



Current Analysis

Current Analysis reports address current economic issues of importance to RBC Financial Group and its clients.

House valuations across major cities

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House prices have been on an upward path across major markets in Canada since the late 1990s. In many of those same markets, price trends were weak during the rest of the last decade. An exception was British Columbia which witnessed rapid growth in house prices until the mid-1990s, and then experienced a prolonged correction long after most other markets in Canada had already done so.

Where do house prices stand today?

This is a difficult question to examine. Raw price trends yield unsatisfactory answers partly because they are not adjusted for broad inflationary pressures over time. Furthermore, there are good reasons as to why house prices differ across time and markets such that having a benchmark to compare against is vitally important.

This leads to the first caution in this analysis in that, like most assets, no single valuation methodology works flawlessly for real estate. One approach is a housing affordability index like our own which measures the costs of home ownership like mortgage payments, heating, and property taxes in relation to incomes over time and across different cities.

This is a good depiction of whether or not housing is affordable relative to current trends in average income growth, the cost of borrowing, energy prices and taxes. Indeed, it shows that housing affordability conditions across most of Canada are among the best ever largely because of healthy income growth over the years combined with low interest rates. But, this approach does not directly address whether or not house prices per se are high today by historical standards, or not.

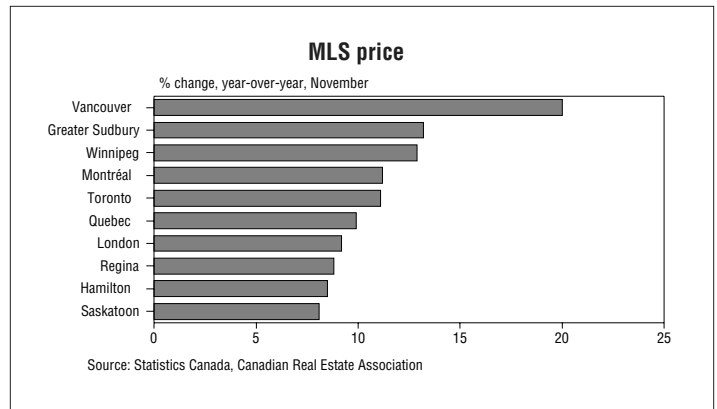
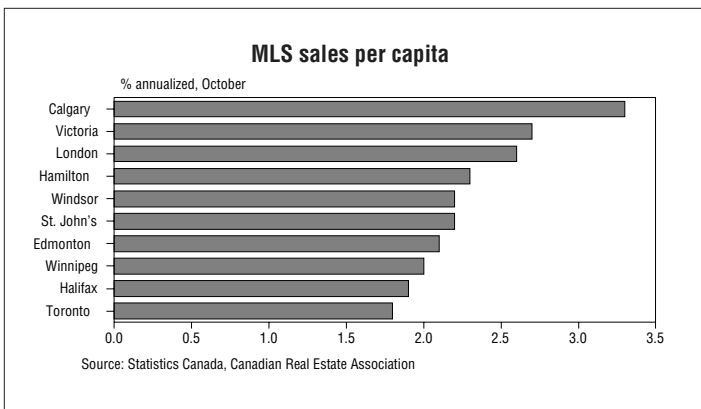
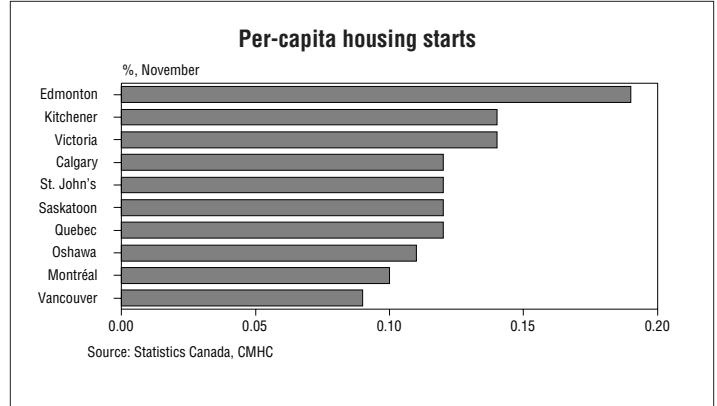
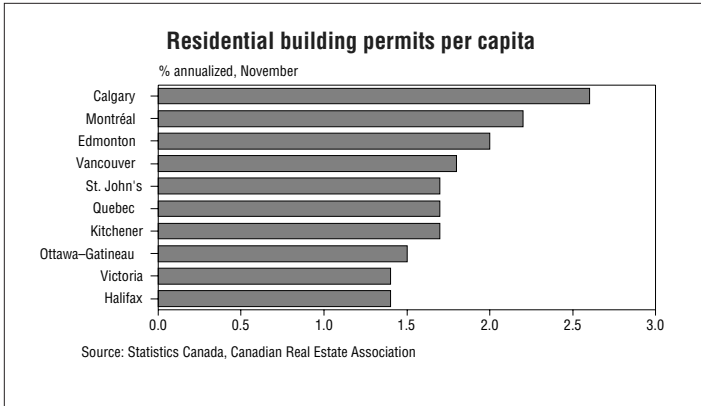
New approach borrowed from equity market concept

To do that, we borrow a concept from equity markets and devise a price-earnings ratio (P/E) for housing. This involves comparing house prices to rental costs using the rent component in Statistics Canada's consumer price indexes for each of the major cities. The idea is that what is paid for a house should be compared either to what cash flow could be earned from proxies for then renting it out over time, or what rent doesn't have to be paid by a home owner with or without a mortgage who is accumulating an asset over time and getting use of their own home.

Main conclusions

The charts on page 2 depict the ratios for major cities across the country and the following observations can be drawn:

City housing market comparisons



▲ The highest P/E ratios exist in Victoria, Edmonton and Calgary (tied), and Halifax;

▲ Compared to renting, housing is cheapest in Toronto, Hamilton, and Winnipeg;

▲ P/E ratios have pushed significantly beyond late-1980s levels in Victoria, Calgary, Edmonton, Regina, Saskatoon, Winnipeg, Ottawa, Montreal, and Quebec City, St. John's, Saint John, and Halifax;

▲ Toronto and Hamilton are still not back to late 1980s valuations;

▲ Vancouver has returned to valuations last seen in the mid-1990s.

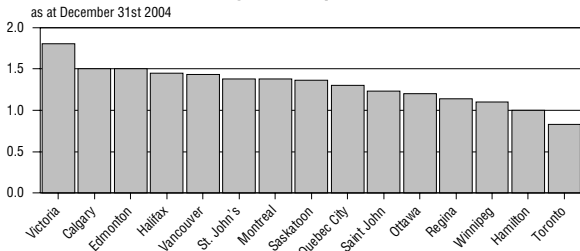
Some cautions

There are, however, some cautions to be flagged when using this P/E concept. First, there may be good reasons as to why P/E ratios would be expected to trend upward with developments in the economy and financial markets over the years. For example, standard

valuation models would suggest that as discount rates - in this case a weighted average of different mortgage term rates - drift downward, then the expected future returns are discounted less heavily and the P/E ratio should trend upward. Further, a p/e ratio like this one reflects as much about weakening rental market conditions as what it says about housing valuations.

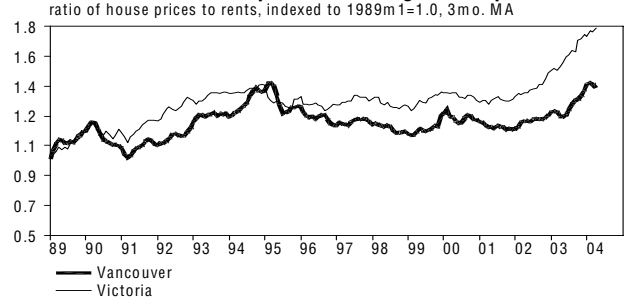
Housing P/E ratios by city

Housing P/E comparisons



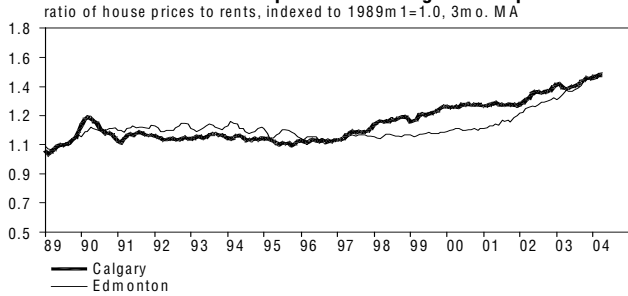
Source: Canadian Real Estate Association, Statistics Canada

B.C. house price- earnings multiples



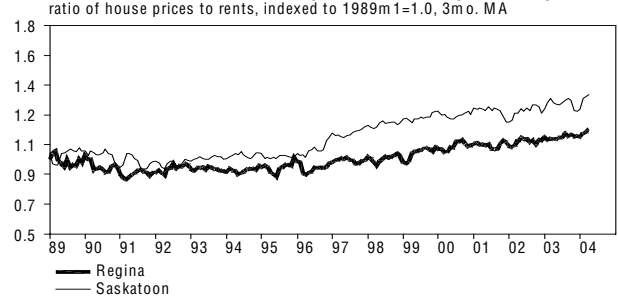
Source: Canadian Real Estate Association, Statistics Canada

Alberta house price- earnings multiples



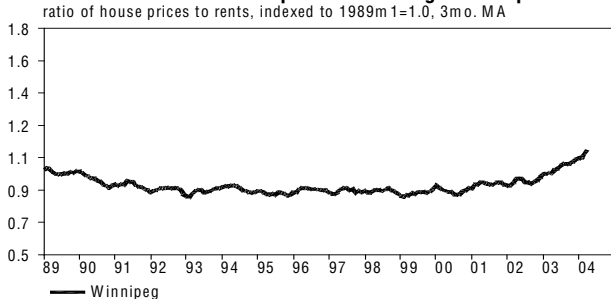
Source: Canadian Real Estate Association, Statistics Canada

Saskatchewan house price- earnings multiples



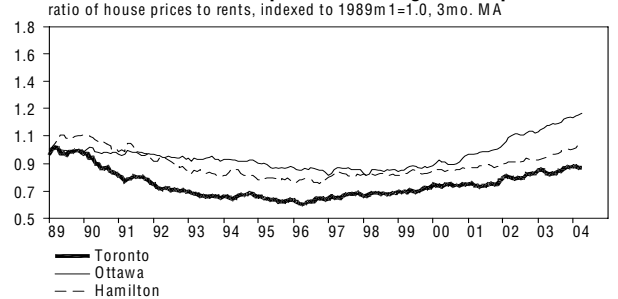
Source: Canadian Real Estate Association, Statistics Canada

Manitoba house price- earnings multiples



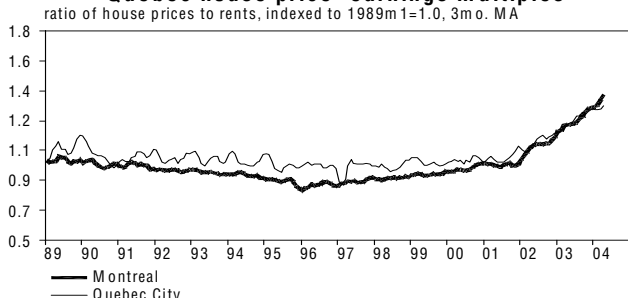
Source: Canadian Real Estate Association, Statistics Canada

Ontario house price- earnings multiples



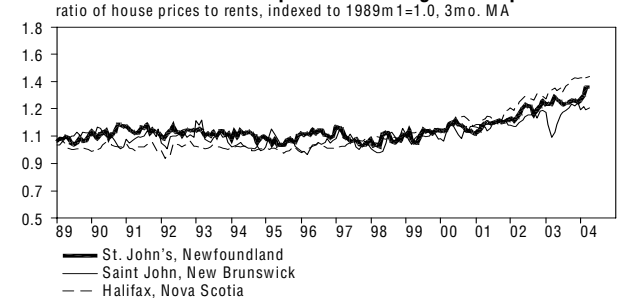
Source: Canadian Real Estate Association, Statistics Canada

Quebec house price- earnings multiples



Source: Canadian Real Estate Association, Statistics Canada

Atlantic house price- earnings multiples



Source: Canadian Real Estate Association, Statistics Canada