RBC WEALTH MANAGEMENT

Global Insight

Focus Article

Housing health check

We take the pulse of the Canadian housing market and explain why it appears to be in a stable condition.

Robert Hogue

For important and required non-U.S. analyst disclosures, see page 6

All values in U.S. dollars and priced as of May 31, 2016, market close, unless otherwise noted.

Focus article

Housing health check

Robert Hogue
Toronto, Canada
robert.hogue@rbc.com

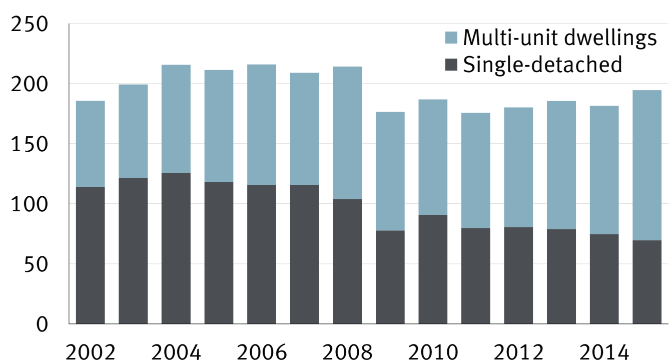
While certain aspects of Canada's housing market bear watching, calls from some corners for a hard landing seem overdone. The country's housing market is diverse and defined by more than just Toronto and Vancouver. RBC Economics' senior economist surveys the landscape and explains why he sees little basis for concerns of a broad-based collapse.

Q. Some commentators seem to think there is a Canadian "housing bubble" that is ripe for collapse. Where does RBC Economics stand in the "hard versus soft landing" debate?

A. Talking about a "Canadian" housing market is an oversimplification that masks varied and unique circumstances across regional markets. Worries of a bubble are typically directed at Vancouver and Toronto—Canada's hottest markets. For the most part, other markets continue to be in balance and raise little concern. In Vancouver and Toronto, land restrictions—either set by geography or policy—have skewed the supply of new housing over the past many years towards higher-density forms, such as condos, while demand for single-detached homes remains strong in both markets. So we are witnessing the law of demand and supply in action: not enough single-detached homes for sale to satisfy demand leads to escalating prices while plentiful supply of condos leads to more moderate price increases.

Housing completions in Canada

Thousand units



Housing completions have skewed towards higher-density forms in recent years, which has resulted in a lack of supply of single-detached homes in certain urban markets.

Source - CMHC, RBC Economics Research

Does this mean that there isn't any localized bubble in Canada? With single-family home prices running 27% above year-ago levels in Vancouver, it would be imprudent to dismiss the possibility that some buyers in some neighbourhoods are getting carried away. But our point is that from a broad perspective, unless interest rates spike or unemployment surges in Canada, we don't see the basis for a Canada-wide hard landing in the near term.

Q. As you point out, escalating prices in the country's most expensive markets—Vancouver and Toronto—have garnered much of the headlines. If I live outside of those markets, would a correction in the Vancouver and/or Toronto market impact me?

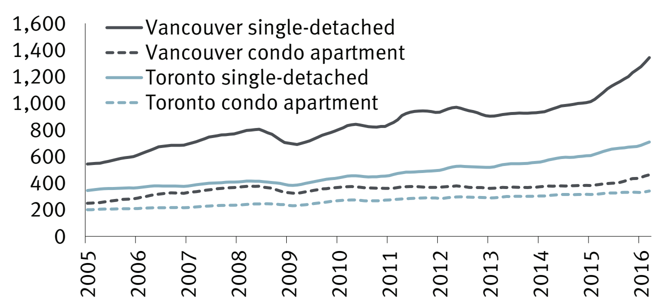
A. In our opinion, a 15%–20% correction in housing prices in Vancouver and/or Toronto would pose little risk for other markets across Canada. In fact, policymakers could well view this as a desirable outcome. If we are dealing with some form of collapse (say, 30%–50% decline) then the main risks for markets across Canada lie with the institutional and regulatory responses. Such a scenario could trigger measures that ultimately restrain mortgage credit from coast to coast, and therefore, negatively impact markets that would be sound otherwise.

Q. Some people worry that home ownership has become unrealistic for today's younger generation in light of deteriorating affordability in certain urban markets. Is this a valid concern?

A. The concern in question really is about housing affordability (or rather the lack thereof) in Canada's two highest-priced markets—Vancouver and Toronto. No doubt that the very high bar to become an owner of a single-detached home in Vancouver and Toronto can be a deterrent for some people to move to or stay in either market.

Home prices

CA$000s



The Vancouver and Toronto markets have experienced robust price appreciation as demand has outstripped supply for single-detached dwellings.

Source - Canadian Real Estate Association, RBC Economics Research; data through 3/31/16

However, we would argue that the risk to a region's economy has more to do with a broader definition of housing affordability that encompasses ownership of other forms of housing as well as rental options. The fact is that, while not exactly cheap, other housing alternatives in both Vancouver and Toronto remain affordable for most. Facing much higher hurdles to own a single-detached home doesn't necessarily mean that the younger generation will skip town. It might just require a change in expectations on their part.

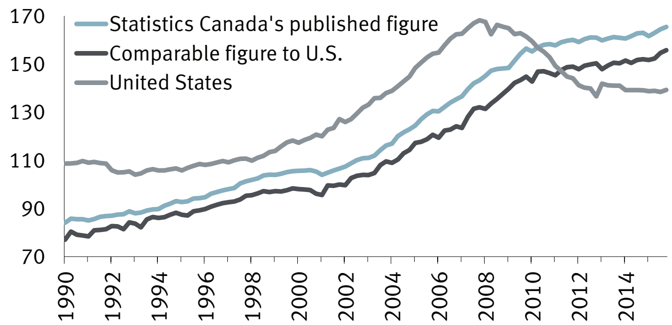
Q. Many comparisons have been made concerning rising household debt levels and home prices here in Canada relative to those in the U.S. in the period leading up to the financial crisis. Can you speak to any relevance you see in that comparison?

A. It is true that the debt-to-income ratio is at a record high in Canada, although when comparing on an apples-to-apples basis it is not quite as high as the U.S.

ratio was at its peak in 2007 just prior to the financial crisis. Moreover, the debt-to-income ratio is not a very useful measure of the health of the household sector because it ignores the effect of interest rates.

Household debt-to-income ratio

Credit market debt as a % of personal disposable income



Source - Statistics Canada, RBC Economics Research

While debt-to-income is at a record high in Canada, it remains below the comparable U.S. ratio at its peak in 2007.

A better measure to look at is the debt-service ratio, which compares the cost of carrying debt (principal and interests) in any given year to income in the same year. This ratio has been quite stable in Canada since 2010 thanks to low and declining interest rates. Despite its shortcomings, the debt-to-income ratio is a gauge of vulnerability for the household sector and therefore cannot be totally ignored. It points to significant risks should adverse conditions similar to those in the U.S. in 2008–09 develop.

Q. Interest rates are a key factor in determining housing affordability. Can you speak to the market's ability to adjust to higher interest rates in the near term?

A. Overnight interest rates in Canada are currently at historical lows and prospects are for only a modest rise in rates starting next year. As rates move higher, we will likely see affordability becoming more challenged. Given the current slow growth, low inflation environment around the globe as well as in Canada, a significant spike in interest rates looks unlikely. A gradual rise in rates would be manageable for housing given the low starting point, the predominance of fixed-rate mortgages, prudence in qualifying mortgage holders, and an expected firm labour market.

Q: The subject of foreign investment in the Canadian housing market has received considerable attention. How do you think about the impact of international investment on housing prices and its potential to act as a destabilizing force?

A. Indeed, this is a topic receiving a lot of attention but for which we have few hard facts. To be sure, there is plenty of anecdotal evidence of buyers coming from abroad in pockets of the Vancouver and, to a lesser extent, Toronto markets. Until we are able to quantify this phenomenon, it is difficult to gauge the extent to which these buyers contribute to price increases. We must keep in mind that both Vancouver and Toronto are economically vibrant migration magnets, and that is a good thing. The rise in home prices resulting from "foreign" capital in-flows cuts both ways: while it may raise the ownership bar for local buyers it also boosts the housing asset value for many current owners.

Research resources

This document is produced by the Global Portfolio Advisory Committee within RBC Wealth Management's Portfolio Advisory Group. The RBC Wealth Management Portfolio Advisory Group provides support related to asset allocation and portfolio construction for the firm's investment advisors / financial advisors who are engaged in assembling portfolios incorporating individual marketable securities. The Committee leverages the broad market outlook as developed by the RBC Investment Strategy Committee, providing additional tactical and thematic support utilizing research from the RBC Investment Strategy Committee, RBC Capital Markets, and third-party resources.

Global Portfolio Advisory Committee members:

Jim Allworth – Co-chair; Investment Strategist, RBC Dominion Securities Inc.

Rajan Bansi – Co-chair; Head of Fixed Income Strategies, RBC Wealth Management Portfolio Advisory Group, RBC Dominion Securities Inc.

Mark Allen – Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group, RBC Dominion Securities Inc.

Alana Awad – Fixed Income Portfolio Advisor, RBC Dominion Securities Inc.

Craig Bishop – Lead Strategist, U.S. Fixed Income Strategies Group, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

Kelly Bogdanov – Portfolio Analyst, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

Paul Bowman – Director, Head of Structured Solutions and FX Strategy, Royal Bank of Canada Investment Management (U.K.) Ltd.

Frédérique Carrier – Director, Head of Equities, Royal Bank of Canada Investment Management (U.K.) Ltd.

Janet Engels – Head of U.S. Equities, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

Hakan Enoksson – Head of Fixed Income - British Isles, Royal Bank of Canada Investment Management (U.K.) Ltd.

Tom Garretson – Fixed Income Portfolio Advisor, RBC Capital Markets, LLC

Christopher Girdler – Fixed Income Portfolio Manager/Strategist, Royal Bank of Canada Investment Management (U.K.) Ltd.

Patrick McAllister – Canadian Equities Portfolio Advisor, RBC Dominion Securities Inc.

Jay Roberts – Head of Equity Advisory, Wealth Management Hong Kong, RBC Dominion Securities Inc.

The RBC Investment Strategy Committee (RISC), consists of senior investment professionals drawn from individual, client-focused business units within RBC, including the Portfolio Advisory Group. The RBC Investment Strategy Committee builds a broad global investment outlook and develops specific guidelines that can be used to manage portfolios. RISC is chaired by Daniel Chornous, CFA, Chief Investment Officer of RBC Global Asset Management Inc.

Additional *Global Insight* authors:

Robert Hogue – Senior Economist, Royal Bank of Canada

Required disclosures

Analyst Certification
All of the views expressed in this report accurately reflect the personal views of the responsible analyst(s) about any and all of the subject securities or issuers. No part of the compensation of the responsible analyst(s) named herein is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the responsible analyst(s) in this report.

Important Disclosures

In the U.S., RBC Wealth Management operates as a division of RBC Capital Markets, LLC. In Canada, RBC Wealth Management includes, without limitation, RBC Dominion Securities Inc., which is a foreign affiliate of RBC Capital Markets, LLC. This report has been prepared by RBC Capital Markets, LLC which is an indirect wholly-owned subsidiary of the Royal Bank of Canada and, as such, is a related issuer of Royal Bank of Canada.

Non-U.S. Analyst Disclosure: Mark Allen, Jim Allworth, Alana Awad, Rajan Bansi, Patrick McAllister, and Jay Roberts, employees of RBC Wealth Management USA's foreign affiliate RBC Dominion Securities Inc.; and Frédérique Carrier, Hakan Enoksson, Christopher Girdler, Paul Bowman, employees of RBC Wealth Management USA's foreign affiliate Royal Bank of Canada Investment Management (UK) Limited; and Robert Hogue, an employee of Royal Bank of Canada; contributed to the preparation of this publication. These individuals are not registered with or qualified as research analysts with the U.S. Financial Industry Regulatory Authority ("FINRA") and, since they are not associated persons of RBC Wealth Management, they may not be subject to FINRA Rule 2241 governing communications with subject companies, the making of public appearances, and the trading of securities in accounts held by research analysts.

In the event that this is a compendium report (covers six or more companies), RBC Wealth Management may choose to provide important disclosure information by reference. To access current disclosures, clients should refer to http://www.rbccm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=2 to view disclosures regarding RBC Wealth Management and its affiliated firms. Such information is also available upon request to RBC Wealth Management Publishing, 60 South Sixth St, Minneapolis, MN 55402.

References to a Recommended List in the recommendation history chart may include one or more recommended lists or model portfolios maintained by RBC Wealth Management or one of its affiliates. RBC Wealth Management recommended lists include the Guided Portfolio: Prime Income (RL 6), the Guided Portfolio: Dividend Growth (RL 8), and the Guided Portfolio: ADR (RL 10), and former lists called the Guided Portfolio: Large Cap (RL 7), the Guided Portfolio: Midcap 111 (RL 9), and the Guided Portfolio: Global Equity (U.S.) (RL 11). RBC Capital Markets recommended lists include the Strategy Focus List and the Fundamental Equity Weightings (FEW) portfolios. The abbreviation 'RL On' means the date a security was placed on a Recommended List. The abbreviation 'RL Off' means the date a security was removed from a Recommended List.

Distribution of Ratings - RBC Capital Markets, LLC Equity Research
As of March 31, 2016

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	887	51.78	258	29.09
Hold [Sector Perform]	722	42.15	115	15.93
Sell [Underperform]	104	6.07	8	7.69

Distribution of Ratings
For the purpose of ratings distributions, regulatory rules require member firms to assign ratings to one of three rating categories - Buy, Hold/Neutral, or Sell - regardless of a firm's own rating categories. Although RBC Capital Markets, LLC ratings of Top Pick (TP)/Outperform (O), Sector Perform (SP) and Underperform (U) most closely correspond to Buy, Hold/Neutral and Sell, respectively, the meanings are not the same because our ratings are determined on a relative basis (as described below).

Explanation of RBC Capital Markets, LLC Equity Rating System
An analyst's "sector" is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular stock represents solely the analyst's view of how that stock will perform over the next 12 months relative to the analyst's sector average. Although RBC Capital Markets, LLC ratings of Top Pick (TP)/Outperform (O), Sector Perform (SP), and Underperform (U) most closely correspond to Buy, Hold/Neutral and Sell, respectively, the meanings are not the same because our ratings are determined on a relative basis (as described below).

Ratings: Top Pick (TP): Represents analyst's best idea in the sector; expected to provide significant absolute total return over 12 months with a favorable risk-reward ratio. **Outperform (O):** Expected to materially outperform sector average over 12 months. **Sector Perform (SP):** Returns expected to be in line with sector average over 12 months. **Underperform (U):** Returns expected to be materially below sector average over 12 months.

Risk Rating: As of March 31, 2013, RBC Capital Markets, LLC suspends its Average and Above Average risk ratings. The **Speculative** risk rating reflects a security's lower level of financial or operating predictability, illiquid share trading volumes, high balance sheet leverage, or limited operating history that result in a higher expectation of financial and/or stock price volatility.

Valuation and Price Target Impediments
When RBC Wealth Management assigns a value to a company in a research report, FINRA Rules and NYSE Rules (as incorporated into the FINRA Rulebook) require that the basis for the valuation and the impediments to obtaining that valuation be described. Where applicable, this information is included in the text of our research in the sections entitled "Valuation" and "Price Target Impediment", respectively.

The analyst(s) responsible for preparing this research report received compensation that is based upon various factors, including total revenues of RBC Capital Markets, LLC, and its affiliates, a portion of which are or have been generated by investment banking activities of the member companies of RBC Capital Markets, LLC and its affiliates.

Other Disclosures

Prepared with the assistance of our national research sources. RBC Wealth Management prepared this report and takes sole responsibility for its content and distribution. The content may have been based, at least in part, on material provided by our third-party correspondent research services. Our third-party correspondent has given RBC Wealth Management general permission to use its research reports as source materials, but has not reviewed or approved this report, nor has it been informed of its publication. Our third-party correspondent may from time to time have long or short positions in, effect transactions in, and make markets in securities referred to herein. Our third-party correspondent may from time to time perform investment banking or other services for, or solicit investment banking or other business from, any company mentioned in this report.

RBC Wealth Management endeavors to make all reasonable efforts to provide research simultaneously to all eligible clients, having regard to local time zones in overseas jurisdictions. In certain investment advisory accounts, RBC Wealth Management will act as overlay manager for our clients and will initiate transactions in the securities referenced herein for those accounts upon receipt of this report. These transactions may occur before or after your receipt of this report and may have a short-term impact on the market price of the securities in which transactions occur. RBC Wealth Management research is posted to our proprietary Web sites to ensure eligible clients receive coverage initiations and changes in rating, targets, and opinions in a timely manner. Additional distribution may be done by sales personnel via e-mail, fax, or regular mail. Clients may also receive our research via third-party vendors. Please contact your RBC Wealth Management Financial Advisor for more information regarding RBC Wealth Management research.

Conflicts Disclosure: RBC Wealth Management is registered with the Securities and Exchange Commission as a broker/dealer and an investment adviser, offering both brokerage and investment advisory services. RBC Wealth Management's Policy for Managing Conflicts of Interest in Relation to Investment Research is available from us on our Web site at http://www.rbccm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=2. Conflicts of interests related to our investment advisory business can be found in Part II of the Firm's Form ADV or the Investment Advisor Group Disclosure Document. Copies of any of these documents are available upon request through your Financial Advisor. We reserve the right to amend or supplement this policy, Part II of the ADV, or Disclosure Document at any time.

The authors are employed by one of the following entities: RBC Wealth Management USA, a division of RBC Capital Markets, LLC, a securities broker-dealer with principal offices located in Minnesota and New York, USA; by RBC Dominion Securities Inc., a securities broker-dealer with principal offices located in Toronto, Canada; by RBC Investment Services (Asia) Limited, a subsidiary of RBC Dominion Securities Inc., a securities broker-dealer with principal offices located in Hong Kong, China; and by Royal Bank of Canada Investment Management (U.K.) Limited, an investment management company with principal offices located in London, United Kingdom.

The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of MSCI Inc. ("MSCI") and Standard & Poor's Financial Services LLC ("S&P") and is licensed for use by RBC. Neither MSCI, S&P, nor any other party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any of such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

Disclaimer

The information contained in this report has been compiled by RBC Wealth Management, a division of RBC Capital Markets, LLC, from sources believed to be reliable, but no representation or warranty, express or implied, is made by Royal Bank of Canada, RBC Wealth Management, its affiliates or any other person as to its accuracy, completeness or correctness. All opinions and estimates contained in this report constitute RBC Wealth Management's judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Every province in Canada, state in the U.S., and most countries throughout the world have their own laws regulating the types of securities and other investment products which may be offered to their residents, as well as the process for doing so. As a result, the securities discussed in this report may not be eligible for sale in some jurisdictions. This report is not, and under no circumstances should be construed as, a solicitation to act as securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. Nothing in this report constitutes legal, accounting or tax advice or individually tailored investment advice. This material is prepared for general circulation to clients, including clients who are affiliates of Royal Bank of Canada, and does not have regard to the particular circumstances or needs of any specific person who may read it. The investments or services contained in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about the suitability of such investments or services. To the full extent permitted by law neither Royal Bank of Canada nor any of its affiliates, nor any other person, accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. No matter contained in this document may be reproduced or copied by any means without the prior consent of Royal Bank of Canada. In the U.S., RBC Wealth Management operates as a division of RBC Capital Markets, LLC. In Canada, RBC Wealth Management includes, without limitation, RBC Dominion Securities Inc., which is a foreign affiliate of RBC Capital Markets, LLC. This report has been prepared by RBC Capital Markets, LLC. Additional information is available upon request.

To U.S. Residents: This publication has been approved by RBC Capital Markets, LLC, Member NYSE/FINRA/SIPC, which is a U.S. registered broker-dealer and which accepts responsibility for this report and its dissemination in the United States. RBC Capital Markets, LLC, is an indirect wholly-owned subsidiary of the Royal Bank of Canada and, as such, is a related issuer of Royal Bank of Canada. Any U.S. recipient of this report that is not a registered broker-dealer or a bank acting in a broker or dealer capacity and that wishes further information regarding, or to effect any transaction in, any of the securities discussed in this report, should contact and place orders with RBC Capital Markets, LLC. International investing involves risks not typically associated with U.S. investing, including currency fluctuation, foreign taxation, political instability and different accounting standards.

To Canadian Residents: This publication has been approved by RBC Dominion Securities Inc. RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. ®Registered trademark of Royal Bank of Canada. Used under license. RBC Wealth Management is a registered trademark of Royal Bank of Canada. Used under license.

To European Residents: Clients of United Kingdom subsidiaries may be entitled to compensation from the UK Financial Services Compensation Scheme if any of these entities cannot meet its obligations. This depends on the type of business and the circumstances of the claim. Most types of investment business are covered for up to a total of £50,000. The Channel Islands subsidiaries are not covered by the UK Financial Services Compensation Scheme; the offices of Royal Bank of Canada (Channel Islands) Limited in Guernsey and Jersey are covered by the respective compensation schemes in these jurisdictions for deposit taking business only.

To Hong Kong Residents: This publication is distributed in Hong Kong by RBC Investment Services (Asia) Limited and RBC Investment Management (Asia) Limited, licensed corporations under the Securities and Futures Ordinance or, by Royal Bank of Canada, Hong Kong Branch, a registered institution under the Securities and Futures Ordinance. This material has been prepared for general circulation and does not take into account the objectives, financial situation, or needs of any recipient. Hong Kong persons wishing to obtain further information on any of the securities mentioned in this publication should contact RBC Investment Services (Asia) Limited, RBC Investment Management (Asia) Limited or Royal Bank of Canada, Hong Kong Branch at 17/Floor, Cheung Kong Center, 2 Queen's Road Central, Hong Kong (telephone number is 2848-1388).

To Singapore Residents: This publication is distributed in Singapore by RBC (Singapore Branch) and RBC (Asia) Limited, registered entities granted offshore bank status by the Monetary Authority of Singapore. This material has been prepared for general circulation and does not take into account the objectives, financial situation, or needs of any recipient. You are advised to seek independent advice from a financial adviser before purchasing any product. If you do not obtain independent advice, you should consider whether the product is suitable for you. Past performance is not indicative of future performance.