

Economic Spotlight

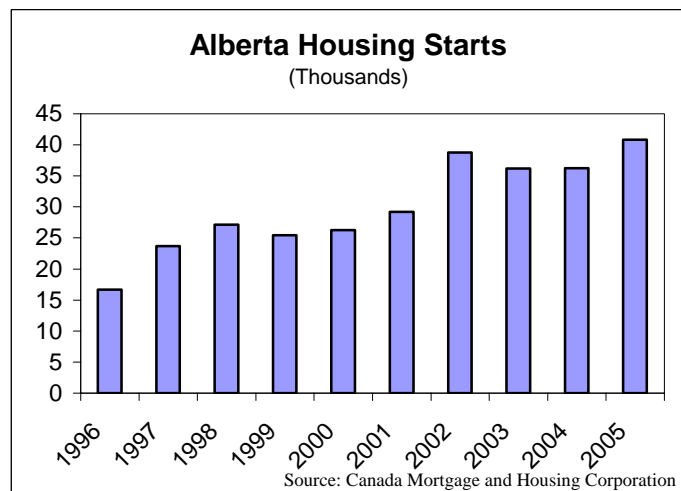
ALBERTA'S HOUSING MARKET

Alberta's economy boomed in 2005, with most sectors of the economy reaching record highs. In particular, the provincial housing market thrived in 2005, with rising house prices and housing starts. Even so, Alberta remains one of the most affordable housing markets in Canada (with the exception of Fort McMurray and Calgary) and is likely to remain so in the near term.

Continued economic growth, along with strong gains in income and population suggest that housing starts are expected to increase in 2006. However, rising interest rates, escalating house prices and rising costs have the potential to slow the Alberta housing market. Housing starts are expected to moderate over the medium term, but are likely to remain healthy by historical standards.

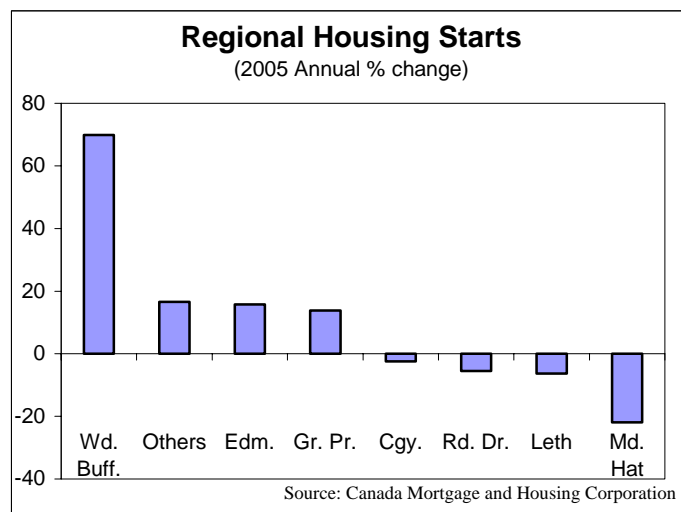
Housing Starts

Housing starts in Alberta totalled 40,847 in 2005, a 27-year high. Strong growth in population (+2.5 per cent), employment (+1.5 per cent), and net inter-provincial migration (41,707 migrants), coupled with favourable labour income gains (+10 per cent), contributed to Alberta's strong housing sector. Thus far in 2006, this trend has shown no signs of slowing with housing starts averaging an annual pace of more than 48,600 in the first five months. The 2006 pace is not considered sustainable over the medium term as pent-up demand wanes and rising prices and interest rates moderate housing starts.



Still, continued increases in migration, robust growth in incomes and employment are expected to keep housing markets healthy. Over the 2007-2009 period, housing starts are expected to average over 36,000, higher than the previous 10-year average of 30,000.

In 2005, the largest increase in starts was in Edmonton, where the region added more than 1,800 units. As shown, Wood Buffalo had the largest growth in housing starts from 2004 (+70 per cent), but only contributed to an additional 602 starts. All of the regions that experienced a decline during 2005 recorded a strong rebound in the first four months of 2006, including Medicine Hat (104 per cent), Red Deer (36 per cent), Calgary (26 per cent) and Lethbridge (3.1 per cent).



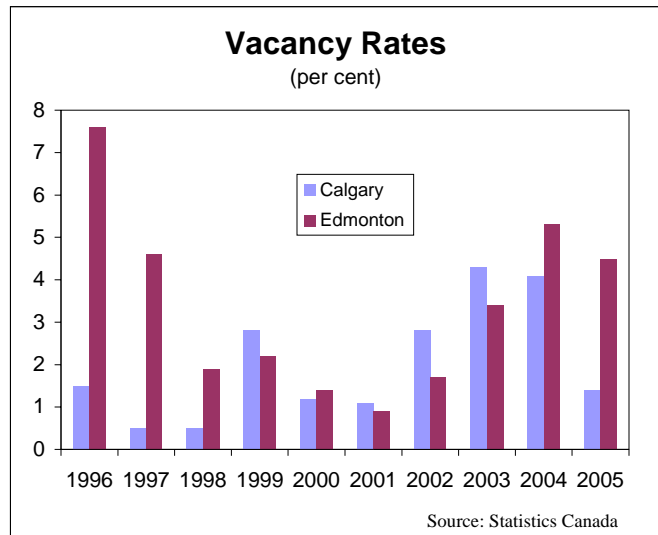
Reflecting the strength in starts, Alberta's

investment in residential construction has also seen robust growth recently. Real residential investment in 2005 increased 15 per cent, to \$8.1 billion, which is the largest growth since 2002. From 2001-2005, growth in residential investment averaged 8.7 per cent per year. In 2005, residential construction accounted for 5.7 per cent of Alberta's GDP, up almost one percentage point from 2001.

Housing Capacity

- Vacancy Rates

Residential construction and strong housing starts in Alberta over the 2001-2004 period did push vacancy rates higher, but most regions saw a decline in vacancy rates during 2005, with the Alberta average vacancy rate declining 1.5 percentage points to 3.1 per cent. Edmonton's vacancy rate declined by 0.8 percentage points to 4.5 per cent in 2005, but is still higher than the 1998 to 2003 average. In Calgary, the rate dropped 2.7 percentage points to 1.4 per cent, its lowest level since 2001. Other areas of Alberta experienced vacancy rates at or below 1 per cent including Red Deer (1 per cent), Lloydminster (0.7 per cent), Wood Buffalo (0.3 per cent) and Grande Prairie (0.2 per cent). Because of the economic activity associated with oil sands projects in some of these regions and continued strong in-migration, vacancy rates are likely to remain low. In some areas, the low vacancy rates have resulted in rising average rents. For example, "the average apartment rent in Wood Buffalo (Fort McMurray) rose 21 per cent in 2005 to \$1,394, making it the most expensive urban centre in which to rent across Canada, surpassing Yellowknife, where the average rent stands at \$1,208"¹.



- Unabsorbed housing inventory & absorption rate

Unabsorbed housing inventories (inventories of existing homes not yet purchased) declined in 2005 in Edmonton (-4.9 per cent) and Calgary (-2.9 per cent), which may continue to have an upward effect on new construction over the near term. In 2005, the absorption rate (the percentage of total housing listings that are selling) increased by 8.4 per cent in Edmonton and by 0.4 per cent in Calgary. This is in contrast to the national average (all Canadian CMAs) where the absorption rate declined by 6.4 per cent.

House Prices

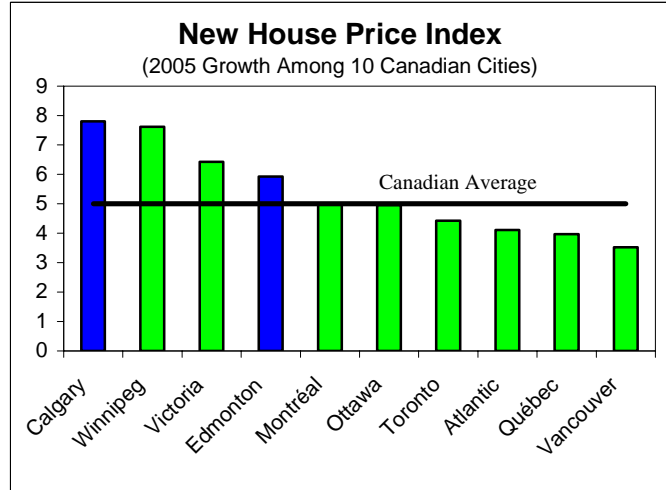
With Alberta's strong housing market, housing prices have also been on the rise over the past few years. Following an increase of 7.1 per cent in 2005, Alberta's new house price index (NHPI) spiked 26 per cent in the first four months of 2006, compared to the same period last year, well above the national rate of 7.5 per cent. Despite the recent rise in prices, Alberta has only averaged 5.5 per cent growth per year since 2001, which is similar to the national average (5.3 per cent).

¹ Canadian Mortgage and Housing Corporation (CMHC): Rental Market Report, Alberta highlights: October 2005 survey.

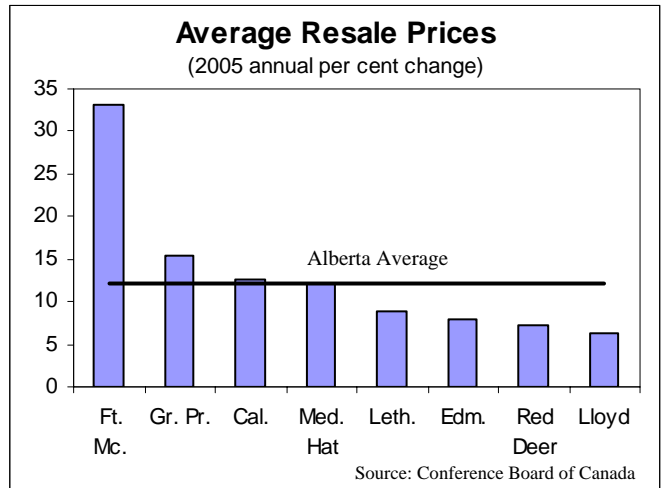
In 2005, Calgary had the highest price increase, at 7.8 per cent, among the major metropolitan centres in Canada. In the first four months of 2006, the Calgary NHPI increased by 33 per cent, whereas Edmonton prices rose 14 per cent over the same period.

The increases in new house prices have not simply been localized to one or two specific areas, but have occurred across many regions of Alberta. Rising construction costs, a lack of supply of homes and rising incomes are causing house prices to move upward in many markets throughout the province.

The new house price index is only calculated for provinces and major cities, but average resale prices of homes are available for all urban centres². In 2005, Alberta saw a large annual increase in average residential resale prices of 12.1 per cent, to more than \$218,000. Resale prices increased more than 6 per cent in all of the eight regions, with the largest gains in Fort McMurray (33 per cent), Grande Prairie (15 per cent), Calgary (13 per cent) and Medicine Hat (12 per cent). The average resale price in Fort McMurray now stands at \$333,855 and is one of the highest in Canada. With large price increases in Calgary, the average resale price was more than \$250,000 in 2005, compared to almost \$194,000 in Edmonton.

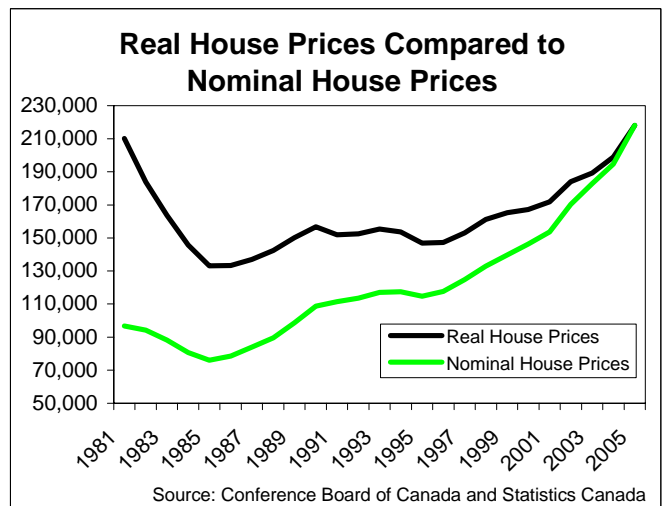


Source: Statistics Canada



Source: Conference Board of Canada

Despite the recent spike in house prices, after adjusting for inflation, real resale house prices in Alberta during 2005 (\$218,000) are only slightly higher than the 1981 real resale house prices (\$210,000). Although real house prices have just surpassed 1981 levels, real per capita personal income has increased 24 per cent since then. Moreover, interest rates are much lower now than they were in 1981, indicating that the housing market is nowhere near the 1980s boom conditions.



Source: Conference Board of Canada and Statistics Canada

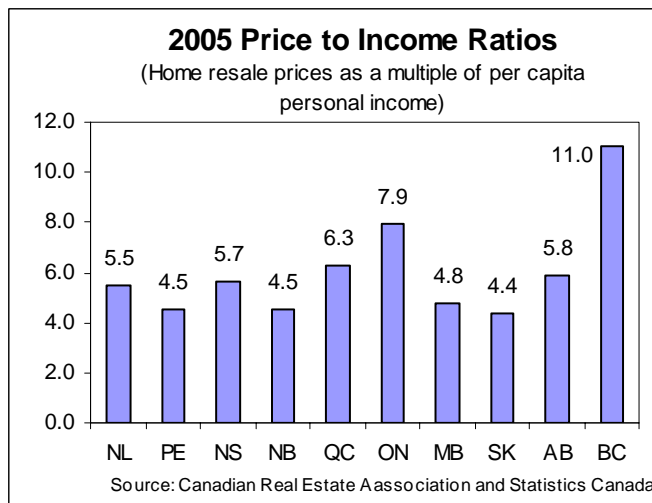
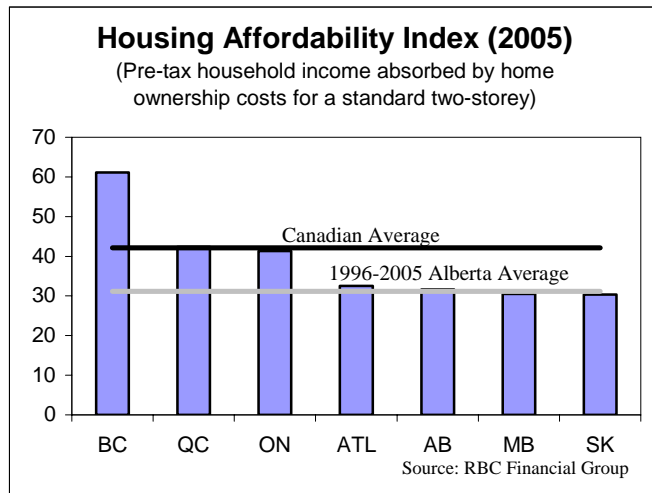
² Therefore, average resale prices can be used as a proxy to see pricing trends in different parts of the province.

Housing Affordability

Although the province is experiencing housing price increases, strong labour markets and large income gains have maintained affordability. During 2005 housing affordability, the percentage of household income absorbed by home ownership costs, was at 31.6 per cent for a standard two-storey home, compared to British Columbia's (61.2 per cent) - the highest provincial percentage - and the national average of (42.2 per cent).

The housing affordability index in 2005 was only 0.4 percentage points above the most recent 10-year average. However, if house prices continue to rise at the same pace they have shown in recent months, Alberta may see a decline in housing affordability across many regions of the province. Also, rising short-term interest rates are likely to affect mortgage rates, which will ultimately affect housing affordability.

Another common approach to measure affordability is to measure house prices to incomes across all provinces. A ratio below 7 is considered a reasonable measure of affordability. This rating is based on the early 1981 data when the housing market in Alberta had a housing bubble. Certainly Alberta does not seem to have an overheated housing market, with a comparable ratio to Nova Scotia and Newfoundland and Labrador. Although the price/income ratio in Ontario appears to be exceeding affordability, British Columbia's housing market is certainly unaffordable.



Conclusion

Continued strong growth in economic activity and population are expected to increase housing starts in 2006. However, starts are expected to moderate over the medium term, as rising interest rates and escalating house prices slow housing demand. Nonetheless, Alberta is expected to maintain a healthy housing market by historical standards over the medium term.

Economics and Public Finance