HOUSING TRENDS AND AFFORDABILITY

March 2012

Housing affordability in Canada improved in the fourth quarter of 2011

Owning a home became more affordable in this country for the second consecutive quarter in the fourth quarter of 2011. The improvement in affordability was modest for the most part but substantial enough to dial back the deterioration that occurred last spring. In the fourth quarter, homebuyers benefited from some softening in home prices—modest declines were registered in several markets—and income gains, which together lightened the load on homeowners budgets of carrying a home financially (based on the market price). Contrary to previous quarters, steady mortgage rates in the closing months of 2011 were a negligible factor behind the latest movement in affordability.

Affordability of two-storey homes improved the most

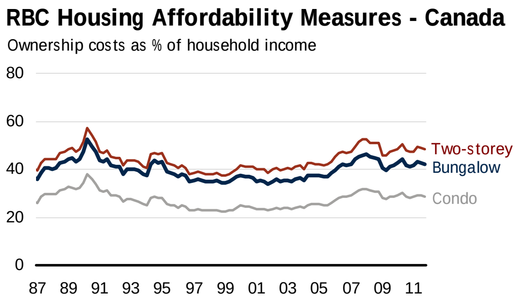
At the national level, it was the two-storey home category that showed the biggest improvement in the fourth quarter of 2011. The RBC Housing Affordability Measure for this category fell by 0.8 percentage points to 48.1% (a decline represents an improvement in affordability). The measure for detached bungalows eased by 0.6 percentage points to 42.2% and the measure for condominium apartments by 0.5 percentage points to 28.5%. As was the case in the previous quarter, events in the Vancouver area market did not have a disproportionate effect on national totals. The affordability deterioration that occurred in the first half of last year reflected in large part dramatic increases in homeownership costs in Metro Vancouver. The partial unwinding of these increases since then has been more closely in line with developments elsewhere in the country.

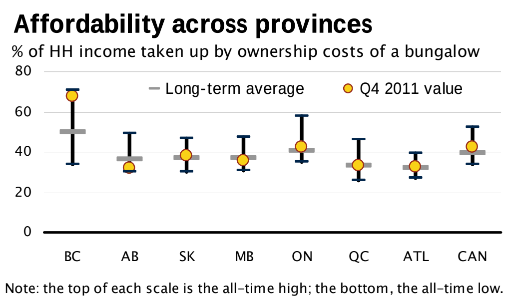
Vancouver continued to reverse some of the earlier sizable deterioration

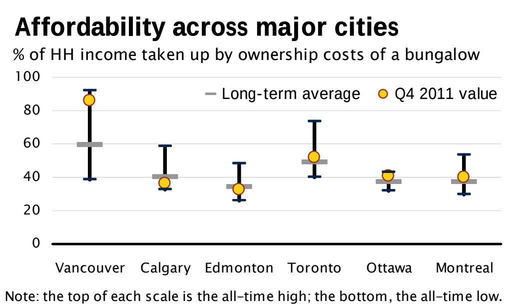
Nearly all provinces and major urban markets experienced a decline in the weight of homeownership costs in the fourth quarter, led by British Columbia and, more specifically, Vancouver. Only Manitoba (in the two-storey and condo segments), Saskatchewan (two-storey), and Ottawa (condo) bucked the trend and showed some erosion of affordability.

Modest affordability stress at the moment

For the majority of markets across Canada, the level of affordability is now close to where it was a year ago (within 1 or 2 percentage points) and to the long-run average. Consequently, there is generally, at worst, only modest affordability stress being exerted on housing demand in Canada at the moment. Despite the improvement in the latter half of last year, Vancouver continues to be a major exception to this. The proportion of a typical Vancouver household income that would be allocated to cover the costs of owning a home at market







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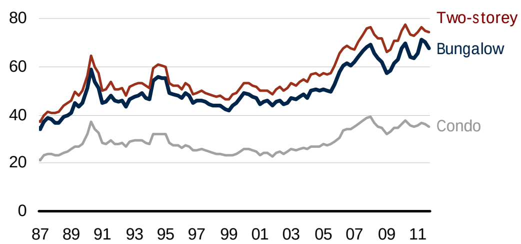
RBC Housing Affordability Measures

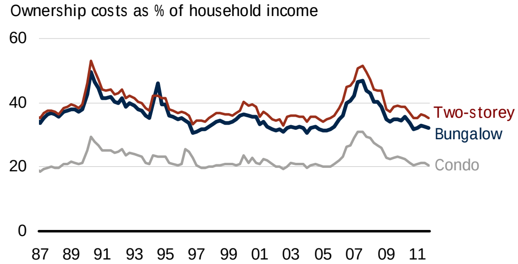
British Columbia

Ownership costs as % of household income



Alberta

Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

prices is still extremely high in this market and no doubt represents a difficult hurdle to clear for local homebuyers. As an indication of this, home resales in the area have moderated below their 10-year average since spring last year, which we largely ascribe to poor affordability. Some affordability challenges are also apparent in Toronto, Montreal, and, to some extent, Ottawa—but they are confined to the two-storey home segment and do not appear to be hampering housing demand in these markets at this point.

Low interest rates to continue to keep housing costs at bay

Despite historically elevated home prices in many parts of Canada, exceptionally low interest rates are keeping housing affordability within a tolerable range. We see few reasons for this to change in 2012. We expect interest rates to remain very low, with the Bank of Canada leaving its overnight rate unchanged until early next year and then raising it only gradually thereafter. We also expect that home prices will stabilize— most markets are showing minimal increases with some experiencing modest declines—amid generally balanced market conditions. These factors will set the stage for flat to marginally improving trends in affordability in Canada in 2012.

Provincial overviews

British Columbia — High homeownership costs ease some more

Housing affordability remains poor in British Columbia, but it improved for the second consecutive time in the final quarter of 2011. The provincial market registered the most significant reduction in homeownership costs among the provinces, with the RBC affordability measures falling between 0.7 and 2.5 percentage points. The main contributing factor for the improvement was a further reversal in the earlier substantial increases in home prices—principally in the Vancouver area. Income gains reflecting higher wages and steady job creation also provided help. The easing of homeownership costs in the latter half of 2011 has reduced some of the stress on B.C. homebuyers albeit marginally. We expect that poor affordability will continue to weigh on local housing demand in the period ahead.

Alberta — Attractive affordability unable to spur buyer interest

Alberta homebuyers were hesitant to pull the trigger in the fourth quarter of 2011, but it was not about lack of affordability or job prospects. Home resales growth slowed noticeably in the Alberta market in the final three months of 2011, yet the affordability of owning a home in the province became even more attractive. Price declines in all housing categories contributed to pulling the RBC affordability measures down by 0.5 to 0.7 percentage points and to their lowest or second-lowest points since 2005. While slowing a little from the third quarter, job creation remained quite robust in Alberta. We believe that the strong labour market—the total employment gain in 2011 (99,000) was the best on records dating back to the mid-1970s—and attractive affordability will work to dissipate any hesitation on the part of Albertan homebuyers in 2012.

Saskatchewan — Current affordability levels not holding anyone back

The affordability of most housing types in Saskatchewan improved for the second consecutive quarter in the fourth quarter. The RBC affordability measures fell by 0.3 percentage points for condominium apartments and by 0.4 percentage points for detached bungalows. The measure for two-storey homes went the opposite way, rising by 0.3 percentage points. Where an improvement was registered, it brought the level of affordability quite close to its long-run average, although even the two-storey measure still stood only modestly above its historical norm. Affordability, therefore, is unlikely to be a factor restraining Saskatchewan homebuyers at this point. Indeed, they were very active in the fourth quarter, with resales surging nearly 9% from the third quarter to their highest levels in almost four years. Strong economic growth will continue to benefit Saskatchewan's housing market in 2012.

Manitoba — Bucking the improvement trend

Manitoba was the only provincial market showing a slight deterioration in affordability in the fourth quarter. Strong housing demand in Manitoba in the second half of last year tightened market conditions in the province and gave way to price increases, particularly for two-storey homes and condominium apartments. Market activity was especially brisk in Winnipeg where existing home sales reached record levels in the fourth quarter. The RBC affordability measures rose by 0.2 percentage points for condominium apartments and by 0.5 percentage points for two-storey homes, whereas the measure for detached bungalows remained flat. Despite this slight erosion, affordability levels in Manitoba are very close to long-run averages, which still indicate little in the way of undue pressure being applied on the province's homebuyers.

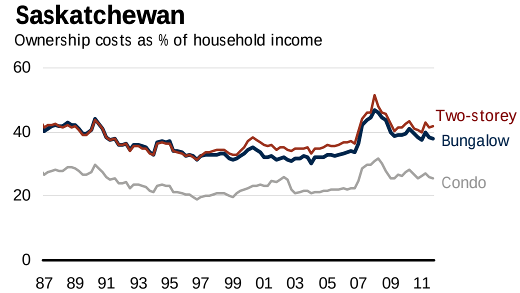
Ontario — Not suffering from any affordability strain at the moment

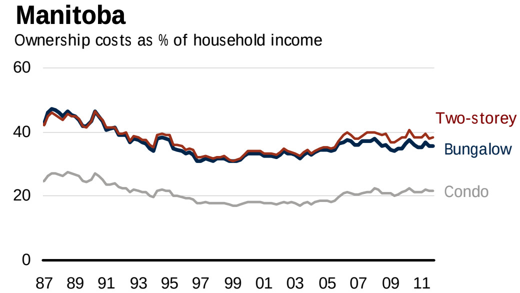
It became a little easier to own a home in Ontario in the latest period, but homebuyers in the province still would have had to allocate a slightly higher than average proportion of their income to cover homeownership costs. The RBC affordability measures for all housing categories in Ontario fell modestly between 0.2 and 0.3 percentage points in the fourth quarter. This improvement reversed only part of the notable deterioration in the first half of last year so that levels remained slightly above long-term averages, particularly in the two-storey home segment. Nevertheless, there continues to be few signs of strain in the Ontario market due to any lack of affordability. Home resales advanced at a good clip in the fourth quarter, and the tight availability of supply increasingly gave the upper hand in pricing to sellers.

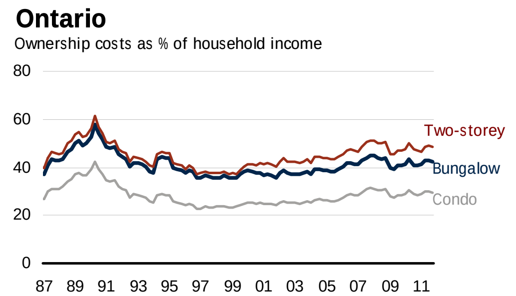
Quebec — In the neutral zone

Housing affordability in Quebec stands in the neutral zone. In the fourth quarter, the RBC affordability measures for the province either equalled their long-run average or, in the case of the two-storey home category, came very close to them. There was broad-based improvement in the latest period, with

RBC Housing Affordability Measures



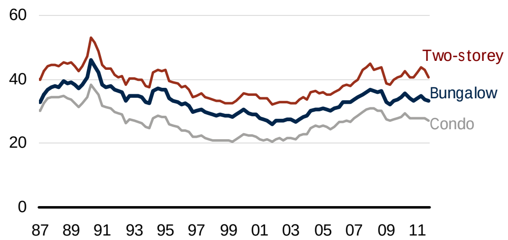




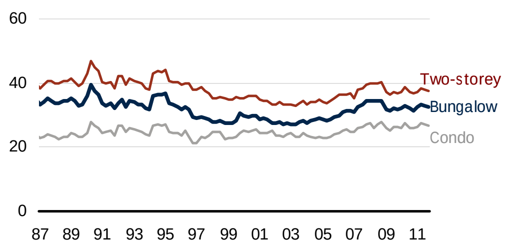
Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures

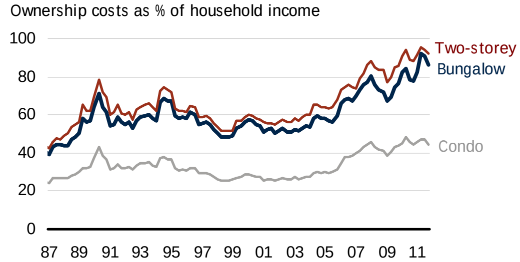
Quebec
Ownership costs as % of household income



Atlantic Provinces
Ownership costs as % of household income



Vancouver
Ownership costs as % of household income



Source: Statistics Canada, Royal LePage, RBC Economics Research

the RBC affordability measures declining modestly for detached bungalows and condominium apartments (by 0.2 and 0.5 percentage points, respectively) but more substantially for two-storey homes (by 2.6 percentage points). The drop in the latter category reversed the notable deterioration that took place in the first half of last year, which will move it off the list of potential concerns. With affordability firmly neutral, home resale activity bounced back quite strongly in the final quarter of 2011 following a lull earlier in the year. Balanced market conditions will keep the Quebec market reasonably stable in the period ahead.

Atlantic —2011 ended on a positive note

Atlantic Canada's housing market ended 2011 the same way it ended 2010—on a generally positive note. In both years, resale activity picked up considerably in the closing quarter of the year and affordability recorded back-to-back improvements. Moreover, in both years, affordability levels stood close to long-run averages and compared favourably against the majority of regions of Canada. In the fourth quarter of 2011, RBC affordability measures eased 0.2 to 0.3 percentage points across all housing categories in the region. Strength in resales was clearly evident in the Halifax area, possibly reflecting a burst of optimism following the announcement of the $25 billion federal government frigate order. St. John's also saw a surge in housing activity late in the year. While most markets in the Atlantic region are balanced, Halifax has moved closer to a sellers' market, and Saint John remains a buyers' market.

Major city markets

Vancouver — A few more steps in the affordability direction

Unaffordability has long been a fact of life in the Vancouver housing market. What raised considerable concerns in the past few years has been the speed at which affordability deteriorated, reaching in the spring of 2011 the worst levels ever recorded in the annals of Canadian real estate. While a host of factors (many of them unique to Vancouver) conspired to catapult residential property values in the area, the market was at increasing risks of losing touch with local reality. Such risks have begun to recede a bit in the past two quarters, however. Home prices have moderated since reaching all-time highs early last year, and this has helped to lower homeownership costs in the latter half of 2011. In the fourth quarter, the RBC affordability measures dropped quite substantially for all housing types (by between 2.0 and 4.6 percentage points). Nevertheless, owning a home at current prices would still take up a huge chunk (86% in the case of a bungalow) of a typical household budget. The ownership bar thus remains extremely high in the Vancouver area market, and this will continue to drive local buyers away.

Calgary — Soon turning a corner?

Despite being one of the more affordable housing markets in Canada and enjoying an economic renaissance, the Calgary area has been unable to sustain any meaningful momentum in home resales last year. After showing an encouraging start, Calgary home resales stayed mostly flat for the rest of the year, ending with a marginal quarterly decline in the fourth quarter. The lacklustre performance was surprising given the strength in the area's labour market—31,000 net new jobs were created in 2011 (a 4.4% increase)—and that housing affordability was the best it has been in the last six years. In the fourth quarter, the RBC affordability measures fell for all housing categories, with declines ranging between 0.2 and 0.7 percentage points, to levels well below long-run averages for the most part. Strong market fundamentals will help the Calgary market turn a corner in the period ahead.

Toronto — Affordability still slightly on the difficult side

Housing affordability continues to be slightly on the difficult side in the Toronto-area market, although less so following some improvement in the latest period (the RBC affordability measures eased between 0.1 and 0.5 percentage points). Owning a two-storey home or a detached bungalow at market price in the area still would have taken up a higher than average share of a typical Toronto household income in the fourth quarter (61.3% and 52.2%, respectively), but this did not seem to unnerve homebuyers. Resale activity continued to advance at a brisk pace that even exceeded the availability of homes put up for sale. It is true that this strong activity is increasingly taking place in the more affordable condo segment (now representing about one-quarter of the market), where the affordability measure (33.9%) is still very close to the historical norm. Conditions in the Toronto-area market are slightly more favourable to sellers presently. This will make further affordability improvement difficult in the near term.

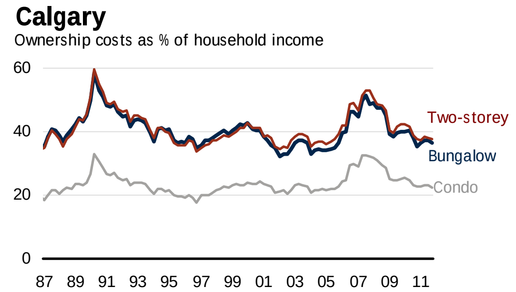
Ottawa — Mixed picture

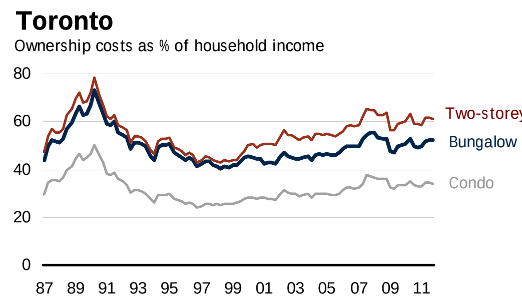
In contrast to Canada's other major urban markets where housing affordability improved across the board, the picture was mixed in the Ottawa area in the final quarter of 2011. Changes in the RBC affordability measures for the area ran the full gamut—the measure for detached bungalows edged lower by 0.1 percentage points, was unchanged for two-storey homes, and rose 0.3 percentage points for condominium apartments. The levels of the RBC affordability measures continue to exceed long-term averages, which suggest to us that some mild affordability strain is likely being exerted on Ottawa-area homebuyers. None of this was evident in the fourth quarter, however, when home resales powered ahead and prices were bid even higher for all housing types, as market conditions made a sharp turn in favour of sellers. It remains to be seen whether such market momentum will be maintained in the period ahead.

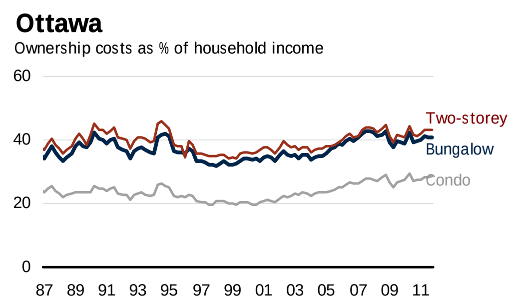
Montreal — Dialling back the earlier deterioration

In the fourth quarter, the Montreal area continued to dial back the earlier substantial deterioration in housing affordability. In fact, the area posted some the bigger improvements in the country for the second consecutive quarter, with the RBC affordability measures falling between 0.7 and 2.0

RBC Housing Affordability Measures

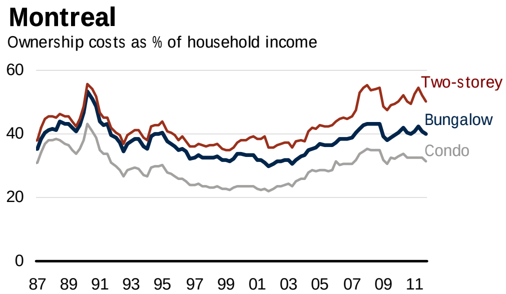






Source: Statistics Canada, Royal LePage, RBC Economics Research

RBC Housing Affordability Measures



Source: Statistics Canada, Royal LePage, RBC Economics Research

percentage points. The Montreal housing market maintained strong momentum in the latter stages of last year, with home resales rising 6.9% in the fourth quarter. This occurred despite a slumping labour market where an astounding 47,000 jobs were lost in the area during the last two quarters of 2011 (representing a decline of 2.4%)—which was worst than any losses during the 2008-2009 recession. Such a slump could weigh on housing demand and market conditions in the near term. Pressure, therefore, will remain for further retracement of the earlier affordability erosion in the Montreal area.

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 lie 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 Q4 2011 ($)	Q/Q % ch.	Y/Y % ch.	Qualifying Income ($) Q4 2011	RBC Housing Affordability Measure Q4 2011 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	349,800	0.2	6.9	76,200	**42.2**	-0.6	1.4	39.4
British Columbia	609,400	-2.1	10.7	117,700	**67.7**	-2.5	4.1	49.7
Alberta	340,600	-0.8	3.9	75,600	**32.1**	-0.5	0.5	36.2
Saskatchewan	326,400	-0.1	3.4	71,900	**37.9**	-0.4	-0.2	36.8
Manitoba	263,900	0.1	3.8	62,200	**35.7**	0.0	0.5	36.9
Ontario	368,600	1.1	7.6	82,900	**42.5**	-0.2	2.0	40.8
Quebec	229,200	2.0	2.7	52,500	**33.3**	-0.2	-0.1	33.1
Atlantic	213,400	1.7	7.0	52,100	**32.6**	-0.3	1.1	32.0
Toronto	515,100	1.4	9.5	108,100	**52.2**	-0.1	3.2	48.9
Montreal	283,300	0.7	4.0	62,800	**40.1**	-0.7	0.3	37.3
Vancouver	790,000	-3.6	15.0	149,000	**86.0**	-4.6	7.9	58.9
Ottawa	374,700	0.7	5.7	87,000	**40.9**	-0.1	1.5	37.2
Calgary	416,600	-1.6	6.2	87,300	**36.7**	-0.7	1.2	40.2
Edmonton	322,900	0.0	3.2	73,500	**32.8**	-0.3	0.3	34.2

Standard two-storey

Region	Average Price Q4 2011 ($)	Q/Q % ch.	Y/Y % ch.	Qualifying Income ($) Q4 2011	RBC Housing Affordability Measure Q4 2011 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	395,500	-0.2	4.8	86,900	**48.1**	-0.8	0.9	43.9
British Columbia	666,800	0.9	5.7	129,200	**74.3**	-0.7	1.6	55.0
Alberta	365,200	-0.9	1.9	83,100	**35.2**	-0.6	0.1	38.9
Saskatchewan	353,800	2.6	8.9	79,200	**41.7**	0.3	1.2	38.3
Manitoba	287,600	2.0	3.5	67,100	**38.5**	0.5	0.4	38.0
Ontario	420,300	1.1	5.5	94,900	**48.7**	-0.2	1.6	44.6
Quebec	279,000	-5.3	2.9	63,900	**40.5**	-2.6	-0.1	39.2
Atlantic	238,900	2.0	5.6	60,100	**37.7**	-0.2	1.0	38.4
Toronto	602,000	1.4	5.6	127,100	**61.3**	-0.2	2.0	54.5
Montreal	358,300	-1.9	5.0	78,600	**50.2**	-2.0	0.7	42.4
Vancouver	845,000	-0.3	8.2	159,800	**92.3**	-2.0	3.8	64.3
Ottawa	383,700	1.0	6.7	91,600	**43.1**	0.0	1.8	39.6
Calgary	414,800	0.0	2.2	90,000	**37.8**	-0.2	0.3	40.8
Edmonton	364,800	-2.2	2.5	83,700	**37.4**	-0.9	0.2	37.5

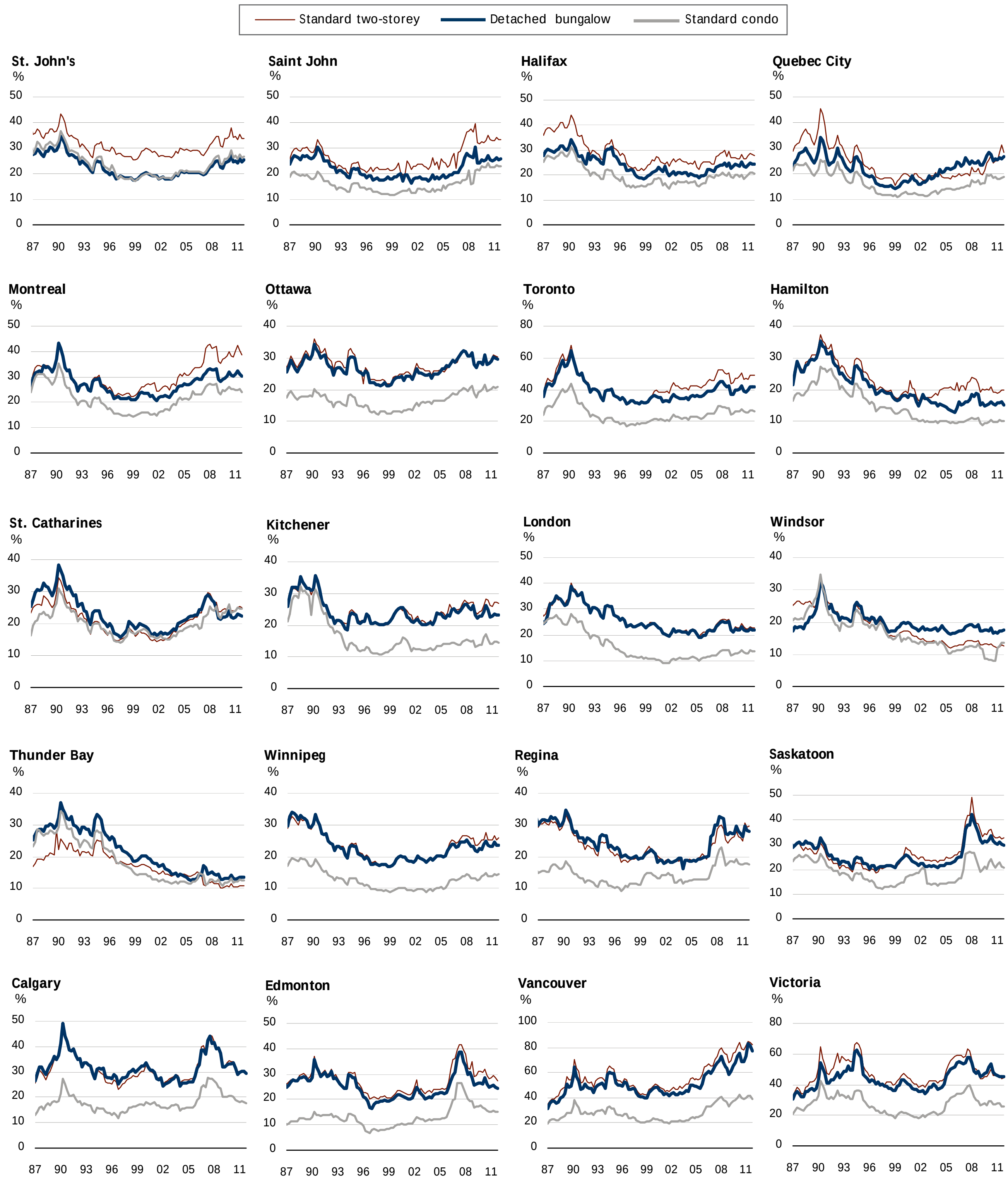
Standard condominium

Region	Average Price Q4 2011 ($)	Q/Q % ch.	Y/Y % ch.	Qualifying Income ($) Q4 2011	RBC Housing Affordability Measure Q4 2011 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	231,800	-0.4	3.6	51,400	**28.5**	-0.5	0.3	27.1
British Columbia	306,000	-2.3	3.4	60,900	**35.0**	-1.3	0.1	28.3
Alberta	212,100	-3.3	0.1	48,300	**20.5**	-0.7	-0.2	22.3
Saskatchewan	217,500	-0.5	4.0	48,500	**25.6**	-0.3	0.0	24.6
Manitoba	160,400	1.7	5.0	37,900	**21.7**	0.2	0.4	21.2
Ontario	252,600	0.3	5.7	57,600	**29.6**	-0.3	1.0	28.1
Quebec	191,000	0.5	0.3	42,900	**27.2**	-0.5	-0.6	27.1
Atlantic	179,900	1.7	6.8	42,700	**26.8**	-0.2	0.9	24.8
Toronto	326,400	-0.1	5.4	70,200	**33.9**	-0.5	1.1	31.6
Montreal	221,800	-2.4	-2.7	49,000	**31.3**	-1.3	-1.4	29.5
Vancouver	403,200	-3.8	4.2	77,500	**44.8**	-2.4	0.4	32.6
Ottawa	262,500	2.2	5.0	60,600	**28.5**	0.3	0.9	23.9
Calgary	248,600	-2.3	0.1	53,700	**22.5**	-0.6	-0.2	23.3
Edmonton	200,500	0.5	3.7	46,400	**20.7**	-0.1	0.3	18.6

* 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.

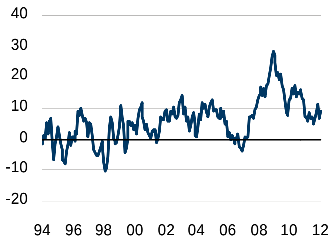


Source: Statistics Canada, Royal LePage, RBC Economics Research

Home prices

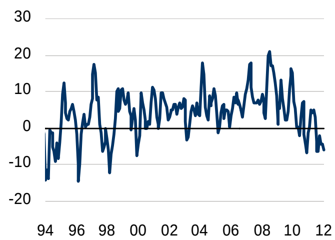
St. John's

%change, year-over-year



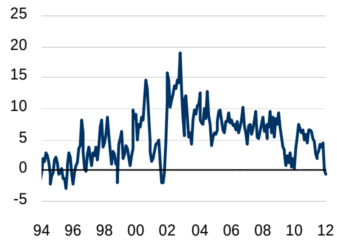
Saint John

%change, year-over-year



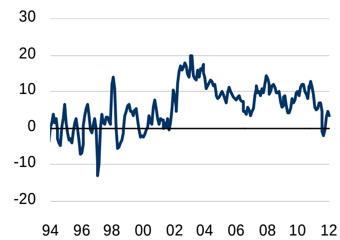
Halifax

%change, year-over-year



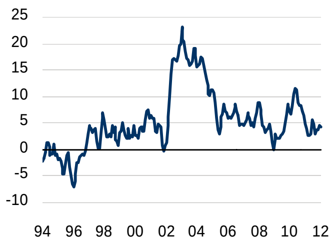
Quebec City

%change, year-over-year



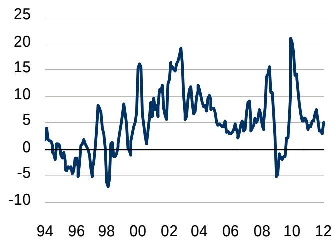
Montreal

%change, year-over-year



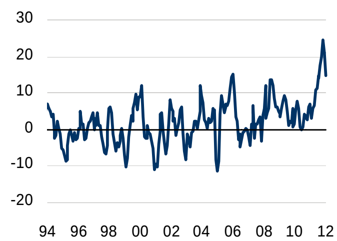
Ottawa

%change, year-over-year



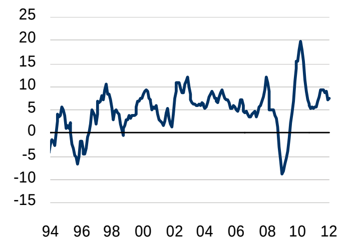
Thunder Bay

%change, year-over-year



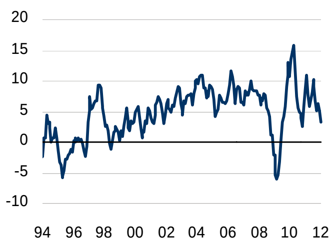
Toronto

%change, year-over-year



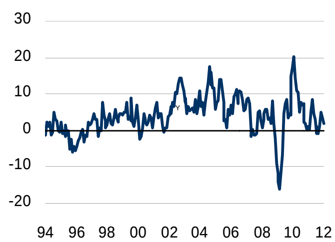
Hamilton

%change, year-over-year



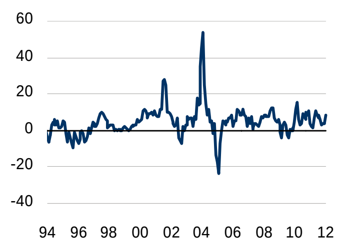
St. Catharines

%change, year-over-year



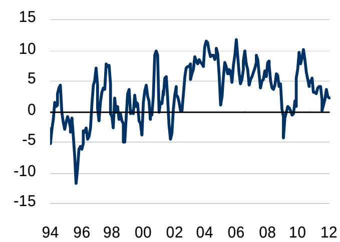
Kitchener

%change, year-over-year



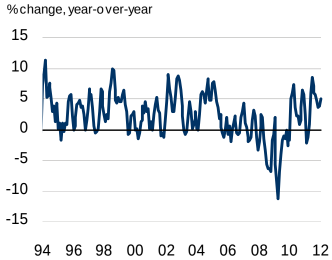
London

%change, year-over-year



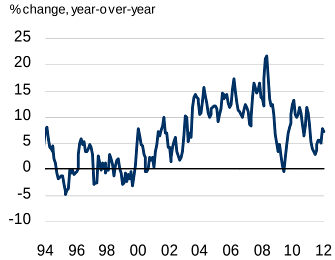
Windsor

%change, year-over-year



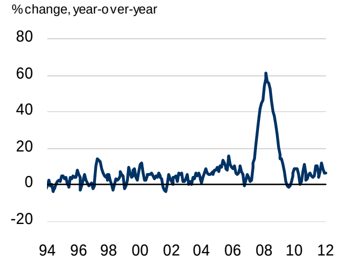
Winnipeg

%change, year-over-year



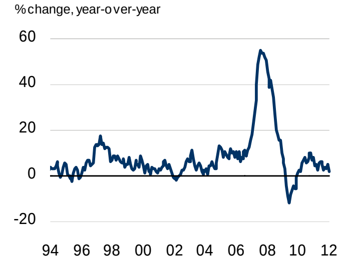
Regina

%change, year-over-year



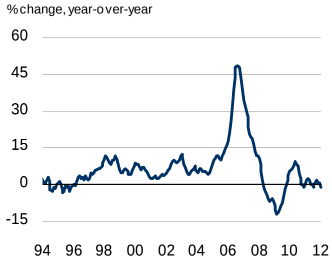
Saskatoon

%change, year-over-year



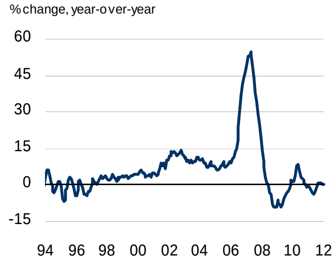
Calgary

%change, year-over-year



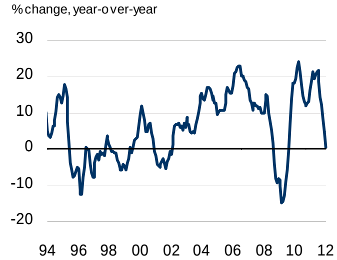
Edmonton

%change, year-over-year



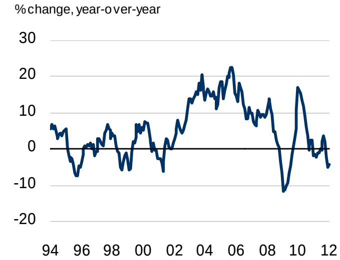
Vancouver

%change, year-over-year



Victoria

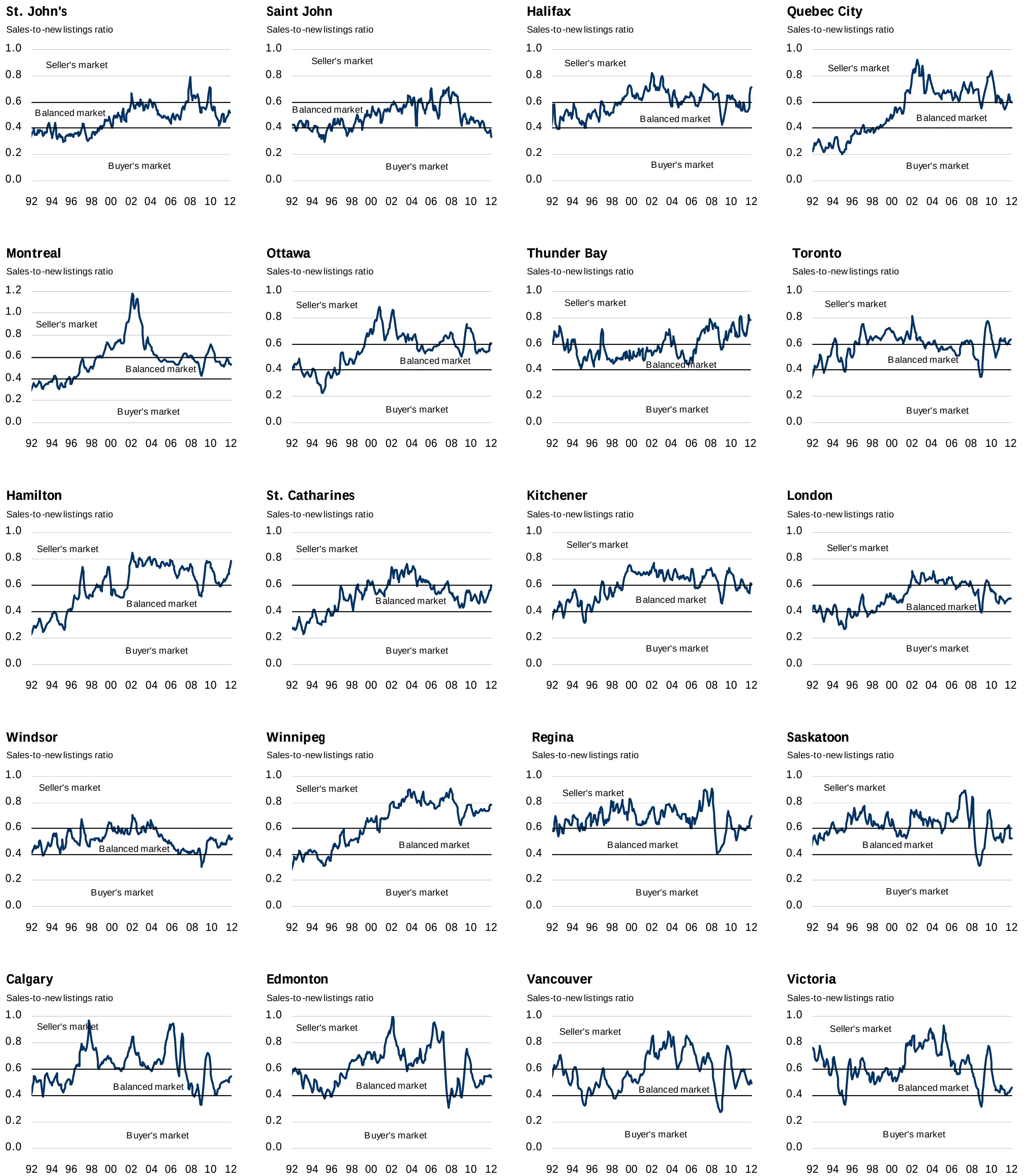
%change, year-over-year



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

Source: Canadian Real Estate Association, RBC Economics Research

Home sales-to-new listings ratio



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

Source: Canadian Real Estate Association, RBC Economics Research