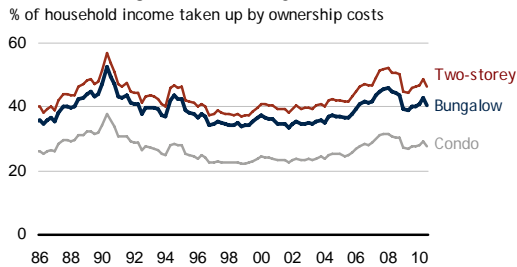


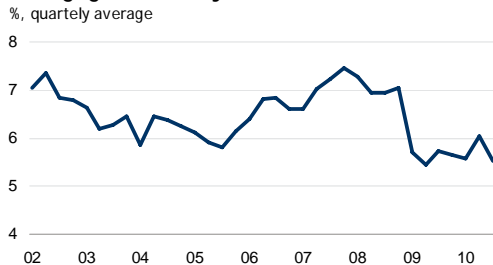
## HOUSING TRENDS AND AFFORDABILITY

November 2010

### RBC Housing Affordability Measures - Canada

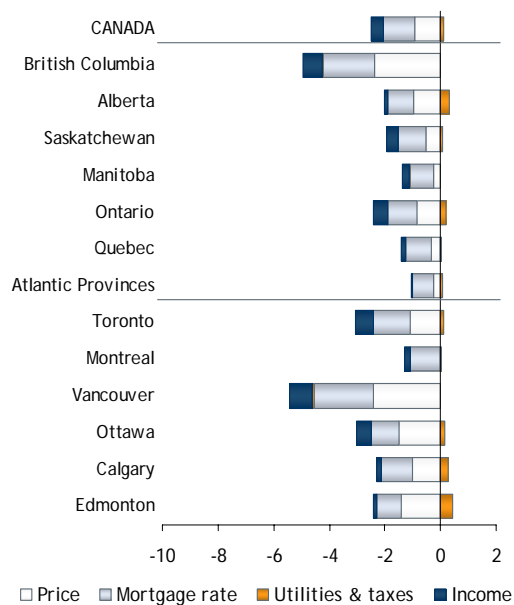


### Mortgage rate, 5-year conventional



### Factors contributing to the change in affordability

Percentage point change from a quarter ago (detached bungalow)



Source: Statistics Canada, Royal LePage, RBC Economics Research

### Robert Hogue

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## Housing affordability improved in the third quarter

Bucking its rising trend since the middle of 2009, the cost of homeownership moderated in Canada in the third quarter of 2010. Lower mortgage rates and some softening in home prices, relative to the previous quarter, combined to reduce the monthly mortgage charges associated with owning a residential property at going market values. At the national level, the RBC Housing Affordability Measures fell for the first time since the second quarter of 2009, going down between 1.4 and 2.5 percentage points depending on the housing type (a decrease represents an improvement in affordability). This result reversed almost two-thirds of the cumulative deterioration that took place in the four preceding quarters thereby returning the measures to their levels as of the end of 2009 (for the most part). After appreciating rapidly during the strong rebound in resale activity last year and early this year, national home prices have retreated modestly in recent months, as market conditions cooled considerably during the spring and summer from their earlier boil. While this represented a decline from the second quarter, home prices were still 5.8% to 6.8% higher year-over-year. Conventional fixed-mortgage rates came down in the third quarter, with the five-year posted rate (the basis on which the RBC Measures are calculated) falling more than 50 basis points to an average of 5.52%, entirely reversing the rise in the second quarter.

The improvement in affordability in the July-September period has reduced some of the stress that had been mounting in housing markets in Canada during the past year; however, the RBC Measures continue to stand slightly above long-term averages, suggesting that some greater than usual tensions persist for Canadian homebuyers. In our view, these tensions are unlikely to derail demand for housing in the near term but will act as a restraint on growth in market activity going forward.

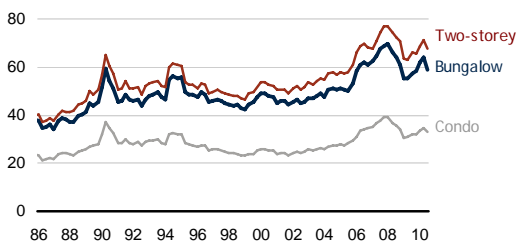
### Owning a home becomes easier to afford everywhere in the country

All provinces saw improvements in affordability in the latest quarter. The most sizeable drops in the RBC Affordability Measures occurred in British Columbia, where elevated property values amplified the effect of the decline in mortgage rates on monthly mortgage charges. Further contributing to the improvement have been lower home prices, particularly for bungalows (which fell 3.0% quarter-over-quarter). Ontario also experienced some notable drops in homeownership costs, pushing down the RBC Measures below their long-term average in the province for bungalows and condominiums. Elsewhere, the affordability improvement in Saskatchewan and Manitoba was especially strong in the two-storey home category, while it was moderate in all housing segments in Alberta, Quebec and the Atlantic Provinces. Alberta and Manitoba are the only two provinces where the RBC Measures stand below their long-term average in all housing categories, indicating to us that there is little stress in these markets.

## RBC Housing Affordability Measures

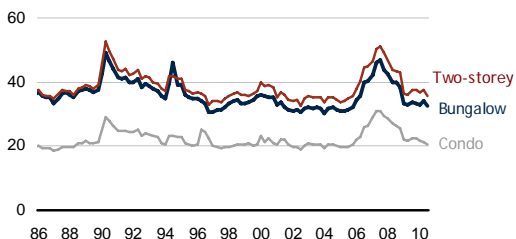
### British Columbia

% of household income taken up by ownership costs



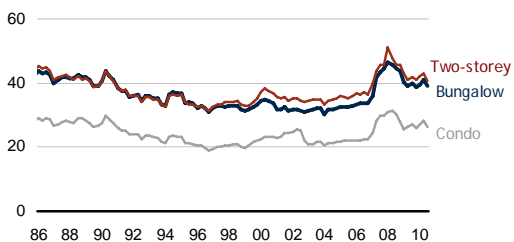
### Alberta

% of household income taken up by ownership costs



### Saskatchewan

% of household income taken up by ownership costs



Source: Statistics Canada, Royal LePage, RBC Economics Research

### Higher interest rates will raise homeownership costs

Looking ahead, with additional cuts in the posted five-year fixed rate already in place in the early part of the fourth quarter of 2010 and previous home price increases still being rolled back in certain markets, further improvement in affordability is likely to take place in the near term. The recent decline in mortgage rates, however, is not expected to be sustained much beyond the closing months of this year. We expect the Bank of Canada will resume its rate hiking campaign by the second quarter of 2011, which will eventually have a more sustained upward effect on mortgage rates. In our view, higher mortgage rates will be the dominant factor raising homeownership costs over the medium term, although increasing household income – as the job situation continues to strengthen in Canada – will provide some positive offset. We expect housing demand and supply to remain mostly in balance, overall, setting the course for very modest home price increases.

## Provincial overviews

### British Columbia – Some reprieve at last

The B.C. housing market won some welcomed reprieve in the third quarter from the significant deterioration in affordability recorded since the middle of 2009. The reprieve came primarily from lower prices and lower mortgage rates. Amid much cooler resale activity during the spring and summer, and greater availability of properties for sale, home prices either fell (notably so in the case of bungalows) or remained stable (in the case of condominium apartments). The decline in mortgage rates that was felt positively across the country had a most powerful effect on B.C. affordability. The province's elevated home price levels relative to income amplify the effects on affordability of movements in mortgage rates. In the third quarter of 2010, the RBC Housing Affordability Measures for British Columbia dropped between 1.8 and 5.0 percentage points, representing the largest declines since the first quarter of 2009. Still, all RBC Housing Affordability Measures remained significantly above long-term averages. Very poor affordability is likely to weigh on provincial housing demand in the period ahead.

### Alberta – Among the most affordable in Canada

Despite substantially improved housing affordability in the province since early 2008, housing demand in Alberta is still a shadow of its former self from just a few years ago, and there are few signs that it is picking up meaningfully. Market conditions remained quite weak in the third quarter, and buyers have emerged clearly in the driver's seat, causing home prices to decline (down between 0.6% and 2.2% depending on the housing type) and contributing to further improvement affordability. The RBC Measures eased between 0.8 and 1.8 percentage points, more than reversing modest rises in the second quarter. Homeownership in Alberta is among the more affordable in Canada both in absolute terms and relative to its historical averages. Such a high degree of affordability augurs well for a strengthening in housing demand, once the provincial job market sustains more substantial gains.

### Saskatchewan – House hunting resumes

Spurred in part by a decline in homeownership costs, Saskatchewan homebuyers resumed house hunting in recent months with home resales in the

province rebounding since August and reversing most of its slide in the first half of this year. The earlier softening of activity, nonetheless, had a lingering effect on home prices in the third quarter, which fell across all housing types relative to the second quarter. In turn, this lingering effect, along with lower mortgage rates, contributed to a significant improvement in affordability. The RBC Affordability Measures dropped between 1.8 and 2.2 percentage points, which was the most since early 2009. While lower than they were a year ago, the measures are still modestly above their long-term average, thereby suggesting to us that current market conditions are stretching homebuyers' budgets to a degree. However, those budgets are likely to be boosted from a strong expected rebound in the provincial economy and, thus, family income this year and next.

### Manitoba – Quickly back on track

Any concerns that housing demand in Manitoba would slip into a slump dissipated in recent months with housing resales picking up smartly in September and October, swiftly turning the page on a particularly weak summer period. No doubt, homebuyers in the province lately took advantage of fairly attractive affordability, which improved for all housing types in the third quarter. The RBC Measures fell between 0.9 and 2.3 percentage points, reversing one-half to three-quarters of the increase that occurred since the spring of 2009. Lower mortgage rates in the third quarter were particularly helpful in bringing down homeownership costs in the province although some price declines (particularly for two-storey homes) also contributed. Manitoba is one of only two provinces, alongside Alberta, where the measures for all housing types are currently below long-term averages, which will be a supportive factor for demand going forward.

### Ontario – Taking a positive turn

Housing market conditions took a positive turn in Ontario in recent months. After four consecutive quarterly increases, the cost of homeownership declined in the third quarter thanks to lower mortgage rates and some softening in property values. RBC's Housing Affordability Measures fell between 1.3 and 2.4 percentage points, fully reversing the increase in the second quarter. Meanwhile, existing home sales ended their earlier precipitous slide by sustaining three straight gains (on a seasonally adjusted basis) from August to October. This recovery confirmed our earlier expectation that the slowdown in activity in the spring and summer largely reflected various transitory factors – including the HST and changes in mortgage lending rules – that brought demand forward to the start of this year. With the market now back in balance, the recent softness in home prices will likely prove to be a healthy recalibrating following a strong rally.

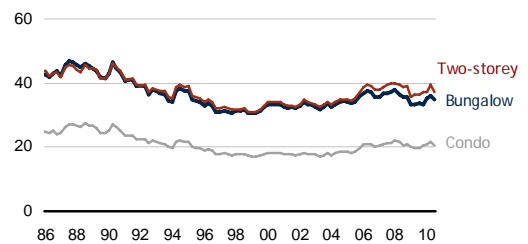
### Quebec – On its way towards stability

The Quebec housing market is making its way toward more stable activity levels. As in other parts of the country, home resales in the province gyrated wildly in the past two years – plummeting to six-year lows at the end of 2008 and then surging to all-time highs at the start of this year; however, the downswing that occurred this spring and early summer turned out to be fairly restrained in Quebec, reaching bottom at levels that were less than 10% below those that prevailed before the housing downturn in 2008. The modest recovery since the end of the summer suggests that activity is being

## RBC Housing Affordability Measures

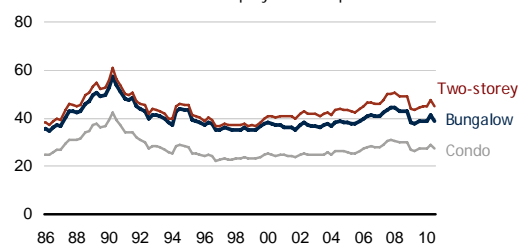
### Manitoba

% of household income taken up by ownership costs



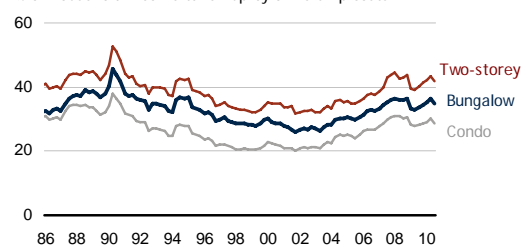
### Ontario

% of household income taken up by ownership costs



### Quebec

% of household income taken up by ownership costs

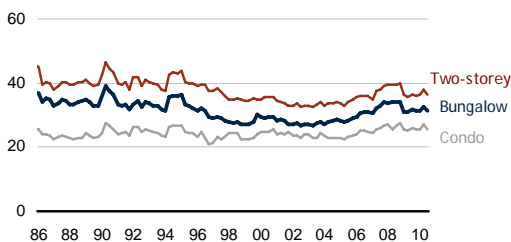


Source: Statistics Canada, Royal LePage, RBC Economics Research

## RBC Housing Affordability Measures

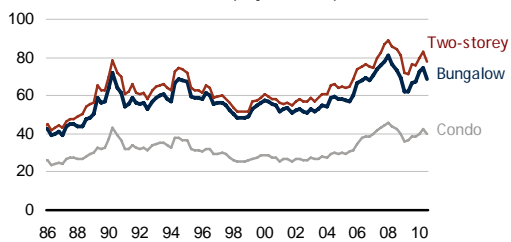
### Atlantic Provinces

% of household income taken up by ownership costs



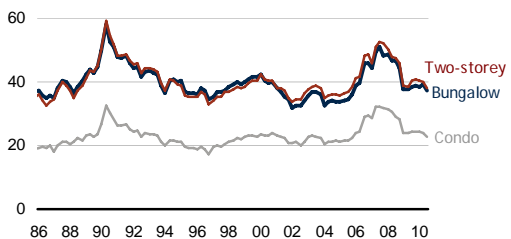
### Vancouver

% of household income taken up by ownership costs



### Calgary

% of household income taken up by ownership costs



Source: Statistics Canada, Royal LePage, RBC Economics Research

restored to a sustainable path. Supporting this trend in the near term is an improvement in affordability in the third quarter. Following four consecutive increases, the RBC Measures for the province fell 1.4 to 1.8 percentage points (depending on the housing type). Still, the Measures remain close to the pre-downturn peaks and above their long-term average, which will act to restrain growth in demand in the period ahead.

### Atlantic – Picking up some steam again

Propelled by stronger activity in the Halifax and, to a lesser extent, Moncton areas, Atlantic Canada's housing market picked up some steam early this fall. This trend follows a marked cooling in activity in the spring when home resales in the region fell back to the lows reached at the end of 2008 – although not as steep as the lows in other parts of the country. The recent strengthening has tightened up market conditions a little, but it was the earlier loosening that had a dominant effect on property values in the third quarter, which saw some modest price declines in the region. This result, along with the drop in mortgage rates, contributed to lower homeownership costs in Atlantic Canada. The RBC Housing Affordability Measures moved down between 1.0 and 1.5 percentage points in the third quarter, with the levels returning to roughly where they were in mid to late-2009. Overall, housing affordability continues to be quite attractive in Atlantic Canada.

### Major city markets

#### Vancouver – Big drop in ownership costs; a little relief

The third quarter brought some relief to Vancouver homebuyers but is unlikely to change the perception that this is an expensive market to enter because affordability remains very poor. After surging in the previous five quarters to close to record high levels, homeownership costs fell in the third quarter as a result of lower mortgage rates and price declines for some housing types (notably bungalows). In fact, RBC's affordability measures for Vancouver recorded their most significant drops among Canada's major cities, dropping 2.2 to 5.4 percentage points, yet this only reversed the increases since the start of this year, representing one-third to one-half of the substantial rise since the spring of 2009. Such high ownership costs continue to weigh on demand, which remains fairly weak despite a modest pick up in home resales in September and October. Nonetheless, downward pressure on prices are limited at this point because supply is generally well aligned with demand.

#### Calgary – Stuck in a low gear

The good news is that Calgary's housing market is no longer running in reverse. The bad news is that it appears to be stuck in a very low gear. Despite affordable homeownership costs, the recent pick up in area home resales has been modest, with levels moving up only to levels that last prevailed 10 years ago – notwithstanding the slump at the end of 2008, during the worst of the housing downturn. Weak demand to a large extent reflects Calgary's still sluggish job market where employment has been stagnant at best in the past year. Meanwhile, availability of homes for sale continues to be plentiful, maintaining downward pressure on property values. In the third quarter, home prices fell in all housing categories, for the second consecutive time in some cases. This result contributed to further improvement in af-

fordability in the area. RBC's affordability measures declined by 1.2 to 2.3 percentage points, representing the third straight drop for two-storey homes and condominiums.

### Toronto – Moving on up

Although triggering a fair amount of anxiety while it unfolded, the Toronto area market's return to earth this spring was, in retrospect, a mostly benign affair. The fears were that the payback for the clearly unsustainable record-high levels of existing home sales at the start of this year would be an all-out rout. The market's recovery since August, however, confirmed that the gyrations had much more to do with the advancing of activity associated with special factors (e.g., HST and new mortgage lending rules) than the vanishing of demand. With the influence of these transitory factors largely dissipating by the end of the summer, the Toronto-area market proceeded to move on up again toward more sustainable levels of activity. Following four consecutive quarters of increases, the RBC Housing Affordability Measures fell appreciably between 1.2 and 3.8 percentage points in the third quarter. Those measures are now close to long-term averages and are consistent with moderate tensions being exerted on homebuyers.

### Ottawa – Homebuyers cautious but back

Once again, the Ottawa-area housing market recently demonstrated its ability to move past soft patches with minimal damage. After reaching all-time highs early this year, home resales plummeted in May (on a seasonally adjusted basis), as homebuyers opted to sit out the traditionally strong spring season. Although such market movements were somewhat more dramatic than in other areas of the province, they were largely driven by the same transitory factors (HST and new mortgage lending rules). Consequently, it was not surprising to see Ottawa homebuyers cautiously returning to the market early this fall, once these special factors had largely run their course. Nonetheless, the weak level of demand in the spring and summer amid still plentiful availability of homes for sale applied downward pressure on prices. This trend had a beneficial effect on affordability in the third quarter with RBC's Measures dropping 2.0 to 2.9 percentage points (depending on the housing type) and helped to reduce some of the stress that had built up in the market in the past year.

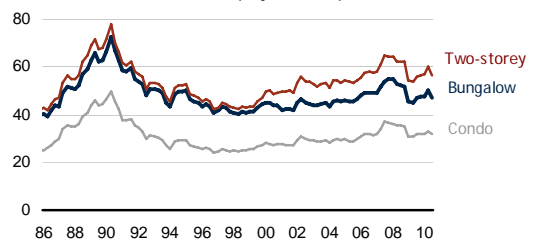
### Montreal – Earlier strength still unwinding

In contrast to most other major Canadian cities, the Montreal housing market has yet to show sustained signs of recovering activity in recent months. Existing home sales in the area peaked at the end of last year and have trended lower ever since. This lack of a turnaround partly reflects the tremendous strength earlier – resales in December to February were record highs for the area – which might be taking longer to unwind than elsewhere; however, the notable increase in the cost of homeownership in Montreal in the past year also likely played a role. The Montreal area is second among Canada's major cities (behind only Vancouver) in terms of the year-over-year rise in the RBC Housing Affordability Measures. No doubt, this deterioration in affordability is weighing on homebuyers at this point. Fortunately, there was some relief in the third quarter with the measures coming down between 1.1 and 1.7 percentage points but, given that current levels remain well above long-term averages, market tensions are likely to persist in the near term.

## RBC Housing Affordability Measures

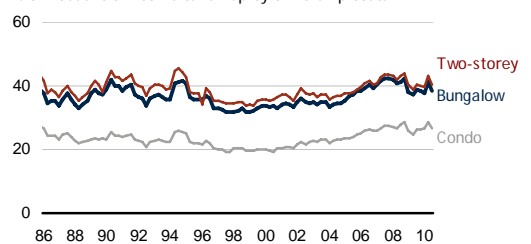
### Toronto

% of household income taken up by ownership costs



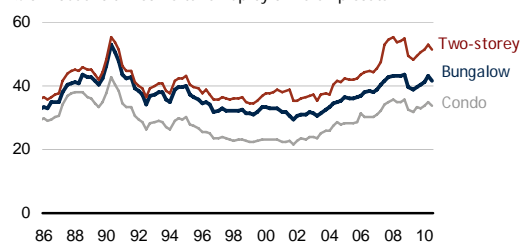
### Ottawa

% of household income taken up by ownership costs



### Montreal

% of household income taken up by ownership costs



Source: Statistics Canada, Royal LePage, RBC Economics Research



## How the RBC Housing Affordability Measures work

The RBC 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 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 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		Qualifying Income (\$) Q3 2010	RBC Housing Affordability Measure			
	Q3 2010 (\$)	Y/Y % ch.		Q3 2010 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	325,300	6.8	72,500	40.4	-2.4	0.3	39.0
British Columbia	544,700	8.5	108,800	59.0	-5.0	1.5	48.9
Alberta	340,500	2.9	74,400	32.5	-1.8	-1.2	36.1
Saskatchewan	312,400	6.3	70,900	39.0	-1.9	-0.8	36.6
Manitoba	251,000	9.2	60,800	34.7	-1.4	1.1	36.8
Ontario	337,400	6.1	77,900	38.9	-2.2	0.2	40.1
Quebec	221,600	9.3	51,700	35.0	-1.4	1.2	32.9
Atlantic	196,600	2.3	48,200	31.4	-1.0	-0.4	31.6
Toronto	466,600	5.0	101,100	47.2	-3.0	-0.1	48.2
Montreal	271,100	11.8	61,600	41.7	-1.3	2.2	36.9
Vancouver	672,500	9.7	131,600	68.8	-5.4	2.4	57.3
Ottawa	340,800	3.4	81,800	38.2	-2.9	-0.5	36.6
Calgary	412,700	2.7	85,000	37.1	-2.0	-1.5	39.9
Edmonton	322,900	5.4	72,900	32.7	-2.0	-0.5	33.9

### Standard two-storey

Region	Average Price		Qualifying Income (\$) Q3 2010	RBC Housing Affordability Measure			
	Q3 2010 (\$)	Y/Y % ch.		Q3 2010 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	370,700	6.3	83,100	46.3	-2.5	0.3	43.3
British Columbia	624,800	8.0	124,500	67.5	-3.9	1.4	54.1
Alberta	365,600	0.1	81,400	35.6	-1.8	-2.0	38.6
Saskatchewan	315,300	5.1	74,100	40.8	-2.2	-1.1	38.0
Manitoba	269,700	7.8	65,000	37.1	-2.3	0.8	37.7
Ontario	388,200	6.2	89,800	44.9	-2.4	0.4	43.7
Quebec	262,100	8.6	61,700	41.7	-1.8	1.3	38.8
Atlantic	222,100	4.3	55,900	36.5	-1.4	0.1	38.0
Toronto	554,700	5.6	120,400	56.2	-3.8	0.1	53.4
Montreal	335,300	8.9	75,800	51.3	-1.7	1.7	41.7
Vancouver	766,300	8.4	149,400	78.1	-4.7	2.0	62.6
Ottawa	350,600	4.8	86,600	40.5	-2.5	0.0	39.1
Calgary	410,500	-1.0	86,700	37.9	-2.3	-2.6	40.3
Edmonton	362,500	1.2	82,500	37.0	-1.9	-1.6	37.0

### Standard condominium

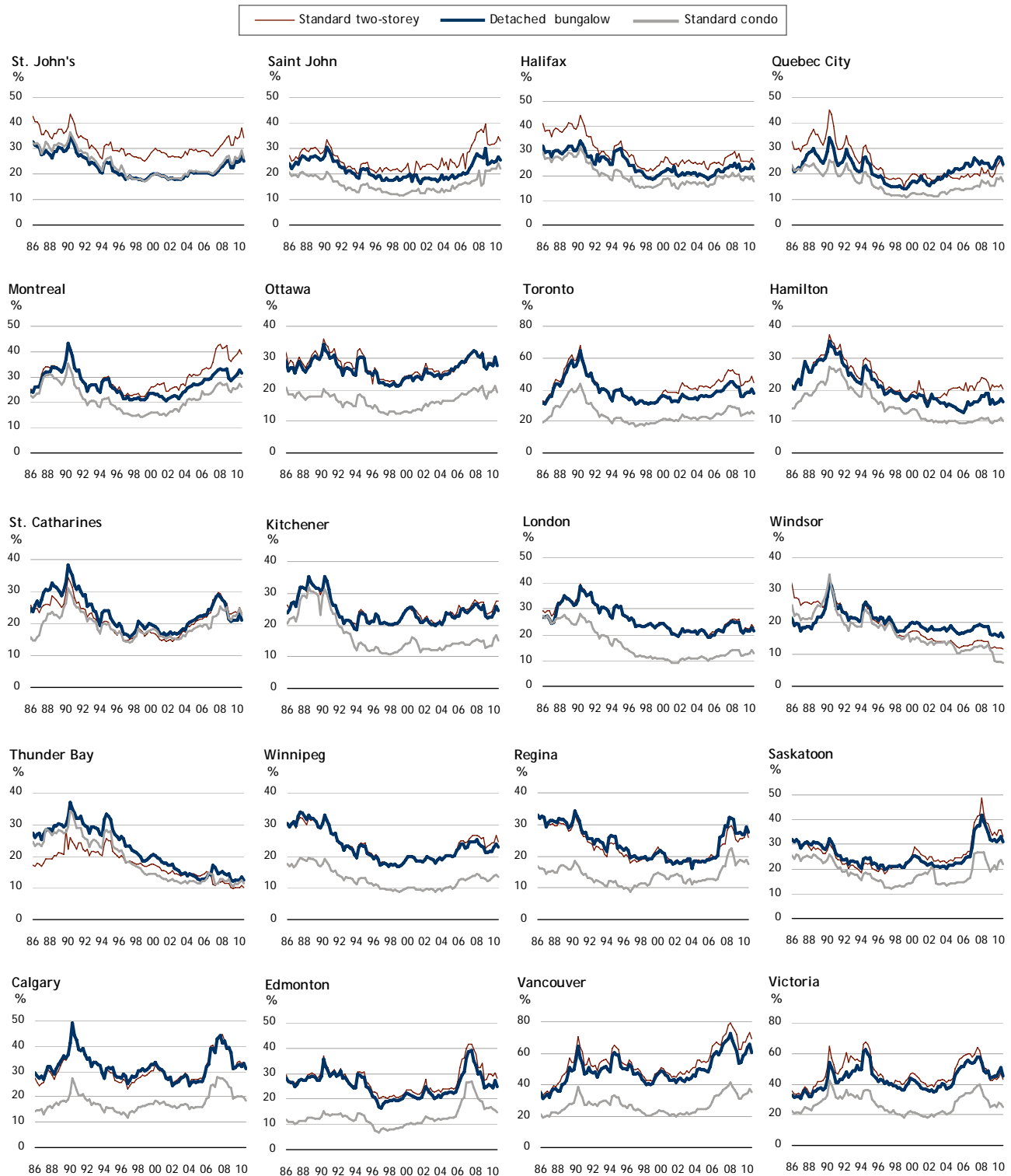
Region	Average Price		Qualifying Income (\$) Q3 2010	RBC Housing Affordability Measure			
	Q3 2010 (\$)	Y/Y % ch.		Q3 2010 (%)	Q/Q Ppt. ch.	Y/Y Ppt. ch.	Avg. since '85 (%)
Canada*	220,900	5.8	49,900	27.8	-1.4	0.1	26.8
British Columbia	297,600	7.6	60,600	32.9	-1.8	0.7	28.0
Alberta	212,600	-2.2	47,300	20.7	-0.8	-1.6	22.1
Saskatchewan	209,200	5.4	48,000	26.4	-1.8	-0.7	24.4
Manitoba	148,200	11.9	36,300	20.7	-0.9	0.9	21.0
Ontario	235,700	6.6	54,900	27.4	-1.3	0.2	27.7
Quebec	185,100	6.9	42,400	28.7	-1.5	0.6	26.9
Atlantic	162,000	1.7	39,000	25.4	-1.5	-0.5	24.4
Toronto	309,900	5.6	68,100	31.8	-1.2	0.1	31.1
Montreal	223,700	6.1	50,000	33.9	-1.1	0.5	29.2
Vancouver	390,400	10.5	76,800	40.1	-2.2	1.6	31.8
Ottawa	238,200	7.1	56,900	26.6	-2.0	0.4	23.5
Calgary	246,700	-1.1	51,800	22.6	-1.2	-1.6	23.0
Edmonton	190,900	-4.1	44,100	19.8	-0.5	-1.7	18.2

\* Population weighted average

Source: Royal LePage, Statistics Canada, RBC Economics Research

## Mortgage carrying costs by city

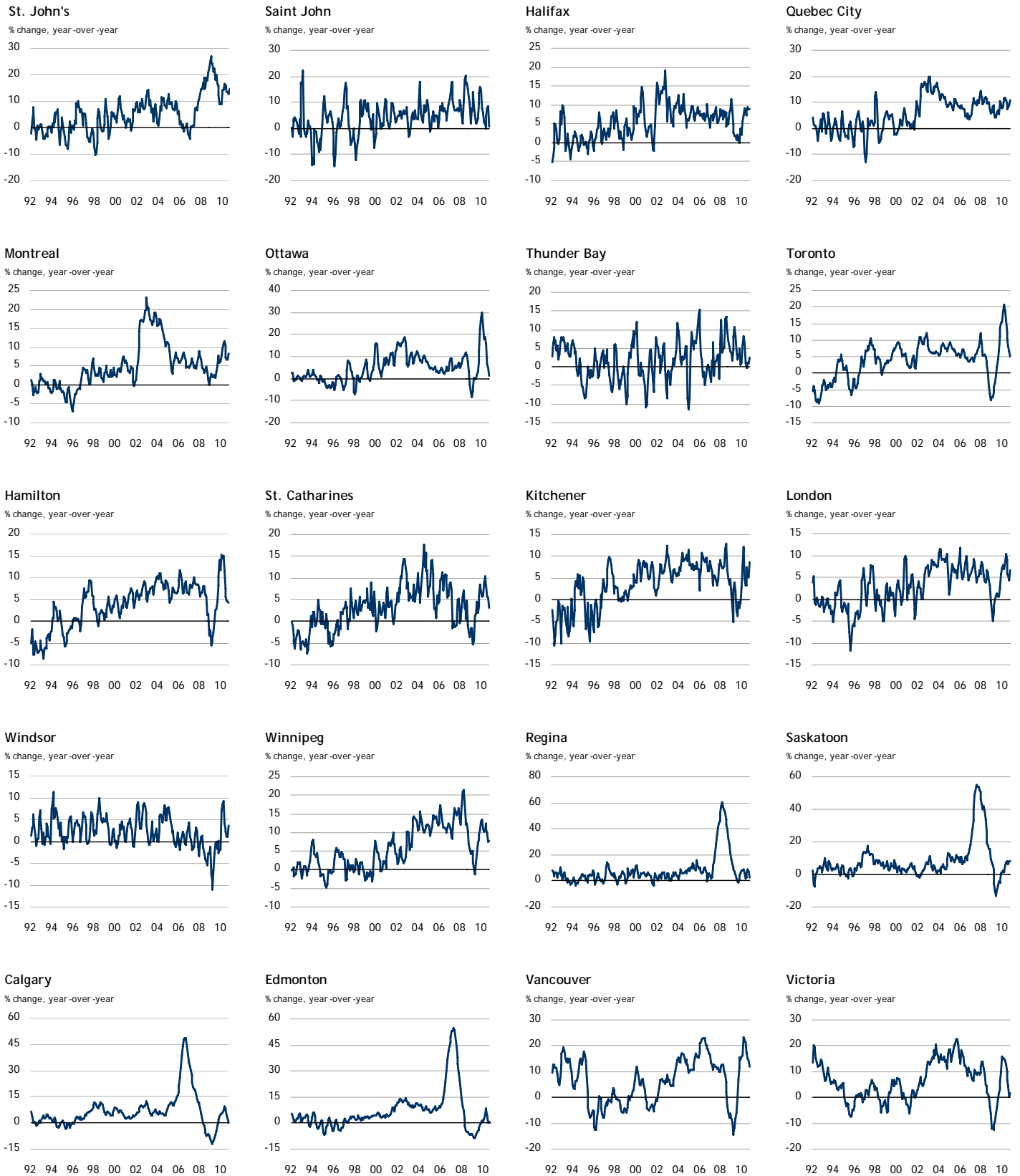
Our standard RBC Housing Affordability Measure captures the proportion of median pre-tax household income required to service the cost of a mortgage on an existing housing unit at going market prices, including principal and interest, property taxes and utilities; the modified measure used here includes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



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

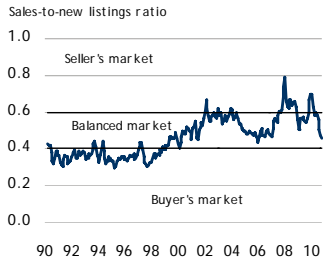
Source: Canadian Real Estate Association, RBC Economics Research



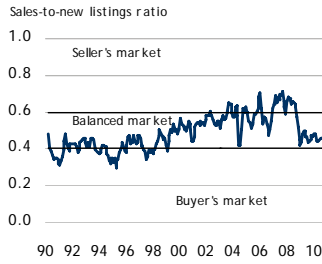


# Home sales-to-new listings ratio

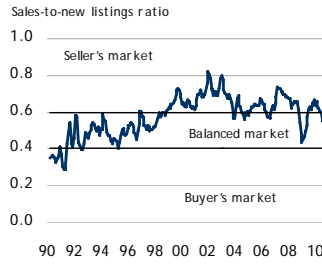
**St. John's**



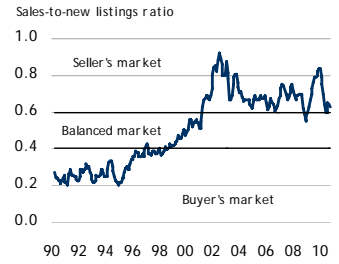
**Saint John**



**Halifax**



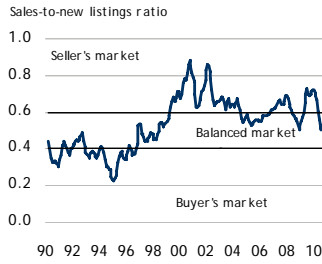
**Quebec City**



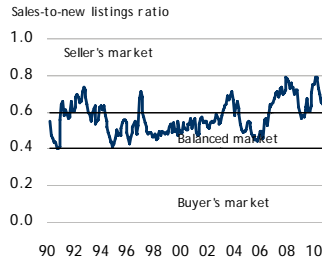
**Montreal**



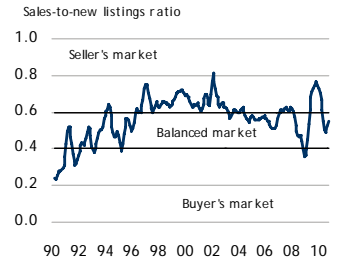
**Ottawa**



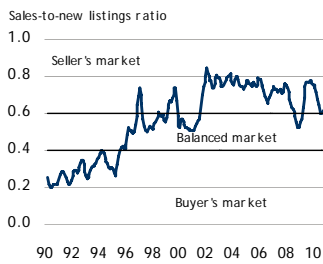
**Thunder Bay**



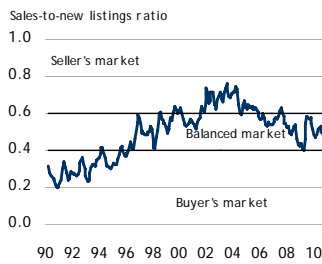
**Toronto**



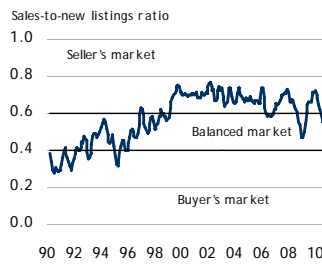
**Hamilton**



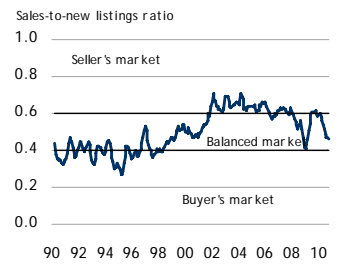
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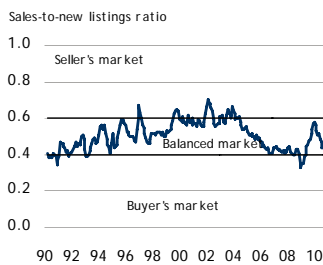
**Kitchener**



**London**



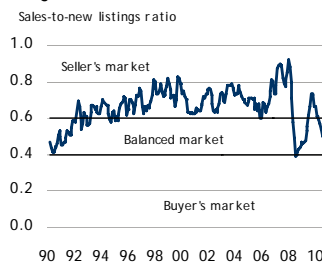
**Windsor**



**Winnipeg**



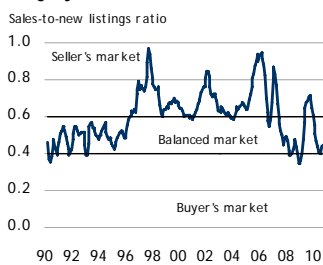
**Regina**



**Saskatoon**



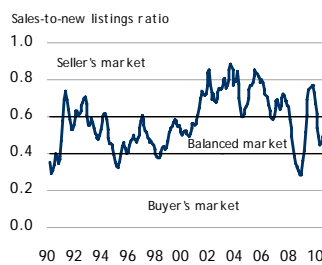
**Calgary**



**Edmonton**



**Vancouver**



**Victoria**



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

Source: Canadian Real Estate Association, RBC Economics Research



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