

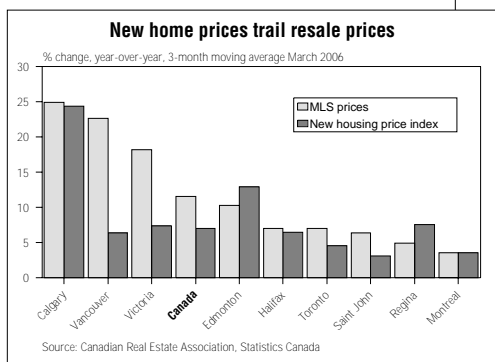
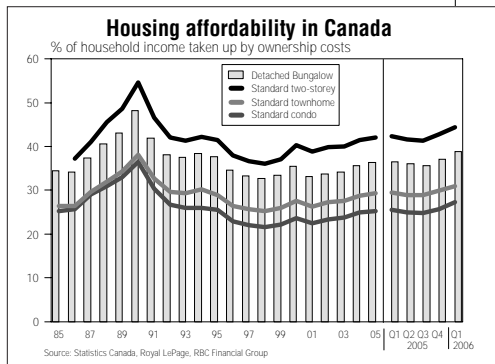


# Housing Affordability

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

## Housing affordability continues to slide

May 2006



▲ The cost of homeownership, including financing, utilities and property taxes, worsened relative to incomes in the first quarter for the second quarter in a row in each of the housing types we track — standard two-storey, detached bungalow, townhome and condo.

▲ Average monthly financing costs increased by between \$70-80 for bungalows, standard two storey and condos compared to the previous quarter and by \$47 for townhomes, swamping the first-quarter's \$40 rise in average monthly household income. Utility costs and property taxes also increased, but they were relatively minor contributors to the blow to affordability.

▲ Toronto's standard two storey home segment was the single noteworthy exception to the broad-based deterioration in housing affordability due to the fact that prices slipped compared to the previous quarter and are 2.3% lower than a year ago. See page 6 for housing affordability conditions in Canada's smaller cities.

▲ British Columbia recorded the worst affordability deterioration this quarter, and its affordability measures lie at or near their highest points on record in every class except for condos. Alberta's house price gains are much stronger than British Columbia's, but Alberta's affordability deterioration was milder due to a lower average starting price and a drop in utilities and property taxes.

▲ The reporting of incomes and property taxes used in our quarterly affordability measure lags the release of resale price and mortgage rate data. However, the fact that resale prices and mortgage rates have continued to advance into the second quarter of this year does not bode well for near-term affordability.

▲ New homes now represent about 32% of all homes sold in Canada compared to about 42% in the late 1980s. At the same time, new home prices have generally been much better-behaved than resale prices as evidenced by the pace of new and resale price gains in recent years (see chart) and relative valuation measures such as price-to-rent comparisons. Recent new home prices have accelerated, but remain well below the growth pace of the late 1980s when both new and resale prices were rising at high rates.

▲ Because of this observation, one could argue that a combination of land shortages and cautious builders are both serving to restrain new supply as a share of the market and to hold back the growth pace in builder list prices compared to the 1980s. By this reasoning, it may well be that builders are indirectly contributing to fairly rapid resale price gains in the current housing market cycle due to tighter supplies of new homes.

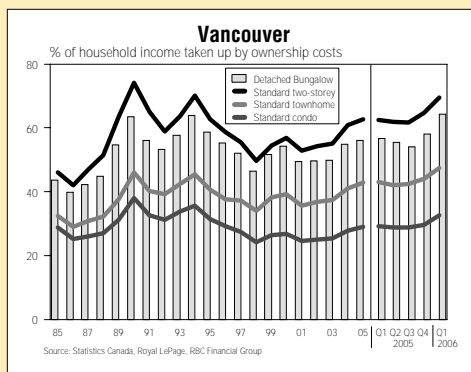
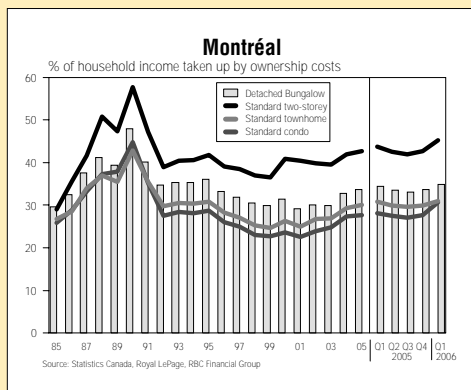
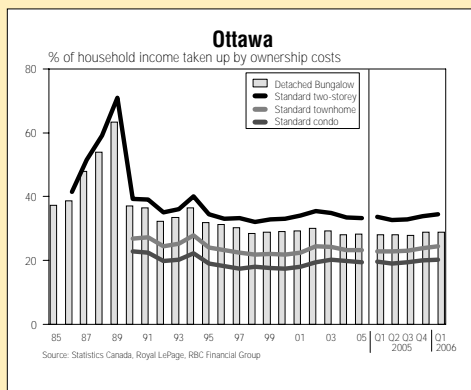
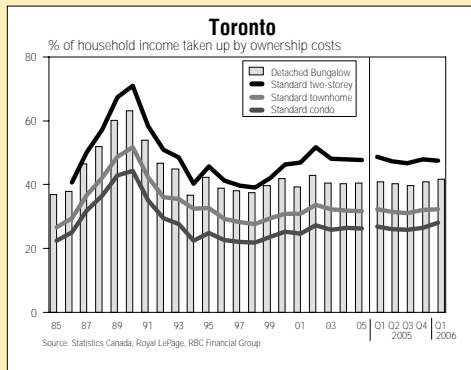
▲ There are significant regional differences to this theme. British Columbia's housing markets are the most heavily driven by resale activity likely due largely to land shortages.

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## Controlled cooling taking hold in Toronto

Except for a mild affordability improvement in the two-storey housing segment due to a dip in prices, affordability conditions deteriorated for a second consecutive quarter across all other classes of homes with the condo sector the hardest hit. This deterioration was largely driven by the combination of higher condo prices, higher mortgage rates and higher monthly utility bills compared to the previous quarter. However, longer-term trends reveal that overall annual price growth in Toronto appears to be cooling from the 7-10% range down to the 3-5% range, indicating that a controlled cooling is continuing to take hold in the housing market.

## An ever so slight deterioration in Ottawa's affordability

There was little change to overall affordability conditions in Ottawa in the first quarter of 2006. All classes of homes experienced a mild deterioration to affordability that was largely fuelled by slightly higher mortgage rates. Ottawa's detached bungalow and condo segments experienced a decline in prices this quarter, but year-over-year price appreciation remains healthy. Ottawa's housing affordability conditions have avoided the volatility experienced in other parts of the country and continue to be relatively stable across all segments.

## Affordability in Montreal worsens for a second consecutive quarter

Montreal experienced an across-the-board deterioration in affordability. The condo sector reported the strongest slide followed by two-storey homes. The deterioration to the condo market was led by a sharp appreciation in prices that bucked the trend of cooling prices that appeared to be setting in throughout 2005. Condo prices were up 10% in the first quarter and 13% compared to a year ago. The combination of a small decline in household income, modestly higher mortgage rates and higher house prices contributed to the overall deterioration in affordability.

## Annual price growth hits 30% in Calgary

Calgary's deteriorating housing affordability trend continued for a fourth consecutive quarter and picked up speed. Conditions were substantially worse than a year ago in all segments of homes. For example, the proportion of median pre-tax household income required to service the cost of mortgage payments, property taxes and utilities for a two-storey home was 28.2% in the first quarter of 2005 – one year later that requirement shot up to 34.4%. This overall erosion in Calgary's affordability was largely price-led with all classes of homes experiencing roughly 30% price appreciation in the first quarter of 2006 compared to a year ago.

## Vancouver price growth outpaces income gains

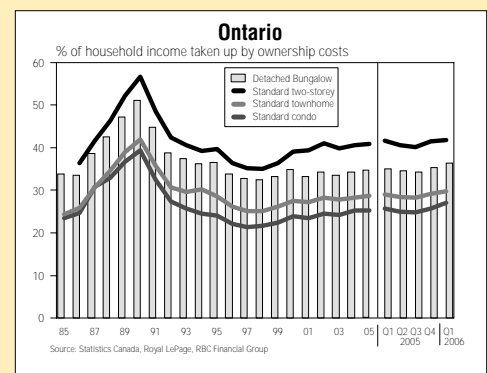
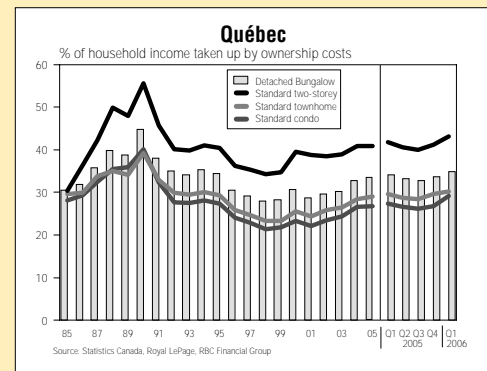
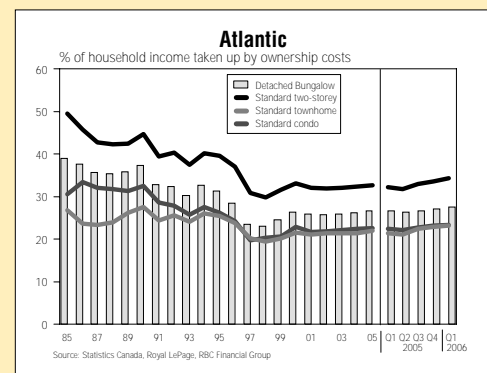
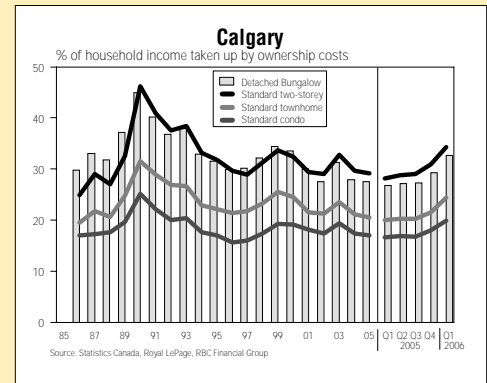
Affordability deteriorated sharply across all housing segments and is at or near the worst points on record. To give a sense of the rapid deterioration it is telling to look at qualifying income levels – the minimum annual income used by lenders to measure the ability of a borrower to make mortgage payments. In the third quarter of 2005, the qualifying income level for a two-storey home was \$102,650 and only two quarters later it rose to \$118,660 – a 16% increase. Although Vancouver continues to experience decent income gains, these have not kept pace with the rapid price growth and higher mortgage rates.

# Regional overviews

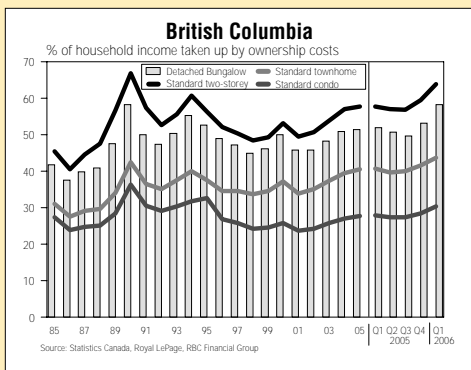
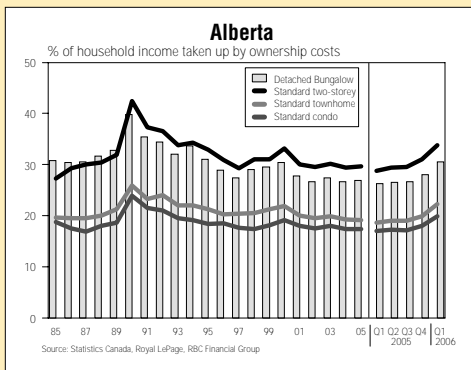
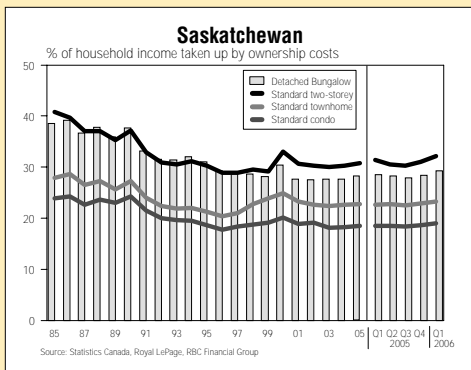
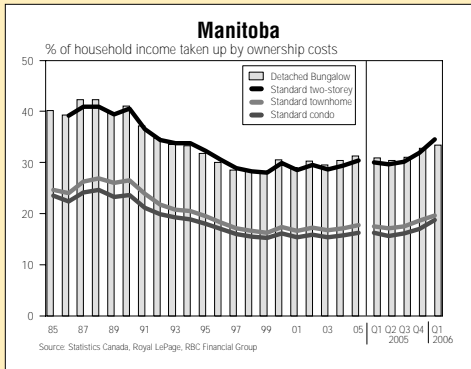
**Atlantic** — Affordability in the Atlantic region deteriorated for a third consecutive quarter, but the pace has been slow and steady. The trend of deteriorating affordability spanned all housing classes with the largest erosion occurring in the two-storey segment. A two-storey home now requires 34% of pre-tax average household income to absorb all related ownership costs compared to about 32% the year before. The townhouse and condo segments are roughly tied as the most affordable home ownership options in the Atlantic region, requiring about 23% of average pre-tax income. Moderate wage gains in the region were not able to offset higher monthly payments necessary to maintain a house. The main drivers of the elevated monthly payments are rising house prices and higher mortgage rates rather than utilities and property taxes. Average utilities costs actually declined slightly in the first quarter and taxes were flat. In dollar terms, mortgage rates and rising prices pushed monthly payments on detached bungalows up by about \$18 compared to the fourth quarter of 2005. The region's strongest annual gains in average weekly earnings occurred in Newfoundland at 5.4% this quarter. New Brunswick and Prince Edward Island led the region with the strongest price surges in the first quarter of 2006 compared to last year. Nova Scotia and New Brunswick reported strong growth in residential unit sales. In fact, the growth rate in Nova Scotia's residential sales in the first quarter was the fastest in the country - up about 29% compared to a year ago.

**Quebec** — Quebec's affordability deteriorated for a second consecutive quarter across the board in the first quarter of 2006. The largest erosion was in the condo market and was largely driven by a 10% year-over-year surge in condo prices and an 8.5% increase from the previous quarter. After two quarters of almost flat prices, the average condo price shot up by about \$13,000 in just one quarter, bringing the average purchase price up to \$171,115. Condos still remain the most affordable option in Quebec, but the townhome segment is now a close runner-up with an average price of \$174,000 reported in the first quarter. Contrary to the price surge seen in the condo market, the price of a townhome declined this quarter. The sales-to-listings ratio has been on a gradual decline during the past year, implying that the widely anticipated controlled cooling in Quebec's housing market is now under way. Residential permits have weakened recently, signalling a slowdown in demand. Housing starts have also begun to cool, with April starts down 23% compared to a year ago.

**Ontario** — A minor across-the-board deterioration in housing affordability was recorded in the first quarter as higher mortgage rates and higher utility bills drove up the cost of ownership. Income gains were up on average about \$50 per month, but this was not enough of an offset. Signs of a soft landing for Ontario's housing market continue to emerge. Residential permits and housing starts retreated in 2005 and have continued to weaken into 2006. April starts and March permits were both down on a year-over-year basis by 22% and 10%, respectively. Except for the condo market, where prices jumped up about 7% year-over-year in the quarter, the pace of price appreciation in other classes of homes appears to be cooling. Condo owners, on average, realized 3.5% gains in the value of their units in one quarter, driving the average price of a condo in the province up to \$206,453. In contrast, the cost of a two-storey and a townhouse actually declined compared to the previous quarter.



# Regional overviews



**Manitoba**—Housing conditions in Manitoba deteriorated across the board for a third consecutive quarter. The two-storey and the condo sector were hit the hardest. Annual price growth for the detached bungalow remained steady at 12% in the first quarter of 2006. The two-storey, townhouse, and condo housing classes had a first-quarter price surge compared to last year with prices up 21.9%, 17.8%, and 24.2%, respectively. Strong house price increases and higher mortgage rates were the chief contributors to the overall deterioration in affordability conditions. These factors alone drove monthly payments up by almost \$40 a month for detached bungalows. Despite the strong deterioration in the condo market, a condo remains quite an affordable option, requiring only about 19% of average pre-tax income to cover ownership costs.

**Saskatchewan**—For a second consecutive quarter, the share of income required to absorb all ownership-related costs rose across all housing classes, but the erosion in affordability was extremely mild. Unlike in neighbouring Alberta, growth in Saskatchewan home prices remained fairly steady at about 7% on a year-over-year basis for all types of homes. Despite decent income growth of about \$49 a month in the first quarter, the higher cost of utilities and rising mortgage rates led to a slight deterioration. Saskatchewan has so far managed to avoid any wild swings in its housing affordability conditions. Housing starts retreated in 2005 by about 9.1%, but so far in the first quarter of 2006 starts are up 36% compared to a year ago. As well, residential sales have maintained decent momentum so far this year.

**Alberta**—The good times for the Alberta economy have come at a cost to homebuyers in the form of an across-the-board deterioration in the first quarter of 2006. Prices are up about 25% in all classes of homes compared to a year ago. In just one quarter, two-storey homeowners realized on average \$28,000 in gains and gains in the other segments were not far off. Second to British Columbia, Alberta's income and employment growth was the strongest in the country. However, the pace of price appreciation and higher mortgage rates outpaced this growth, contributing to the deterioration in affordability. Even lower utility bills and lower property taxes in the quarter did not bring relief to homeowners' monthly payments, which were up about 22% compared to a year ago. Alberta's house price gains are much stronger than British Columbia's, but Alberta's affordability slide was milder due to a lower average starting price and a drop in utilities costs and property taxes.

**British Columbia**—Affordability deteriorated to levels comparable to that of the late 1980s for a detached bungalow and a two-storey home. The average price for a two-storey home now sits at \$474,064, up \$35,000 in one quarter alone. This translates into a 64% affordability rating, meaning that 64% of pre-tax average household income is now required to absorb ownership-related costs. While affordability seems to be deteriorating at a remarkably fast pace, the economy's fundamentals continue to exhibit strength. Year-over-year April employment growth (3.6%) and first-quarter growth in average weekly earnings (6.2%) were the strongest in the country. However, mortgage rates and rising house prices outpaced income gains and led to a \$225 increase in monthly two-storey home payments in the first quarter. Condos continue to be the most cost-effective ownership choice. Condo prices continue to record a hefty growth pace, reporting 15% year-over-year price growth in the first quarter of 2006.

# Housing affordability summary tables

## Detached bungalow

Region	Average Price		Qualifying Income (\$) Q1 2006	Affordability Index (%)	
	Q1 2006 (\$)	Y/Y % ch.		Q4 2005 (rev)	Q1 2006
Canada*	260,649	9.2	62,599	37.1	38.8
British Columbia	434,538	18.7	93,932	53.1	58.1
Alberta	255,586	23.8	60,014	28.0	30.5
Saskatchewan	161,042	6.8	44,084	28.5	29.3
Manitoba	190,564	11.6	51,178	32.8	33.5
Ontario	275,222	4.6	66,945	35.3	36.4
Quebec	199,556	3.2	50,453	33.7	34.8
Atlantic	147,875	5.2	38,723	27.2	27.6
Toronto	383,640	3.1	88,155	40.8	41.7
Montreal	214,196	3.0	53,222	33.7	34.9
Vancouver	513,667	20.3	109,836	58.1	64.4
Ottawa	245,030	2.8	62,497	28.9	28.9
Calgary	311,878	31.2	70,314	29.3	32.7

## Standard two storey

Region	Average Price		Qualifying Income (\$) Q1 2006	Affordability Index (%)	
	Q1 2006 (\$)	Y/Y % ch.		Q4 2005 (rev)	Q1 2006
Canada*	299,014	7.7	71,687	42.8	44.5
British Columbia	474,064	16.5	102,984	59.3	63.7
Alberta	277,384	25.7	66,352	31.1	33.8
Saskatchewan	174,643	7.0	48,514	31.1	32.2
Manitoba	197,600	21.9	52,832	31.9	34.5
Ontario	316,429	0.7	77,020	41.4	41.8
Quebec	248,268	5.1	62,490	41.1	43.2
Atlantic	184,772	9.9	48,106	33.6	34.3
Toronto	432,305	-2.3	100,410	47.8	47.5
Montreal	283,272	5.2	68,920	42.6	45.2
Vancouver	553,097	17.3	118,659	64.7	69.6
Ottawa	298,222	2.1	74,447	33.8	34.5
Calgary	322,853	31.0	73,813	30.9	34.4

## Standard townhouse

Region	Average Price		Qualifying Income (\$) Q1 2006	Affordability Index (%)	
	Q1 2006 (\$)	Y/Y % ch.		Q4 2005 (rev)	Q1 2006
Canada*	207,373	7.8	49,938	30.0	31.0
British Columbia	324,662	13.0	70,562	41.5	43.7
Alberta	185,563	27.3	43,768	19.9	22.3
Saskatchewan	125,125	7.8	35,152	23.0	23.3
Manitoba	107,852	17.8	30,040	18.7	19.6
Ontario	224,579	3.2	54,708	29.1	29.7
Quebec	174,000	3.4	43,816	29.6	30.3
Atlantic	124,750	12.2	32,478	22.9	23.2
Toronto	294,254	1.2	68,341	32.1	32.4
Montreal	190,820	1.3	47,169	29.9	30.9
Vancouver	377,727	16.3	81,086	44.1	47.5
Ottawa	204,714	7.5	52,680	23.9	24.4
Calgary	230,967	30.4	52,476	21.5	24.4

## Standard condo

Region	Average Price		Qualifying Income (\$) Q1 2006	Affordability Index (%)	
	Q1 2006 (\$)	Y/Y % ch.		Q4 2005 (rev)	Q1 2006
Canada*	182,972	10.5	44,086	25.7	27.4
British Columbia	220,217	15.0	49,136	28.4	30.4
Alberta	162,526	24.6	39,045	18.1	19.9
Saskatchewan	101,500	6.7	28,610	18.7	19.0
Manitoba	105,126	24.1	28,801	17.1	18.8
Ontario	206,453	6.8	49,797	25.8	27.1
Quebec	171,115	9.9	42,317	26.8	29.2
Atlantic	129,667	6.6	32,857	23.2	23.4
Toronto	254,505	5.6	59,170	26.6	28.0
Montreal	196,206	13.1	46,872	27.7	30.7
Vancouver	253,868	18.3	55,765	29.8	32.7
Ottawa	173,750	3.5	43,801	20.0	20.3
Calgary	188,167	28.6	42,928	18.0	20.0

\* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Financial Group

## How RBC's Housing Affordability Indexes work

RBC Financial Group'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 reasonable property benchmark for the housing market.

Alternative housing types are also presented including 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 is estimated on a quarterly basis for each province and for the Montreal, Toronto, Ottawa 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 higher the Indexes, the more difficult it is to afford a house. For example, an affordability indexes 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.

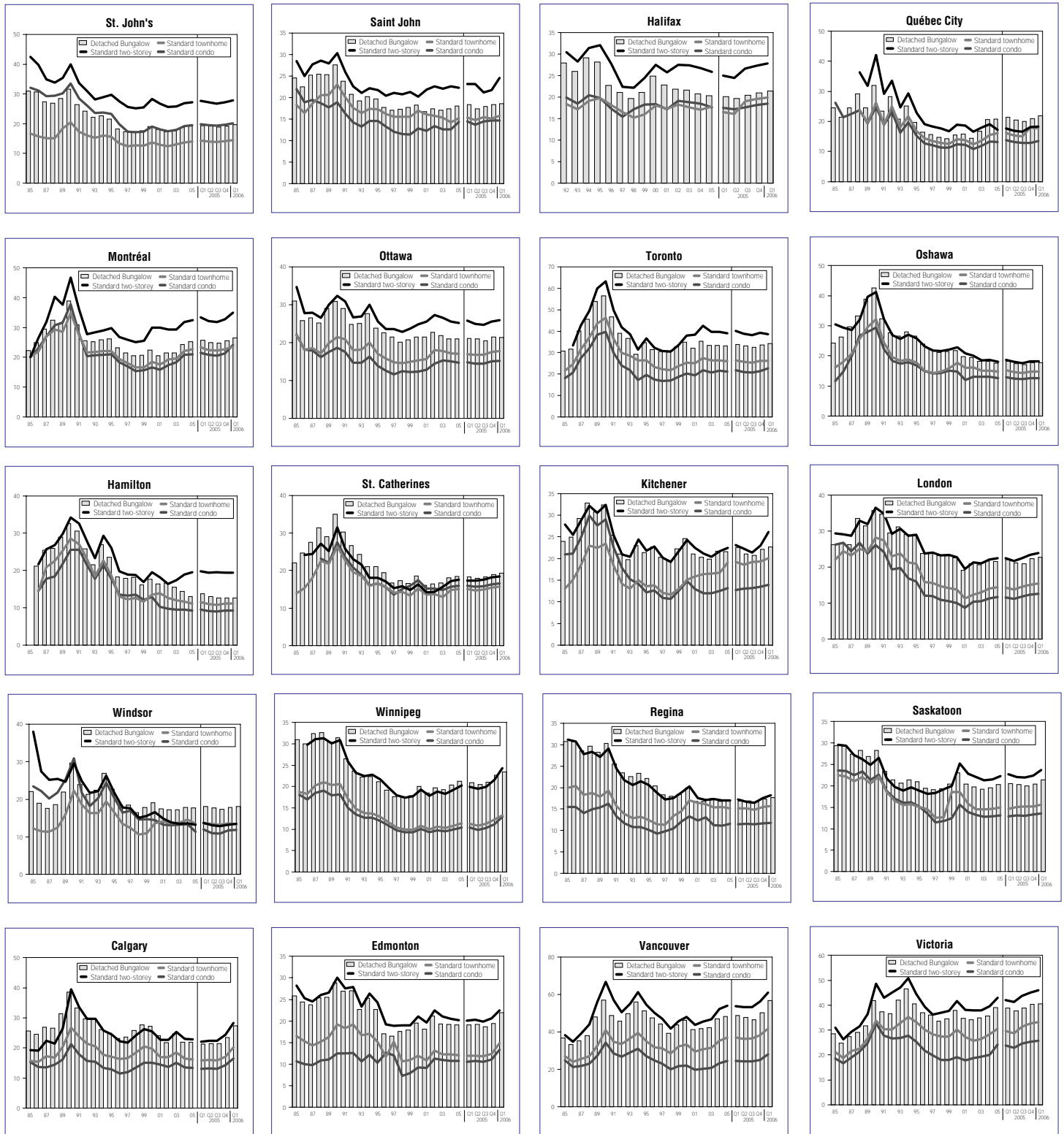
Qualifying income is the minimum annual income used by lenders to measure the ability of a borrower to make mortgage payments. No more than 32% of a borrower's gross annual income should go to "mortgage expenses" — principal, interest, property taxes and heating costs (plus maintenance fees for condo mortgages).

Note: The housing affordability index is based on gross household income estimates. As such, it does not show the impact of various provincial property tax credits, which can alter relative levels of affordability.



# Appendix: Housing conditions in Canada's smaller cities

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 CMAs. 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