

Economic Analysis By Economist Carl Gomez

Presented July 2010 Exclusively to The Members of REIN™



Observing the forest from the trees
"Where does the housing market go from here?"

Carl Gomez
 Vice President, Investment Research



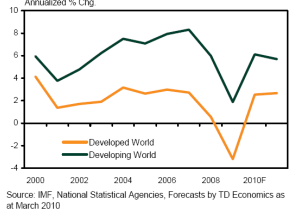
Economic & lending market outlook




Global economic themes

- Global economy is firmly in recovery mode and risk of a double dip is low
- But there is significant variance in regional economic performance unfolding
- Emerging markets are growing strongly while the developed world will see slower growth than is usual as it face considerable challenges related to fiscal deficits and the rebalancing of monetary conditions
- Expect heightened volatility in global capital markets
- With significant economic slack and high unemployment, the risk of deflation (or more likely "disinflation") is higher than inflation over the next few years

GLOBAL GROWTH OUTLOOK



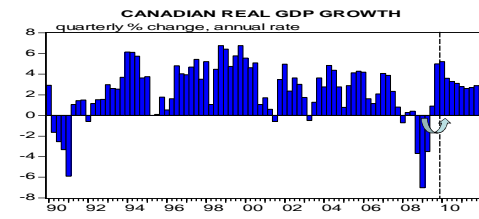
Source: IMF, National Statistical Agencies, Forecasts by TD Economics as at March 2010




Canadian economic outlook

- Unlike much of the developed world, Canadian economy has seen a "V" shaped recovery
- Growth was 5 and 6% respectively in Q4 and Q1 – the strongest in a decade
- Growth led by the domestic side of the economy, but even the external side has benefited from a cyclical rebound in global trade activity

CANADIAN REAL GDP GROWTH
 quarterly % change, annual rate



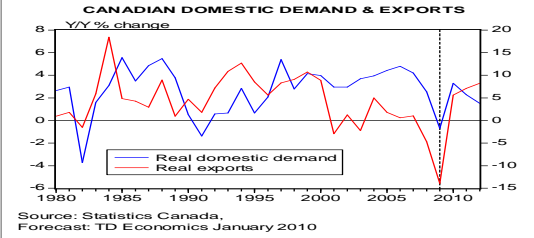
Source: Statistics Canada
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CANADIAN DOMESTIC DEMAND & EXPORTS
 Y/Y % change



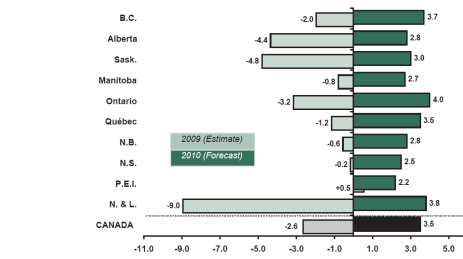
Source: Statistics Canada,
 Forecast: TD Economics January 2010




Canadian provincial outlook

- Central Canada leads the recovery, benefitting in part from a cyclical rebound in exports/manufacturing
- Western markets also recovering - particularly BC (Olympics/housing) - but excess capacity and weak natural gas prices holds back Alberta

Real GDP (% chg.)



Estimate and forecast by TD Economics as at April 2010.

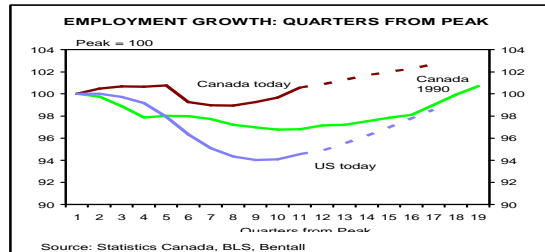


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Canadian employment situation

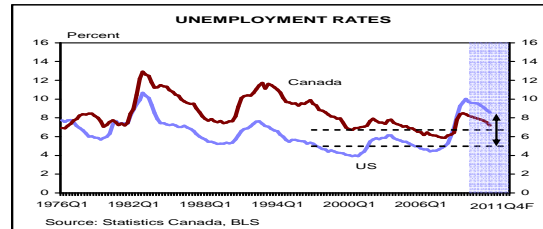
- Canadian jobs are already back to pre-recession levels but the US is not likely to get there until at least 2013
- There is less slack in Canada's labour market - it will return to "full employment" levels faster than the US - will mean greater support for Canadian income growth



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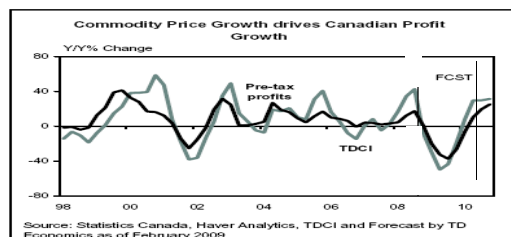
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Fundamental drivers of the Canadian economy

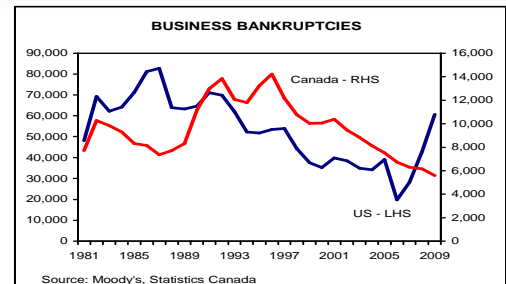
- Canada's domestic outperformance is partly driven by its orientation to commodities
- Stronger commodity prices support profits, incomes, jobs and net worth in Canada



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Fundamental drivers of the Canadian economy

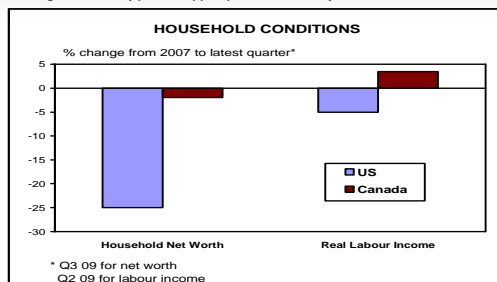
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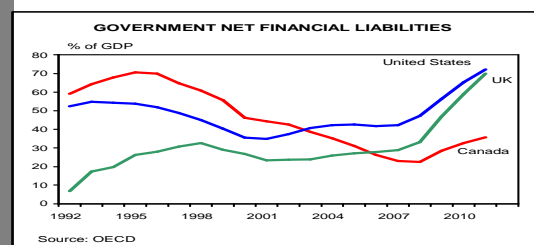
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Fiscal and monetary policy

- Canadian government is less burdened by recent fiscal spending
- Interest rates will rise from "emergency levels" but should remain near historical lows in the near term given global anxieties



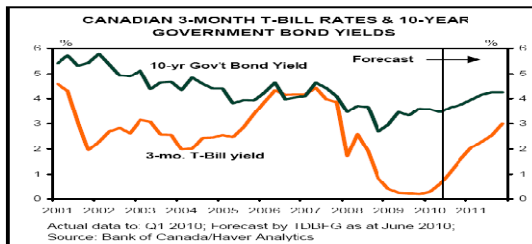
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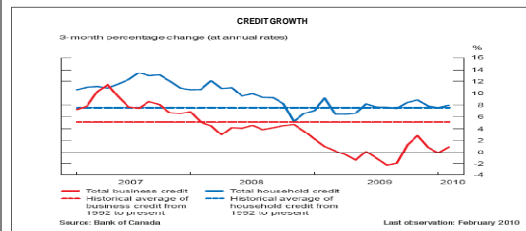


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Residential lending market – credit availability

- Unlike the US., credit has continued to be extended in Canada
- Combined with still historically low mortgage rates, debt markets have been very supportive to Canadian households

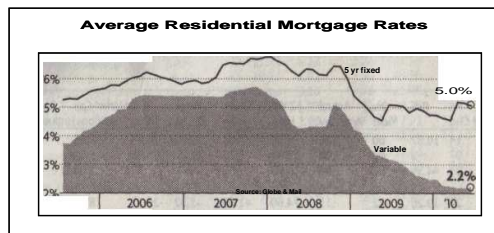


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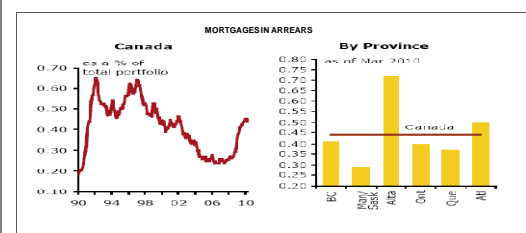


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Residential lending market – relative stability

- Some stress has appeared in Canada's residential lending market
- But Canada's mortgage market is on a much more stable footing than the US

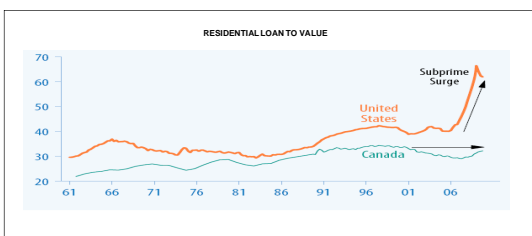


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Housing market outlook

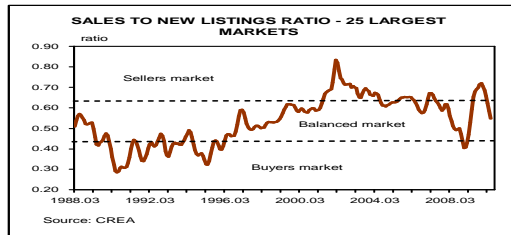


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Canadian housing market conditions

- After an impressive run, home sales are trending lower while listings are increasing
- The net result is a housing market moving back into balanced conditions, and a return to a buyer's market should not be dismissed

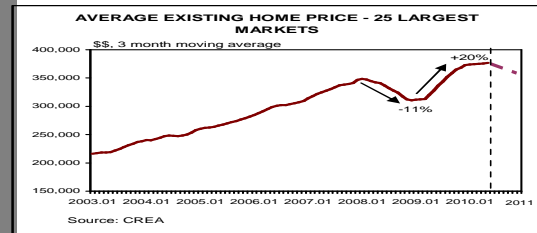


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Canadian housing market conditions...cont'd

- The impressive return to a sellers market over the past twelve months caused house prices to grow by double digit levels
- However the rebalancing of supply and demand conditions could result in a modest price correction in the months ahead

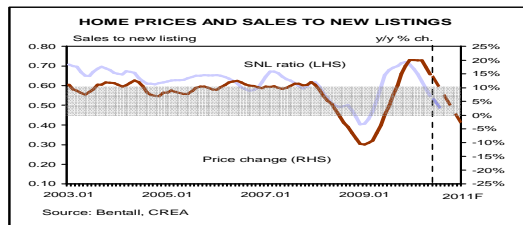


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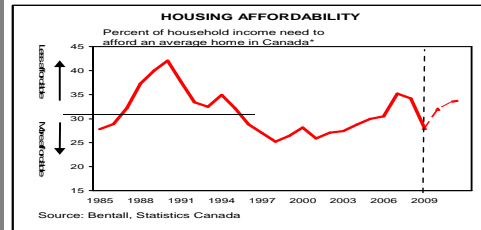


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Housing (un)affordability

- Improved housing affordability was a major reason for stronger housing demand last year
- Mortgage rates are slowly rising off their secular lows and together with high existing home prices, will result in less supportive conditions for ownership demand going forward

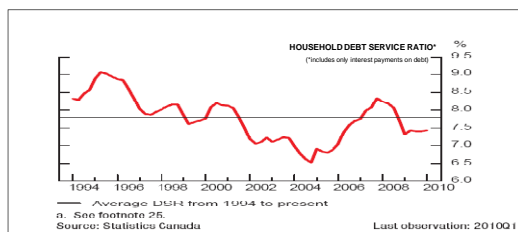


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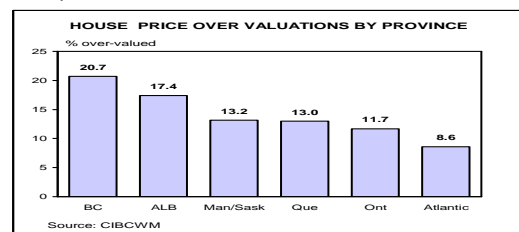


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Housing is over valued

- The biggest factor recently impairing housing affordability is the over valuation of house prices
- Over valuations are largest in the West, but all markets require some correction to restore equilibrium



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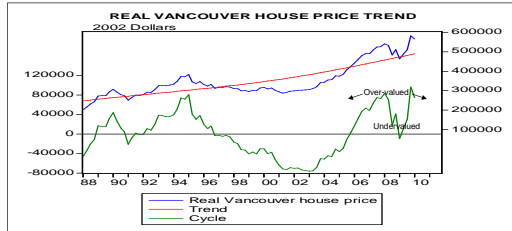


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Is there a bubble in Vancouver?

- After a momentary correction in 2008, Vancouver home prices have reached another record high
- All else equal, this suggests that Vancouver home prices are over-valued relative to historical trends and a bubble cannot be dismissed

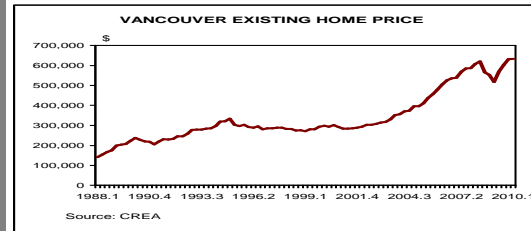


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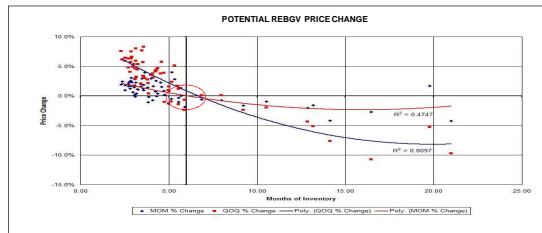


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Magnitude of prices changes in Vancouver

- An exogenous event does not necessarily need to occur to prompt a price correction
- Supply and demand are the main factors determining price direction – should months of inventory rise to about 10 – it would result in annual price declines of about 20%

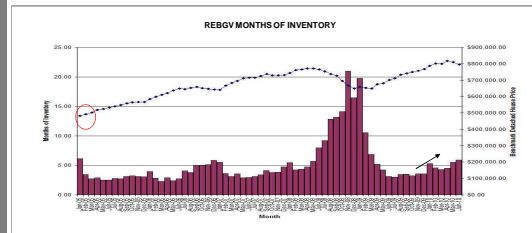


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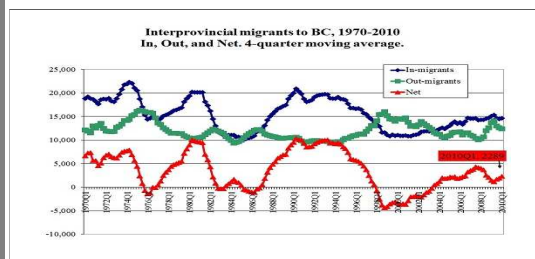


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What's not driving prices in BC

- Unlike Alberta and Saskatchewan, population growth has not been "out of the ordinary" in BC over the past decade
- Consequently, it should not be used as a fundamental explanation for BC's outsized home price gains

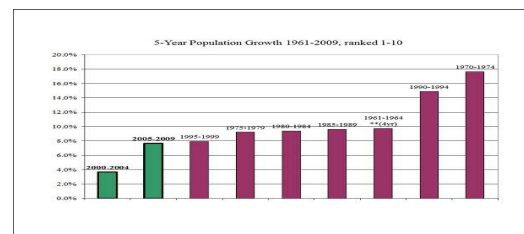


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Buyer psychology

- Psychology has been a major force driving housing demand and prices this decade
- Even with slightly higher mortgage rates, ownership costs are generally better than comparable rents in most markets
- From an investor's standpoint, positive cashflows remain possible – the exception is Vancouver and Victoria

Market	Standard Condominium				Ownership costs*(Q4 09)	Avg 2 bed Rent (Condo)	Ownership Discount (Q4 09)	Ownership Discount (Q1 09)
	Q4 2009 Average	Last Quarter Average	Q1 2009 Average	Condo % Change				
Montreal	220,625	213,278	209,593	5.26%	\$1,052	\$1,070	-1.67%	-10.55%
Ottawa	218,167	213,583	207,833	4.97%	\$1,040	\$1,193	-12.79%	-16.61%
Toronto	309,316	300,632	300,722	2.86%	\$1,475	\$1,487	-0.80%	-18.10%
Saskatoon	197,500	210,000	186,500	5.90%	\$942		na	na
Calgary	256,056	249,500	257,189	-0.44%	\$1,221	\$1,310	-6.79%	-11.97%
Edmonton	213,380	213,250	206,854	3.15%	\$1,018	\$1,122	-9.31%	-16.70%
Vancouver	452,750	445,500	405,000	11.79%	\$2,159	\$1,448	49.11%	18.94%
Victoria	265,000	275,000	265,000	0.00%	\$1,264	\$1,223	3.33%	7.01%
National	205,756	204,358	193,474	6.35%				

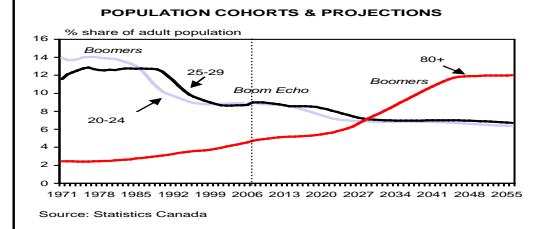
Source: Royal LePage assumes 4.25% 5 yr mortgage rate, 20% dp and 30 am

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Demographics and the baby-boom echo

- Attractive affordability and stability of our mortgage market has affected the "mindset" of households in Canada, driving all age cohorts towards homeownership – this is in huge contrast to the US
- But changing market conditions could prompt the growing baby boom echo generation to return to the long term secular trend of young people moving away from home ownership



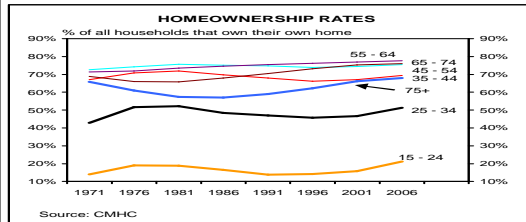
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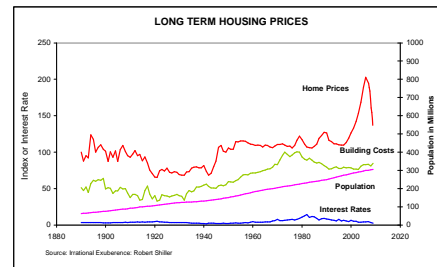
Source: CMHC

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The big picture

- Over the long run, home prices do not grow by much more than the general rate of inflation
- As such, real estate's fundamental investment appeal should be mainly from the income/cash flow it produces



Source: Inflation Evidence: Robert Shiller

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