

Banks urge Ottawa to tighten mortgage rules

Top bankers pushing government to clamp down on market to avoid any chance of U.S.-style collapse

Canada's top bankers are pushing the government to clamp down on the mortgage market to cool off the rise in home prices.

The heads of the country's six largest banks have privately told policy makers that they fear the wide-ranging economic fallout of a U.S. style binge-and-collapse in housing. To head off any chance of that happening, they are willing to accept tighter rules on mortgages that would slow the real estate market, even though it would mean forgoing some short-term profits from giving out ever bigger mortgages as home prices jump.

The chief executives of the Big Six made their point last November, when they met with Bank of Canada Governor Mark Carney. The country's top commercial bankers, who between them control more than three-quarters of the country's \$940-billion mortgage market, said then that they wanted the government to look at far-reaching options, such as raising the minimum down payment to as much as 10 per cent and shortening the maximum amortization period to 30 years.

Mr. Carney didn't disagree, according to people familiar with the November talks.

"We're talking about being pre-emptive here," said a senior bank executive who spoke on condition of anonymity. "We're not in a bubble yet, or a credit crisis."

Changing the rules would be a relatively simple, sensible, proactive thing to do, said a top executive at a second major bank.

However, the real key is convincing Finance Minister Jim Flaherty.

The government, not the central bank, sets regulations on the length of amortizations and the size of down payments, and bankers realize that no politician will score points with voters by making it more difficult for Canadians to buy homes.

Mr. Flaherty publicly mused in December about acting if a bubble appeared "in the future," but with house prices rocketing higher in recent months, those pushing for change don't want him to wait.

The average resale price of a home in Canada was \$337,410 in December, according to data from the Canadian Real Estate Association. That was 19 per cent higher than in December, 2008, and sales activity has also increased sharply.

With more signs each month that gains in house prices are accelerating, there are indications the government is considering a move.

In recent months, the Department of Finance has canvassed the mortgage industry for ideas on whether tighter mortgage rules are needed, and if so, what would be appropriate. Government officials have held a number of meetings and discussions on the topic in the last two months.

That has led to pushback from some in the mortgage industry who argue that stiffer amortization and down payment rules for all buyers could undermine the housing sector and hurt Canadians by causing the values of their homes to drop.

Some of those opponents of big changes have suggested to the government that it consider more targeted rule changes, if Ottawa feels that something needs to be done.

That could mean only tightening up the requirements for people with weak credit scores, or for people who are buying an investment property rather than a home to live in.

Mr. Flaherty will not say whether he will act. He reiterated his view there is "no clear evidence now of a housing bubble in Canada."

That view is shared by Canada Mortgage and Housing Corp., which said in an e-mailed statement that while some analysts and commentators say there's a house price bubble forming, "it is not clear that this perspective is supported by the facts."

Nevertheless, Mr. Flaherty is "actively monitoring the housing market and a variety of issues in that context," the minister said in an e-mailed response to questions.

"I have policy tools available to take action to counter negative trends. I have used some of them before and can use some or all of them again."

One of the most powerful tools would be what the banks suggested: tightening the criteria for getting a home loan that's insured by one of the country's mortgage insurers - a sector dominated by government-owned CMHC.

The federal government already did so in 2008, eliminating no-down-payment mortgages.

In almost all cases, a home buyer in Canada who is placing a down payment of less than 20 per cent of the home price must have the mortgage insured.

Getting mortgage insurance from CMHC or one of its competitors now requires a 5 per cent down payment, and the maximum amortization period is 35 years.

CMHC sells an estimated 75 per cent of mortgage insurance in Canada.

Thanks to rising home prices and surging sales, CMHC has about \$480-billion of insurance in force.

As a result, the company has become "the rule maker, in the mortgage market, said Peter Routledge, an analyst at Moody's Investors Service who recently wrote a report suggesting the government look at shortening amortizations and raising down payments to protect the banking system.

"To the extent that the rule makers in the mortgage industry inject a little conservatism, I don't think the banks would look at that as a bad thing," Mr. Routledge said.

In fact, that's exactly what the bank CEOs urged when they gathered on Nov. 25 with Mr. Carney in Toronto's financial district, where the central bank has an office.

While some of the bank executives were more vocal than others, none disputed the idea that it would be wise for Ottawa to take action, according to people familiar with the discussions.

Higher required down payments and shorter amortizations would curb housing prices by cutting the amount most Canadians could bid for a house.

Such changes would also mean smaller mortgages and lower interest payments over the life of the loan - in other words, less money for the banks.

Canadian mortgages account for 40 per cent of the loans of the six largest banks, and comprise the biggest chunk of their portfolios.

The bankers' effort is all the more notable given the unique structure of the Canadian mortgage business. Banks get the profits from mortgages with their decades of interest payments, but have little risk of direct loss because of mortgage insurance.

Consumers cover the premiums and, because most mortgage insurance is underwritten by CMHC, the federal government ultimately takes the risk.

It's not the potential of big losses on mortgages that scares banks, says Mr. Routledge of Moody's. But if there were a spike in foreclosures in Canada, as has happened in the United States, consumers would likely struggle to make payments on other loans that aren't insured, such as credit card debt. Such a situation would also likely cause a big economic slowdown.

"Imagine instead of a few hundred people in Toronto in any particular month being foreclosed upon, it's a few thousand," said Mr. Routledge.

"The impact on the broader economy and the overall level of consumer confidence is significant in the U.S."

Mr. Carney, who said again this week that he too believes there's no bubble, has raised concerns about the level of debt that consumers are taking on.

He has said that interest rates are likely to rise in coming years, and warned that banks should not be lulled into complacency by the fact that mortgages are insured.

But a number of voices in the mortgage industry caution that a dramatic change to the rules could put too much of a damper on the market, and possibly be more damaging to the economy than the problem Ottawa is trying to avoid.

Much of the population's net worth is tied up in their houses, and the concern is that if tighter rules caused home prices to fall, consumers would rein in their spending.

"Some people talk about 10 per cent down payments, and we would have serious concerns with that," said Jim Murphy, head of the Canadian Association of Accredited Mortgage Professionals.

CMHC has already increased its vigilance when it comes to approving insurance, said mortgage planner Robert McLister.

"These days, if a deal remotely smells funny, or an appraisal is slightly unrealistic, it's shot down without hesitation. There is such an aversion to defaults in our market."

Should the government decline to move, the banks could always try to tighten lending standards on their own. But that might not have the desired impact because there are many other providers of mortgages.

"Even though we're in an oligopoly, every mortgage has a dozen bidders on it," said Mr. Routledge.

The tale of Canada's housing market

Residential mortgage debt as a percentage of personal disposable income has been rising since the early 1980s.

But thanks to lower mortgage rates, the debt service ratio - a measure of how well Canadians can afford their monthly interest payments - was trending downwards until a couple years ago.

And since the banks' losses on mortgages in Canada are so small as to be insignificant, they have steadily continued to dole out more in mortgages each and every year.

Meanwhile, the country enjoyed unusually strong growth in home prices this decade. After a brief drop in late 2008, house prices resumed their upward trajectory, catching bankers and economists off guard and separating Canada's housing market greatly from the experience in the U.S.

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