RBC ECONOMIC RESEARCH

CANADIAN HOUSING HEALTH CHECK

August 2018

Largest four housing markets

Toronto — Stretched affordability remains a top vulnerability. The market is finally getting over the stress test hump though rising interest rates will pose challenges. Regulatory changes made the market healthier—it is now balanced, well supported by economic and demographic fundamentals, and while condo building activity is elevated we see few signs of overbuilding. Downward pressure on prices will soon subside.

Montreal — This is one of the stronger markets in Canada at present with a generally positive risk/vulnerability profile. Buyer interest has been quite resilient in the face of the stress test. Demand-supply conditions are tight and prices are accelerating moderately. Gradual erosion of affordability is a factor worth monitoring closely as is a rise in multi-unit project construction.

Vancouver — Extremely poor affordability is the number one source of vulnerability. Recent policy measures continue to pose near-term risks. Demand-supply conditions have eased but remain balanced, which tempers the risk of a material price decline in the near term. Elevated construction levels and slower population growth are a potentially risky mix.

Calgary — The stress test foiled the burgeoning market recovery this year. Demand-supply conditions have loosened, taking away support for prices in the process. High condo inventories remain an issue, as is slower population growth. On a positive note, stronger oil prices should boost sentiment and pave the way for an eventual market turnaround.

Rising interest rates are the next big test for the housing market

Nation-wide: The probability of a steep and widespread housing downturn over the next 12 months is still low. Markets across the country are gradually adapting to the mortgage stress test; rising interest rates now pose the bigger near-term challenge.

Local housing markets: While risk/vulnerability profiles vary significantly, no major markets appear to be at risk of an imminent severe downturn. Calgary and other prairie markets have weaker profiles, and Montreal (and Ottawa) stronger ones.

Interest rates: Prospects for higher interest rates are a central risk factor in the period ahead. High-priced housing markets such as Vancouver and Toronto are most exposed. Areas where households hold elevated debt levels such as in Alberta also are exposed.

Housing policy: Adjustment to the new stress test is progressing well though it may continue to pose short-term challenges for some markets. In British Columbia, market-cooling measures announced in the 2018 provincial budget added a further layer of policy adjustment risk. Longer term, the tightening of mortgage and housing policy rules will reduce risks.

Affordability: The high cost of homeownership in Vancouver, Toronto and, to a lesser degree, Montreal represents a significant vulnerability for Canada's major markets.

Surging prices: This is no longer an issue in Toronto and increasingly less so in Vancouver where prices gains have moderated since spring.

Unemployment: Labour market-related risks eased significantly in Alberta and, to a lesser extent, Saskatchewan. Labour market conditions are strong in the majority of other provinces and generally provide solid support for local housing markets.

Strong construction levels: Elevated levels of apartment construction in Vancouver, Toronto and Montreal raise some longer-term absorption issues. There's little risk near term as unsold inventories are low at the present time.

Monitoring dashboard

	Canada	Vancouver	Calgary	Toronto	Montreal
Affordability	🔴	🔴	🟢	🔴	🟡
Resale market balance	🟢	🟢	🟢	🟢	🟢
Rental market balance	🟢	🟢	🔴	🟢	🟢
Interest rates	🟢	🟢	🟢	🟢	🟢
Labour market	🟢	🟢	🟢	🟢	🟢
Demographics	🟢	🔴	🔴	🟢	🟢
New home inventory - singles	🟢	🟢	🟢	🟢	🟢
New home inventory - multiples	🟢	🟢	🔴	🟢	🟢
Homes under construction - singles	🟢	🟡	🟢	🟢	🟢
Homes under construction - multiples	🔴	🔴	🟡	🔴	🔴

🔴 Significantly outside historical norms and posing much higher risk than usual
🟡 Modestly outside historical norms and posing moderately higher risk than usual
🟢 Within historical norms or not posing any immediate threat

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Background

Canadian Housing Health Check provides RBC Economics' assessment of key indicators of Canada's housing market that are deemed to offer early warning of potential imbalances. This monitoring exercise is one of the tools used regularly by RBC Economics to follow developments in this important sector of the Canadian economy. The report focuses on indicators that have been closely correlated (leading or coincident) with housing downturns and significant home price declines during housing cycles in the past three decades or so. While we believe that housing affordability and the sales-to-new listings ratio (and months' inventory) are the best indicators of market stress and price pressure, respectively, no single indicator provides perfect and accurate early warning signals of impending trouble. Accordingly, *Canadian Housing Health Check* emphasizes a 'dashboard' approach to convey the point that trouble in the housing market can arise from many directions and that it is imperative to monitor the situation broadly. This approach is complemented by a detailed review of individual indicators that includes a graphical depiction of the current situation within a historical context and a brief discussion of the rationale of our assessment.

About the graphics and risk 'zone' system

The dashboard graphics display the current values of the indicators (dark blue bar) within zones that we consider safe (green), concerning (yellow) or dangerous (red). The width of each graphics represents the range of values posted by the indicator during the past 30 years (or period of time available). The far left corresponds to the safest measure ever recorded and the far right, to the most extreme imbalance reached historically. For most indicators, the left corresponds to low values but for some (sales-to-new listings ratio and net immigration) to high values.

The yellow and red zones appearing in dashboard graphics and individual indicator charts generally were determined by analyzing past housing downturns and constitute our estimations of thresholds above (or, in some cases, below) which market imbalances and significant home price declines occurred at the national level in Canada. The yellow zone comprises a range of values that, historically, have been mostly associated with imbalances but not always with housing downturns (i.e. sustained price declines). In other words, these values give somewhat ambiguous and sometimes 'false' signals. The red zone, however, comprises values that represent imbalances much more clearly and of larger magnitude. An indicator in the red zone should be considered a source of worry. The farther to the right in the red zone in the dashboard graphics are the values, the more extreme is the imbalance, the more intense is the stress exerted on the market and, ultimately, the more severe the potential correction.

The specific rules at the national level are as follows:

- **RBC Affordability Measure for the aggregate of all housing types**: yellow threshold = 41.5% (0.3 standard deviations above the long-term mean); and red at 45.1% (1.0 standard deviations above the mean).
- **Sales-to-new listings ratio**: yellow threshold = 0.40; and red = 0.35.
- **Months of inventory**: yellow threshold = 7.0; red = 8.5.
- **Rental vacancy rate**: yellow threshold = 3.2% (long-term mean); and red = 3.7% (0.5 standard deviations above the mean).
- **Real 5-year bond yield relative to trailing 12-month average**: yellow threshold = 1.0 percentage point (1 standard deviation above the mean); red = 2.0 percentage points (2 standard deviations).
- **Unemployment rate relative to trailing 12-month average**: yellow threshold = 0.41 percentage points (0.6 standard deviation above the mean); red = 0.9 percentage points (1.5 standard deviations).
- **Net immigration per 1,000 population**: yellow threshold = 6.5 (0.5 standard deviations above the mean); red = 5.0 (0.4 standard deviations below the mean).
- **Completed and unoccupied units per 1,000 population, singles and semis**: yellow threshold = 0.29 (0.3 standard deviations above the mean); red = 0.36 (1.3 standard deviation above the mean).
- **Completed and unoccupied units per 1,000 population, multiples**: yellow threshold = 0.36 (the mean); red = 0.47 (0.9 standard deviation above the mean).
- **Housing under construction per 1,000 population, singles**: yellow threshold = 2.11 (0.5 standard deviations from the mean); red = 2.33 (1 standard deviation from the mean).
- **Housing under construction per 1,000 population, multiples**: yellow threshold = 3.93 (0.5 standard deviations from the mean); red = 4.58 (1 standard deviation from the mean).

The areas shaded in grey in the indicator charts correspond to housing downturns – i.e., periods during which home prices (as defined as average prices of homes sold on the MLS system) fell by more than 5% from monthly peak to trough. It is important to note that the precise timing of these downturns can vary depending on the home price measure used. The grey shaded areas, therefore, should be seen as broad guidelines.

CANADA

Affordability

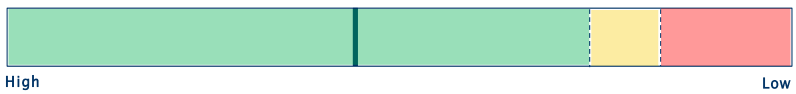
Risk implications

RBC affordability measure – aggregate

Near-term: negative
Medium-term: negative

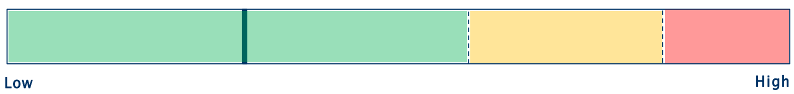
Existing home market balance

Sales-to-new listings ratio



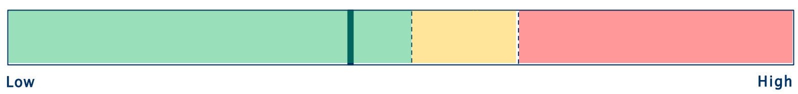
Near-term: positive
Medium-term: neutral

Months of inventory



Near-term: positive
Medium-term: neutral

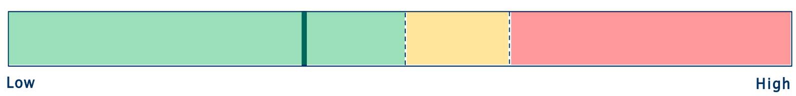
Rental vacancy rate



Near-term: positive
Medium-term: positive

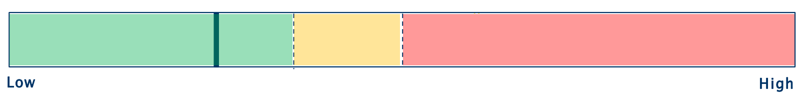
Demand fundamentals

Change in real 5-Year bond yields



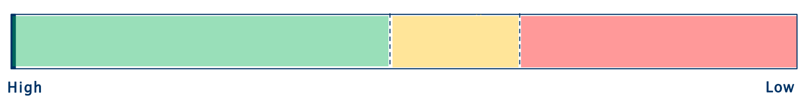
Near-term: negative
Medium-term: negative

Change in the unemployment rate



Near-term: positive
Medium-term: positive

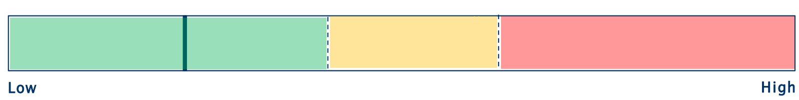
Net immigration rate



Near-term: positive
Medium-term: positive

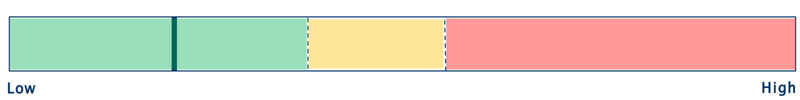
Supply fundamentals

Completed and unsold units per capita – singles and semis



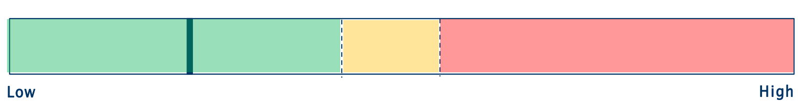
Near-term: positive
Medium-term: positive

Completed and unsold units per capita – multiples



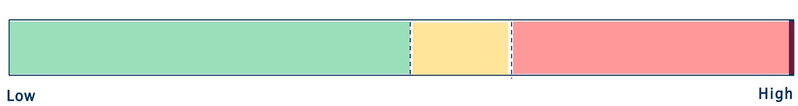
Near-term: positive
Medium-term: positive

Housing under construction per capita – singles



Near-term: positive
Medium-term: positive

Housing under construction per capita – multiples

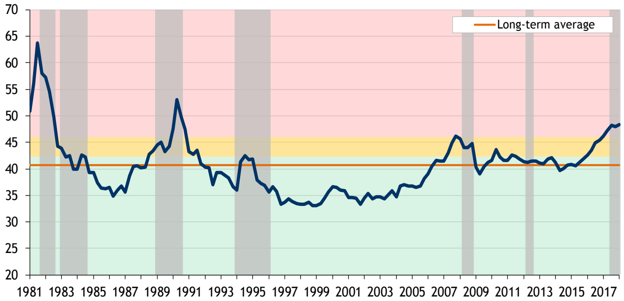


Near-term: neutral
Medium-term: negative

CANADA

Affordability

RBC affordability measure - aggregate
Ownership costs as % of household income, Canada



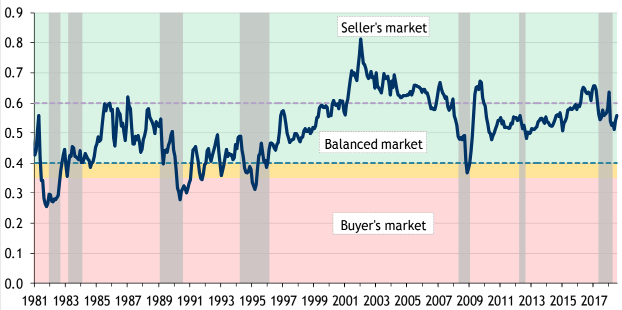
Source: RBC Economics Research, Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage

Stretched affordability continues to be a significant source of vulnerability in Canada.

The most recent reading of RBC's aggregate housing affordability measure (48.4% in Q1 2018) suggests the presence of greater-than-average market stress for buyers in Canada though this is skewed by extremely poor affordability in Vancouver and Toronto. The situation is not alarming in most other markets.

Existing home market balance

Sales-to-new listings ratio
Monthly, S.A., Canada

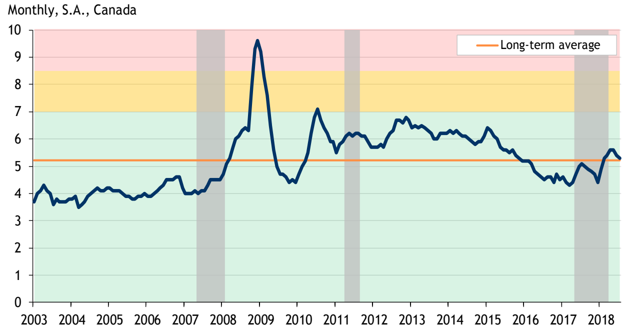


Source: RBC Economics Research, Canadian Real Estate Association

Demand-supply conditions are balanced overall. This means that the odds of an imminent broad-based price decline are low.

Canada-wide, the sales-to-new listings ratio settled into the range consistent with balanced market conditions after climbing into seller's market territory in 2016. This re-balancing was largely engineered by policy as the introduction of Ontario's Fair Housing Plan in April 2017, the new stress test and market-cooling measures in BC earlier this year cooled resales significantly.

Months of inventory
Monthly, S.A., Canada

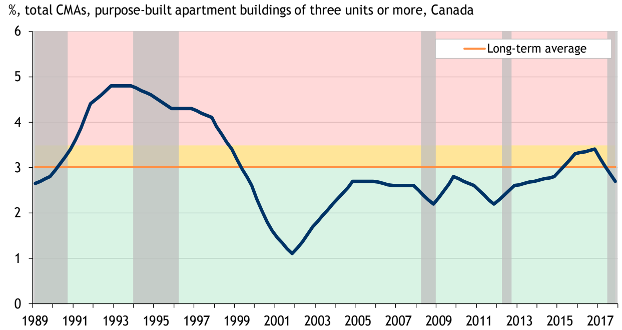


Source: RBC Economics Research, Canadian Real Estate Association

The for-sale inventory is well within historical norms and consistent with continued price increases.

A pick-up in new listings in Ontario since spring last year returned the number of months of inventory in Canada closer to its long-run average of 5.3 from historically low levels in 2016.

Rental vacancy rate
%, total CMAs, purpose-built apartment buildings of three units or more, Canada



Annual:1988-2010; Semi-annual: 2011-current
Source: RBC Economics Research, CMHC

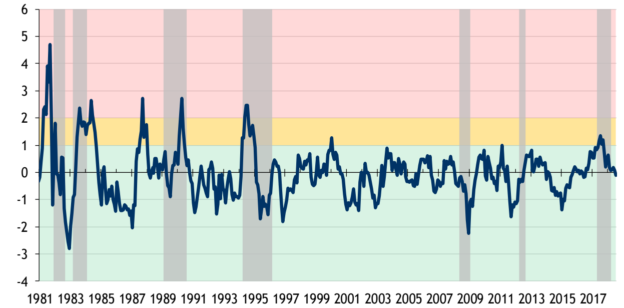
The rental market is tight overall in Canada and does not pose a threat to the home purchase market.

The latest rental vacancy data for October 2017 shows a drop to 2.7% at the national level from 3.4% in 2016, which is slightly below the long-term average (3.0%). The decline was widespread across the country.

CANADA

Demand fundamentals

Real 5-year bond yields relative to trailing 12-month average
Percentage points, Canada



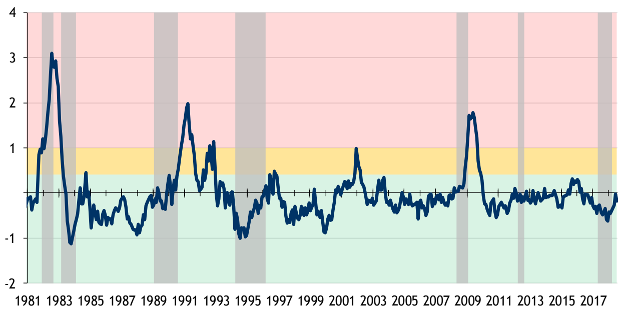
Source: RBC Economics Research, Bank of Canada, Statistics Canada

The risk of an interest rate shock eased this year thanks to a slowing pace of increase in longer-term interest rates. We nonetheless caution that future rate hikes could potentially be problematic for the market.

After picking up markedly over the second half of 2017, the yield on the five-year Government of Canada bond grew more slowly so far in 2018. The recent deceleration meant that the real yield was effectively flat relative to its 12-month trailing average in June and July, which no longer threatened to shock the housing market.

RBC's base case interest rate forecast calls for the overnight rate to rise by another 75 basis points by mid-2019. RBC expects longer-term rates to move up in tandem with short-term rates. This scenario would present increasing risks to the housing market in the period ahead.

Unemployment rate relative to trailing 12-month average
Percentage points, Canada



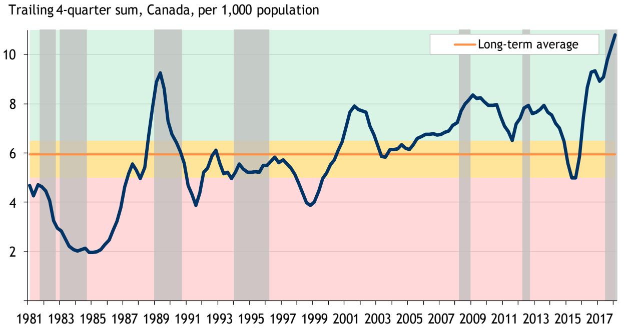
Source: RBC Economics Research, Statistics Canada

Labour market conditions pose little risk nationally at this point—quite the contrary.

Areas of the country that previously posed a higher degree of risk such as Alberta have seen an improvement with that province's unemployment rate coming down noticeably since early 2017.

The national unemployment rate fell to its lowest level since the mid-1970s this spring and has remained mostly stable since. The rate has been below its trailing 12-month average since May 2016.

Net immigration rate
Trailing 4-quarter sum, Canada, per 1,000 population



Source: RBC Economics Research, Statistics Canada

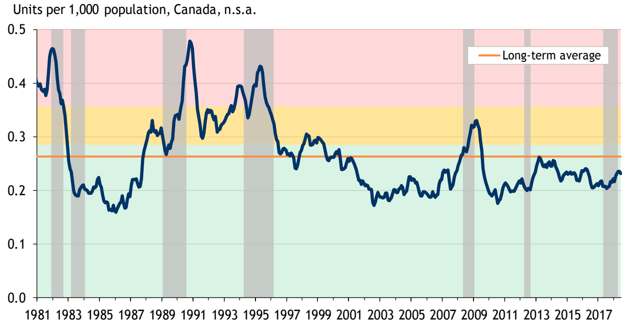
Decades-high levels of immigration strengthen the risk/vulnerability profile of Canada's housing market.

The rate of net immigration in Canada (measured per 1,000 population) has surged since late-2015, which provides strong support for housing demand.

The rate is likely to remain elevated in light of the federal government boosting its target for new permanent residents from 300K in 2017 to 310K in 2018, and further to 330K in 2019 and 340K in 2020.

Supply fundamentals

Completed and unsold units - singles and semis
Units per 1,000 population, Canada, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

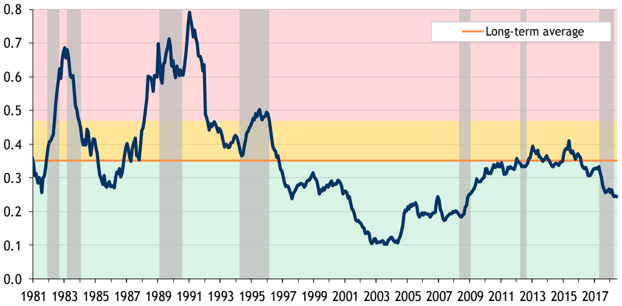
There are no signs of excess supply of new single-detached units in Canada at this stage.

The unsold inventory remains historically low at 0.23 per 1,000 population in June 2018—still well below the long-run average of 0.26—despite picking up slightly since the middle of last year.

CANADA

Supply fundamentals

Completed and unsold units - multiples
Units per 1,000 population, Canada, n.s.a.



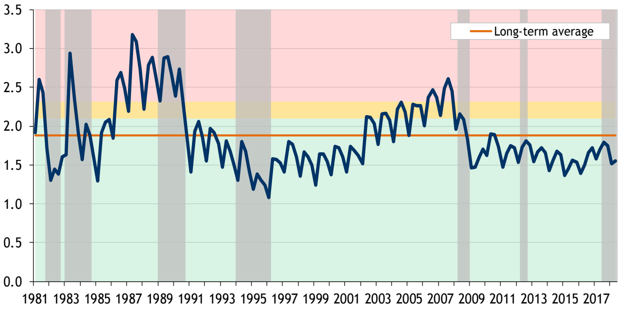
Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

On the multi-unit dwellings side, the inventory of completed but unsold condos continues to evolve constructively in Canada and is no longer a source of concern.

Market absorption has been solid in the past three years. This helped draw down the unsold inventory markedly to a 10-year low of 0.24 units per 1,000 population in June.

The latest reading of this indicator was below the long-term average (0.36) and well below the 0.48 threshold that would signal a high degree of excess.

Housing under construction - singles
Units per 1,000 population, Canada, n.s.a.

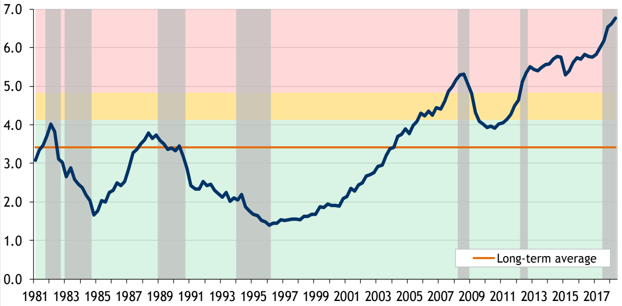


Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

We remain unconcerned about overbuilding in the single family home segment.

Construction levels remain well below historical averages (when measured on a per 1,000 population basis).

Housing under construction - multiples
Units per 1,000 population, Canada, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

On the multiples side, however, record-high levels of apartments under construction in Canada entail some degree of absorption risks over the medium term.

Nonetheless, strong apartment construction should be weighed against solid demand for lower-priced housing options in markets such Vancouver and Toronto.

Most of the units being built are in the Toronto (30% of total), Vancouver (18%) and Montreal (12%) areas.

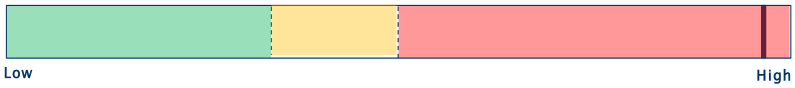
The run-up in condo building over the past two decades in large part reflected structural changes that arose from policy (e.g. rules limiting urban sprawl) and affordability (condo apartments are the more affordable housing type) considerations, and therefore, represents a market share gain over single-family homes.

GREATER TORONTO AREA

Affordability

Risk implications

RBC affordability measure – aggregate



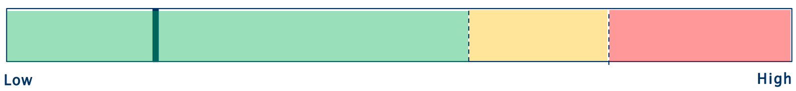
Near-term: negative
Medium-term: negative

Existing home market balance

Sales-to-new listings ratio

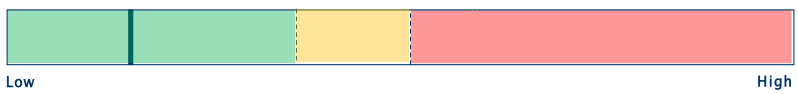
Near-term: positive
Medium-term: neutral

Months of inventory – Ontario



Near-term: positive
Medium-term: neutral

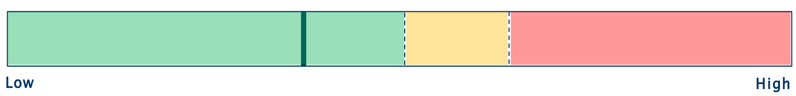
Rental vacancy rate



Near-term: positive
Medium-term: positive

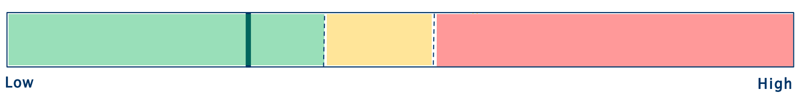
Demand fundamentals

Change in real 5-Year bond yields



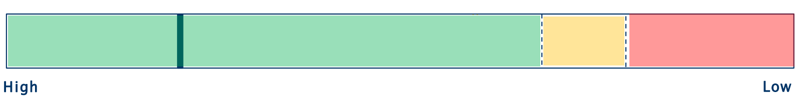
Near-term: negative
Medium-term: negative

Change in the unemployment rate



Near-term: positive
Medium-term: positive

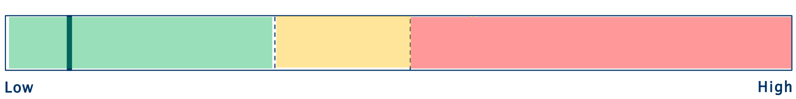
Population growth



Near-term: positive
Medium-term: positive

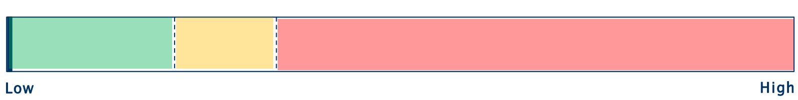
Supply fundamentals

Completed and unsold units per capita – singles and semis



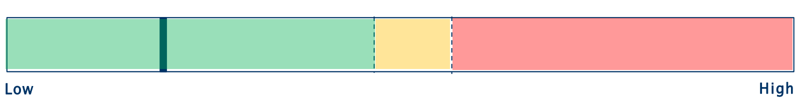
Near-term: positive
Medium-term: positive

Completed and unsold units per capita – multiples



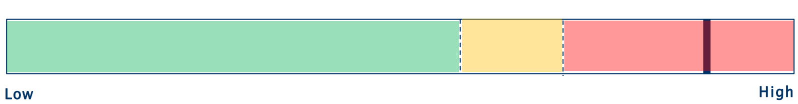
Near-term: positive
Medium-term: positive

Housing under construction per capita – singles



Near-term: positive
Medium-term: positive

Housing under construction per capita – multiples

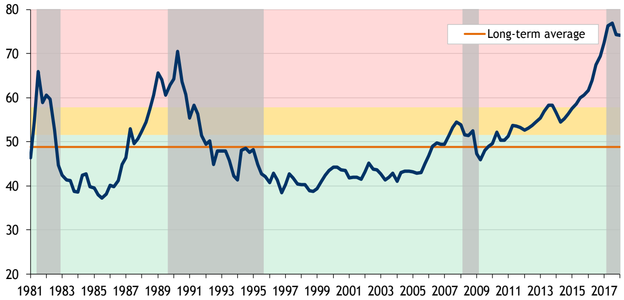


Near-term: neutral
Medium-term: neutral

GREATER TORONTO AREA

Affordability

RBC affordability measure - aggregate
Ownership costs as % of household income, Toronto



Source: RBC Economics Research, Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage

RBC's measure of affordability for the GTA is in a zone that historically has been followed by a market correction.

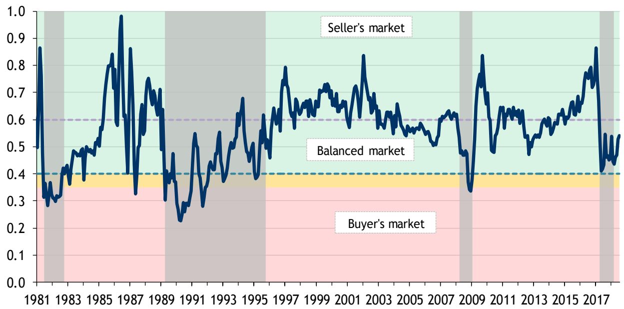
We saw slight improvements in Q4/2017 and Q1/2018 though this reversed only a small fraction of the deterioration that occurred since 2015.

Most of the affordability pressure is concentrated in the single-family home side of the market; however, stress has increased in the condo segment as well in the past year and a half.

Stretched affordability is poised to become a more pressing issue now that interest rates are rising. The Toronto-area market is more sensitive to a substantial rise in interest rates than most markets in Canada.

Existing home market balance

Sales-to-new listings ratio
Monthly, S.A., Toronto



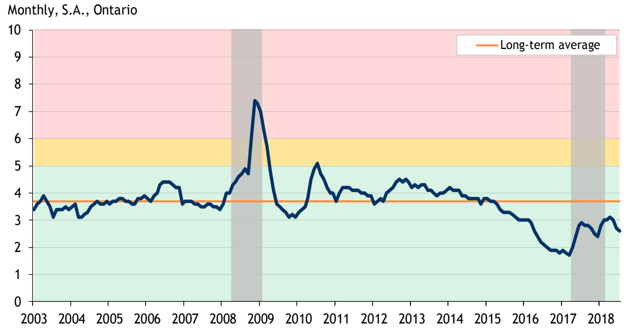
Source: RBC Economics Research, Canadian Real Estate Association

Demand-supply conditions have remained balanced this year despite the significant cooling of the market caused by the new stress test that came into effect January 1, 2018.

Ontario's Fair Housing Plan in April 2017 prompted a sharp re-balancing of demand and supply, with higher-end segments bearing the brunt of the adjustments.

Downward pressures on prices that emerged last year—and which primarily affected the single-detached segment—are now starting to ease, suggesting that prices have likely bottom out in the area.

Months of inventory
Monthly, S.A., Ontario



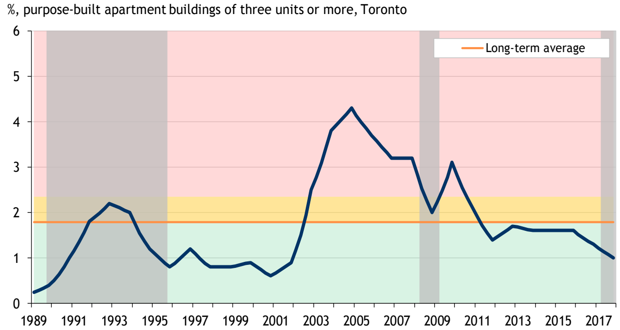
Source: RBC Economics Research, Canadian Real Estate Association

Inventories of homes for sales (active listings) indicate that some degree of market tightness persists.

Data available at the provincial level shows that there were 2.6 months' worth of inventory in Ontario, still significantly lower than the long-run average of 3.7.

Separate data from the Toronto Real Estate Board show that the number of months of inventory in the Toronto area was 2.6 in July 2018, up from 1.3 a year earlier.

Rental vacancy rate
%, purpose-built apartment buildings of three units or more, Toronto



Source: RBC Economics Research, CMHC

GTA's rental market continues to be very tight with the vacancy rate falling further to 1.0% last fall—a 16-year low.

Toronto's condo boom hasn't flooded the rental market or cause vacancies to rise materially.

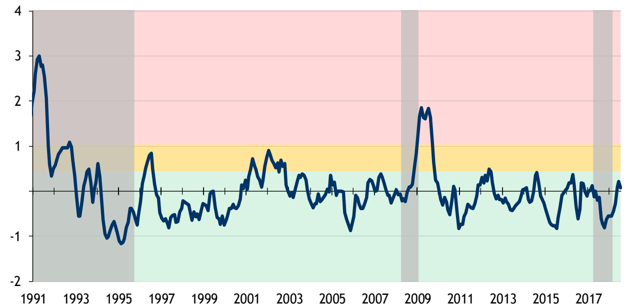
Toronto Real Estate Board statistics showed that condo rental activity was strong historically in Q2/2018 but edged down 0.6% compared to a year ago. Average rent continued to rise at a brisk pace (by more than 10.4% y/y for a one-bedroom apartment).

GREATER TORONTO AREA

Demand fundamentals

Unemployment rate relative to trailing 12-month average

Percentage points, Toronto



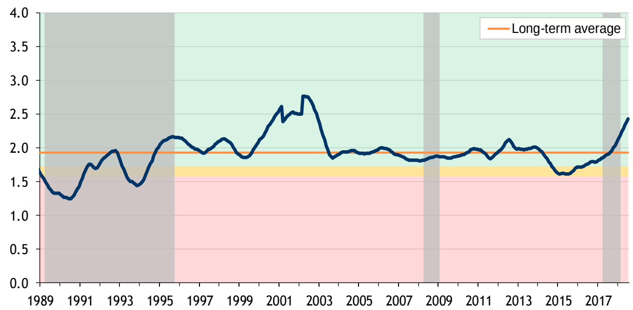
Source: RBC Economics Research, Statistics Canada

Labour market conditions in the GTA continue to be generally supportive for the area's housing market and pose little risks.

Toronto's unemployment rate remains on an eight-year long downtrend. It fell to its lowest point ever in March 2018 (5.8%) in more than 17 years. It since rebounded partially to 6.1% in July.

Adult population growth

Y/Y % change in the 15+ population, Toronto



Source: RBC Economics Research, Statistics Canada

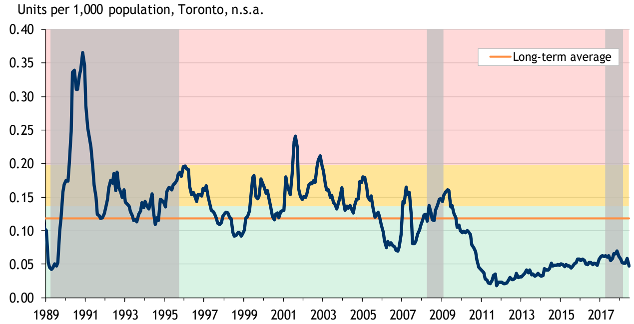
Demographic fundamentals continue to be solid in the GTA. In fact, they strengthened even more in the past couple of years with the rate of growth in adult population picking up to a 15-year high of 2.4% by mid-2018.

A rate below 1.5% would be a source of concern.

Supply fundamentals

Completed and unsold units - singles and semis

Units per 1,000 population, Toronto, n.s.a.



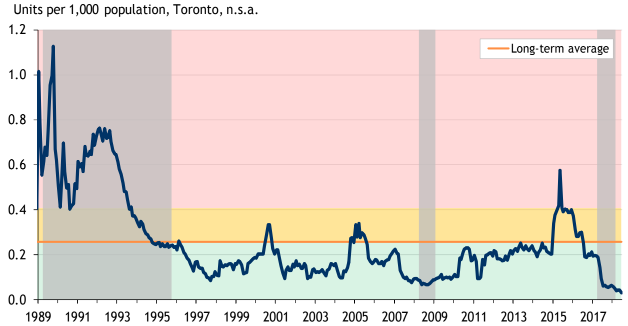
Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

There are no indications of overbuilding of single-family homes in the area at present.

Inventories of newly completed and unsold the single-family continue to be historically low.

Completed and unsold units - multiples

Units per 1,000 population, Toronto, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

Previously high inventory of recently completed and unsold condo units is no longer a concern in the Toronto area.

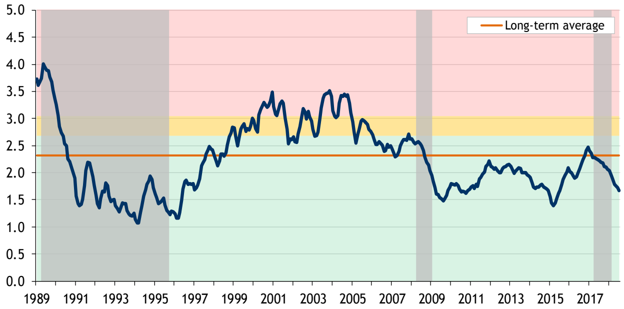
Absorption of newly built condos has been brisk in the GTA since late 2015 and the unsold inventory is now effectively entirely depleted.

The unabsorbed inventory fell to an all-time low of 0.05 units per 1,000 population in June 2018.

GREATER TORONTO AREA

Supply fundamentals

Housing under construction - singles
Units per 1,000 population, Toronto, n.s.a.

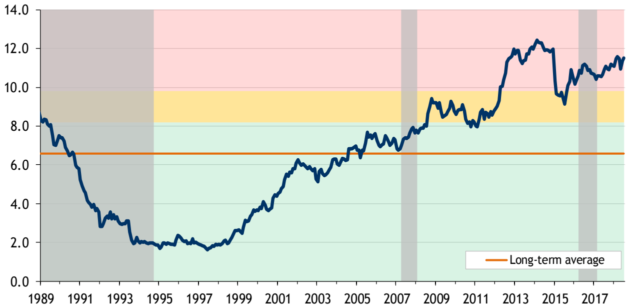


Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

There are no signs of any impending single-unit supply glut at this stage.

The number of single-detached units under construction in the GTA has fallen since the spring of 2017 as builders slowed down the pace of new starts following Ontario's Fair Housing Plan. The most recent level of single-unit construction activity was well below the long-term average for the area when measured in per 1,000 population terms.

Housing under construction - multiples
Units per 1,000 population, Toronto, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

The number of multi-unit dwellings under construction continues to be historically high and in the 'high risk' zone.

However, the potential threat this poses to the market is tempered by the low level of unsold condo inventories and solid demand in the existing condo market given rapid population growth.

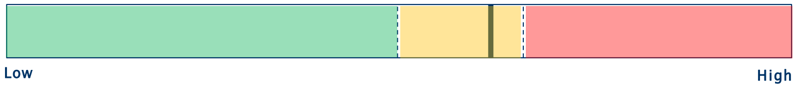
The potential for a wave of completions over a short period of time raises absorption risks for the condo resale and/or rental markets. So far, though, both of these markets have absorbed the increased supply handily.

GREATER MONTREAL AREA

Affordability

Risk implications

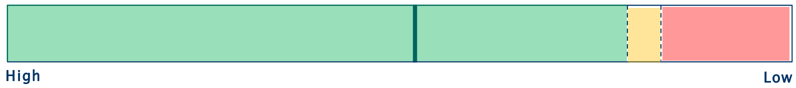
RBC affordability measure – aggregate



Near-term: neutral
Medium-term: neutral

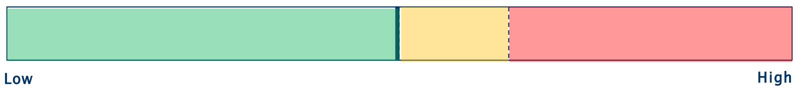
Existing home market balance

Sales-to-new listings ratio



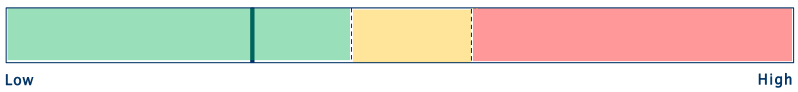
Near-term: positive
Medium-term: positive

Months of inventory – Quebec



Near-term: neutral
Medium-term: neutral

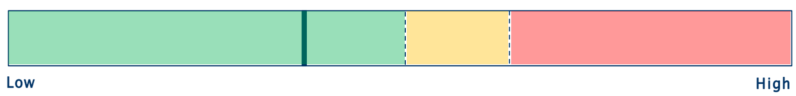
Rental vacancy rate



Near-term: positive
Medium-term: positive

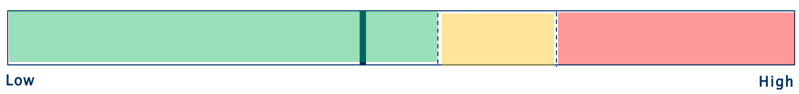
Demand fundamentals

Change in real 5-Year bond yields



Near-term: negative
Medium-term: negative

Change in the unemployment rate



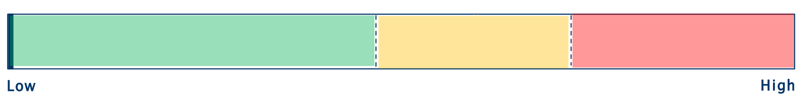
Near-term: positive
Medium-term: positive

Population growth

Near-term: positive
Medium-term: positive

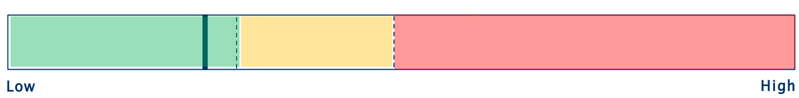
Supply fundamentals

Completed and unsold units per capita – singles and semis



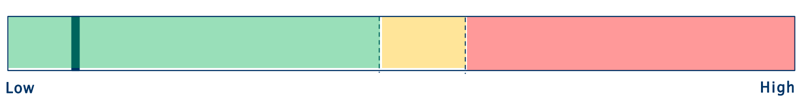
Near-term: positive
Medium-term: positive

Completed and unsold units per capita – multiples



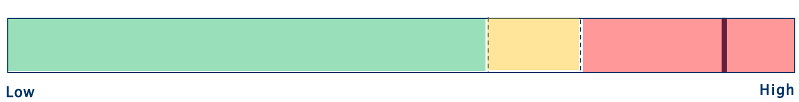
Near-term: positive
Medium-term: positive

Housing under construction per capita – singles



Near-term: positive
Medium-term: positive

Housing under construction per capita – multiples



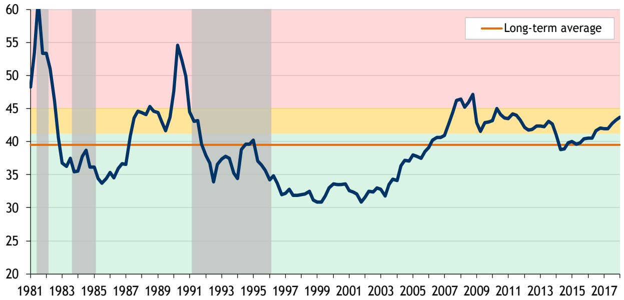
Near-term: neutral
Medium-term: negative

GREATER MONTREAL AREA

Affordability

RBC affordability measure - aggregate

Ownership costs as % of household income, Montreal



Source: RBC Economics Research, Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage

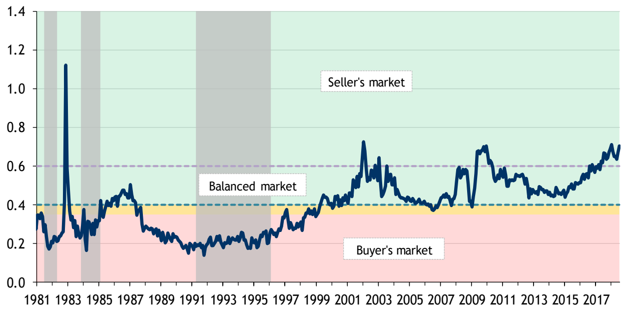
Affordability remains generally manageable for Montreal buyers at this point though not for much longer if the ownership costs continue to increase at the same rate as they have since early 2015.

RBC's aggregate measure most recently was 43.7%, within a range consistent with moderate risk.

Existing home market balance

Sales-to-new listings ratio

Monthly, S.A., Montreal



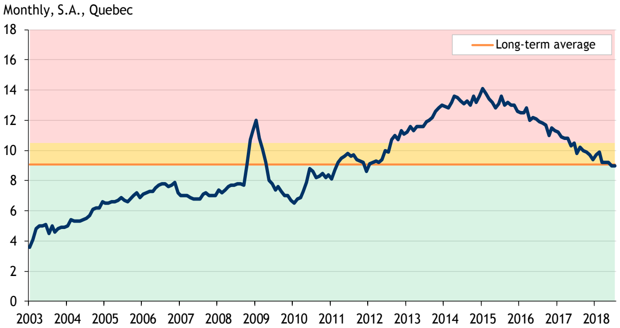
Source: RBC Economics Research, Canadian Real Estate Association

The steady tightening of demand-supply conditions in the Montreal area suggests that the rate of price increase will strengthen in the period ahead. The risk of a sharp decline is low in the near term.

Home resales were up by 4% in the second quarter of 2018. Robust sales activity took place amid a continued decline in the number of homes put up for sale each month, which resulted in a significant drawdown in inventories across all housing categories.

Months of inventory

Monthly, S.A., Quebec



Source: RBC Economics Research, Canadian Real Estate Association

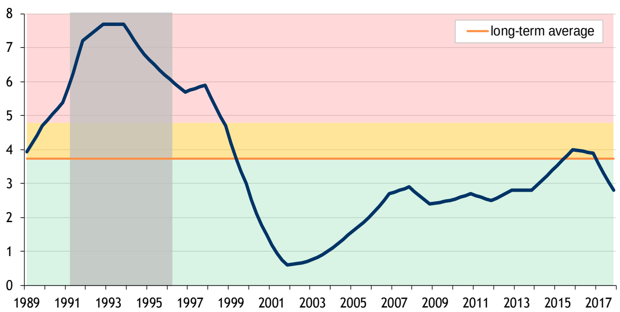
Inventory data provide further evidence of firming marked conditions and low risk of imminent price declines in Montreal.

The number of months' inventory continues to trend downwardly overall in Quebec and is poised to enter the 'low-risk zone'.

Local real estate board data show that the number of months' inventory was relatively low at 5.7 in Q2/2018 for single-detached homes and at a balanced level of 8.0 for condos.

Rental vacancy rate

%, purpose-built apartment buildings of three units or more, Montreal



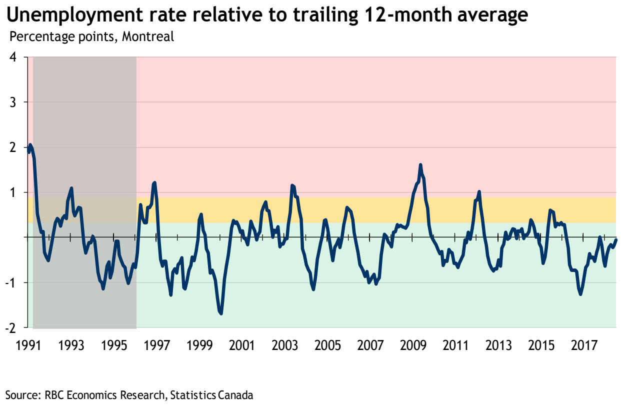
Source: RBC Economics Research, Statistics Canada

The risk of oversupply in Montreal's rental market diminished significantly last year. The rental vacancy rate fell from 3.9% in October 2016 to a four-year low of 2.8% in October 2017 and is now in low-risk territory.

That being said, a record-high 11,200 purpose-built rental units are under construction in the Montreal area. Completion of these units may put upward pressure on the vacancy rate in the coming years.

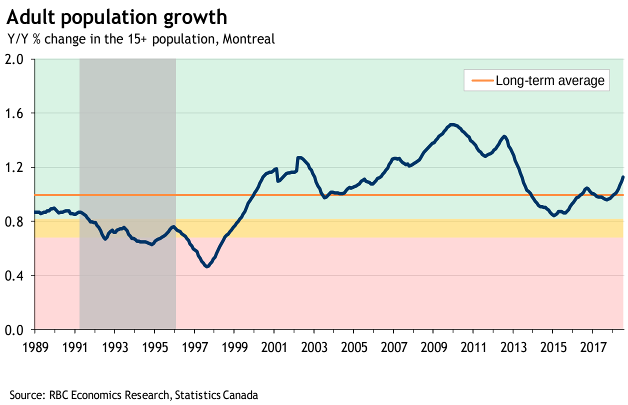
GREATER MONTREAL AREA

Demand fundamentals



Montreal's job market remains generally healthy and offers strong support for the housing market.

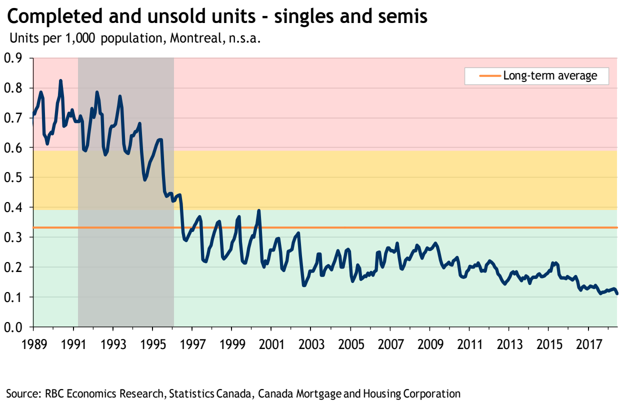
The unemployment averaged 6.0% over the first seven months of 2018, near the lowest point on records dating back to 1987.



Overall demographic conditions pose little risks for the market at this stage.

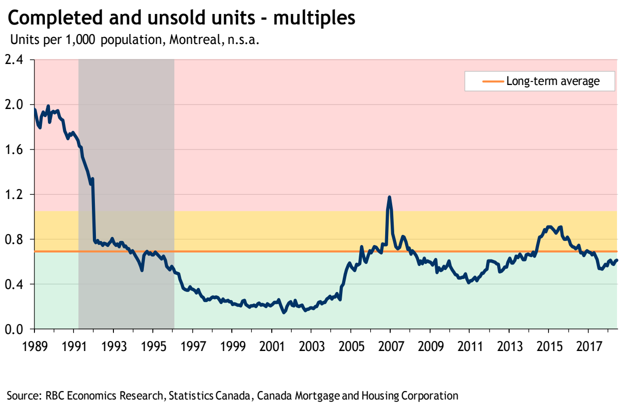
Following a two year-long period of easing growth, Montreal's adult population has grown at a faster rate since mid-2015, marginally exceeding its long-term average of 1.0% most recently.

Supply fundamentals



There's no evidence of overbuilding in the single-family market segment.

The number of unsold newly completed homes are near all-time lows in the Montreal area.



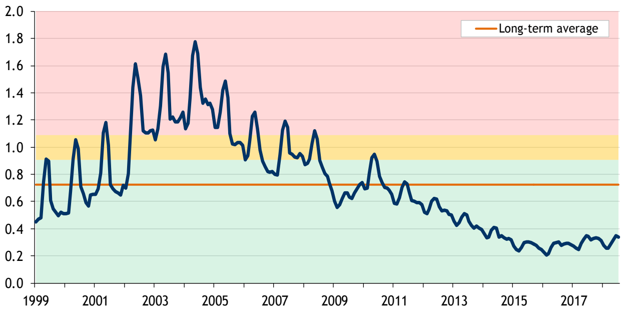
There are few signs of overbuilding on the multi-unit dwelling side either. Strong market absorption in the past couple of years cut the unsold inventory to healthy levels since the middle of 2017.

Unsold inventory picked up slightly this year but, at 0.61 units per 1,000 population in June 2018, it remains below the long-term average and within the low-risk zone.

GREATER MONTREAL AREA

Supply fundamentals

Housing under construction - singles
Units per 1,000 population, Montreal, n.s.a.

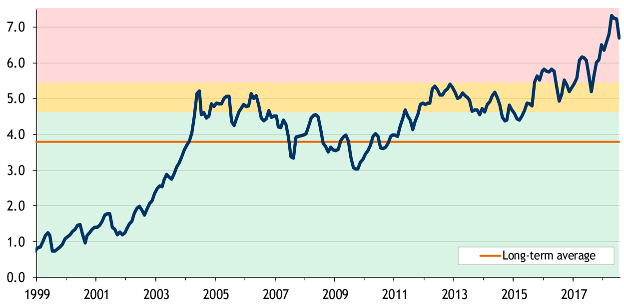


Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

The risk of any overbuilding of single-family homes in the short term is extremely remote.

Current levels of construction are significantly below long-run averages and well within the 'safe zone'.

Housing under construction - multiples
Units per 1,000 population, Montreal, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

A potential risk of overbuilding of multi-unit dwellings is present in Montreal.

The number of multi-unit dwellings under construction is just coming off a record high set at the start of 2018.

This in large part reflects a significant increase in purpose-built rental apartment projects. Condo units under construction also rose since mid-2017 but remain below their peak reached between 2012 and 2014.

Strong construction activity of higher-density housing categories partly reflects a structural shift from single-detached toward multiple-unit forms of housing. This shift is supported by urban development policy and affordability advantage relative to single-family homes.

GREATER VANCOUVER AREA

Affordability

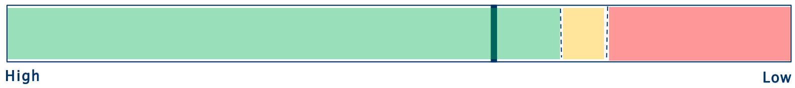
Risk implications

RBC affordability measure – aggregate

Near-term: negative
Medium-term: negative

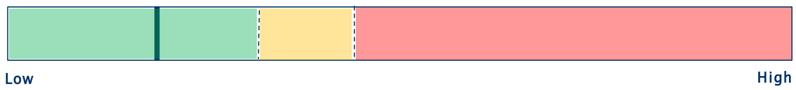
Existing home market balance

Sales-to-new listings ratio



Near-term: positive
Medium-term: neutral

Months of inventory – BC



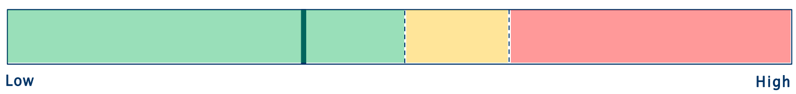
Near-term: positive
Medium-term: positive

Rental vacancy rate

Near-term: positive
Medium-term: positive

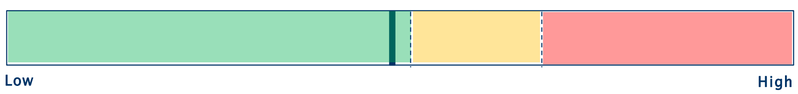
Demand fundamentals

Change in real 5-Year bond yields



Near-term: negative
Medium-term: negative

Change in the unemployment rate



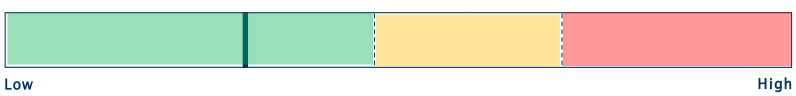
Near-term: positive
Medium-term: positive

Population growth

Near-term: neutral
Medium-term: negative

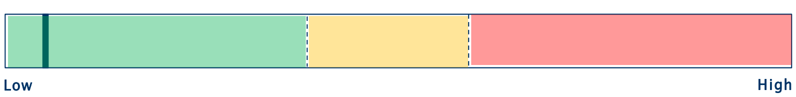
Supply fundamentals

Completed and unsold units per capita – singles and semis



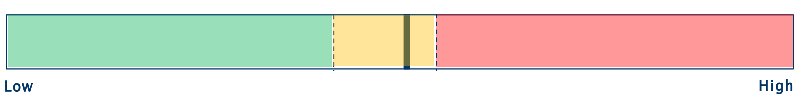
Near-term: positive
Medium-term: positive

Completed and unsold units per capita – multiples



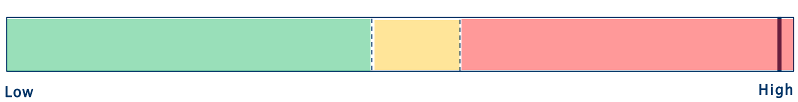
Near-term: positive
Medium-term: positive

Housing under construction per capita – singles



Near-term: neutral
Medium-term: neutral

Housing under construction per capita – multiples



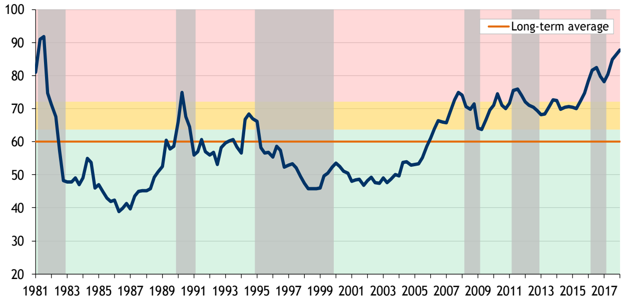
Near-term: neutral
Medium-term: negative

GREATER VANCOUVER AREA

Affordability

RBC affordability measure - aggregate

Ownership costs as % of household income, Vancouver



Source: RBC Economics Research, Brookfield RPS, Statistics Canada, Bank of Canada, Royal LePage

Housing affordability remains extremely poor and represents a major vulnerability for the Vancouver-area market.

Affordability stress is found in both single-family and condo apartment categories; however, it is far more intense in the former.

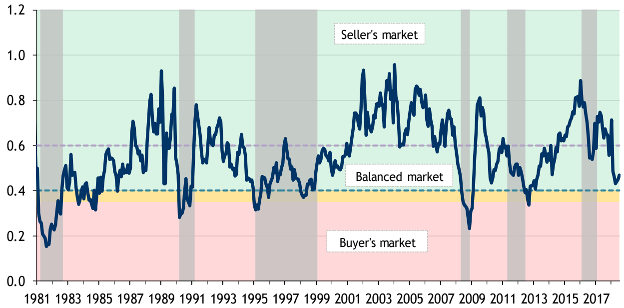
At 87.8% in Q1/2018, RBC's aggregate affordability measure for the area was near its worst level on record.

Poor affordability is likely among the factors that contributed to a significant moderation in home resales in the area since the winter of 2016. Policy changes—including the 15% foreign-buyer tax implemented in August 2016, OSFI's new stress test and a slew of additional market-cooling measures announced in the 2018 BC budget (including an increase to 20% of the foreign buyer tax)—as well as rise in interest rates also likely contributed significantly.

Existing home market balance

Sales-to-new listings ratio

Monthly, S.A., Vancouver



Source: RBC Economics Research, Canadian Real Estate Association

The significant cooling of the market this year has re-balanced demand-supply conditions following a period that saw buyers far outnumbering sellers throughout most of 2017.

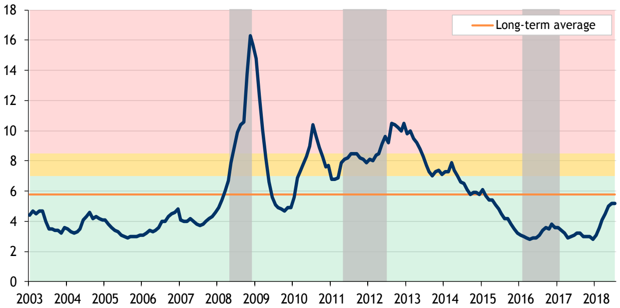
The current balance in the market minimizes the odds of a material price decline though further loosening of demand-supply conditions cannot be ruled out in the near term.

The sales-to-new listings ratio has been volatile so far in 2018—surging to 0.71 in January before dropping to the lower end of balanced territory in April (0.43) and May (0.44).

This volatility is testament to the state of flux in which the market finds itself at this juncture in light of the market-cooling measures introduced in the past few months.

Months of inventory

Monthly, S.A., British Columbia



Source: RBC Economics Research, Canadian Real Estate Association

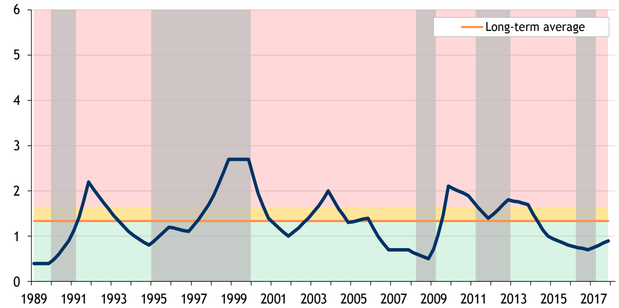
A still-low inventory of homes for sale also makes a material price drop unlikely in the near term.

The number of months' inventory in British Columbia remains below the long-run average of 5.8 despite rising steadily this year.

Similarly, the Real Estate Board of Greater Vancouver continues to report historically-low levels of active listings despite notable increases this year. Active listings have fallen to decades-low in 2016 and 2017.

Rental vacancy rate

%, purpose-built apartment buildings of three units or more, Vancouver



Source: RBC Economics Research, CMHC

Vancouver's rental market shows no evidence of any looming surplus that would cause concerns for the home ownership market.

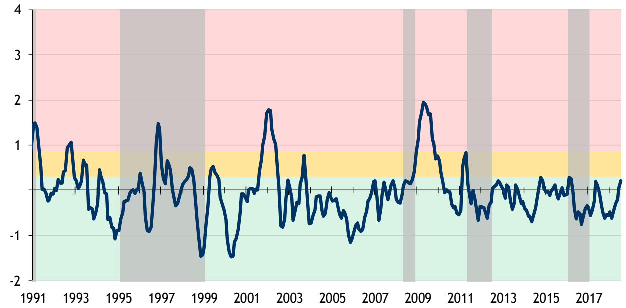
Conditions remain very tight in Vancouver's rental market.

The area's rental vacancy rate was 0.9% in October 2017—among the lowest ones in the country—up marginally from 0.7% in October 2016.

GREATER VANCOUVER AREA

Demand fundamentals

Unemployment rate relative to trailing 12-month average
Percentage points, Vancouver

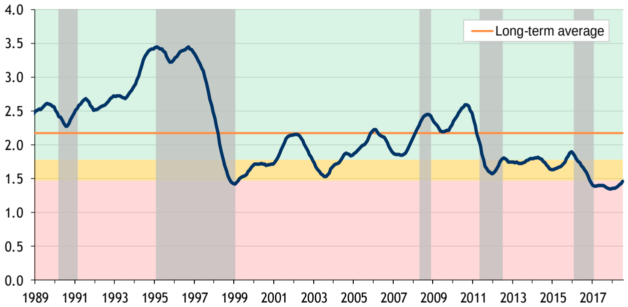


Source: RBC Economics Research, Statistics Canada

Labour market developments do not pose any immediate threat to the housing market at this stage.

The job situation in Vancouver continues to be broadly positive. The unemployment rate (averaging 4.1% so far in 2018) is the lowest among Canada's larger urban areas though it has picked up slightly since spring.

Adult population growth
Y/Y % change in the 15+ population, Vancouver



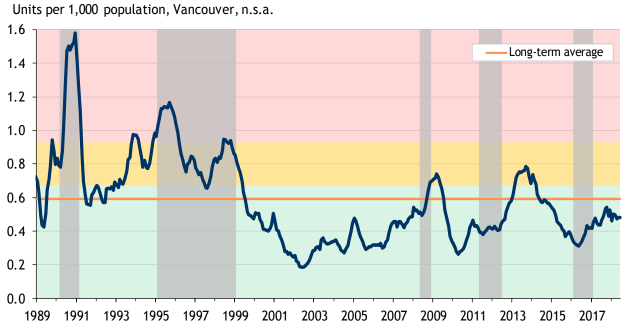
Source: RBC Economics Research, Statistics Canada

A slowdown in Vancouver's population growth since last year is worth monitoring closely. If sustained, it could pose a risk to the market in light of the high levels of housing construction currently.

While the rate of growth in Vancouver's adult population (1.5% y/y in July 2018) is strong relative to most Canadian cities, it has slowed down noticeably in the past year and a half. It remains unclear whether this will be a temporary phenomenon or something more permanent caused by a fundamental issue such as poor affordability.

Supply fundamentals

Completed and unsold units - singles and semis
Units per 1,000 population, Vancouver, n.s.a.

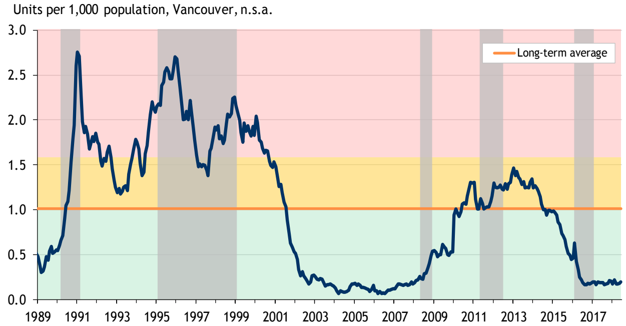


Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

The Vancouver-area market shows few signs of being overbuilt or becoming so in the near term.

Absorption of single-detached and semi-detached units has been quite strong since early 2014, although there has been some modest easing in 2018. The number of recently completed and unsold units has risen moderately from 0.31 units per 1,000 population in April 2016 to 0.48 in June 2018—still well into the 'safe zone' and below the long-range average of 0.60 units.

Completed and unsold units - multiples
Units per 1,000 population, Vancouver, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

Similarly, the situation on the multi-unit dwelling side of the market remains safe as there are abnormally low levels of unsold units at this point.

The number of completed and unsold units has trended lower since early 2014, reaching a nine-year low in August 2016 and staying flat since then.

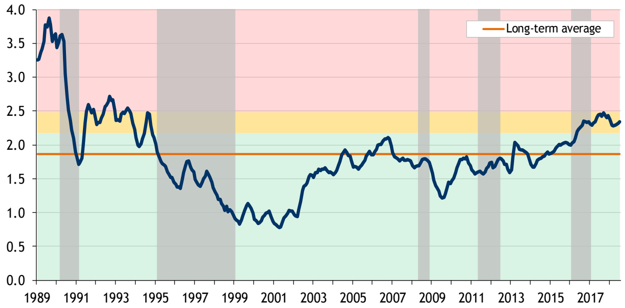
Historically-low inventories have persisted despite an increase in condo unit completions in 2017 and 2018.

GREATER VANCOUVER AREA

Supply fundamentals

Housing under construction - singles

Units per 1,000 population, Vancouver, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

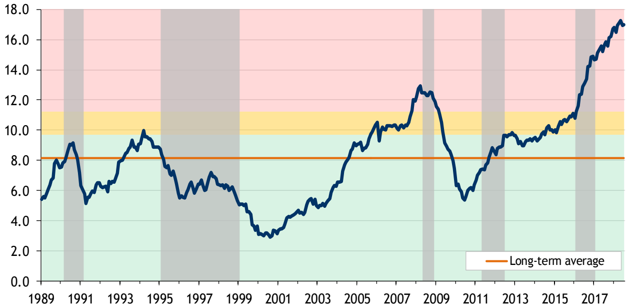
An increase in single-detached home construction over the past three years poses moderate risk to the market though still-low inventories of unsold units act as a mitigating factor.

Builders boosted construction in response to earlier strong demand for single-family homes. This caused the number of units under construction to climb to it highest level in 23 years in the fall of 2017.

The cooling of demand for high-priced properties this year led to a slight easing of single units under construction in 2018.

Housing under construction - multiples

Units per 1,000 population, Vancouver, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

Record levels of multi-family dwelling construction signal a greater-than-usual risk of imbalance in this market segment. However, such risk also is tempered by the tight market conditions in the condo re-sale market segment and low inventories of newly built and unsold units.

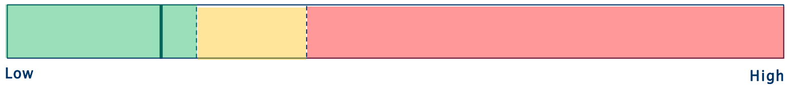
Vancouver recorded its strongest ever levels of apartment starts in 2016 and 2017, which resulted in a surge in the number of units under construction. A slight moderation of starts so far in 2018 points to some easing in the period ahead.

CALGARY AREA

Affordability

Risk implications

RBC affordability measure – aggregate



Near-term: positive
Medium-term: positive

Existing home market balance

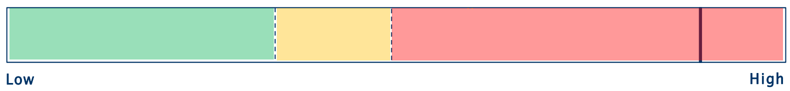
Sales-to-new listings ratio

Near-term: neutral
Medium-term: positive

Months of inventory – Alberta

Near-term: negative
Medium-term: neutral

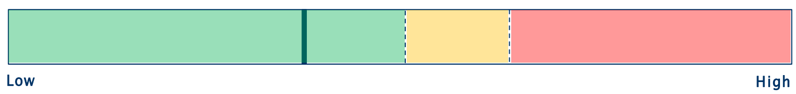
Rental vacancy rate



Near-term: negative
Medium-term: negative

Demand fundamentals

Change in real 5-Year bond yields

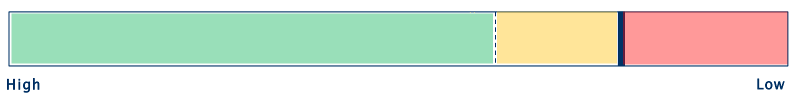


Near-term: negative
Medium-term: negative

Change in the unemployment rate

Near-term: positive
Medium-term: positive

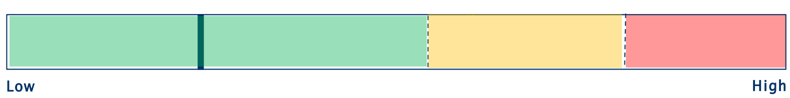
Population growth



Near-term: negative
Medium-term: neutral

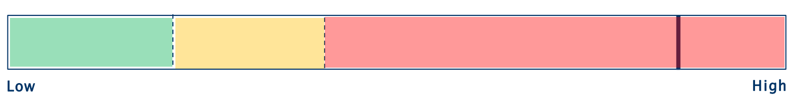
Supply fundamentals

Completed and unsold units per capita – singles and semis



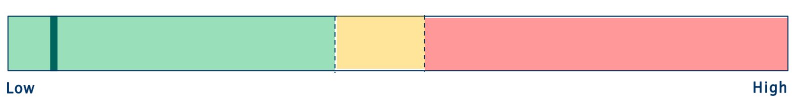
Near-term: positive
Medium-term: positive

Completed and unsold units per capita – multiples



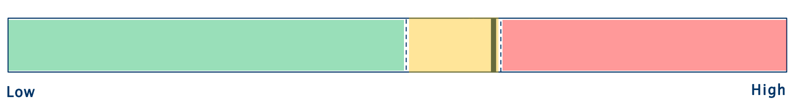
Near-term: negative
Medium-term: negative

Housing under construction per capita – singles



Near-term: positive
Medium-term: positive

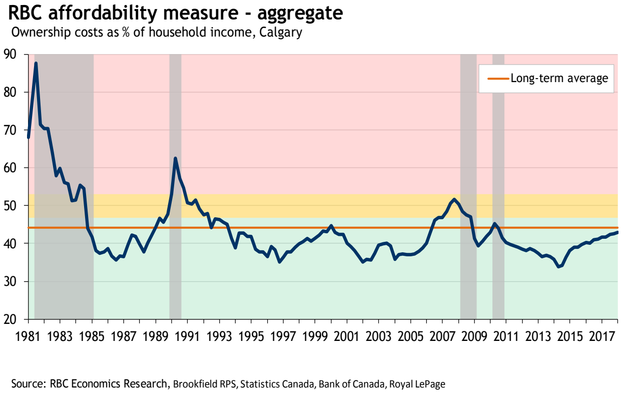
Housing under construction per capita – multiples



Near-term: neutral
Medium-term: neutral

CALGARY AREA

Affordability

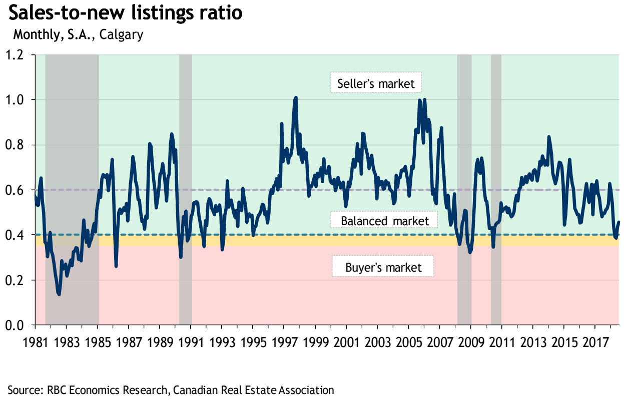


Housing affordability continues to be a generally constructive factor for the Calgary market despite deteriorating slightly since early 2015.

RBC's aggregate measure for the area, at 43.0% in Q1/2018, remains well within the safe zone.

The Calgary market still faces a number of issues; however, affordability is unlikely to be one of them.

Existing home market balance

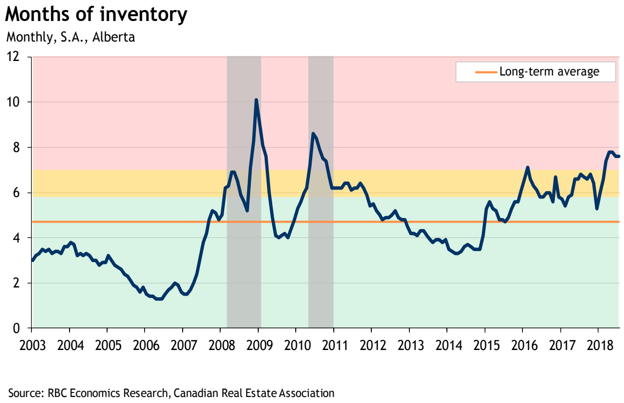


Demand-supply conditions are on the soft side which provides little support for prices.

The mortgage stress test implemented in January foiled a burgeoning recovery in resale activity, causing market conditions to loosen this year.

The sales-to-new listings ratio fell since January and averaged 0.42 since March—at the edge of a buyer's market.

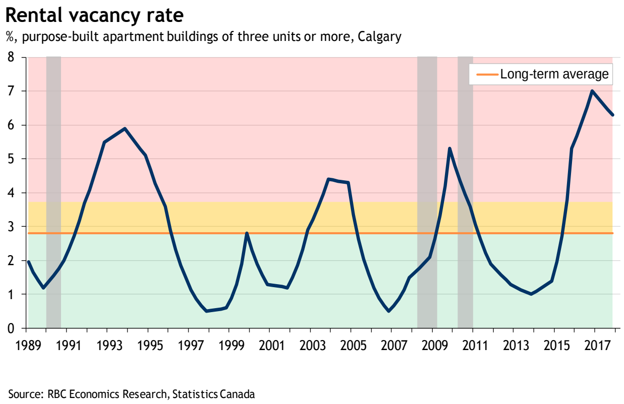
Prices are under mild downward pressure.



Plentiful for-sale inventories make a strengthening in prices unlikely in the near term.

The number of months' inventory jumped to an eight-year high of 7.6 in Alberta since March 2018.

Active listings in the Calgary area were up 26% y/y in July according to the Calgary Real Estate Board. The strongest increases were for attached and detached homes.



Calgary's rental market appears to be over-supplied.

The rental vacancy rate surged to a record high of 7.0% in October 2016 before edging downwardly to 6.3% in October 2017.

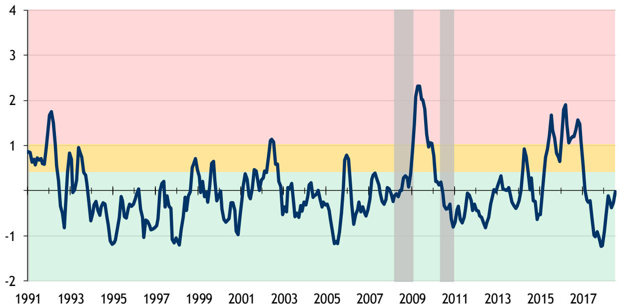
Such elevated vacancy rate raises significant downside risks for rent values in the area and revenue prospects for condo investors.

Indeed, CMHC figures show that average apartment rent fell between 3% and 11% in 2017 depending on the size of the unit.

CALGARY AREA

Demand fundamentals

Unemployment rate relative to trailing 12-month average
Percentage points, Calgary

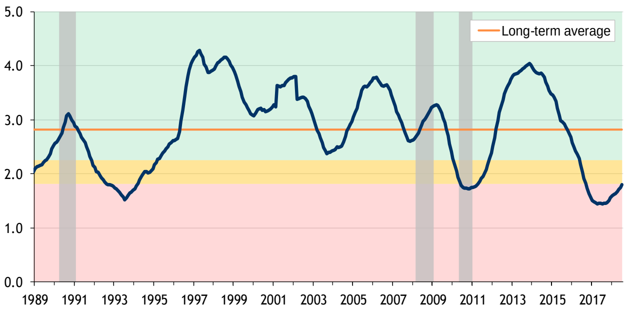


Source: RBC Economics Research, Statistics Canada

A still-high unemployment rate continues to weigh on Calgary's housing market though the situation improved noticeably in the past year and a half.

Calgary's labour market turned a corner in 2017 with the unemployment rate falling sharply from a modern-day high of 10.3% at the end of 2016. While the labour market recovery stalled this year, we expect that sustained growth in the provincial economy will bring things back on track going forward.

Adult population growth
Y/Y % change in the 15+ population, Calgary



Source: RBC Economics Research, Statistics Canada

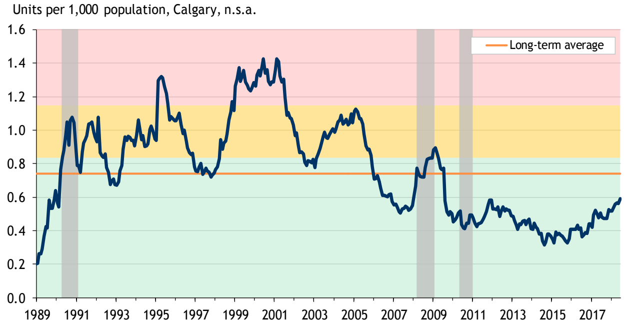
There's been a slight easing in the (still-elevated) demographics-related risks. Prospects for further strengthening in the labour market bodes well for this easing to continue in the period ahead.

The 2015-2016 provincial economic slump led to a sharp slowdown in Calgary's adult population growth—from a cyclical high of 4.0% in early 2014 to a 23-year low of 1.4% in September 2017.

Adult population growth has since picked up, reaching 1.8% in July 2018—still below the longer-run average of 2.8%.

Supply fundamentals

Completed and unsold units - singles and semis
Units per 1,000 population, Calgary, n.s.a.



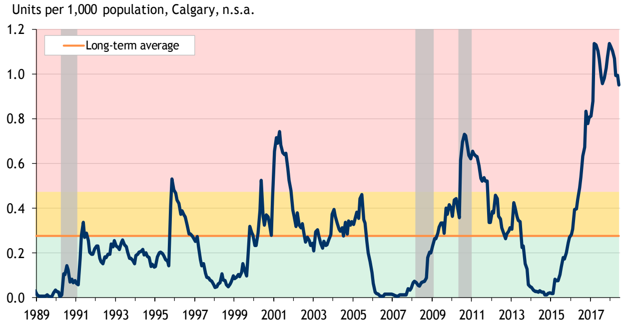
Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

There are few signs of overbuilding in the single-detached segment.

The number of unsold single-detached and semi-detached remains historically low on a per 1000 population basis despite a gradual increase since early 2017.

That number is unlikely to rise much further because single-detached home starts are now slowing down.

Completed and unsold units - multiples
Units per 1,000 population, Calgary, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

However, there's strong evidence of a surplus in the multi-unit segment.

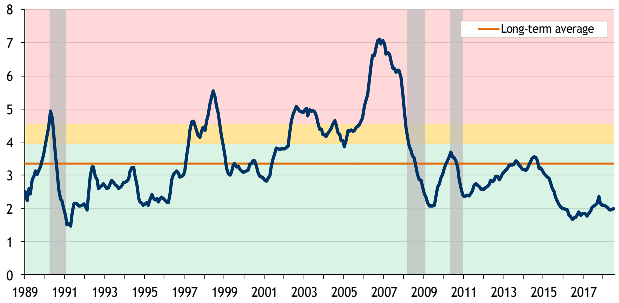
The number of unabsorbed units surged since the spring of 2015 (when Calgary arguably had a supply shortage) to record-high levels throughout most of 2017 and the first half of 2018.

The stock of unsold units was driven higher by sharp increases in condo apartment completions in 2015 and 2016 at a time when demand turned cold.

CALGARY AREA

Supply fundamentals

Housing under construction - singles
Units per 1,000 population, Calgary, n.s.a.

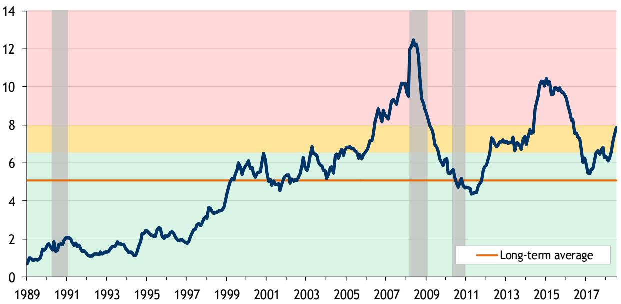


Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

The relatively few single-detached units under construction presently pose little threat to the market.

The drop in single-detached home starts in 2015 and 2016 sharply reduced the number of units under construction to historically low levels over the past three years.

Housing under construction - multiples
Units per 1,000 population, Calgary, n.s.a.



Source: RBC Economics Research, Statistics Canada, Canada Mortgage and Housing Corporation

Risks associated with multi-unit dwelling construction are rising close to a worrying level again.

Strong increases in rental apartment starts in the past year (albeit from very low levels) boosted the number of units under construction in the Calgary area. Condo construction also picked up modestly.

Any further rises in multi-dwelling starts and construction levels would raise absorption risks materially given the softness of both the rental and resale condo markets at present.