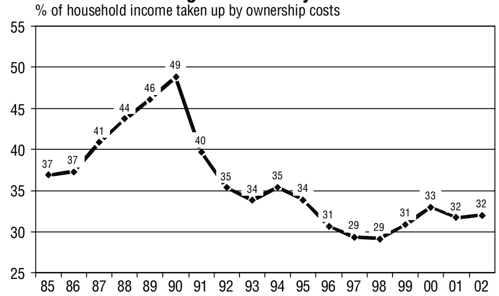
RBC Financial Group

Highlights

Housing Affordability Index

Housing affordability in Canada

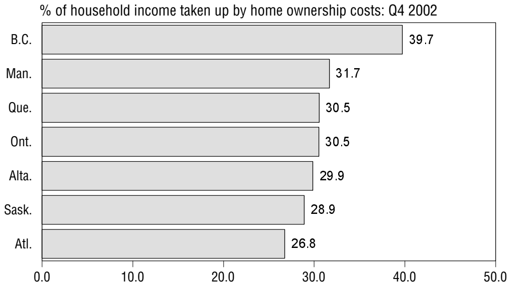
% of household income taken up by ownership costs



Source: Statistics Canada, Royal LePage, RBC Financial Group

Provincial affordability comparisons

% of household income taken up by home ownership costs: Q4 2002



Source: Statistics Canada, Royal LePage, RBC Financial Group

Economics Department

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Housing demand still strong but rising prices begin to bite into affordability

▲ A combination of historically low mortgage rates, pent-up demand and solid income and job gains ignited a red-hot housing market in 2002. Sales of existing homes in Canada increased 10.6% to 421,227 units, the best result on record while housing starts increased sharply, up 26% to 205,034 – the best result since 1989.

▲ A key feature supporting Canada's housing markets in 2002 was the relative weakness and volatility in equity markets during the year. As stock prices sagged, Canadian investors were lured into the housing market, inspired by stable but rising house prices.

▲ In the fourth quarter of 2002, RBC's housing affordability index was 31.8%, essentially unchanged from the previous quarter, but up from a three-year low of 30.6% in the fourth quarter of 2001. The affordability index measures the proportion of pre-tax household income taken up by ownership costs for a detached bungalow.

▲ While five-year mortgage rates remained low through 2002, falling to just 6.80% in the fourth quarter from 6.85% in the third quarter, house prices — the other main element in the affordability equation — rose rapidly, up 7.3% in the fourth quarter. This effectively offset reductions to borrowing costs during the quarter.

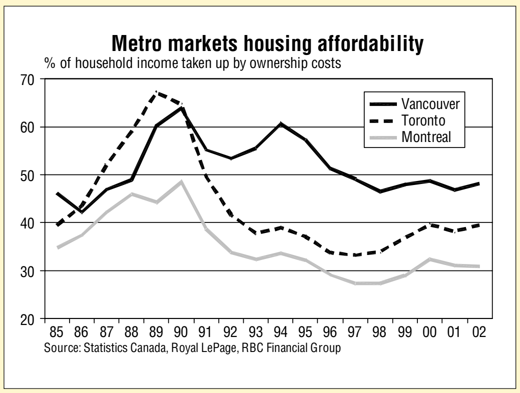
▲ Higher house prices were a function of tight market conditions evident across the country as the supply of new listings struggled to keep pace with demand. Although homebuilding activity surged through the year, new homebuilders were also cautious to carefully match supply with demand in an effort to avoid the excessive inventory accumulations that were prevalent during the speculative late 1980s and early 1990s.

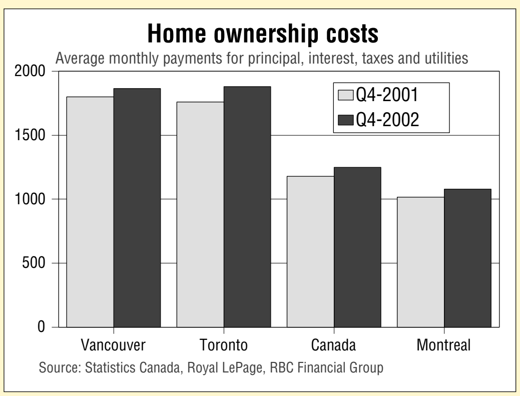
▲ We expect that housing affordability will mildly deteriorate through 2003 to an average reading of 33.4%, up from an average reading of 32% in 2002. While some of this deterioration will be the result of a moderate rise in borrowing costs as the Bank of Canada starts hiking interest rates, nearly one-half of the deterioration will also be due to rising house prices as a result of more move-up buying activity. Even at 33.4%, however, the affordability index remains at reasonable levels by historical standards and demand conditions are expected to stay favourable thanks to a deep pool of pent-up demand and the continuing support of favourable job and income growth.

▲ For the first quarter of 2003, the affordability index is expected to drift up to 32.7%. In practical terms, this means that the cost of owning an average detached bungalow in Canada should amount to $1,288 a month (principal, interest, taxes and utilities), a 5.8% rise above the year-ago level. This ranges from an expected low of $935 in the Atlantic to a high of $1,597 in British Columbia during the first quarter of this year.

▲ Housing starts will remain strong during 2003 although they will moderate from the red-hot pace of 2002. We expect housing starts to average 200,800 units this year, down 2% from the 205,034 units recorded last year.

Metropolitan markets



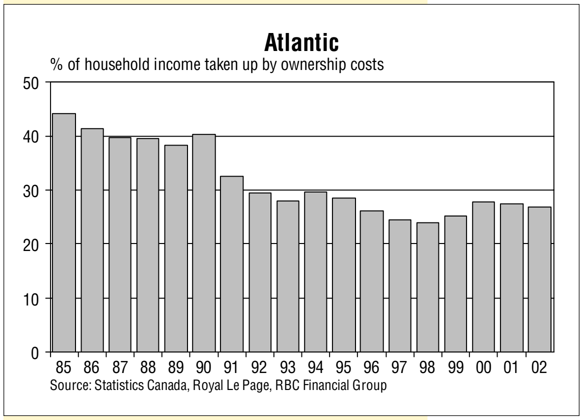


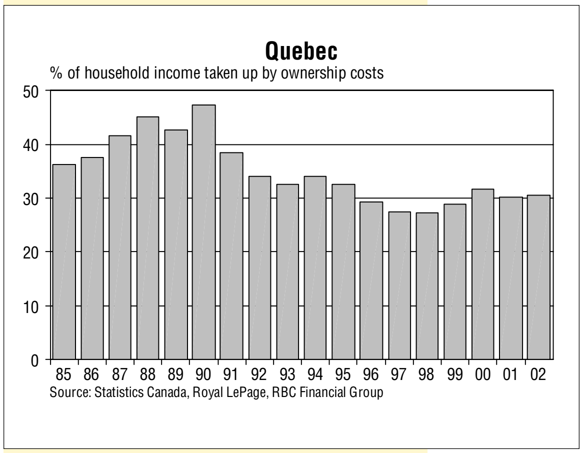
Vancouver — Vancouver's housing market finished 2003 on a strong note. Existing home sales increased a solid 21% over the previous year, topping 34,000 units, the highest level since 1992. Average sales prices moved up 5% to $301,473, maintaining Vancouver's reputation as the most expensive region in Canada for residential real estate. Although sales levels in 2002 consistently improved every month from June, a declining inventory has left market conditions very tight with potential buyers hard-pressed to find product. Developers in the area have been quick to respond with housing starts in the region increasing 22% in 2002. However, supply remains limited compared to the very deep pool of pent-up demand that has recently been unleashed by historically low mortgage rates. Sales growth will cool down in 2003 as the moderate rise in mortgage rates and higher home prices begin to cut into affordability. At 47.7%, Vancouver's housing affordability indicator is much too high, suggesting that regional income growth has failed to keep pace with the rising costs of single detached housing. Still, Vancouver's housing markets remain a top draw for international and American buyers and investors, who view Vancouver's prices as relatively inexpensive when adjusted for their currency differentials.

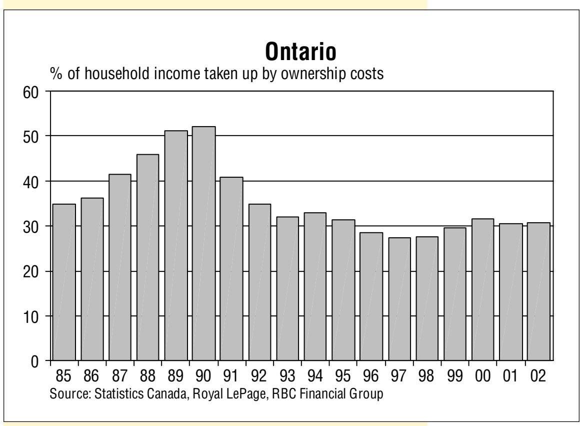
Toronto — A record of more than 74,000 existing homes changed hands in the Greater Toronto area in 2002. Tight markets also pushed average prices sharply higher in the final quarter, with the average house price for 2002 reaching $276,000, up 10% from the previous year. However, an increase in new listings has recently helped to ease the inventory crunch. Despite lower mortgage rates, rising prices offset the improvement to borrowing costs, leaving Toronto's affordability index at 39.1% during the final quarter, essentially unchanged from the quarter before. But a combination of steadily rising prices and marginally higher mortgage rates will likely contribute to declining affordability in 2003. First-time buyers will be increasingly drawn to more inexpensive home as such as single detached housing in outlying suburban regions or entry-level condos in the downtown core. Even though overall sales levels in Toronto are expected to slow in 2003, they will remain at healthy levels thanks to the lagged effects of 2002's strong employment growth, which should continue to support solid housing demand this year.

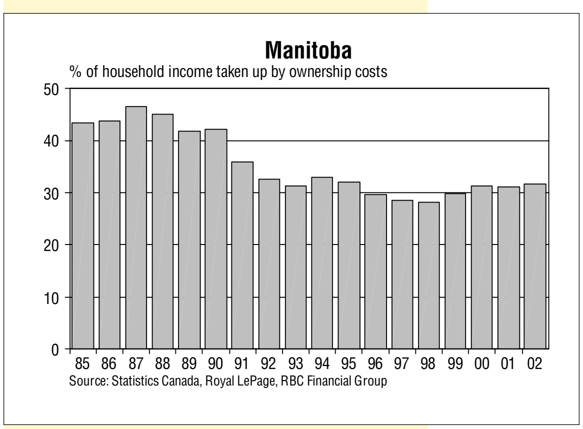
Montreal — Existing home sales in Montreal last year shot up 18% to a record 47,000 while average prices climbed 12% to $144,000 thanks to one of the tightest resale markets in the country. At the end of 2002, Montreal's sales-to-new listings ratio was just above 70%, indicating seller's market conditions. New housing markets also had a banner year as starts increased by 55% to 20,500 units, the highest levels in more than a decade. Low mortgage rates, a robust job market and low vacancy rates were the major drivers of the boom. But, following several years of only modest activity, pent-up demand was also a major catalyst for the surge. At 30.7% in the fourth quarter, Montreal's affordability indicator remains the lowest among major metropolitan regions, although it is now 3.5% higher than a year ago thanks to rising prices. But despite the prospects of moderately rising mortgage rates and a continuing increase in prices this year, housing will remain well within the reach of most potential buyers. Moreover, the release of pent-up demand can still be relied upon. This, combined with robust consumer confidence and a healthy job market is expected to keep Montreal's housing markets humming in 2003, albeit, at a much more sustainable pace.

Regional overviews









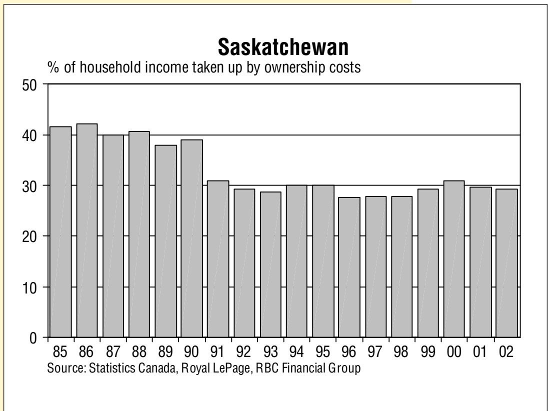
Atlantic — At 26.8% of household income in the fourth quarter of 2002, ownership costs for a detached bungalow in the Atlantic region remain the most affordable in Canada. Given lower borrowing costs during the fourth quarter of 2002 (five-year mortgage rates averaged 6.80% in the quarter, seven basis points cheaper than the same period last year) affordability levels would have been even better were it not for moderately rising house prices. Lower inventory levels were mainly responsible for rising home prices, although increased move-up buyer activity in regions such as Halifax and Moncton also exerted upward pressure. Still, sales-to-listing ratios are hovering slightly lower than 60%, pointing to balanced market conditions overall. New residential construction also improved in 2002, with housing starts in the region up 18% over the previous year. Housing demand should remain at healthy levels due to good affordability. However, sales levels will begin to ease in 2003 in response to rising borrowing costs while new homebuilding activity will also begin to moderate in response not only to rising rates but declining household formation levels in some regions.

Quebec — Housing markets were on fire in 2002. Average housing prices jumped a whopping 12% – the sharpest increase of any province — while sales activity climbed to their highest levels on record. The strong jump in prices was almost entirely a function of the strength in housing demand. Resale market conditions have been residing in seller's territory for the last few months. Yet despite the higher prices experienced in the fourth quarter, the affordability indicator remained at 30.5% — essentially unchanged from the previous quarter. While the slightly lower costs of borrowing have, indeed, helped to offset the increase in house prices, recent steady gains to household income have also prevented a more pronounced deterioration in affordability. So, despite the average monthly payments for a detached bungalow increasing by 8% from year-ago levels (to $1,037 in the fourth quarter) this will not present much financial hardship for Quebecers thanks to solid income growth. Tight resale markets fuelled by pent-up demand, low historical mortgage rates and a solid economy has also pushed residential construction activity to new highs in 2002. Total housing starts reached above 42,000 units last year, the highest levels seen in the province since 1991. Housing demand should remain solid this year, thanks in no small part to the deep pool of potential housing demand still available in Quebec. However, rising prices and borrowing costs will erode affordability a bit in 2003, moderating both sales and construction activity to a more sustainable pace.

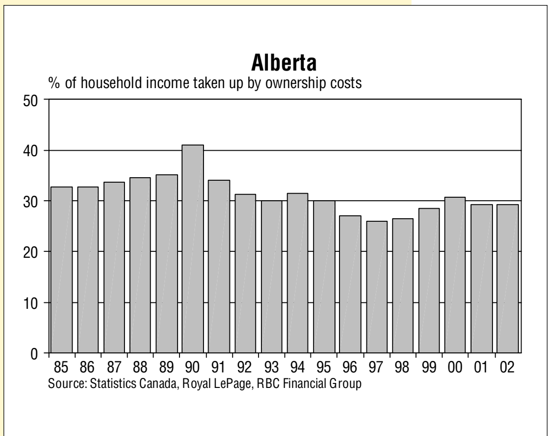
Ontario — After spending much of the year in seller's market conditions, especially in the Toronto and Ottawa areas, market conditions began to ease during the final quarter of 2002. While a steady increase in new listings helped to boost inventory levels, potential homebuyers became more cautious and were not as willing to overpay for new purchases, bringing the sales-to-new-listing ratio back to a more balanced 60% level. Still, average selling prices increased more than 10% on year-ago levels. So, despite lower borrowing costs, our affordability indicator for Ontario remained at 30.5% in the fourth quarter, unchanged from the previous quarter. This amounts to an average monthly payment of $1,382 (principal, interest, taxes and utilities) 5% higher than the same period last year. Tight resale markets, low interest rates and a robust provincial economy also lifted new residential construction activity. Housing starts rose to 84,000 units, the highest level seen in Ontario since the late 1980s. But, while the late 1980's building boom saw a high degree of speculation which caused a housing bubble to form and subsequently burst, growth in 2002 was more balanced as developers brought

Regional overviews

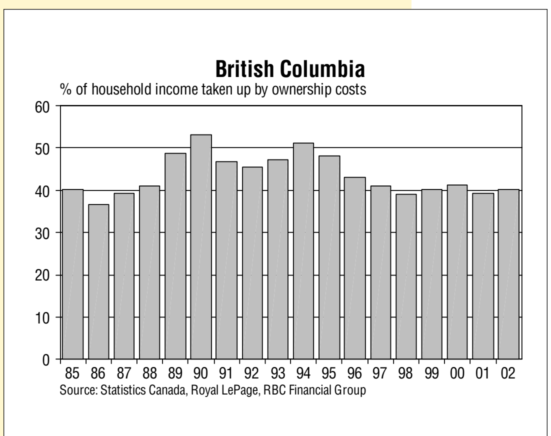
on product in order meet current demand. The new home market has also effectively helped to balance overall market conditions. Moderately rising house prices coupled with higher mortgage rates, will likely cause affordability to deteriorate during 2003. However, housing demand will remain healthy thanks to solid job and income growth as well the continuing release of pent-up housing demand formed during some of the leaner years of the mid 1990s.



Manitoba — Housing markets in Manitoba have generally retained a reputation for being one of the most stable in Canada. However in 2002, an extreme shortage of new listings produced some of the tightest resale market conditions ever seen in the province. Average selling prices have recently climbed faster than at any time in the last 10 years. The shortage of product has also forced many potential buyers to put off purchases, causing sales activity to fall 4% in 2002. Rising prices have also taken their toll on affordability, this despite the lure of lower mortgage rates in 2002. The province's affordability indicator climbed to 31.7% in the final quarter, indicating that it took just above 31% of pre-tax household income to service the ownership costs of a detached bungalow. Tight resale markets also triggered a surge in new home construction in 2002. Housing starts jumped 22% to 3,620 units and the addition of some of these new units will likely help to alleviate the inventory crunch this year.



Saskatchewan — Generally balanced market conditions thanks to a marginal slowdown in sales levels, allowed housing prices to grow at a moderate 3% pace during 2002. As such, affordability levels have also remained relatively stable in the province. In fact, lower borrowing costs helped to push Saskatchewan's affordability indicator slightly lower to 28.9% during the fourth quarter of 2002, the same level experienced a year earlier. At 28.9% of household income, the cost of home ownership in Saskatchewan remains one of the lowest in Canada and is a key feature of this market. While construction activity responded to favourable housing conditions in 2002, with starts surging by 25% to 2,960 units, a pullback in housing activity is expected this year, as a result of slightly softer employment growth. Also, continuing outflows of working age individuals to other provinces is also expected to be downward drag on housing demand.

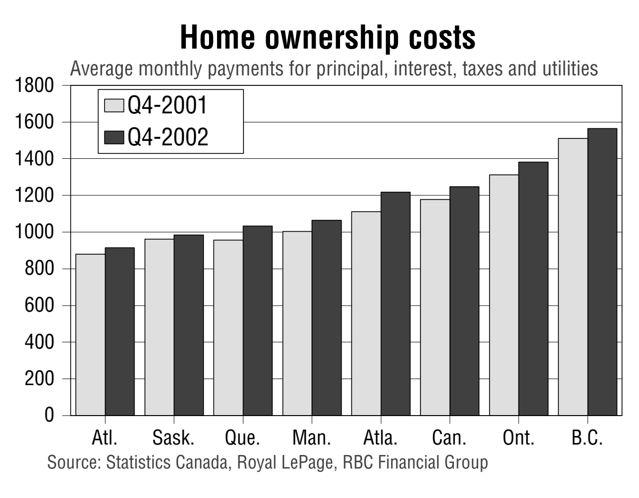


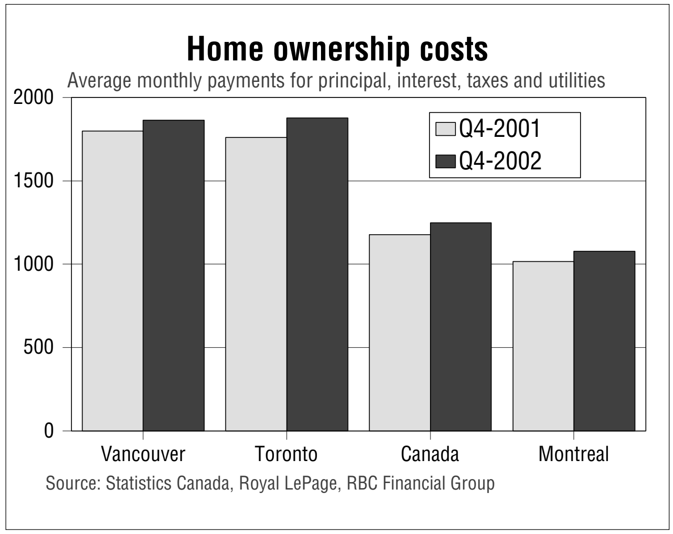
Alberta — It was another solid year for housing markets in Alberta. Existing home sales increased 4% in 2002 while average house prices jumped nearly 11%. In Calgary and Edmonton, average prices for a detached bungalow increased by an even higher margin. Rising price levels have eroded affordability in Alberta, with our indicator sitting at 29.9% during the fourth quarter of 2002, nearly 8% higher than in the same period last year. Still, at 29.9%, Alberta remains the third most affordable market in Canada (behind the Atlantic region and Saskatchewan) thanks in no small part to solid household income growth. The contrast in housing prices and affordability levels with British Columbia has been a contributing factor to Alberta's growing population of working-aged individuals. B.C. residents have been consistently leaving that province in favour of Alberta since the last half of the 1990s. This, in itself, has contributed to the strength of Alberta's housing market. Although new homebuilders have directly responded to the steady demand for housing, with starts increasing by almost 4% in 2002, higher prices and eroding affordability will likely take some of the steam out of Alberta's housing market in 2003. Still, a red-hot economy and robust employment growth will keep housing demand at very healthy levels.

British Columbia — Housing markets were exceptionally buoyant and a major source of economic growth for the province in 2002. Total housing starts increased by nearly 30%, led by a 48% rise in single detached construction and a 16% improvement in multiple activity. Low mortgage rates and sparse inventories, which resulted in tighter resale markets and rising prices, triggered much of the improvement in construction activity. Existing home sales increased 19%, while average prices were up 7%. A steady increase in average prices was also the primary reason that British Columbia's affordability indicator remained essentially unchanged at 39.7% in the fourth quarter of 2002 compared to the quarter before despite the marginal decline in average mortgage rates. The recovery of British Columbia's housing markets, which began in 2001, has been largely inspired by the sharp reductions in borrowing costs during the past year and a half. Following several years of poor housing market conditions caused by weak income growth, leaky condos and high home prices, low historical mortgage rates have recently unleashed a deep pool of pent-up housing demand. Still, the province's housing market remains one of the least affordable in all of Canada. Looking forward, we expect that as mortgage rates begin to moderately rise this year, both housing starts and sales will likely level off. A stronger improvement in incomes and job growth will be necessary in order to sustain housing demand at potential levels in the longer-term.

Home ownership cost comparison

Average monthly payments for principal, interest, taxes and utilities





How RBC's Housing Affordability Index works

RBC Financial Group's housing affordability index shows the proportion of median pre-tax household income required to service the cost of mortgage payments (principal and interest), property taxes and utilities on a detached bungalow, a typical target home for first-time buyers. The index is based on a 25% down payment and a 25-year mortgage loan at a five-year fixed rate and is estimated on a quarterly basis for each province and for the Montreal, Toronto and Vancouver metropolitan areas.

The index uses household income rather than family income to account for the growing number of unattached individuals in the housing market. The indices are based on quarterly estimates of this annual income, created by annualizing and weighting average weekly earnings by province and by urban area. (Median household income is used instead of the arithmetic mean to avoid distortions caused by extreme values at either end of the income distribution scale. The median represents the value below and above which lie an equal number of observations.)

The higher the Index, the more difficult it is to afford a house. For example, an affordability index of 50% means that home ownership costs, including mortgage payments, utilities and property taxes, take up 50% of a typical household's pre-tax income.