

Economic Spotlight

ALBERTA'S HOUSING MARKET

Alberta's housing market has experienced exceptional growth in recent years. Housing starts, home sales and house prices are at near-record levels. At the same time, several factors point to a coming slowdown in the housing sector. The U.S. Federal Reserve Board has recently raised interest rates for the first time in four years, beginning what is likely to be an extended monetary tightening cycle, and Canada is expected to follow suit. These developments have raised questions about the sustainability of the Alberta housing market's current strength.

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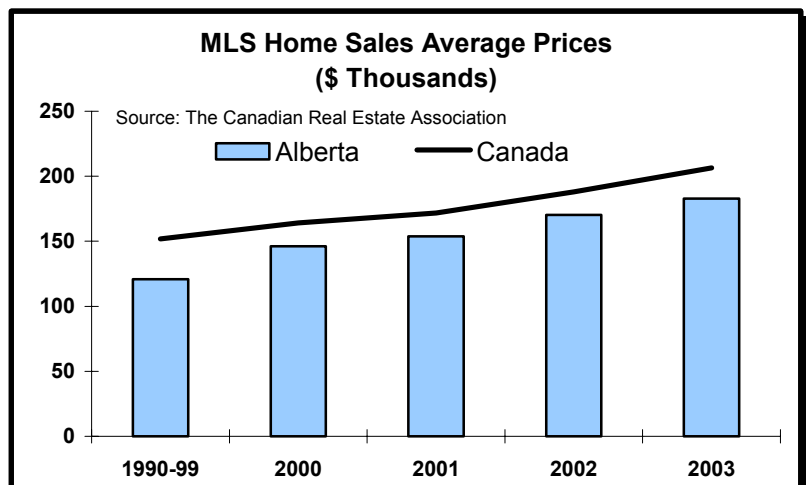
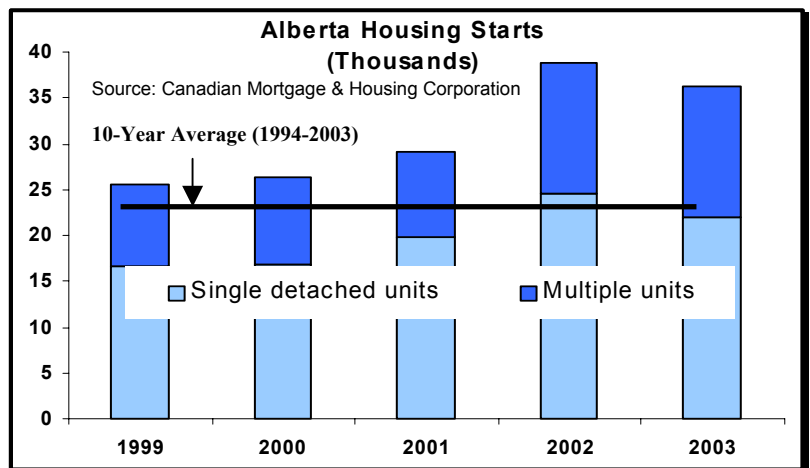
Through the first half of 2004, housing starts in Alberta have continued at a rapid pace, averaging 35,000 units (at annualized rates). This is similar to 2003 levels, and down only slightly from the recent peak achieved in 2002, when starts reached a 20-year high of 38,700. Over the past five years, single detached housing starts have increased by 31% while multiple unit starts have increased by 63%.

Spurred by low interest rates, strong population and employment growth, and healthy income gains, MLS home sales increased by 18% over the past 3 years. Growth in demand has led to increases in housing prices. Between 2000 and 2003, the MLS average home price in Alberta increased by an average annual rate of 7.8%, from \$146,258 to \$182,845. This is similar to the Canadian (8.0%) and U.S. (7.3%) growth rates over the same period (the U.S. housing market has experienced uneven growth, with some regions recording annual price increases in the double digits). Even so, these increases are modest compared to the average increases experienced in Australia (13.9%) and the United Kingdom (16.6%) over this period.

Vacancy Rates

With rapid growth in multiple unit starts, apartment vacancy rates have increased.

In 2003, Edmonton and Calgary reported rates of 3.4% and 4.4%, respectively. Alberta vacancy rates were higher in 2003 than in any of the preceding five years. However, they remained comparable to the most recent 10-year Alberta average of 3.6%, which is also the Canadian average over this period. Similarly, while unabsorbed housing inventories (the inventories of existing houses not yet purchased) rose in 2003 in Edmonton and Calgary, these inventories remained below the recent 10-year averages for both cities. Nevertheless, these trends are expected to have a moderating effect on new construction over the near to medium term.



Housing Affordability

Apart from demographics, a key factor affecting the demand for housing is affordability. The most commonly used measure of affordability is the percentage of household income absorbed by home ownership costs. By this measure, Alberta remains in an enviable position, both in historical terms and in comparison to the rest of Canada. In the first quarter of 2004, average home ownership costs in Alberta represented 25.8% of pre-tax household income.

This was 5.6 percentage points below the Canadian average of 31.4%.

Furthermore, despite significant price increases, housing affordability in Alberta has actually improved since the 1990s. In the first quarter of 2004, Alberta's housing affordability index was 10% lower than the most recent 10-year average.

Housing affordability is likely to deteriorate somewhat in the second half of 2004 and 2005, since interest rates are expected to increase at a moderate pace. However, Alberta begins from a very strong position. In 2003, Albertans' per capita personal disposable incomes were 15% above the Canadian average, yet Alberta's average house prices were 11% below the Canadian average. Furthermore, the continued healthy growth of Alberta's economy should facilitate further gains in employment, incomes, and population, partially mitigating the effects of the anticipated interest rate increases.

Risks to Alberta's Housing Market

One possible risk to Alberta's housing sector is that posed by a substantial spike in interest rates. While not expected, such a development would increase default rates, particularly for recent homebuyers who may be overleveraged. However, in view of Alberta's advantageous position in housing affordability, this risk is less significant in Alberta than in many other jurisdictions.

In addition, the recent near-record housing starts in Alberta are partly the result of very high levels of net inter-provincial migration, which moderated in 2003 (while still leading all provinces for the seventh consecutive year). With Alberta's net in-migration expected to remain somewhat lower in the future than over the past five years, Alberta's housing activity is likely to subside to some degree.

Conclusion

Market fundamentals point to a softening of the North American housing market, including in Alberta. However, barring a dramatic spike in interest rates, Alberta's housing market seems well positioned for a 'soft-landing', as it does not exhibit the typical characteristics of a 'housing bubble'. Housing capacity utilization (as measured by vacancy rates and unabsorbed inventories) has declined recently, but remains well within historical norms. Alberta's favourable affordability profile and strong economic fundamentals suggest that housing activity is likely to remain healthy, albeit at a somewhat more moderate level than in recent years.

