ECONOMIC VIEWPOINT

Desjardins Affordability Index

A Long Road Back to Affordability

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HIGHLIGHTS

- Canadian housing affordability is expected to continue improving through 2028, driven primarily by rising household incomes. While home prices relative to household disposable incomes should return to around their 2015–19 average in the near term, elevated mortgage rates are expected to keep affordability—as measured by the Desjardins Affordability Index (DAI)—well below its pre-pandemic norm.
- Affordability should improve across most provinces, but large differences are expected to persist. Ontario and BC are expected to remain the country's least affordable housing markets, while Quebec should maintain its middle ground position between these expensive markets and the considerably more affordable Atlantic and Prairie provinces.
- Fully restoring affordability to pre-pandemic norms by the end of 2028 at the national level would require a significant shift from our baseline outlook. Holding other factors constant, the mortgage rate would need to be about 115 basis points lower than forecast, household disposable income about 10% higher or average home prices around 10% lower.

Canadian housing affordability is finally improving, but it remains a far cry away from pre-pandemic levels. The recent rise in the DAI reflects some relief after a rapid deterioration in the relationship between household incomes and homeownership costs starting in 2020. But the improvement has been modest compared with the scale of the earlier decline, and affordability remains deeply uneven across the country. The outlook for affordability will depend on how home prices, household incomes and borrowing costs evolve from here.

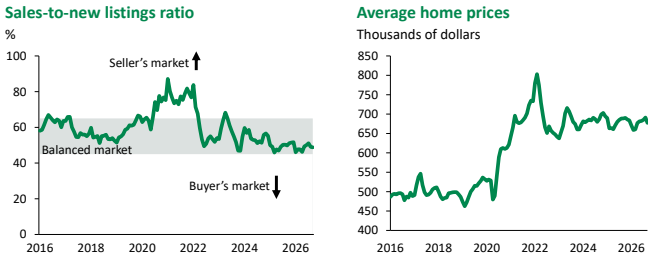
From a Housing Boom to a Mortgage Rate Shock

The recent deterioration in affordability began with an extraordinary surge in housing demand. Rock-bottom mortgage rates reduced monthly mortgage costs during the early part of the pandemic, while lockdowns and the rapid adoption of remote work led some households to look for more space. Demand increased rapidly, pushing the country into a seller's market and driving home prices sharply higher (graph 1).

The boom quickly spread beyond Canada's traditionally expensive metropolitan areas. Remote work gave some buyers greater flexibility to look further afield, with home prices rising more rapidly outside city centres in 2020. Although low mortgage rates partially mitigated the effect of rising prices on monthly payments in the near term, they couldn't prevent affordability from deteriorating as prices pulled increasingly far ahead of household incomes.

Graph 1

Canada's Pandemic Housing Boom Quickly Became a Seller's Market



Canadian Real Estate Association and Desjardins Economic Studies

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The end of the pandemic housing demand boom didn't bring a quick reversal. Inflation accelerated and proved persistent, prompting the Bank of Canada to raise policy rates rapidly, contributing to a sharp increase in mortgage borrowing costs just as home prices had reached record levels. The result was a second major affordability shock for prospective buyers. Home prices subsequently fell in some markets, particularly in Ontario and BC. But a lower selling price didn't necessarily translate into a lower monthly payment. The conventional 5-year mortgage rate had risen by more than 3 percentage points, while the variable rate rose about 6 percentage points. In other provinces, home price declines were short-lived, with prices subsequently resuming their climb. Combined with high borrowing costs, rising prices remained a headwind to improving affordability.

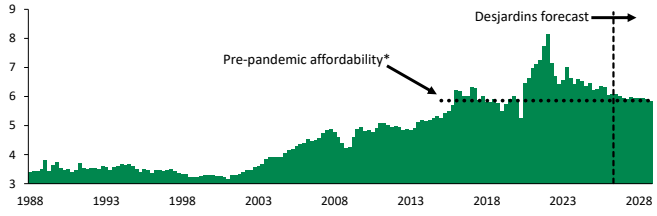
The Drivers of Affordability May Be Changing

After several years of extraordinary swings, the relationship between household incomes and home prices is expected to become considerably more stable. Disposable income per household should continue to rise through 2028, while still-elevated borrowing costs and only a modest recovery in home sales are expected to limit average home price growth, as detailed in our latest Desjardins Housing Outlook. Canada's average home price relative to household disposable income has already fallen substantially from its pandemic-era peak and should return to around its 2015–19 average within the next few quarters (graph 2). On this measure, much of the pandemic-era deterioration in affordability should soon be unwound.

Graph 2

Home Prices Relative to Income Should Soon Return to Pre-Pandemic Levels

Price-to-income ratio



* 2015–2019 average price-to-income ratio

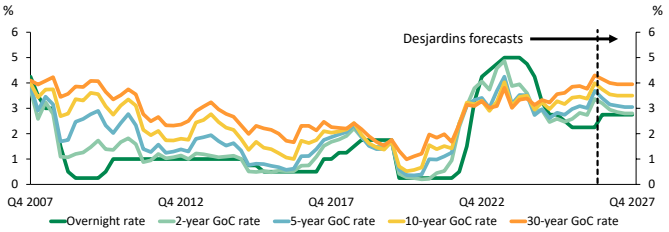
Statistics Canada, Canadian Real Estate Association and Desjardins Economic Studies

But the cost of financing those homes is expected to remain considerably higher than before the pandemic. The 5-year fixed mortgage rate has declined from its 2023 peak but has edged higher in recent months. Looking ahead, the bond yields that influence fixed mortgage rates are expected to ease before levelling off, while the Bank of Canada policy rate that influences variable mortgage rates is expected to rise once more before stabilizing (graph 3). Overall, borrowing costs are expected to remain well above pandemic-era lows and stay somewhat elevated relative to the previous decade.

Graph 3

Despite Near-Term Hikes from the Bank of Canada, We Expect Longer-Term Yields to Fall

Policy rate and Government of Canada bond yields



Bank of Canada and Desjardins Economic Studies

A Gradual Improvement Is Expected in Affordability

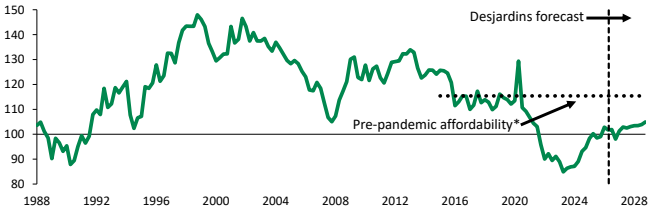
Canadian homebuying affordability is expected to continue improving through 2028. One important source of pressure has already eased considerably: the national price-to-income ratio is expected to return to around its 2015–19 average in the near term. But home prices relative to incomes capture only part of the cost of homeownership. The more comprehensive DAI (methodology box on page 3), which also incorporates mortgage rates and other homeownership costs, is expected to remain well below its pre-pandemic average over the outlook horizon (graph 4). Despite the normalization in home prices relative to incomes, elevated mortgage borrowing costs should therefore leave broader affordability well short of its pre-pandemic norm.

Graph 4

Housing Affordability Remains Far Below Pre-Pandemic Levels

Desjardins Affordability Index (DAI)

Higher = more affordable



* 2015–2019 average DAI

Statistics Canada, Canadian Real Estate Association, Bank of Canada and Desjardins Economic Studies

METHODOLOGY BOX
What Is the DAI?

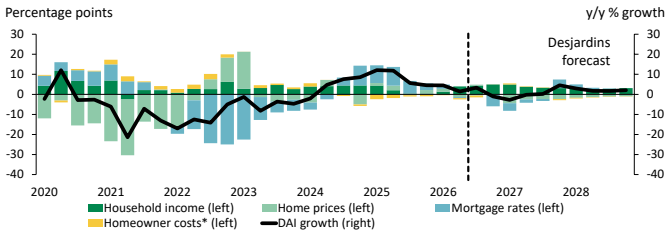
The DAI compares the average household after-tax disposable income with the income needed to qualify for a mortgage on an average-priced existing home. It includes typical housing-related costs such as property taxes, utilities and condo fees. The DAI uses 5-year fixed mortgage rates, a 20% down payment, no mortgage insurance and a 25-year amortization.

An index value of more than 100 indicates greater affordability, as the average household disposable income is more than enough to qualify for a mortgage on an average-priced home. A rising index means homeownership is getting more affordable.

Conversely, a value under 100 means that the average household doesn't earn enough after tax to qualify for a mortgage on an average-priced home. A falling index implies homeownership is getting less affordable.

The composition of DAI changes helps to explain how affordability is expected to improve from here. Household disposable income is anticipated to provide the main source of improvement in the DAI, while higher home prices and other ownership costs should offset some of those gains. Mortgage rates are expected to further offset gains in the near term and provide little relief through the end of the outlook (graph 5).

Graph 5
Income Growth Is Expected to Drive Gradual Affordability Gains

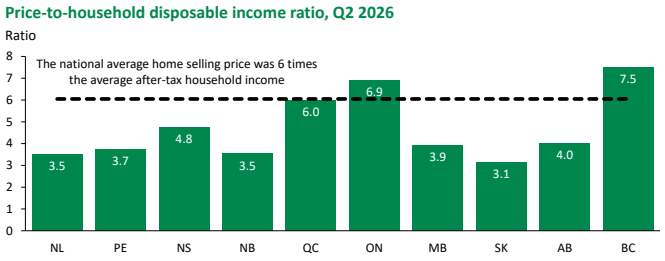


* Includes utilities, property taxes and condo fees.
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But the Recovery Won't Look the Same Everywhere

Canada's national affordability figures mask vastly different provincial experiences. BC and Ontario enter the forecast as the country's least affordable housing markets, with average home prices of about 7.5 and 7.0 times household disposable income, respectively (graph 6). That gap persists despite home price declines of around 10% in BC and 20% in Ontario from their early 2022 peaks. Quebec is less stretched but still stands apart from most of the country: the average home sells for about six times household disposable income, compared with less than five times income in Atlantic Canada and across the Prairies. Recent affordability gains have been more limited in Quebec, as continued home price growth has offset some of the benefit of rising household incomes.

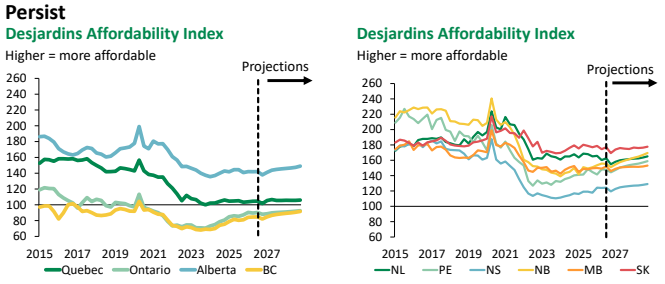
Graph 6
Ontario and BC Remain Canada's Least Affordable Housing Markets



Statistics Canada, Canadian Real Estate Association and Desjardins Economic Studies

Higher home values can leave buyers particularly sensitive to increases in mortgage rates, as an increase in rates translates into a larger increase in monthly carrying costs on a higher outstanding mortgage balance. Affordability in Ontario and BC is expected to improve through 2028 as incomes rise and price growth remains muted, but neither is likely to come close to closing the gap with other provinces. Quebec is also expected to remain considerably less affordable than it was historically, as further income gains may be largely offset by rising home prices (graph 7).

Graph 7
Affordability Should Improve Across Most Provinces, but Gaps Will Persist



Statistics Canada, Canadian Real Estate Association, Bank of Canada and Desjardins Economic Studies

Homeownership across the Atlantic provinces remains well within the means of households with average incomes despite the unusually large increases in home prices during the early pandemic period. The DAI should continue to improve in these provinces, albeit remaining well below 2019 levels.

The Prairie provinces have a significant affordability advantage. Alberta households have similar average incomes to BC households, but average home prices are roughly half as high. Strong home price growth is expected to limit further affordability gains in Manitoba and lead to a modest deterioration in affordability in Saskatchewan through 2028.

What Would It Take to Fully Restore Affordability?

What would it take for Canadian homebuying affordability to fully return to its pre-pandemic norm by the end of 2028? Based on our DAI framework, and holding incomes, home prices and other homeownership costs at their forecast values, the 5-year fixed mortgage rate would need to be about 115 basis points lower than its currently forecasted level. Alternatively, if mortgage rates remain at their baseline level, household disposable income would need to be about 10% higher than forecast. Or, if incomes and borrowing costs evolve as expected, average home prices would need to be around 10% lower than forecast.

These scenarios are illustrative and hold other factors constant. In practice, changes in one affordability driver could influence the others. For example, lower mortgage rates could strengthen housing demand and put upward pressure on home prices, offsetting some of the affordability gains from lower borrowing costs. Indeed, the pent-up demand from households priced out of the market remains strong, suggesting that significant affordability relief could trigger a quick demand rebound.

Conclusion

Canadian housing affordability is expected to continue improving through 2028, but a full recovery is likely to take longer. Home prices relative to household incomes should return to around their pre-pandemic norm much sooner than the broader DAI, underscoring the role that elevated borrowing costs are expected to play in holding back the affordability recovery.

The path back to affordability therefore doesn't necessarily require further home price deterioration. Income gains or lower borrowing costs could continue to close the remaining gap, but their expected evolution under our baseline outlook is unlikely to fully restore affordability by the end of 2028. Instead, Canadian homebuyers are expected to reach the end of 2028 with affordability improved, rather than fully restored.

The recovery is also expected to remain uneven across the country. Ontario and BC should remain the most challenging provinces to buy a home, despite substantial home price declines from their peaks, while Quebec should remain less affordable than the Atlantic and Prairie provinces. Several smaller provinces remain far more affordable in absolute terms but have experienced significant deteriorations in affordability compared to prior to the pandemic. These gaps are expected to narrow somewhat through 2028, but large differences in affordability should persist across the country.