The Mortgage Centre

Submission to the Standing Committee on Finance

The following submission is in response to the Standing Committee on Finance's comprehensive study of issues surrounding the Canadian residential real estate market; the impact of the housing market on the Canadian Financial System and challenges surrounding access to residential home ownership.

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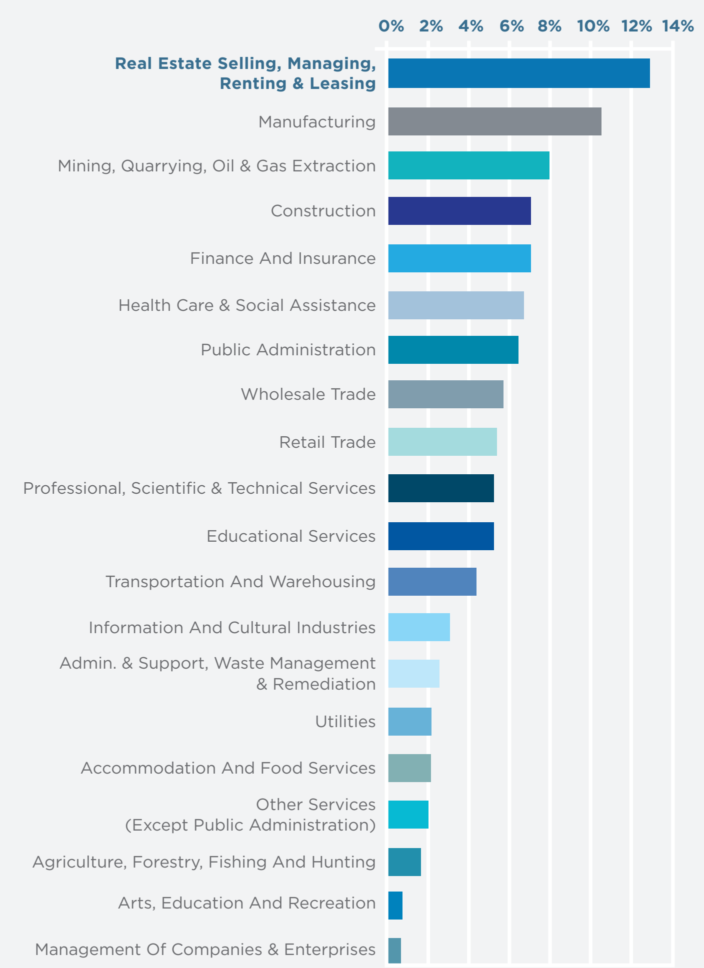
Executive Summary

Thank you for the opportunity to make a submission on the impact of the housing market on the Canadian Financial System and challenges surrounding access to residential home ownership. Mortgage Centre Canada is part of Canada's largest brokerage firm with 5,000 community-minded mortgage professionals. Together with our affiliated companies, Dominion Lending Centres and Mortgage Architects, we facilitate approximately 38% of all mortgages in Canada, more than any of the 5 biggest banks.

Each year, our mortgage professionals work alongside lenders to provide hard-working individuals and families the opportunity to realize a dream – long-term financial security in a home. In many parts of the country, such as Toronto and Vancouver, our clients have prudently saved for many years to earn the down payment and right to secure a mortgage with a lending institution or bank. In other areas of Canada, such as the Prairies and Quebec, seniors amid the rapidly aging baby-boomers and young families faced with an unstable economic future, are relying on the equity of their homes for wealth security.

Although we appreciate and share the government's concern regarding the debt levels of Canadians, brokers across Canada were surprised by the extensiveness and immediacy of mortgage rule changes announced October 3rd 2016, which had significant impacts on thousands of our clients and your constituents. What was within reach for many, is no longer attainable, which has a direct and immediate impact on the economy at the local, regional and national level. The housing market represents roughly 13% of Canada's GDP, so the impact is quite significant. Housing has been one of the major contributors to economic growth in recent years.

CANADIAN 2015 GDP BY INDUSTRY



Data Source: Statistics Canada
http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/gdps04a-eng.htm

Mortgage Centre Canada supports government's goal to prudently and responsibly manage the financial backdrop of our country in a rapidly changing global political and economic environment. However, we respectfully disagree with the scope and timing of the policy changes and we welcome and are grateful for the opportunity to provide feedback on behalf of our clients and brokers.

Outlined below are our perspectives and recommendations on the key changes to mortgage rules in Canada and how to make housing more affordable for Canadians.

Expanding Mortgage Rate Stress Tests to all Insured Mortgages

All new mortgages now need to qualify at the greater of either the Bank of Canada posted rate (4.64%) or the contract rate. The net effect on first-time home buyers is that their purchasing power has been reduced by upwards of 20%, which has significant impacts on many marginal buyers. Not only does the stress test reduce purchasing power, it makes housing less, rather than more affordable.

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photo illustration

Here are two real-life examples of clients who have been directly impacted:

A young gentleman from Lethbridge, Alberta was, under the previous rules, pre-approved for a $250,000 mortgage but has had his pre-approval reduced to $200,000 because of the stress test benchmark rate of 4.64%. He is single, employed, debt-free (after paying off a truck loan) and is easily able to afford payments on a $250,000 mortgage.

His goal was to find a home with a basement suite or enough rooms to rent to friends. However, he is now in a position where he can only purchase a small home or a condo. His projected monthly expenses will increase as he will no longer have the option to rent parts of his home or he will be paying monthly condo/strata fees on a condo.

In London, Ontario a young working woman has saved $40,000 over five years to purchase a single-family dwelling and with the new rules is only able to afford a condo. However, finding a condo with low enough strata fees to meet her monthly budget is proving impossible so she has no option now but to continue renting. As a result, she is unable to build equity, and as housing prices rise she is falling further behind.

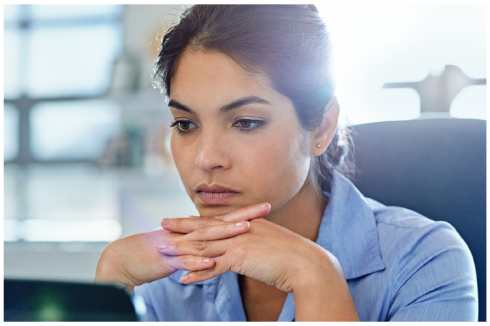

photo illustration

These are just two examples of thousands of cases we are seeing firsthand across the country. Individuals and families who have had their purchasing power reduced by 20% are now looking at purchasing condos with monthly fees or smaller homes in less desirable locations - farther away from where they work, resulting in increased commuting costs. For those who must now postpone home purchases to save more, they are falling further behind as house prices in many regions (and prices of many goods and services across our economy), rise and become further out of reach.

The unintended consequence of the stress test is it has made housing less affordable, not more affordable. This is in contrast to provincial government policies that are trying to make housing more affordable - such as in British Columbia which has launched a down payment program to help new home buyers enter the market.

With that in mind, and even with a hot housing market, we believe there is an extremely low chance of the kind of defaults witnessed in the United States in 2008 given Canada's current default rate of circa 0.28%.

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Mortgage Centre Canada agrees with government's core objective to reduce the risk of a major rise in defaults should rates increase and we also agree that a stress test is the most prudent policy to achieve this. However, using the Bank of Canada posted rate as a benchmark is excessive in our view, as an overnight 2 percentage point increase in mortgage rates is unlikely given the low inflation rate and moderate growth in Canada.

We recommend a more modest benchmark rate that sits halfway between the Bank of Canada posted rate and the current contract mortgage rate. This would be sufficient to protect Canadians from over-extending in the inevitability
of a rate increase.

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New Restrictions On Low-Ratio Mortgage Insurance Eligibility Requirements

Portfolio (bulk) insurance on low loan-to-value mortgages (with at least 20% down payments), used predominantly by monoline lenders, must now meet the same criteria as high-ratio mortgages (less than 20% down).

Additionally, mortgages with amortizations of more than 25 years, refinancings, mortgages on homes valued at more than $1 million, and property that is not owner-occupied can no longer qualify for portfolio insurance.

While traditional lenders, (such as the top 5 banks), have multiple revenue streams to finance mortgage loans, giving them the ability to effectively insure their own loans, the same cannot be said for non-traditional or monoline lenders.

Monoline lenders access funds through the mortgage-backed securities market, which can only be accessed with insured mortgages. They, therefore, rely on portfolio insurance to finance their lending activity. As a result of the new requirements, investors are less inclined to fund monolines who must now charge higher rates, as investors expect a risk premium, which must be passed along to the consumer. Genworth Canada estimated in October of last year that one-third of their monoline portfolio of new insurance written would no longer be eligible for mortgage insurance.

1/3 of monoline (non big bank) mortgages would no longer be eligible for mortgage insurance under these new rules.

This puts traditional lenders at a competitive advantage as monoline rates go up. Mortgage credit availability is reduced to the extent that some monolines will be forced to close or merge with other institutions, also reducing competition in the marketplace.

Again, just like the new stress test rules, the net impact on the consumer is negative, making housing less affordable. As well, because the new rules prohibit insurance on non-owner occupied properties, there is an added strain on the already tight rental market as those who invest in rental properties face higher rates and fewer borrowing options.

Additionally, with the limitations on refinancing (some lenders are either not offering it anymore while others are adding a rate premium) consumers are facing higher debt-servicing costs. Although not the most prudent fiscal strategy, it is not uncommon for consumers to consolidate debt and pay off higher interest consumer debt by consolidating it into a lower interest mortgage. With this option taken away, consumers are facing higher overall interest debt loads.

We would therefore recommend that government reverse these changes or at least allow refinanced mortgages and mortgages on homes valued at up to $1.5 million (given in some major markets homes over $1 million are commonplace and not a luxury) to be portfolio insured. We would also be open to seeing the threshold reduced to a 75% loan-to-value ratio, rather than removing eligibility for these products entirely.

Mortgage Insurance Rules and Lender Risk Sharing

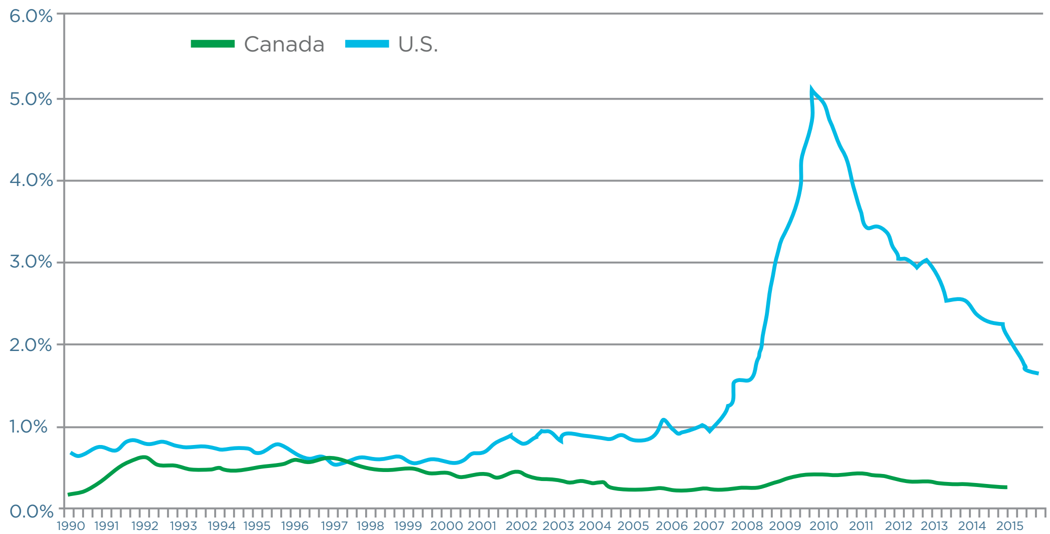
The Federal Government backs 100% of the mortgage insurance obligations of CMHC, a unique approach compared to other nations. A lender risk-sharing program would raise the risk associated with funding mortgage and increase the capital lenders require. Once again, while banks are sufficiently capitalized to retain loans on their books, smaller lenders are not and thus would need to increase mortgage lending rates to offset additional risk, thus increasing costs to consumers. Additionally, as monoline lenders who are unable to raise sufficient capital close their doors or merge with others to remain in the market, there will be less competition among lenders, thus increasing rates and costs for borrowers.

Even the banks are likely to pass off the cost of risk sharing to the consumer, increasing fees and mortgage rates, further reducing housing affordability.

From a consumer perspective, the net effect again would be that housing become less affordable, not more affordable. In our view, this is unnecessary given Canada's low default rate of circa 0.28% and the fact that CMHC has more than enough in reserves to cover outstanding mortgages in the unlikely event of a major rise in defaults.

MORTGAGES IN ARREARS 90 DAYS AND OVER - CANADA VS. U.S.

Number Of Housing Loans In Serious Default As A Percentage Of Total Mortgages Outstanding



Source: CBA, Mortgage Bankers Association

Conclusion

Mortgage Centre Canada recognizes and appreciates the government's legitimate concern regarding the debt load of Canadians and concern related to housing affordability. When setting and analyzing housing and mortgage policy, it is important to remember that 70% of households in Canada own their dwelling. Many Canadians are relying on the equity in their home for a retirement cushion.

The real culprit to lack of affordability is supply. To make housing more affordable without adding supply means housing prices must fall, which has a net-negative effect on the financial security of Canadians. At the same time, measures to make mortgages more difficult to obtain result in reduced housing affordability.

By making housing less affordable and reducing demand (impacting home values), we are unintentionally widening the wealth gap for middle-class Canadians. We would strongly urge government to focus its affordability efforts with a robust strategy that involves city planners, developers and municipal and provincial governments looking at innovative ways to expediently increase the housing stock, both for home ownership and for rental.

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As it pertains to mortgage rules and recommendations, and in addition to the recommendations above, we echo those put forward by Mortgage Professionals Canada:

- **Suspend all measures yet to be implemented to analyze whether the already-implemented changes will have the intended policy impact.**
- **Adjust the November 30, 2016 change to allow for refinances to be included in portfolio insurance. If an 80% loan-to-value ratio is objectionable, reduce the threshold to 75% rather than removing eligibility to these products entirely. This adjustment would alleviate some of the competitive disadvantage pressure the cumulative effect of these changes place on the non-bank lenders.**
- **Reconsider the increased capital reserve requirements for lenders implemented on January 1, 2017 especially on insured mortgages.**
- **A review be conducted into the long-term impact of regional-based pricing on the Canadian economy as a whole, and the potential additional harmful effects on already strained regional economies.**
- **Refrain, at this time, from implementing the proposed risk-sharing model.**

Once again, thank you for this opportunity and we look forward to many more opportunities to contribute to mortgage and financial policies moving forward.

Eddy Cocciollo

President, Mortgage Centre Canada

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