, declining between 0.1 and 0.4 percentage points. The restraint in pricing might be a reflection of some push back from buyers in light of the fact that, despite the small improvement in the fourth quarter, ownership costs remain historically elevated relative to household incomes in Ottawa. All RBC measures are above their long-term averages.

Montreal — On record pace

Since early fall of 2009, the Montreal area market has been setting new records on a regular basis. Eager buyers have not let some recent erosion in affordability get in the way of making the leap into homeownership and have driven up sales of existing homes to the highest ever tallies each month since September 2009. With so many homes finding takers, the pool of properties available for sale has shrunk markedly, handing pricing power to sellers. Consequently, prices, which had shown much resilience during the downturn, have found their way to new heights in recent months. In the fourth quarter of 2009, gains were especially strong for two-storey homes and bungalows. Incidentally, these are the housing types for which affordability deteriorated in the Montreal area. RBC measures jumped 1.0 and 0.9 percentage points for two-storey homes and bungalows, respectively, in the fourth quarter of 2009. The measures for townhouses and condominiums eased slightly, down 0.1 and 0.2 percentage points, respectively, although this came on the heels of hefty increases in the third quarter of 2009.

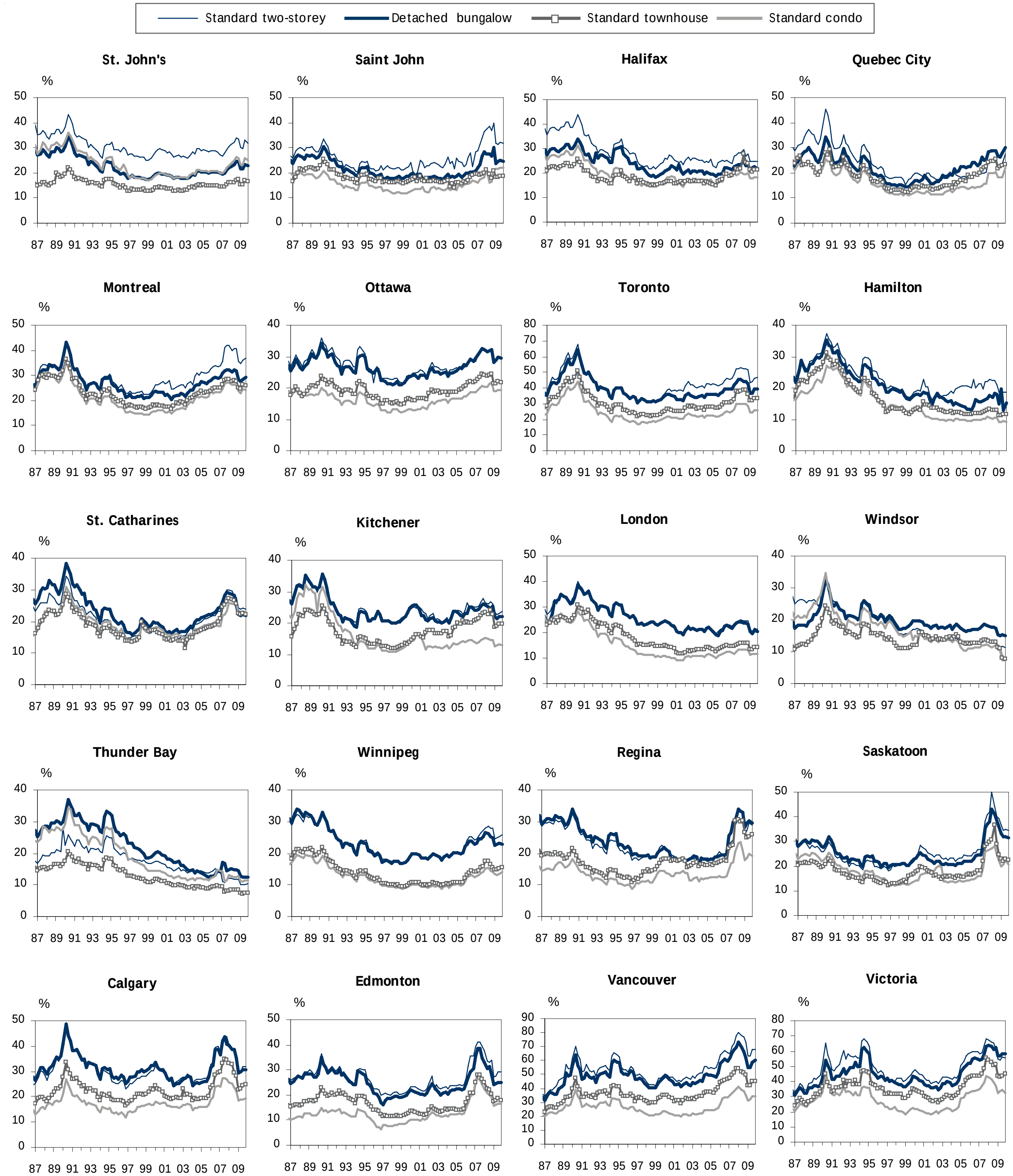
RBC housing affordability measures



Sources: Statistics Canada, Royal LePage, RBC Economics Research

Mortgage carrying costs by city

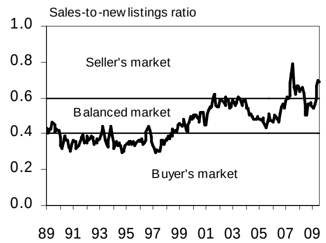
Our standard housing affordability measure captures the proportion of median pre-tax household income required to service the cost of a mortgage on an existing housing unit at the going market price, including principal and interest, property taxes and utilities; the modified measure used here includes the cost of servicing a mortgage, but excludes property taxes and utilities due to data constraints in the smaller CMAs. This measure is based on a 25% down payment and 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.



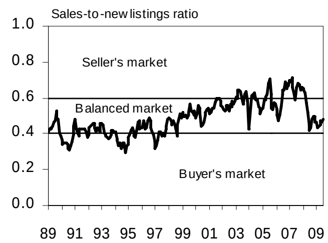
Source: Statistics Canada, Royal LePage, RBC Economics Research

Resale housing market conditions in Canada's metro cities

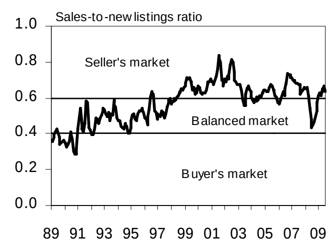
St. John's



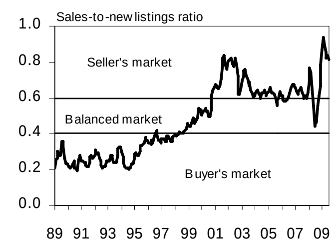
Saint John



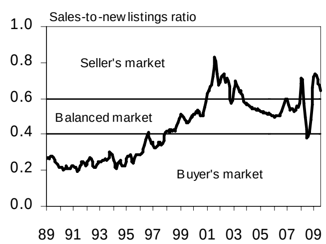
Halifax



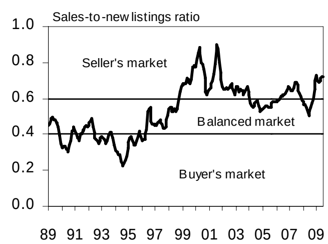
Quebec City



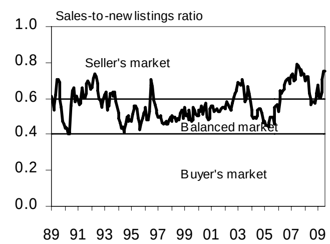
Montreal



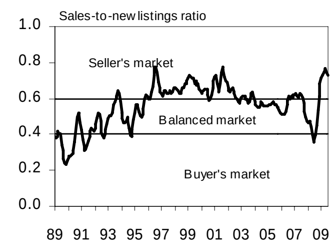
Ottawa



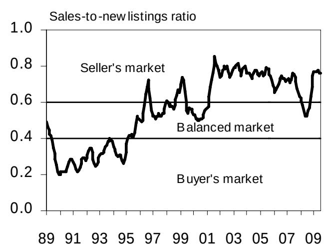
Thunder Bay



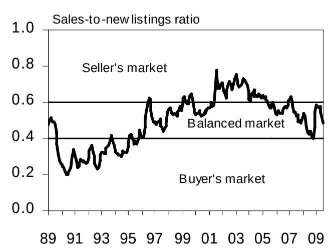
Toronto



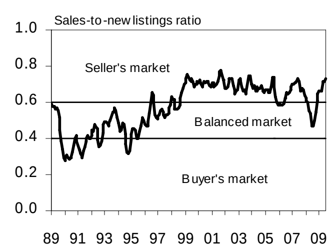
Hamilton



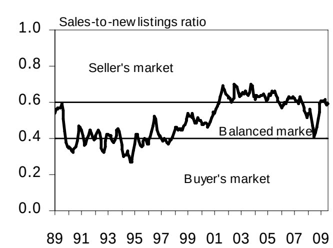
St. Catharines



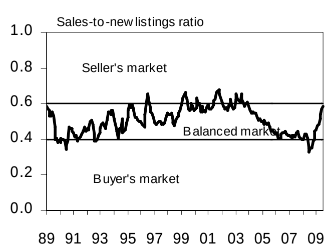
Kitchener



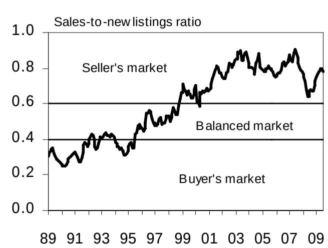
London



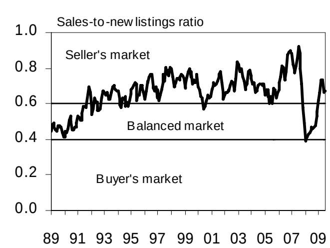
Windsor



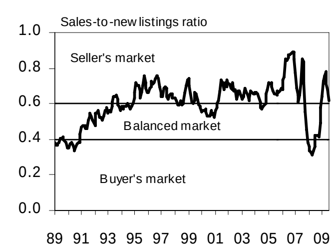
Winnipeg



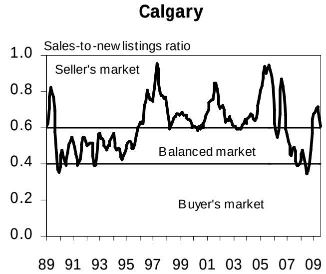
Regina



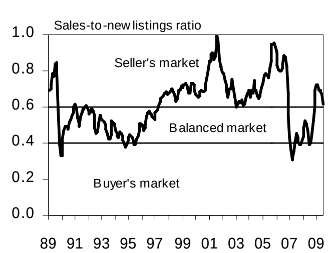
Saskatoon



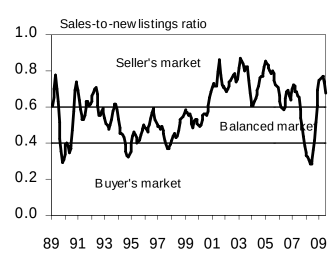
Calgary



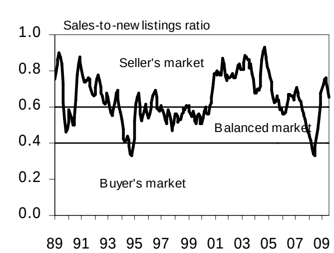
Edmonton



Vancouver



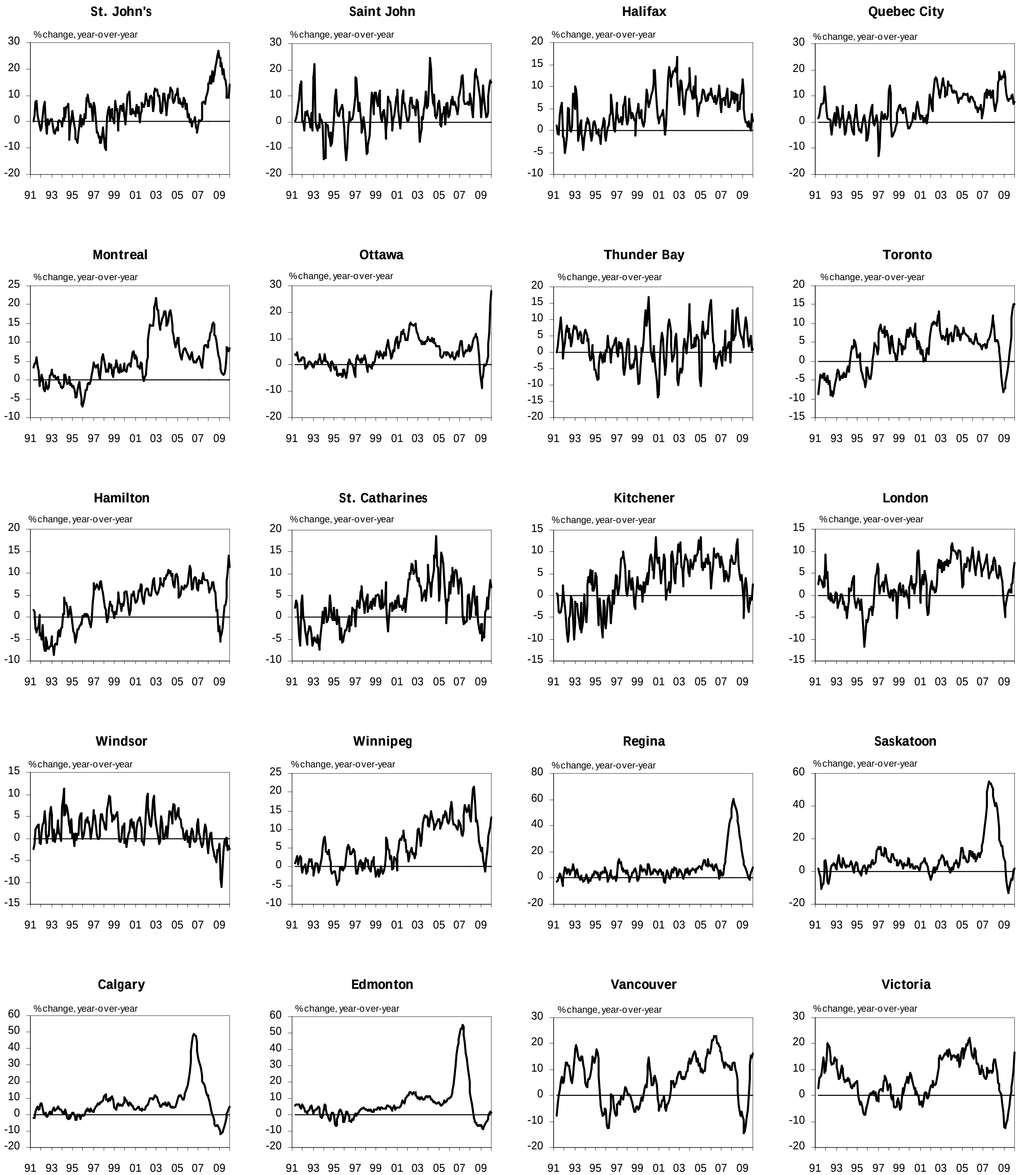
Victoria



Sales-to-listings ratios are based on a three-month moving average.

Source: Canadian Real Estate Association, RBC Economics Research

House prices in Canada's metro cities



House prices are based on a three-month moving average.

Source: Canadian Real Estate Association, RBC Economics Research

Housing affordability summary tables

Detached bungalow

Region	Average Price Q4 2009 ($)	Y/Y % ch.	Qualifying Income ($) Q4 2009	Affordability Measure Q4 2009 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	310,800	5.4	70,300	40.6	0.3	-3.4	39.2
British Columbia	518,000	9.5	104,900	62.3	1.0	-2.8	49.1
Alberta	333,600	-0.4	74,300	33.7	-0.4	-4.9	36.4
Saskatchewan	296,900	3.1	68,700	40.8	-0.7	-4.5	36.4
Manitoba	230,500	8.9	58,100	35.0	-0.5	-2.6	37.2
Ontario	323,500	3.7	75,100	39.5	0.1	-4.2	40.5
Quebec	209,600	8.4	50,100	34.5	0.8	-1.7	33.1
Atlantic	189,000	4.1	47,700	31.1	-0.6	-3.1	32.1
Toronto	452,800	5.8	98,500	49.1	0.1	-4.5	48.5
Montreal	249,600	4.8	58,400	39.1	0.9	-3.0	36.9
Vancouver	635,800	12.1	126,000	69.0	1.4	-1.7	57.1
Ottawa	342,100	6.0	81,200	40.4	-0.3	-3.2	37.1
Calgary	412,500	0.5	86,500	37.1	0.1	-5.5	40.0
Edmonton	309,000	3.0	71,300	32.9	-0.4	-3.6	34.1

Standard two-storey

Region	Average Price Q4 2009 ($)	Y/Y % ch.	Qualifying Income ($) Q4 2009	Affordability Measure Q4 2009 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	355,500	4.8	80,900	46.7	0.3	-4.2	43.5
British Columbia	583,700	6.1	118,100	70.2	-0.2	-5.2	54.4
Alberta	370,900	-1.2	83,600	37.9	-0.2	-5.8	39.0
Saskatchewan	309,500	6.6	73,600	43.7	-0.8	-3.6	37.8
Manitoba	260,300	9.9	64,400	38.8	0.5	-2.6	38.1
Ontario	372,900	4.1	86,700	45.6	0.2	-4.7	44.0
Quebec	249,900	8.1	60,100	41.4	1.1	-2.1	39.0
Atlantic	214,000	3.2	55,400	36.1	-0.3	-3.8	38.7
Toronto	537,300	4.6	117,100	58.4	0.3	-5.9	53.7
Montreal	315,700	4.0	73,000	48.9	1.0	-4.2	41.6
Vancouver	716,000	7.3	141,600	77.5	-0.1	-5.1	62.4
Ottawa	338,000	3.4	83,400	41.5	-0.4	-4.2	39.5
Calgary	427,100	2.3	91,300	39.2	0.3	-5.2	40.5
Edmonton	364,900	-0.3	83,900	38.7	-0.2	-5.4	37.3

Standard townhouse

Region	Average Price Q4 2009 ($)	Y/Y % ch.	Qualifying Income ($) Q4 2009	Affordability Measure Q4 2009 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	251,600	5.4	56,900	32.9	0.2	-2.8	30.6
British Columbia	407,900	7.3	82,300	48.9	0.8	-3.1	36.8
Alberta	256,500	-0.2	57,000	25.8	-0.4	-3.8	25.4
Saskatchewan	234,000	3.2	55,100	32.7	-0.1	-3.5	27.6
Manitoba	153,700	16.3	38,800	23.4	0.2	-0.6	23.1
Ontario	267,800	4.7	61,900	32.6	0.0	-3.2	31.4
Quebec	173,900	7.4	42,100	29.0	0.2	-1.6	28.1
Atlantic	166,600	4.2	41,200	26.9	0.0	-2.7	29.0
Toronto	385,400	6.5	83,100	41.4	0.1	-3.6	37.8
Montreal	222,900	7.8	51,800	34.7	-0.1	-1.9	31.8
Vancouver	476,300	5.6	94,500	51.7	0.5	-4.2	41.9
Ottawa	252,300	3.5	62,500	31.1	-0.2	-3.0	28.0
Calgary	332,400	2.3	69,500	29.8	0.5	-3.9	28.9
Edmonton	221,100	-0.3	51,400	23.7	-1.1	-3.3	23.1

Standard condominium

Region	Average Price Q4 2009 ($)	Y/Y % ch.	Qualifying Income ($) Q4 2009	Affordability Measure Q4 2009 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	211,600	4.5	48,500	28.0	0.1	-2.5	27.0
British Columbia	278,500	7.5	57,600	34.2	-0.2	-2.2	28.2
Alberta	222,100	0.1	49,700	22.5	-0.1	-3.3	22.4
Saskatchewan	195,100	9.1	45,900	27.3	-1.1	-1.7	24.3
Manitoba	141,600	17.0	35,700	21.5	0.6	-0.5	21.3
Ontario	223,500	2.9	52,500	27.7	0.0	-3.1	27.9
Quebec	176,100	5.1	41,200	28.4	0.4	-2.1	27.0
Atlantic	159,400	6.8	39,100	25.5	-0.1	-2.1	24.7
Toronto	300,600	4.6	66,300	33.0	0.2	-3.4	31.3
Montreal	209,000	5.9	47,900	32.0	-0.2	-2.3	29.2
Vancouver	362,700	12.4	72,400	39.6	0.4	-1.0	31.7
Ottawa	225,100	3.9	54,000	26.9	-0.1	-2.6	23.7
Calgary	256,100	-0.4	54,500	23.4	0.1	-3.7	23.1
Edmonton	207,200	1.4	47,500	21.9	0.2	-2.8	18.4

* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Economics Research

How RBC's housing affordability measures work

RBC Economics Research's housing affordability measures show the proportion of median pre-tax household income required to service the cost of mortgage payments (principal and interest), property taxes and utilities on a detached bungalow, a standard two-storey home, a standard town house and a standard condo (excluding maintenance fees).

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 town house 1,000 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 and 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 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 lie an equal number of observations.)

The housing affordability measure is based on gross household income estimates and, therefore, does not show the impact of various provincial property tax credits, which can 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).