

## Economic Spotlight

### After the Boom: Inventory Surplus and Price Moderation in Alberta's Housing Market

#### Summary:

Exceptionally strong economic and population growth have fuelled the demand for housing in Alberta. In 2006, housing starts jumped nearly 20% to a new high of 48,962, surpassing the previous record of 47,525 starts set in 1978. Currently in 2007, housing starts are averaging around 49,600 on a seasonally adjusted basis.

Current housing market conditions are showing signs of an inventory surplus, resulting in longer periods for homes to sell as buyers have a greater selection to choose from. Across the province, sales-to-inventory levels have declined from a peak in December 2006 of over 100% (no new net additions to inventory) to below 40% in September. This marks a move to a more balanced market from the sellers market the province has been experiencing for the last few years. House prices have spiked, but seem to be moderating in response to higher inventory levels currently on the market.

#### Assessment of Current Conditions:

##### *Housing Starts*

Overall, Alberta housing starts have remained strong so far in 2007, running about the same level as the 2006 record level. Fuelling the growth in 2007 has been the strength in multiple unit starts, up 24% from the same time period in 2006. If it was not for this strength, single detached housing starts would have pulled down the overall figure, as single starts are down 15% in the first ten months of this year.

The trend of slower single-detached housing starts and stronger multiple unit starts is widespread across the province (See Table 1). Fort McMurray and Lethbridge are the two exceptions. Extreme demand for housing in Fort McMurray resulting from strong economic activity in the area has resulted in a 45% increase in single starts and an almost 71% increase in multiple starts so far in 2007. Lethbridge on the other hand seems to be a late bloomer in the Alberta housing boom, waiting until this year to see any growth in starts.

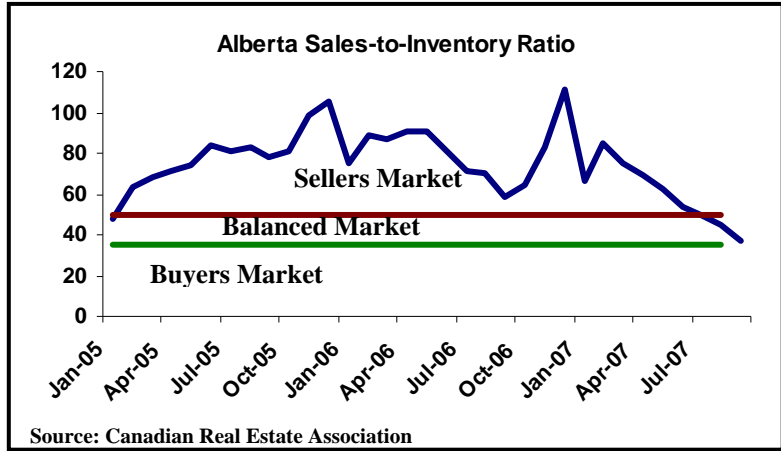
**Table 1. Preliminary Housing Starts January to October 2007 vs. January to October 2006 (% Change)**

	Single Starts	Multiple Starts	Total
Calgary	-25.4	7.9	-13.7
Edmonton	-12.2	38.6	6.6
Fort McMurray	45.3	70.9	57.7
Grande Prairie	-22.9	20.9	-6.7
Lethbridge	54.7	131	68.5
Medicine Hat	-15.2	25.3	4.7
Red Deer	-3.4	68.4	13.9

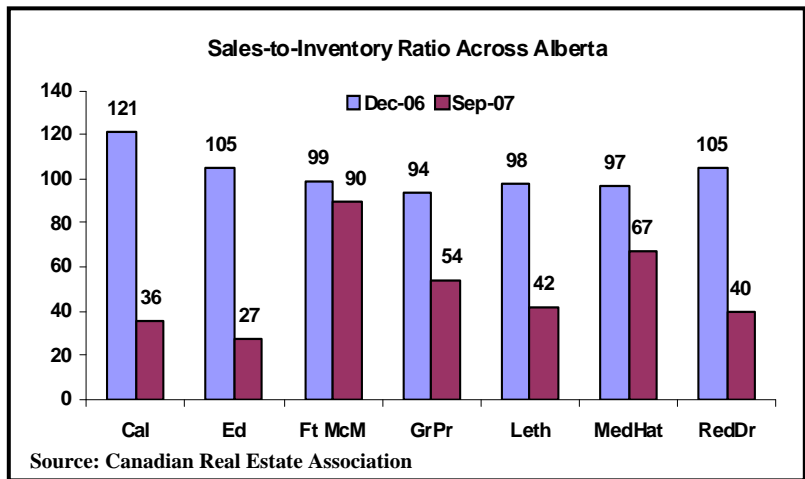
Source: Canadian Housing and Mortgage Corporation

**Inventory Levels**

On a provincial basis, sales-to-inventory ratios have moderated to 37% in September, meaning 37% of the houses on the market during a given month are being sold. This is the lowest level the sales-to-inventory ratio has been at since January 1996 and is a stark contrast to December 2006 when the sales-to-inventory ratio was 112%. The Alberta housing market has been a sellers market since the beginning of 2005.



Most activity on the resale market seem to have peaked at the end of 2006 and early 2007 for the communities across Alberta. Fort McMurray continues to be an anomaly with current sales-to-inventory ratios at 90%, implying that all that is put on the market is most likely to be sold in that month. The situation in Fort McMurray is a function of the activity in Alberta’s oilsands. A few parcels of land have been opened for housing development in Fort McMurray which should lead to an increase in housing starts in the area over the next couple of years, but the local market is expected to remain tight.



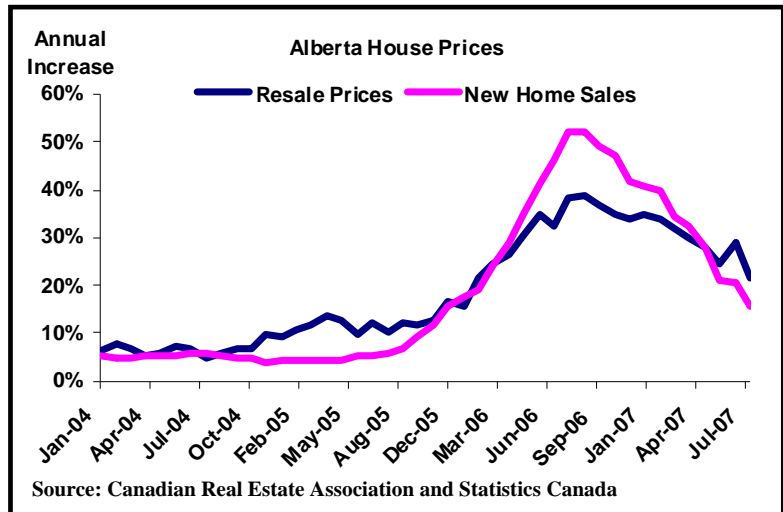
As the graph above depicts, Edmonton has moved to more of a buyers market given the high levels of inventory currently on the market resulting in a 27% sales-to-inventory ratio (its lowest level since January 1994). Although housing starts are down in Edmonton, units under construction are up 29% in September from a year ago. With the increase in the number of new homes coming up for completion, lower absorption rates and a high level of inventory on the resale market, the Edmonton housing market will continue to see ample inventory levels available to buyers and should contribute to a continuation of a buyers market for the next several months. CMHC estimates that if the sales-to-inventory ratio remains around 30% until March or April of 2008, Edmonton could see house prices weaken.

In Calgary, residential construction activity is its strongest since 1972. Although housing starts are lower so far this year, housing completions are up 14% from last year and are expected to

continue to be strong as there are a record number of units under construction. Unlike Edmonton, Calgary's absorption rates are up and have actually helped to reduce the total inventory of completed and unabsorbed units. The market has thus remained relatively balanced in Calgary.

**House Prices**

The build up of inventory on the market has resulted in some easing of price growth. Although September data shows Alberta resale prices are up almost 20% from a year-ago, this is its slowest increase since the beginning of 2006. New home sales continue to show price growth, albeit at a slower pace. This indicator is lagged as the price is determined when a house deal is signed and not when construction of the home is completed, resulting in a lag of anywhere from 6 to 18 months.

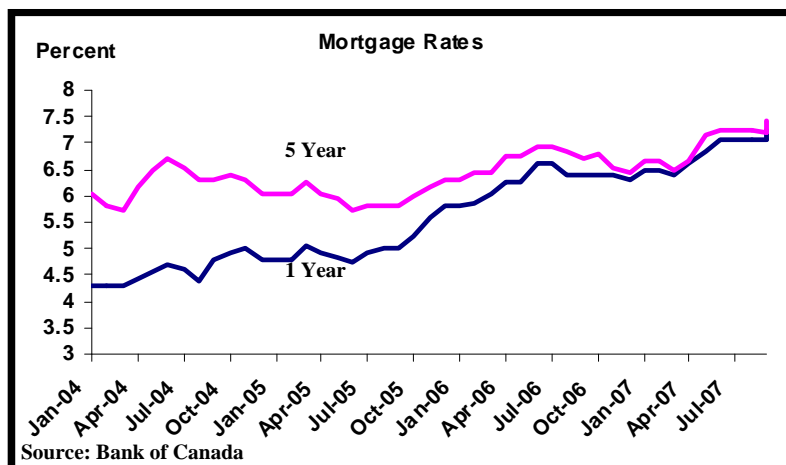


Construction costs have eased slightly, partly a result of weaker U.S. housing starts relieving some pressure on construction supplies.

With many of the new homes under construction nearing completion, some further build-up of inventory is expected in the short-term, as many of these home owners will need to sell their current homes before taking possession of their new home.

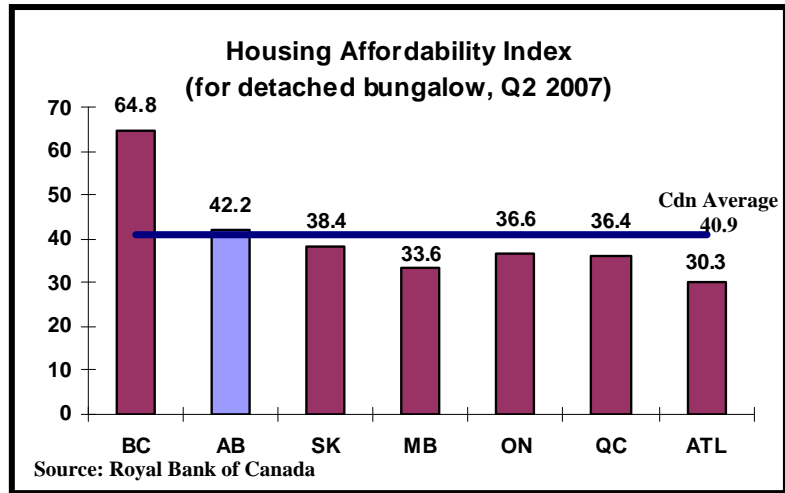
**Mortgage Rates**

Mortgage rates have been steadily on the rise over the past couple of years. One-year mortgage rates have risen from a low of 4.3% in the first quarter of 2004 to 7.25% in October 2007, while 5-year mortgages have increased from a low of 5.7% in June 2005 to 7.44% in October 2007. Higher mortgage rates combined with rising house prices have pushed up mortgage carrying costs, slowing the number of first-time home buyers entering the housing market. Alternatively, first-time home owners have opted for the condominium or rental market as an affordable alternative. Unfortunately this could pose another risk for higher rents given the extremely low vacancy rates in the province.

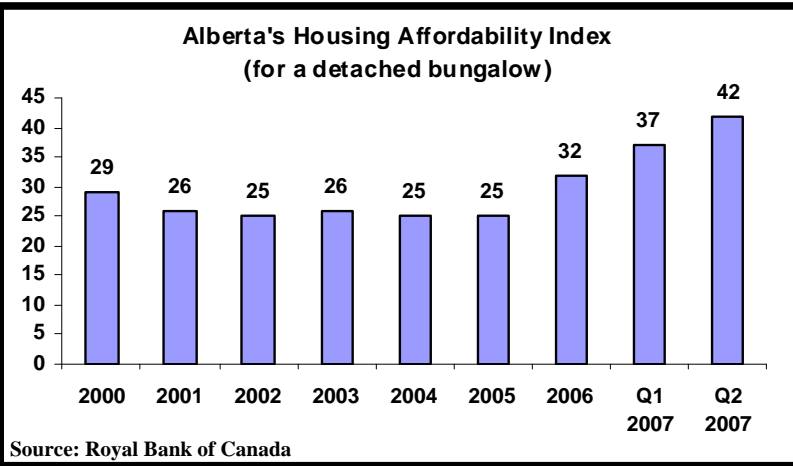


### ***Housing Affordability in Alberta***

Rising mortgage costs, surging house prices and higher home operation costs all contributed to the slide in Alberta's housing affordability rating in the Royal Bank's latest Housing Affordability Index released in September 2007. Housing affordability is the measure of pre-tax household income absorbed by home ownership costs (i.e. mortgage, property taxes and utility payments).



In the second quarter of 2007, Alberta's affordability index for a detached bungalow was 42%, more expensive than the 37% posted in the first quarter of 2007 and ten percentage points above the index level for the second quarter of 2006. The Royal Bank noted that although Albertans have been able to 'avoid British Columbia's stressed affordability conditions', Albertans are now



paying more than Ontarians for most housing types, except two-storey homes, and are above the national average (40.9%) for the home affordability index.

Although Albertans are experiencing strong labour income gains of over 12% in the first half of 2007, the gains in real wages have been minimal given the province's higher inflation rate. Wages, on average, have increased 5.6% while inflation in the province is tracking close behind at 5%. The main driver of Alberta's inflation has been the shelter component of the index, contributing 2.7 percentage points to the overall 5% year-to-date increase. The current inventory levels will help in stabilizing the Alberta housing market and consequently prices. Inflation is also expected to cool, giving Albertans some gains in real wages.

**Concluding Remarks:**

Rising interest rates, escalating housing prices and overall rising costs have the potential to slow the housing market in the near term. Current inventory levels will continue to put some downward pressure on prices and activity, as buyers have ample choice (and now time) when looking for a home. But with people continuing to move to Alberta and a strong domestic economy, the amount of inventory surplus will likely be short-term in nature as the market filters out serious sellers from those that were testing the market and looking to 'cash in' on the hot housing market. Most Alberta home builders have adjusted building schedules leading into 2008 to accommodate the current level of inventory.