

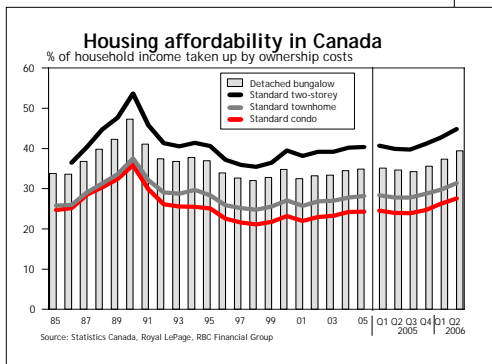


Housing Affordability

Cross-country trends in housing affordability with an overview of provincial and major metropolitan housing markets.

Central Canada's affordability worsens despite cooling prices

September 2006



▲ Overall Canadian housing affordability conditions deteriorated in the second quarter for a third consecutive quarter largely driven by stronger house prices, the weakest pace of growth in household incomes since the first quarter of 2005 and modestly higher interest rates. Nationwide, utilities costs dipped, while property taxes inched upward.

▲ The regional divide intensified this quarter, however, as it became increasingly important to separate trends emerging in the west from those in the rest of the country, particularly central Canada where a clear, controlled housing market slowdown is well under way.

▲ British Columbia's housing markets are on the verge of entering uncharted waters. Affordability has plummeted for three consecutive quarters in every housing segment, with the bungalow and townhome markets setting new records, while condos and standard two-storey homes lie close to 1990 records. Qualifying incomes for a conventional mortgage have surged roughly 50% in the past three years across every segment of Vancouver's market due to sustained double-digit price increases.

▲ Affordability deteriorated in all housing segments in central Canadian markets — except Quebec's condo market where affordability improved as condo prices dipped in the Montreal area. This deterioration was due to higher mortgage rates and utilities costs that outpaced modest income gains except in Ontario's condo market where the deterioration was the result of sharp price increases. House price growth has cooled off markedly in central Canada except in Ontario's condo market.

▲ The sharpest erosions in affordability occurred in Alberta and British Columbia due to double-digit price gains. Alberta's eye-popping price gains, however, still leave it somewhat below past affordability stress points, while housing in Calgary and Edmonton is still more affordable than in Toronto, Montreal and Vancouver relative to incomes.

▲ Saskatchewan and Manitoba also witnessed affordability deteriorations, particularly in Manitoba which has witnessed rapid upward movement in this measure over 2006. Atlantic Canada's eroding housing affordability is being disproportionately driven by Nova Scotia where a listings shortage is sparking price gains in a seller's market.

▲ A look at just the cost of servicing a mortgage shows widespread affordability deterioration in many cities across the country (see charts on page 5).

▲ Mortgage innovation is garnering a great deal of attention in this type of housing market. It is vitally important, however, to understand that there are sound, global drivers to more advanced innovation in many countries and not to misrepresent it as late-cycle improvidence. Indeed, the mortgage market of the future will likely come to be thoroughly unrecognizable.

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Metro markets

Toronto's housing markets cooling down

It has become clear that the Toronto housing market is cooling down, but remains much healthier than past stress points. Housing affordability deteriorated within every segment in the second quarter. Higher interest rates drove a part of this deterioration, while utilities costs remain 12% higher than a year ago partly due to electricity rate hikes that offset some of the drop in natural gas prices. Every category of housing saw price increases in the hot spring and early summer market compared to the previous quarter. The yearly pace of price gains, however, continues to slow to the low single-digits for bungalows and townhomes while condos have reaccelerated their gains to the 10.6% mark over a year ago and prices in the standard two-storey segment are down a touch.

Steady-as-she-goes in Ottawa's housing market

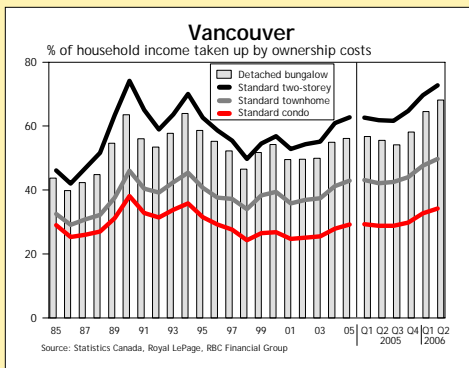
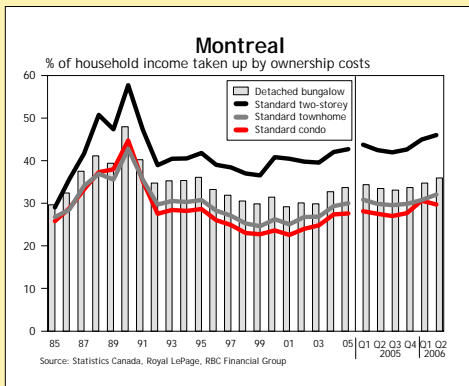
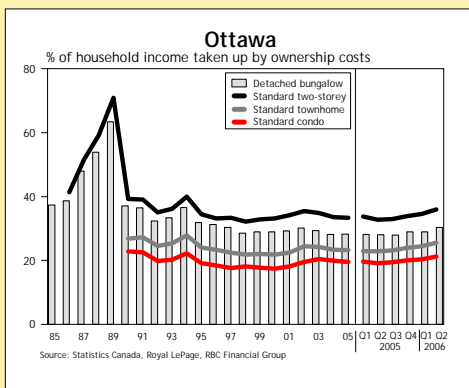
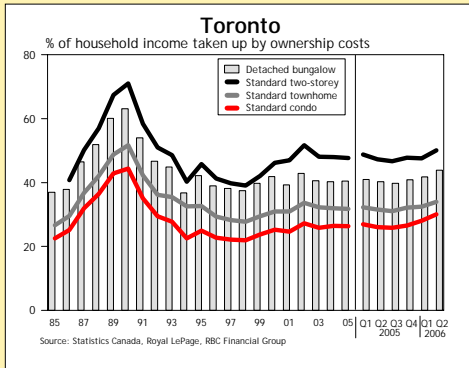
Although housing affordability deteriorated across the board in the second quarter, conditions continue to remain fairly stable with little by way of affordability changes in the past decade. House price gains in Ottawa have been relatively more modest than in other markets in the past few years and have slowed to the 0-5% yearly range in every key housing class. Furthermore, the market is well-balanced between buyers and sellers with a sales-to-listings ratio of 0.6. Income growth has helped to offset the impact of rising mortgage rates, utilities costs and house prices. Except in the standard two-storey segment, qualifying incomes sit comfortably below average household income.

Condos in Montreal more affordable in second quarter

Condos were the only housing segment that finally saw some relief, with affordability actually reporting a mild improvement. Unfortunately for condo owners, it was because of a 6.4% drop in prices compared to the previous quarter. This price drop offset pressures coming from higher interest rates, higher utilities and higher property taxes. All other home segments experienced a deterioration in affordability. Detached bungalows, two-storeys and townhomes are all up only 3-5% in price compared to a year ago, but this gradual slowdown has unfolded during the last two years.

Vancouver's 1990 record-high index reading within sight

The indexes for two of four housing classes — townhomes and bungalows — have now set new all-time record highs while the other two — standard two storeys and condos — lie within sight of new records. Every class of housing witnessed sizeable affordability deteriorations, reinforcing the previous quarter's huge deterioration. A two-storey Vancouver home still leads the country as the most expensive housing option in Canada. The average price for a two-storey crept up to \$563,397 in the second quarter, with house price growth remaining in double-digits (up 16% year-over-year). Although two-storey homes in other key cities have seen a run-up in prices as well, the average cost of a two-storey home in Toronto — the closest behind Vancouver — still trails by a whopping \$120,000. The recommended level of qualifying income required to purchase a two-storey home in Vancouver has climbed almost \$25,000 in just one year, reaching \$124,668 in the second quarter. This steep requirement is almost 2.5 times more than current median household income (\$54,912). Fortunately, new listings on the market have outpaced sales in the first half of the year, adding balance to a very tight market. While this should help soften the pressure for prospective buyers, ultimately the market still remains very much tilted in favour of sellers.



Metro markets

Prices still outstrip income gains in Calgary and Edmonton

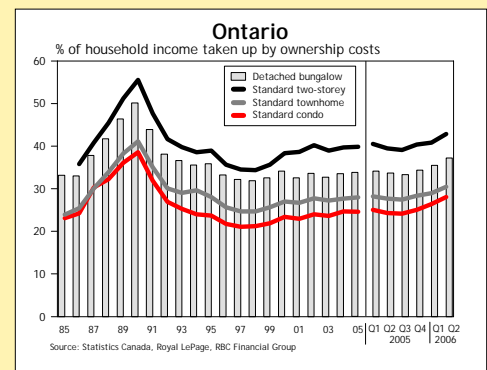
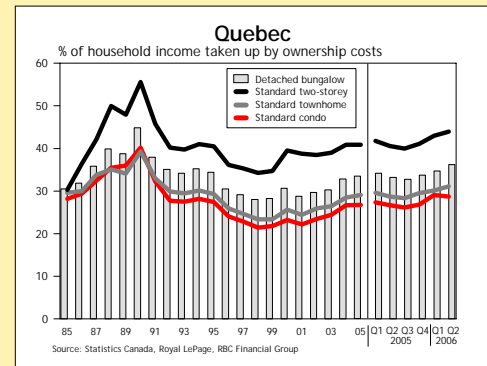
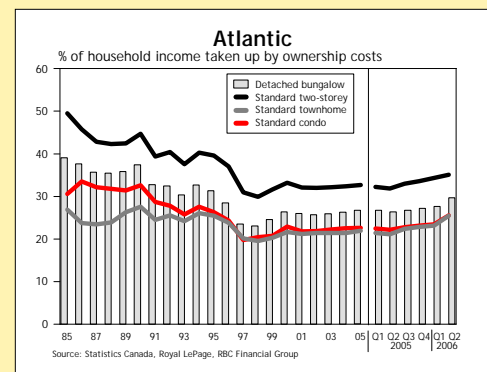
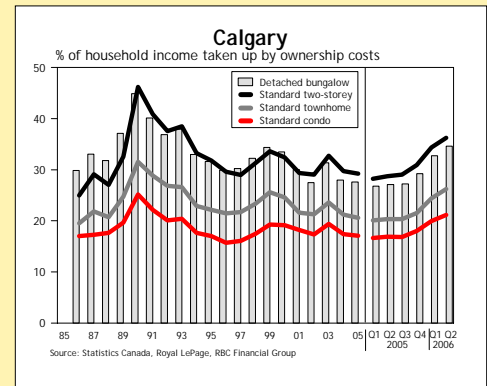
With all the hype surrounding Alberta's overheating housing markets, including its further deterioration in affordability conditions in the second quarter, it is important to keep in perspective that housing in Calgary and Edmonton is still far more affordable than in Vancouver, Toronto and Montreal. In early 2005, house prices began to accelerate alongside rising household income, providing little evidence of unsustainable fundamentals. More recently, however, the fundamentals — primarily wage growth — have failed to keep pace with skyrocketing house prices. As new listings are simply unable to keep pace with sales, there is little near-term relief ahead for prospective buyers. So, while affordability conditions are still tame compared to other cities, the rapid acceleration in prices has driven up qualifying income levels by roughly 30% year-over-year in each of the previous two quarters. One obviously wouldn't extrapolate such growth in qualifying incomes indefinitely but, for now, affordability still remains healthier than in the past and in comparison to other big cities.

Regional overviews

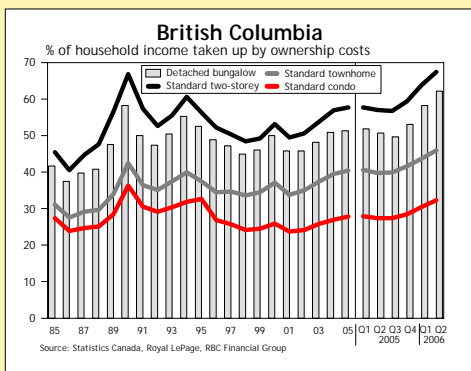
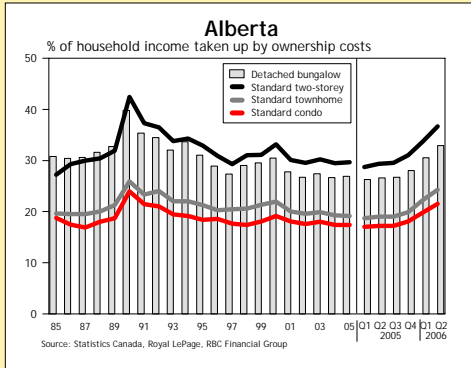
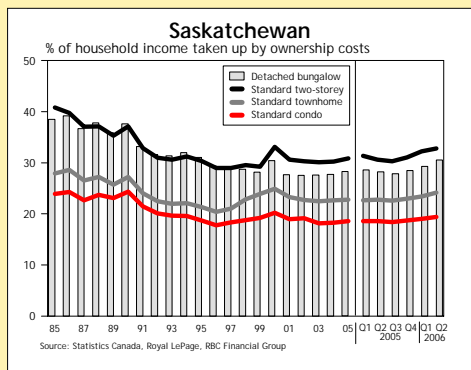
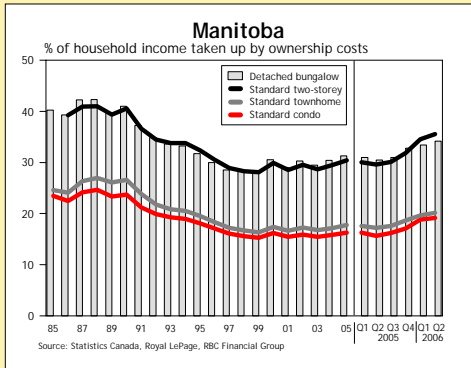
Atlantic — Affordability deteriorated across all home types with the strongest deterioration hitting the townhouse segment. Several forces combined to create unfavourable housing conditions in the second quarter, including big jumps in house prices, higher mortgage rates and a 4% increase in utilities. Healthy income growth helped offset what could otherwise have been an ever-sharper deterioration. While we still expect Atlantic Canada's housing market to continue to cool down in the coming year, this quarter's temporary pick-up was largely skewed by increased activity in Nova Scotia's housing market. Since the start of the year, annual growth in sales (up 17%) has been outpacing growth in new listings (up 6%). This imbalance has driven the rapid pace of price growth during the first half of this year. Meanwhile, housing markets in the remaining Atlantic provinces have moved into a more balanced position.

Quebec — Three of four housing segments witnessed a deterioration in affordability in the second quarter, with condos being the exception. Within those three segments, the deterioration was driven by mild house price gains in the 4-6% range, a tepid pace of income growth, higher mortgage rates, higher property taxes and higher utilities costs. The amount of median pre-tax income required to purchase a condo declined very modestly from 29.1% down to 28.7% as average condo prices slipped by \$7,700 from the previous quarter. Most of the province's housing markets are in the midst of an orderly slowdown as prices grow much more slowly than the double-digit pace of earlier years.

Ontario — Despite a cooling pace of price gains in most segments, Ontario's second-quarter housing affordability deteriorated for the third straight quarter. Higher mortgage rates and utilities costs were to blame as growth in household incomes failed to keep pace. Nevertheless, all signs of a soft landing appear to be unfolding. Apart from condos, prices have moderated and are now consistently growing in the 3-5% annual range. Condos reversed several quarters of weak price gains by notching a 10% gain from year-ago prices to post the sharpest affordability deterioration of any segment this quarter. Condos remain, however, the most affordable housing option in the province.



Regional overviews



Manitoba — Affordability in the province deteriorated for the fourth consecutive quarter across all housing segments in the second quarter, but the erosion was less severe than in the prior two quarters. Prospective homeowners were handed some relief in the form of a decline in quarter-on-quarter house prices for detached bungalows and condos. The price of townhomes was unchanged and the two-storey was up just 0.4%. The strong pace of annual house price growth, however, continues unabated. In fact, the sharpest affordability deterioration was felt in the two-storey home segment, where prices were 21% higher than a year ago. Although the market remains tilted in favour of home sellers, growth in new listings has overtaken sales since the start of the year. An increased supply of homes combined with slower wage growth and higher mortgage rates should soften the housing market in the coming year.

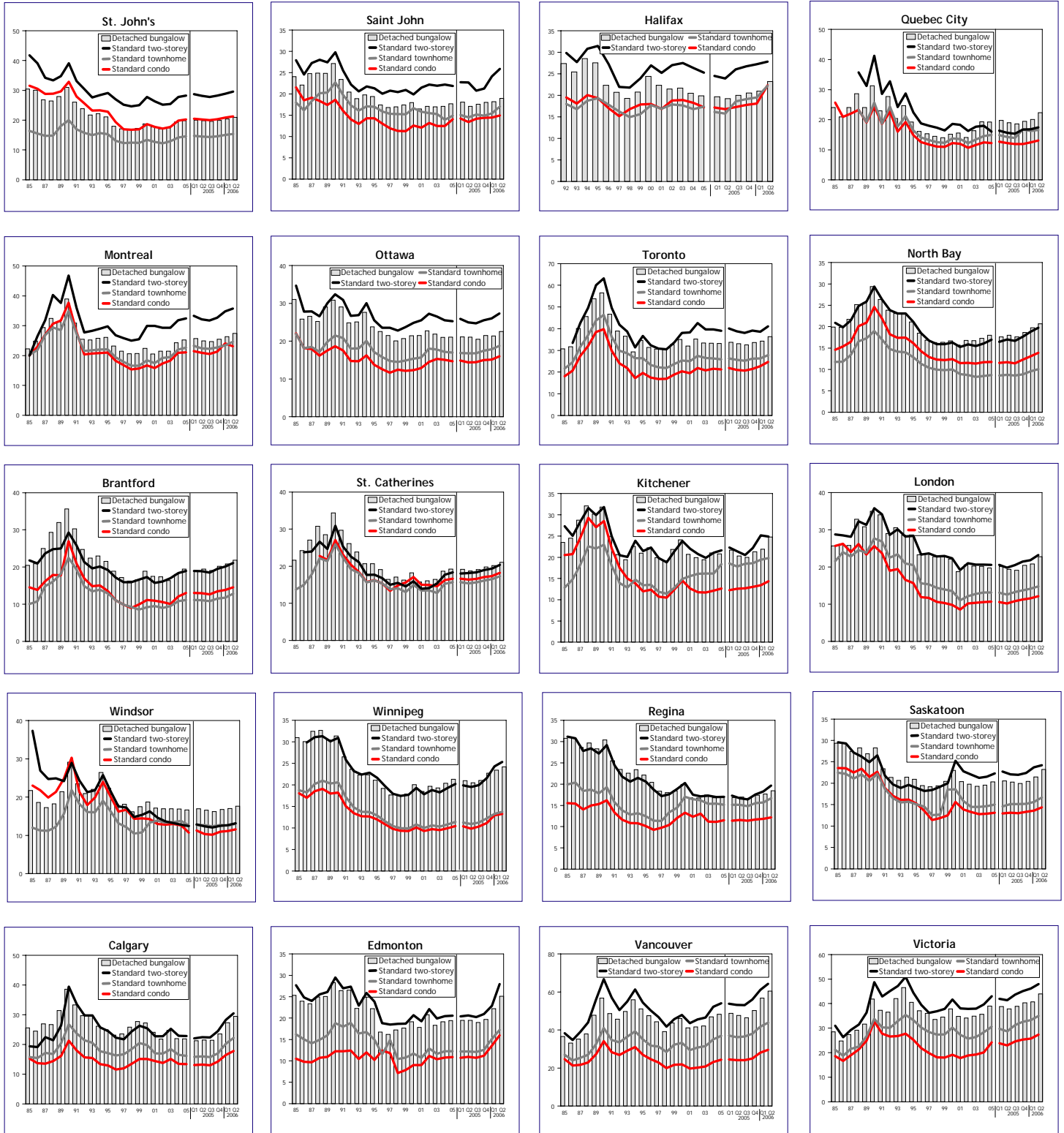
Saskatchewan — A fairly mild deterioration in housing affordability was recorded in every housing class for the third straight quarter. That said, solid wage earnings combined with fairly modest average house price growth have helped keep affordability conditions generally well-behaved. House prices, which popped into double-digit growth in early 2005, have pulled back to a more sustainable pace — especially compared to the blistering pace being set by its neighbours to the west. Saskatchewan is still the most affordable place to purchase a two-storey home with only 33% of median pre-tax income required to absorb ownership-related costs. Interest rates were another key driver of the slight deterioration but were largely offset by lower utility bills.

Alberta — Another sharp across-the-board affordability deterioration occurred in the second quarter. Similar to the first quarter, the deterioration was entirely driven by higher house prices and mortgage rates. Stripping out property taxes and utilities, monthly payments increased on average by \$182 for a two-storey home. Incomes are growing at a fairly rapid 5% pace, but house price growth is several multiples faster than that. Home prices have surged dramatically with prices up roughly 30% year-over-year in all classes of homes. The housing market remains extremely tight with demand well above supply. At the midpoint of 2006, sales were up 22% while new listings were down 4% compared to year-ago levels. This situation of excess demand has kept the sales-to-new listings ratio well into seller's territory, averaging 0.91 so far this year. Apart from Alberta, every other province has seen their housing market steer toward more balanced supply and demand conditions — particularly east of the Manitoba border.

British Columbia — Affordability has plummeted sharply for three consecutive quarters, with the bungalow and townhome markets setting new records, while condos and standard two-storey homes lie close to 1990 records. Surging prices and rising interest rates are to blame despite healthy year-over-year income growth of 4.6%. The condo market is the only segment where the recommended qualifying income is in line with average household income at roughly \$52,000. Qualifying incomes in all other segments are well above median household incomes. Condos are by far the most affordable option, but it is still the most expensive condo market in the country. With healthy wage gains not maintaining enough upward momentum to absorb rapidly rising prices, we expect the current pace of price appreciation to begin to moderate. Sales have actually retreated for the last three consecutive months, while new listings have grown. This rebalancing could signal a mildly cooler market ahead, which would be a welcome development in order to avoid fanning inflationary flames in a tight economy.

Mortgage carrying costs by city

Our standard housing affordability index measures the proportion of median pre-tax household income required to service the cost of a mortgage, including principal and interest, property taxes and utilities; the modified index used here includes the cost of servicing a mortgage, but excludes property taxes and utilities due to data constraints in the smaller CMA. This measure is based on a 25% downpayment and a 25-year mortgage loan at a five-year fixed rate and is estimated on a quarterly basis. The higher the index, the more difficult it is to afford a house.



Source: Statistics Canada, Royal LePage, RBC Economics Research

Housing affordability summary tables

Detached bungalow

Region	Average Price		Qualifying Income (\$) Q2 2006	Affordability Index (%)	
	Q2 2006 (\$)	Y/Y % ch.		Q1 2006 (rev)	Q2 2006
Canada*	269,785	10.9	66,409	37.3	39.4
British Columbia	453,923	21.6	100,926	58.2	62.2
Alberta	274,782	28.1	65,247	30.5	33.0
Saskatchewan	167,917	8.3	46,410	29.3	30.5
Manitoba	189,446	9.6	52,329	33.4	34.2
Ontario	280,896	4.3	70,286	35.5	37.2
Quebec	205,694	5.7	53,382	34.7	36.2
Atlantic	157,523	11.8	41,860	27.6	29.7
Toronto	391,635	3.3	92,530	41.8	43.9
Montreal	217,867	3.9	55,833	34.7	36.0
Vancouver	530,111	21.8	116,786	64.5	68.2
Ottawa	249,060	0.8	65,434	29.0	30.3
Calgary	325,967	32.1	74,935	32.7	34.6

Standard two storey

Region	Average Price		Qualifying Income (\$) Q2 2006	Affordability Index (%)	
	Q2 2006 (\$)	Y/Y % ch.		Q1 2006 (rev)	Q2 2006
Canada*	306,499	8.8	75,461	42.7	44.8
British Columbia	489,098	16.9	109,405	63.8	67.4
Alberta	301,880	30.2	72,677	33.8	36.7
Saskatchewan	176,308	7.3	49,871	32.3	32.8
Manitoba	198,386	20.7	54,415	34.5	35.5
Ontario	323,511	2.2	80,944	40.8	42.9
Quebec	248,861	4.9	64,755	43.0	44.0
Atlantic	183,807	8.7	49,482	34.3	35.1
Toronto	443,077	-0.4	105,675	47.6	50.1
Montreal	283,595	4.8	71,452	45.0	46.0
Vancouver	563,397	16.1	124,668	69.7	72.8
Ottawa	301,303	2.8	77,614	34.5	36.0
Calgary	337,067	30.9	78,432	34.4	36.2

Standard townhouse

Region	Average Price		Qualifying Income (\$) Q2 2006	Affordability Index (%)	
	Q2 2006 (\$)	Y/Y % ch.		Q1 2006 (rev)	Q2 2006
Canada*	213,857	9.5	52,812	29.8	31.4
British Columbia	333,305	14.0	74,639	43.7	46.0
Alberta	202,211	33.1	48,047	22.3	24.3
Saskatchewan	129,500	5.7	36,759	23.4	24.2
Manitoba	107,852	17.3	30,820	19.6	20.1
Ontario	229,546	3.7	57,487	29.0	30.4
Quebec	176,750	5.0	45,856	30.1	31.1
Atlantic	136,754	22.7	35,878	23.2	25.4
Toronto	299,920	1.7	71,602	32.4	33.9
Montreal	195,210	3.5	49,706	30.8	32.0
Vancouver	384,327	16.4	85,109	47.6	49.7
Ottawa	207,286	5.1	54,993	24.4	25.5
Calgary	246,111	34.3	56,779	24.4	26.2

Standard condo

Region	Average Price		Qualifying Income (\$) Q2 2006	Affordability Index (%)	
	Q2 2006 (\$)	Y/Y % ch.		Q1 2006 (rev)	Q2 2006
Canada*	187,414	12.0	46,371	26.3	27.5
British Columbia	228,986	16.9	52,461	30.5	32.3
Alberta	176,079	30.2	42,587	19.9	21.5
Saskatchewan	103,000	3.1	29,498	19.0	19.4
Manitoba	103,801	25.2	29,302	18.8	19.1
Ontario	213,966	10.3	52,921	26.4	28.0
Quebec	163,399	3.9	42,269	29.1	28.7
Atlantic	140,125	14.6	35,975	23.4	25.5
Toronto	266,705	10.6	63,413	28.1	30.1
Montreal	183,704	4.4	46,114	30.6	29.7
Vancouver	259,202	17.9	58,624	32.7	34.2
Ottawa	176,569	4.4	45,856	20.3	21.2
Calgary	197,333	29.7	45,783	20.0	21.2

* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Economics Research

How RBC's Housing Affordability Indexes work

RBC Economics Research's housing affordability indexes shows 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 indexes 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 indexes use household income rather than family income to account for the growing number of unattached individuals in the housing market. The indices are 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 index 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 indexes, the more difficult it is to afford a house. For example, an affordability index 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. 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 condo mortgages).

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