Looking for a "New Normal" in the Residential Mortgage Market

Prepared for:

Canadian Association of Accredited Mortgage Professionals

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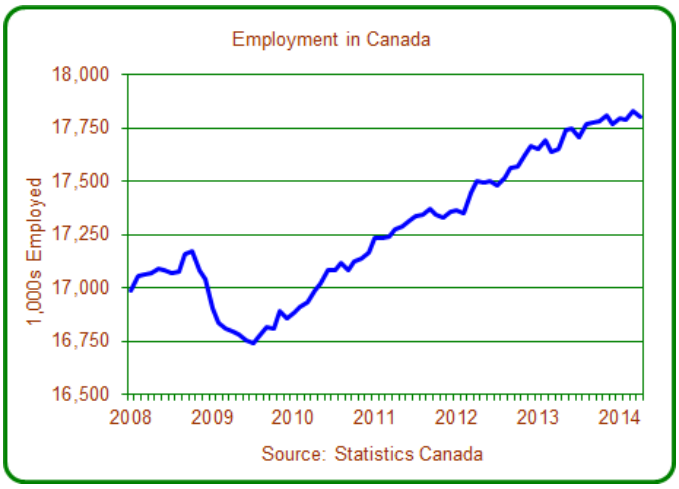
1.0 Introduction and Summary

The health of the residential mortgage market depends on trends in the housing market, as well as the broader Canadian economy (especially job creation). In turn, the housing market and the mortgage market influence the state of the economy.



The Canadian economy grows in cycles (waves that occur over periods of five to ten years). But, within those trends there are also shorter-term variations. At present, the job creation is quite weak, with the year-over-year growth rate at just 0.8% (and there has been little or no job creation since last August). By contrast, the adult population in Canada is growing by 1.3% per year. As a result, the percentage of adults who have jobs has fallen, to 61.5% as of this April versus 61.8% a year ago. Whether or not this is a short-lived variation or a new phase in the cycle is unknown, but it will be watched closely.

Housing plays a major role in job creation: housing construction, home renovations, resale market activity, and mortgage lending contribute directly to job creation. Of equal (perhaps greater) importance, rising housing values support consumer confidence and consumer spending, and thereby lead to job creation.

Prior to the recession of 2008/09, the Canadian economy was exceptionally strong, with rapid job creation (and the share of Canadians who had jobs was at record levels). It is fair to say that the housing market and the broader economy were over-heated.

However, since the recession, housing activity and job creation have both moderated, to rates that should be considered healthy and sustainable. Job growth was more-or-less matching the rate of population growth. Meanwhile, in many (but not all) communities in Canada, housing markets have been more-or-less in balance. Prices have increased, but excellent affordability has been sustained. Mortgage borrowing has been readily supported by incomes.

In the mortgage market, the pre-recession environment (which included zero-down-payment mortgages and forty-year amortization periods) was clearly too lax and some fine-tuning of regulations was desirable. In three stages during 2008 to 2011, mortgage insurance criteria were tightened. In response to economic conditions as well as the changed lending environment, by late 2011 and 2012 housing market indicators were showing a reasonable state of balance in most communities. At that time, it could reasonably have been concluded that further tightening was not warranted.

But, at mid-2012 a fourth set of changes to federal mortgage insurance criteria was a step too far and resulted in a sharp further reduction in housing activity. The impacts of

that are still playing-out in the housing market, and they are now starting to affect the broader economy.

This gives rise to the theme of this report "looking for a new normal in the residential mortgage market". By the end of 2011, conditions were in place for a sustainable housing market and a healthy interaction between housing markets and the economy.

This report argues that the changes made in 2012 were inappropriate: there was an issue of inadequate housing supply in a few communities that was resulting in excessive price growth in those communities. But, the policy response to these localized supply issues was to depress housing demand, which applies (unnecessarily) to all areas of Canada, and creates unnecessary negative pressures on the Canadian economy. Appropriate policy reactions would have focused on the supply issues in those few communities.

This author is hopeful that as housing market and economic conditions evolve during the coming year, the dialogue will change, to a discussion that addresses those few challenging local situations (of insufficient supply) and that evolving policies will give more consideration to improving the health of housing markets and (by extension the economies) in the majority of Canadian communities.

This report has been prepared for CAAMP by Will Dunning, Chief Economist. It provides an overview of the evolving state of the residential mortgage market in Canada. Major sections of this report are:

- Introduction and Summary
- Mortgage Choices
- Financial Parameters
- Consumer Sentiment
- Outlook for the Mortgage Market

Data used in this report was obtained from various sources, including an online survey of 2,000 Canadians. More than one-half (57%) were homeowners with mortgages and the rest were renters, homeowners without mortgages, or others who live with their families and are not responsible for mortgage payments or rents. The survey was conducted by Maritz Research (a national public opinion and market research firm) for CAAMP, during April and May 2014.

Mortgage Choices

Mortgage Types and Amortization Periods

For homes that have been purchased recently (during 2013 up to the time of the survey), fixed rate mortgages are most popular, with a 74% share of new mortgages. One-fifth of mortgages have variable or adjustable rates, and combination mortgages have a 6% share.

With federal mortgage insurance now being limited to amortization periods of no more than 25 years, mortgages with longer mortgage amortization periods are seeing a falling

share. For mortgages on homes purchased during 2013 to the present, 92% have contracted amortization periods of 25 years or less and 8% have extended amortization periods. Overall, the data indicates that 87% of all mortgages have contracted periods of no more than 25 years.

Analysis of the survey data compares borrowers' expectations about their repayment horizons with the original contracted horizons. In addition, for homeowners who have fully repaid their mortgages, actual amortization periods are contrasted with the original contracted periods. In both analyses, repayment horizons are being significantly accelerated:

- For mortgages that have been repaid during the past two decades, actual repayment periods have generally been about one-third shorter than the contracted periods.
- For current mortgages, borrowers are making significant efforts to accelerate repayment, including voluntarily increasing their regular payments and making lump sum pre-payments.
- The analysis finds that some owners who bought their properties many years ago have refinanced their homes, with the result that their total amortization horizons (the length of time from the date of purchase to the final repayment) can be very long. However, in those few cases, loan-to-value ratios are quite low.

Among borrowers who took out a new mortgage during 2013 up to the time of the survey this spring, 47% obtained the mortgage from a Canadian bank and 39% from a mortgage broker. Other categories accounted for 14% of new mortgages.

Financial Parameters

There are currently about 9.55 million homeowners in Canada, of whom about 5.60 million have mortgages and may also have a Home Equity Line of Credit (or "HELOC"). An estimated 3.95 million homeowners are mortgage-free, although they may have other forms of debt. In total, about 2.2 million Canadian homeowners have HELOCs.

Interest Rates

Looking at interest rates, the CAAMP/Maritz data indicates that:

- The average mortgage interest rate for homeowners' mortgages is 3.24%, a drop from the average of 3.50% found in the fall 2013 survey.
- For mortgages on homes purchased recently (during 2013 to date), the average rate is 3.25% (similar to the average of 3.23% that was recorded during the fall of 2013). For mortgages renewed recently, the average is 3.02%.
- Looking further, for borrowers who have recently renewed a mortgage, the average interest rate is now lower (by 0.58 percentage point) than the rates prior to renewal.
- Among about 2.2 million borrowers who have renewed or refinanced mortgages since the start of 2013, about 1.2 million saw their interest rate fall, 750,000 saw increases, and 250,000 had no change. For borrowers who saw their interest rates increase at renewal, the increases were minor for most. It is estimated that about 75,000 of these borrowers had their rates increase by more than 1 percentage point.

This is a very small number relative to the 5.60 million Canadian homeowners who have mortgages.

- Mortgage rate discounting remains widespread in Canada. During 2013 to the present, the average actual rate for 5-year fixed rate mortgages (3.23%) has been 1.95 percentage points lower than typical "posted" rates (which have averaged 5.18%).

Impacts of Future Rises in Interest Rates

Low interest rates in Canada have strongly stimulated housing activity, which has contributed to growth of mortgage credit. It is very reasonable to ask – as many have – if consumers will be able to afford their mortgage payments when interest rates inevitably rise.

CAAMP has addressed this important question in several forums, including a special research report ("Revisiting the Mortgage Market – The Risk is Minimal") published in January 2011. That research concluded that Canadian mortgage borrowers and lenders have been prudent and there is very substantial room to absorb higher interest rates. Anyone with an interest in this topic should read that report, which is available at the CAAMP website.

In this spring 2014 edition of the CAAMP report, analysis has been conducted of pending renewals, and the current actual mortgage interest rates for those mortgages have been compared to current market interest rates.

- For mortgages that will be renewed in the next half year, the current average rate is 3.38%. With 5-year fixed rate mortgages widely available at this rate or lower, for most of these borrowers, interest rates should be unchanged or fall when the mortgage are renewed.
- Just 4% of the borrowers who will renew during the next six months have current interest rates below 2.5%. This is a widely available rate for variable rate mortgages. Therefore, 96% of these borrowers could in theory obtain renewals at a rate that is equal to or lower than their current rates, by choosing a variable rate mortgage.
- Actual impacts of renewals will depend not just on the interest rates, but also on how much budgetary room the borrowers had initially, how much their incomes have grown, and how much additional financial room they have created for themselves by making voluntary additional payments.
- For renewals during the next two years, most borrowers would benefit by renewing at current interest rates.
- In other words, during the near term, mortgage renewal is likely to be a positive event for the borrowers and therefore for the broader economy.

Home Equity

The CAAMP study asked questions that yielded estimates of homeowners' equity.

- On average, home equity in Canada is equivalent to 73% of the value of the homes.
- Among homeowners who have mortgages (but not HELOCs), on average their home equity represents 51% of the value of the homes.
- For owners with both mortgages and HELOCs, the equity ratio is 54%.

- For owners without mortgages but with HELOCs, the equity share is 81%.
- For owners without mortgages or HELOCs, equity is (of course) 100%.
- More than 80% of homeowners in Canada have 25% or more equity in their homes.

Equity Take-Out

About 11% of homeowners took equity out of their home in the past year. The average amount is estimated at $51,000. These results imply that the total amount of equity take-out during the past year has been $53 billion.

The most common uses for the funds from equity take-out are debt consolidation and repayment (estimated at $16.9 billion), followed by $13.4 billion for renovation or home repair, $12.5 billion for investments, $6.6 billion for purchases (including education), and $3.3 billion for "other" purposes.

Consumer Sentiment

In this section, consumers were asked to indicate their degrees of agreement or disagreement with six different statements. A score of 10 would indicate complete agreement with the statement; conversely, a rating of 1 indicates complete disagreement.

Consumers generally agree (average score of 7.01) with a statement that "low interest rates have meant that a lot of Canadians became homeowners over the past few years who probably should not be homeowners".

But, responses to questions about personal circumstances - ability to weather a potential downturn in home prices (average rating of 6.98) and low levels of "regret" about their own mortgage choices (average of 3.68) paint a different picture, that as individuals Canadians have behaved cautiously. It is not immediately obvious how this contradiction can be resolved. Perhaps the responses to the first question reflect what they are seeing in the media and hearing in comments from opinion leaders, moreso than reflecting actual behavior.

There is a strong belief that "real estate in Canada is a good long-term investment" (average score of 7.34) and agreement that mortgages are "good debt" (average of 7.13).

By a very large margin, Canadian home owners are happy with their decisions to buy their homes (91% are "happy"). To the extent that some regret the decision to buy, the regrets are about the particular property purchased (7%) rather than about home ownership in general (less than 2%). This pattern holds for both recent buyers and those who purchased earlier.

A home is both a place to live and an investment. According to the spring 2014 CAAMP/Maritz survey, Canadian home owners (those who have purchased during the past decade) see their homes as 69% a place to live and 31% an investment.

Canadians are highly comfortable with their mortgages. When offered a list of 10 different emotions to choose from, 65% picked “comfortable”. A minority (15%) indicated they are “nervous” about their mortgages.

Outlook for the Mortgage Market

Growth of mortgage credit in Canada is driven by several factors. The most important is the volume of new housing that is completed and requires mortgage financing. Housing completions are expected to slow gradually and this will contribute to a very gradual slowing in the rate of mortgage credit growth.

Another significant factor is that low interest rates mean that consumers pay less for interest and therefore are able to pay-off principal more rapidly. Current low interest rates have therefore tended to reduce the rate of growth of mortgage debt.

Resale market activity and price growth tend to increase the rate of mortgage credit growth.

A further factor, which will persist for the long-term, is that Canadians move away from slow growth communities to high growth areas that have higher house prices and larger associated mortgages. This factor drives as much as one-quarter of mortgage growth in Canada.

Changes in the mortgage insurance criteria that took effect in July 2012 have substantially reduced resale housing activity in Canada, but this has not yet substantially affected the rate of credit growth (the slowdown of credit growth that has occurred during the past half-decade has more to do with a drop in housing starts and completions after the recession of 2008/09, as well as the lower interest rates that have allowed consumers to more rapidly pay-off principal). The impact of the July 2012 policy change will become more substantial when housing completions are reduced (during 2015 and beyond, as the result of reduced housing starts – the impact of the policy change on housing starts is now just beginning and it will take more time for housing completions to slow).

Mortgage credit growth in Canada has averaged 8.4% per year during the past decade. The growth rate has slowed, and is currently 5.0% year-over-year (as of February). The growth rate is likely to remain at this level for the rest of the year then slow gradually during 2015 (to about 4.5% by year end).

By the end of 2015, total outstanding residential mortgage credit is forecast at $1.34 trillion, up from the most recent figure of $1.23 trillion (as of February 2014).

About CAAMP

CAAMP is the national organization representing Canada’s mortgage industry. With 12,000 mortgage professionals, its membership is drawn from every province and from all industry sectors. This diversified membership enables CAAMP to bring together key players with the aim of enhancing professionalism.

Established in 1994, CAAMP has taken a leadership role in Canada's mortgage lending industry and has set the standard for best practices in the industry.

In 2004, CAAMP established the Accredited Mortgage Professional ("AMP") designation to enhance educational and ethical standards for Canada's mortgage professionals.

CAAMP's other primary role is that of consumer advocate. On an ongoing basis CAAMP aims to educate and inform the public about the mortgage industry. Through its extensive membership database, CAAMP provides consumers with access to a cross-country network of the industry's most respected and ethical professionals.

About the Author

Will Dunning is an economist, and has specialized in the analysis and forecasting of housing markets since 1982. In addition to acting as the Chief Economist for CAAMP he operates an economic analysis consulting firm, Will Dunning Inc.

About Maritz Research

Maritz Research is a wholly owned subsidiary of Maritz Inc., the largest performance improvement company in the world, headquartered in St. Louis, Missouri. For more than 20 years, Maritz Inc. has been the largest provider of customer satisfaction research in the United States and a major supplier of brand equity research. In Canada, Maritz Research has been developing marketing research solutions for Canadian clients under the brand Maritz-Thompson Lightstone since 1977, and has grown to become one of Canada's largest full-service marketing research consultancies.

Disclaimer

2.0 Mortgage Choices

This section uses data from the consumer survey to highlight consumer choices in the mortgage market.

Dimensions of the Mortgage Market

There are currently about 13.85 million households in Canada[1], including:

- 9.55 million homeowners of whom 5.60 million have mortgages and 3.95 million are mortgage-free.
- Among the 5.60 million owners who have mortgages, about 1.75 million also have Home Equity Lines of Credit (known as "HELOCs"). Among homeowners without mortgages, about 500,000 owe money on a HELOC.
- In total, about 2.2 million homeowners have HELOCs.
- About 3.5 million homeowners have neither mortgages nor HELOCs.
- There are about 4.3 million tenants.

Housing and Mortgaging Activity During 2013

Combining various data from the consumer survey, it is estimated that during 2013 about 625,000 to 650,000 Canadian households bought homes.

- About 575,000 of these buyers took mortgages. Among these about 125,000 also took a HELOC.
- A small share of the buyers (less than 25,000) did not take a mortgage but did take a HELOC.
- About 50,000 took no financing on the property.
- As of this spring, the total outstanding mortgage principal for these buyers is estimated at $134 billion, and a further $10 billion is owed on HELOCs.
- Among the households who purchased homes during 2013, 55% (about 350,000) were first-time home buyers.

Among the households who bought homes during 2013, 34% (about 225,000) sold another home at the same time. Drilling even deeper into the data, about 40% of these households (75,000 to 100,000) still owed money on that home (and therefore they would have paid-off or transferred the mortgages at the time). The total amount of those remaining mortgages is estimated at $13 billion. The implication of this is that while buyers took on $134 of mortgages, the fact that $13 billion was paid off means that the net impact was a $121 billion increment for residential mortgage credit.

About 180,000 Canadian homeowners fully repaid their mortgages during 2013.

[1] This estimate of total households is based on data from the 2011 Census, updated by this author based on data from Statistics Canada's 2011 National Household Survey, as well as data from Canada Mortgage and Housing Corporation on housing completions and changes in vacancies.

About 1.5 million homeowners with mortgages renewed or refinanced their mortgages during 2013. The combined total principal is $242 billion. Almost one-third of the borrowers who renewed their mortgages during 2013 also have HELOCs, on which they owe a total of $32 billion.

Other findings include:

- Just over one million homeowners (11% of all homeowners) took equity out of their homes during the past year, adding about $34 billion to their home mortgages and $19 billion to their HELOCs, for a combined total of about $53 billion.
- Based on the various information provided by consumers, it is estimated that the regular mortgage payments made by home owners add up to a total of $87 billion per year. Of this, $59 billion is paying down mortgage principal and about $28 billion is for interest. In other words, across all mortgage holders, less than one-third of the total mortgage payments are for interest and more than two-thirds of the payments result in reduction of principal.
- In addition, it is estimated later in this section that about 800,000 current mortgage holders made lump sum payments in the past year, totaling $8 billion.
- Furthermore, among the 180,000 Canadians who repaid their mortgages during 2013, lump sum payments totaled about $5 billion.
- About 900,000 mortgage holders voluntarily increased their regular payments during the past year, by amounts that equate to about $4 billion per year.

The reader is cautioned that these estimates are based on a sample survey and as such are subject to variation.

Fixed Rate Versus Variable Rate Mortgages

The CAAMP/Maritz study found that 65% of mortgage holders (almost 3.7 million out of 5.60 million) have fixed rate mortgages, 28% (about 1.55 million) have variable and adjustable rate mortgages, and 7% (about 375,000) have "combination" mortgages, in which part of the payment is based on a fixed rate and part is based on a variable rate. In this edition of the CAAMP/Maritz study (as has been the case in prior surveys) variable rate mortgages are slightly more popular with people in the oldest age bracket compared to the younger age groups.

Table 2-1
Percentages of Mortgages by Type,
By Age Group

Mortgage Type	*18-34*	*35-54*	*55 +*	*Total*
Fixed-rate	68%	66%	62%	65%
Variable or adjustable-rate	25%	27%	32%	28%
Combination	7%	7%	6%	7%
All Types	100%	100%	100%	100%

Source: Maritz survey for CAAMP, spring 2014; analysis by the author.

As is shown in the first column of the next table, among mortgages for homes that were purchased during 2013 up to the time of the survey in the spring of 2014, fixed rate mortgages were chosen much more frequently, with the share at 74%. Among these

recent buyers, 70% of first-time buyers chose fixed rate mortgages versus 78% for repeat buyers. For mortgages that have been renewed this period, the fixed rate share of 64% is similar to the overall share for all mortgages. Variable and adjustable rate mortgages are much more frequent for those who have renewed recently (27%) than for those who have purchased recently (20%).

Table 2-2
Percentages of Mortgages by Type,
For New Purchase Mortgages and Recent Renewals

Mortgage Type	*Purchase During 2013/14*	*Renewal or Refinance During 2013/14*	*All Mortgages (1)*
Fixed-rate	74%	64%	65%
Variable or Adjustable Rate	20%	27%	28%
Combination	6%	9%	7%
All Types	100%	100%	100%

Source: Maritz survey for CAAMP, spring 2014; analysis by the author.
Note: (1) includes mortgages that were neither originated nor renewed recently.

Mortgage Amortization Periods

Mortgage holders were asked several questions related to mortgage amortization, to profile their choices and their expectations.

- Mortgage holders were asked about the contracted amortization periods at the time the mortgages were initiated, and when they expect to have their mortgages repaid. This data is used to compare their current expectations to the original amortization periods.
- The subsequent section discusses steps taken to change amortization periods.
- Then, in the following sections, more detailed information is obtained on actions taken by mortgage borrowers to shorten or lengthen their amortization periods, for example through voluntary payment increases, lump sum payments, and, on the other hand, through equity take-out.

A large majority of residential mortgages in Canada have contracted amortization periods of 25 years or less. The first column of the table below indicates that 87% of mortgages have original contracted periods of no more than 25 years and 13% have original contracted periods exceeding 25 years. The share with extended amortization periods had increased during the prior past half decade, due to the availability of longer term mortgages. But, as of July 2012, the maximum amortization period for insured mortgages is 25 years. The second column of data shows the distribution for homes that were purchased during 2013 and to the present in 2014. This data indicates that a minority (8%) of homes purchased during this period had extended amortization periods. This share is much lower than in prior years – as is shown in the third data column, for homes that were purchased during 2009 or 2012, 28% had extended amortizations.

The fourth to sixth columns in the table summarize consumers' expectations about how long their actual amortization periods will be, considering their current payment levels and plans for the future (including lump sum payments and additional efforts they have and will make to repay their mortgages). Overall, it is expected that total amortization

periods (averaging 20.8 years) will be just slightly shorter than the originally contracted amortization periods (21.0 years). However, for recent borrowers (those who purchased during 2013 and 2014, as well as those who purchased during 2009 to 2012), the expected total amortization periods are shorter (by about four years) than the contracted periods.

But, for all mortgaged homes, the expected total amortization period (averaging 20.8 years) is almost identical to the original contracts (an average of 21.0 years). This finding is initially surprising, but further exploration of the data provides an explanation. In all cases, the actual and expected amortization periods shown here are the numbers of years since the homes were purchased. A small number of mortgages have very long expected amortization periods (in the spring 2014 survey, 2% of the mortgages have expected amortizations exceeding 40 years). Most of these cases (two-thirds) are related to homes that were purchased more than 20 years ago. The data does not allow us to definitively interpret these cases, but it is quite likely that the current mortgages were obtained at a later date than the purchase, for example, to finance a renovation, to make a major purchase (such as a vacation property), to invest, or to assist children (with education expenses, a down payment for a home, or a wedding). For those mortgages, therefore, the total expected amortization periods may have been over-estimated (since there were some years that were actually mortgage-free).

Table 2-3
Percentages of Mortgages by Length of Original Amortization Period and by Current Expectation

Amortization Period	*Original Contracted Amortization Period*			*Expected Total Amortization Period*		
	All Mortgages	*Homes Purchased During 2013/14*	*Homes Purchased During 2009/12*	*All Mortgages*	*Homes Purchased During 2013/14*	*Homes Purchased During 2009/12*
Up to 25 Years	87%	92%	72%	76%	91%	83%
More Than 25 Years	13%	8%	28%	24%	9%	17%
Including…						
26-30 years	9%	8%	19%	13%	9%	10%
31-35 years	4%	0%	9%	6%	0%	5%
36-40 years	1%	0%	1%	5%	1%	2%
Total	100%	100%	100%	100%	100%	100%
Average Amortization Period	21.0 years	21.8 years	22.6 years	20.8 years	18.0 years	18.8 years

Source: Maritz survey for CAAMP, spring 2014; analysis by the author.

Actions that Accelerate Repayment

The CAAMP/Maritz survey asked homeowners who have mortgages about actions that can change the number of years it takes to pay off a mortgage. Three different actions were listed. The responses are summarized in the next table.

The consumer responses indicate quite clearly that recent purchasers are more likely to take steps to shorten amortization periods than are prior purchasers (to increase their payments, make lump sum payments, or increase the frequency of payment).

Table 2-4
Actions Taken in the Past Year to Shorten Amortization Periods, by Period of Purchase

Period of Purchase	*Increased Amount of Payment*	*Made a Lump Sum Payment*	*Increased Frequency of Payments*	*Took One or More of these Actions*	*Took None of these Actions*
Before 1990	16%	16%	3%	35%	65%
1990s	19%	9%	6%	30%	70%
2000-2004	19%	14%	4%	33%	67%
2005-2009	18%	15%	6%	35%	65%
2010-2014	15%	16%	7%	35%	65%
All Purchase Periods	16%	14%	7%	35%	65%

Source: Maritz survey for CAAMP, spring 2014; analysis by the author.

The survey also collected data on the dollar amounts of increased payments and lump sum payments. Various survey data can be combined to estimate total amounts.

- About one-in-six mortgage holders (16% out of 5.60 million, or about 900,000) voluntarily increased their regular payments during the past year. The average amount of increase was about $375 per month, for a total of about $4 billion per year. This is the effect of increases that were made during the past year. In addition, voluntary increases that were made in prior years are contributing to accelerated repayment of mortgages.
- About 14% of mortgage holders (about 800,000) made lump sum payments during the past year. The average amount was about $10,000, for combined repayment estimated at $8 billion.
- As is shown in the table above, 7% of mortgage holders (about 425,000) increased the frequency of their payments.
- 35% of mortgage holders (2.0 million out of 5.60 million) took one or more of these three actions.

In addition, the survey asked homeowners without mortgages when they had repaid the mortgage. About 180,000 borrowers repaid their mortgage during 2013. Total lump sum payments made at the time amounted to $5 billion.

For 2014, close to 250,000 mortgage holders have already paid off their mortgages or expect to before the end of the year. If they make lump sum payments at the same rate as occurred last year, total lump sum payments at the time of mortgage retirements would be about $6 billion for 2014.

The survey data indicates that total regular mortgage payments result in about $59 billion in principal repayment (at an annualized rate).

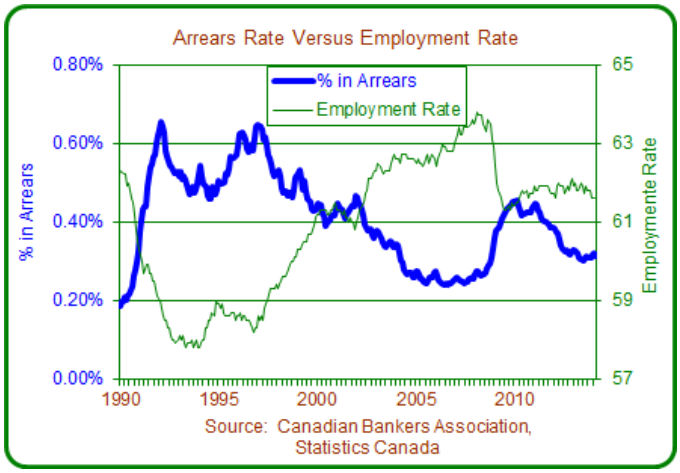
This snapshot portrays activity during a short period of just 12 months. It seems very reasonable to assume that over longer periods similarly substantial percentages of mortgage borrowers will take these actions to shorten their repayment periods.

On the other hand, out of 9.55 million homeowners, almost 11% (just over one million) took out equity during the past year, through either increasing their mortgage amount (about 550,000 households), drawing on a HELOC (about 475,000 households), or by taking both actions (a small number, in the range of 25,000 households). Withdrawals via mortgage increases totaled about $34 billion and draws on HELOCs totaled about $19 billion, for a combined total of about $53 billion[2]. Equity take-out averaged about $51,000 per household that took-out equity. Averaged across all 9.55 million home owners, the figure is about $5,500.

Mortgage Arrears

Data on mortgage arrears from the Canadian Bankers Association, which covers 7 major banks, shows that a very small percentage of Canadian mortgage holders are behind on their payments (this data shows mortgages that are three or more months in arrears). The data shows that there was a rise in mortgage arrears during the recession, with a peak at the end of 2009 (although at a lower level than during the recession of the early-to-mid-1990s). The arrears rate fell during 2010 until late in 2012. During the past year, the rate has been roughly flat, at just over 0.3% (about 1-in-300 borrowers), although the data hints that during recent months the rate of arrears might have increased fractionally. The most recent datapoint is for February 2014.

In the Canadian context, most mortgage defaults are due to reduced ability to pay, especially including job loss, but also income reductions due to reduced hours or reduced hourly pay rates. Marital breakdown is also a cause of financial difficulty (this might usually fit into the category of reduced ability to pay).



The chart to the right illustrates the importance of changes in the employment situation. It contrasts arrears rates with the Canadian "employment rate" (which shows the percentage of adults who are employed). This data shows very clearly that changes – up or down – in the employment rate are followed in a few months by changes in the arrears rate (in the opposite direction). The job losses that occurred during the recession was the primary cause of the rise in mortgage arrears: a sharp drop in the employment rate was followed by increased arrears. The employment rate has

[2] In issues of these reports up to the spring of 2013, equity take-out was calculated only for take-out via increased mortgage principals. Therefore, equity take-out calculations here should not be compared to estimates in the prior reports.

not completely recovered (it is about two percentage points below the pre-recession peak), which helps explain why the arrears rate has not returned to the low level seen before the recession. Most recently, the employment rate has fallen slightly and correspondingly the arrears rate has increased slightly.

Types of Mortgage Representatives Consulted

Mortgage holders were asked which types of mortgage representatives they consulted when obtaining their current mortgages on their primary residence and, secondly, through which type of mortgage representative they obtained their mortgage.

For all current mortgages on homes that were purchased during 2013 up to the time of the survey in 2014 (shown in the second column of data in the table), 47% were obtained from a bank. Mortgage brokers had a 39% share. Credit unions were the source for 8% of these mortgages, followed by 1% from life insurance or trust companies and 5% were from an "other" source.

Looking more broadly, at all current mortgages (regardless of when the property was purchased, shown in the fourth column of data), 57% were obtained from a bank, 26% from a mortgage broker, 9% from a credit union, 4% from a life insurance or trust company, and 43% from an "other" source.

The first and third columns of data indicate which types of mortgage professionals were consulted at the time the mortgages were obtained. Since more than one type of professional could be consulted, the percentages sum to more than 100%. Bank representatives were consulted most frequently (by 72% of all current mortgage holders), followed by 41% for mortgage brokers. For properties purchased during 2013 to the present, 68% of mortgage borrowers consulted bank representatives and 54% consulted mortgage brokers.

Table 2-5
Consumers' Use of Mortgage Representatives

Type of Mortgage Representative	*Purchased During 2013/14*		*All Purchase Periods*	
	Consumer Consulted Mortgage Professional	*Obtained Through Mortgage Professional*	*Consumer Consulted Mortgage Professional*	*Obtained Through Mortgage Professional*
Mortgage Representative from a Canadian Bank	72%	47%	68%	57%
Mortgage Broker	41%	39%	54%	26%
Mortgage Representative from a Credit Union	17%	8%	22%	9%
Mortgage Representative from a Life Insurance or Trust Company	13%	1%	16%	4%
Other	5%	5%	5%	4%
Total	147%	100%	165%	100%

Source: Maritz survey for CAAMP, spring 2014; analysis by the author.

3.0 Financial Parameters

Interest Rates

The CAAMP/Maritz study collected data on mortgage interest rates for current mortgage holders. The average mortgage interest rate for these mortgage borrowers is 3.24% as of the spring of 2014, down from the 3.50% rate seen in the fall of 2013.

Very few residential mortgages in Canada have high interest rates. In this survey, only 4% of mortgages have interest rates of 5% or more. The number with interest rates of 8% or more is negligible.

The next table looks at average mortgage interest rates by type of mortgage, for all mortgages and for two subsets: mortgages for homes purchased during 2013 up to the date of the survey and mortgages that were renewed during the same period.

This survey data shows that:

- For mortgages that have been initiated or renewed during the past year, interest rates are generally equal to or lower than interest rates for all mortgages.
- Interest rates vary depending on mortgage type, with fixed rate mortgages generally having higher rates than for variable/adjustable mortgages. However, the spread between fixed and variable rates has narrowed: for mortgages that have been renewed recently (the third line of data) the spread is just 0.21 percentage points.

Table 3-1
Average Mortgage Interest Rates

	Mortgage Type			*All Types*
	Fixed-rate	*Variable or Adjustable Rate*	*Combination*	
All Mortgages	3.37%	2.91%	3.34%	3.24%
Purchases During 2013/14	3.25%	N/A (1)	N/A (1)	3.25%
Renewals During 2013/14	3.06%	2.85%	N/A (1)	3.02%

Source: Maritz survey for CAAMP, spring 2014; analysis by the author.
Note: (1) insufficient data to generate an estimate

The survey also asked those who have renewed a mortgage what the interest rate was prior to renewal, and those rates have been compared to the mortgage borrowers' current rates. The results are summarized in the next table. It shows that among borrowers who have renewed a mortgage during 2013 to the present, more than one-half (54%) had a reduction in their interest rate and 34% had an increase. 12% had no change in their interest rate. On average, for all mortgages renewed during that period, the interest rate was reduced by 0.58 percentage point.

Table 3-2 ***Changes in Mortgage Interest Rates for Mortgages Renewed During 2013/14***			
Change in Interest Rate	*Fixed-rate*	*Variable or Adjustable Rate*	*Total*
% with Rate Decreased	63%	30%	54%
% with Rate Unchanged	9%	17%	12%
% with Rate Increased	28%	53%	34%
% with Rate Increased by 1 Point or More	5%	0%	3%
Total	100%	100%	100%
Average Change in Interest Rate (percentage points)	-0.73	-0.09	-0.58
Source: Maritz survey for CAAMP, spring 2014; analysis by the author. Note: estimates are not available for combination type mortgages due to small sample size.			

Combining the various estimates developed in this study:

- Out of 5.60 million homeowners who have mortgages,
- About 2.2 million have renewed their mortgages during 2013 or during 2014 to the present.
- About 1.2 million have seen their mortgage rates fall.
- About 250,000 had no change in their interest rate.
- About 750,000 had their rates increase.
- About 75,000 of these households have seen increases of 1 percentage point or more.

The data from this study indicates that few mortgage borrowers have been negatively affected by increases in interest rates for their mortgages.

Impacts of Future Rises in Interest Rates

Since the fall of 2008 there have been repeated discussions about that will happen when interest rates "inevitably rise" and mortgage borrowers have to renew at higher interest rates. Some commentators have expected catastrophic results. CAAMP has joined in the discussions, through two pieces of analysis:

- Two editions of a special report "Revisiting the Mortgage Market" that were published by CAAMP in January 2010 and January 2011 performed simulations using very large databases of actual mortgages. Most of the mortgages in the databases are high-ratio and therefore are among the most susceptible to increased interest rates. The analyses found that the vast majority of the borrowers were positioned to afford payment increases that would result if their interest rate rises to a 5% rate: very small numbers (about 2,000 to 2,500 home buyers who purchased in 2010) might have total debt service ratios ("TDS ratios") of 45% or more.
- In addition, the CAAMP/Maritz semi-annual consumer surveys have shown repeatedly that substantial shares of mortgage borrowers have voluntarily increased their regular payments and/or made lump sum payments. These payments reduce

their potential amortization periods to less than the contracted periods. It means that if interest costs increase to unaffordable levels, the borrowers can often reduce their payments (within the limits imposed by the contracted amortization period).

Starting in the fall 2013 edition of CAAMP's reports, mortgage holders were asked about the "length of time remaining in your term". These responses have been combined with the responses on the consumers' actual interest rates.

Results are summarized in the table on the next page. The analysis shows (in the first column of data) that for mortgages that will be renewed during the coming one-half year:

- The average of the actual mortgage rates is 3.38%. Major lenders are currently advertising discounted rates for five year fixed rate mortgages that are the same or lower than this. Typical discounted rates are even lower for shorter terms. For variable rate mortgages, advertised rates are typically in the range of 2.35% to 2.6% (with some lenders offering even lower rates). Therefore, for this group of mortgages that will be renewed during the coming half-year, the average interest rate should fall after renewals.
- The table also summarizes the distributions of current interest rates. Among those mortgages that will be renewed during the coming half year, just 4% have rates less than 2.5%. In other words, almost all of these borrowers (as much as 96%) would see their interest costs unchanged or even reduced if they take a variable rate mortgage.
- 49% of these upcoming renewals have current rates exceeding 3.5%: most of these borrowers should see their interest rates cost fall at their renewal, regardless of the choices they make about mortgage type or term, if they negotiate a typical discounted interest rate.
- 47% of the mortgages have current interest rates in the range of 2.5% to 3.5%. This is a grey area, with the outcomes dependent on the types and terms of mortgages chosen. In theory, all of these borrowers could renew at rates of about 2.5% using variable rate mortgages and therefore their interest costs would be the same as before or lower.
- Overall, this data suggests that for most mortgage holders who renew during the coming half year, interest costs will either fall or be unchanged. Very few of these borrowers will see substantial rises in their interest costs.

In the second column of data (for mortgages that will be renewed late this year and early in 2015):

- About one-fifth of the borrowers have current rates below 2.5%. Outcomes for these borrowers will depend on the choices they make at the pending renewal, but also on how much budgetary discretion they have: how much budgetary room did they have when they first took their mortgage, to what extent have their incomes increased, to what extent have they made extra efforts to accelerate repayment in the past, which will have given them room to adjust their payment levels.
- Based on the data from the 2010 and 2011 studies, as well as from the consumers' surveys, these consumers will have flexibility to absorb moderate rises in their interest costs. For the four-fifths of these borrowers whose current interest rates exceed 2.5% (and the 50% whose rates exceed 3%), renewals at current mortgage interest rates can be tolerated, and in fact many of these borrowers will see their interest costs fall when they renew.

Similar conclusions can be drawn for borrowers who will renew more than a year from now (in the third and fourth columns of data).

About 750,000 mortgages are due to be renewed during the coming year. Of these 100,000 have current interest rates below 2.5% and therefore they are likely to see some increases in their interest costs. But, these borrowers are less than 2% of total mortgage holders. Another 800,000 mortgages are due for renewal during the second year. 175,000 of these (about 3% of current mortgage holders) have current interest rates below 2.5%. Not all of these borrowers are at risk: outcomes will depend on how much discretion they currently have, as well as their choices of mortgage term and mortgage type. A key factor in the outcomes will be the extent to which the marketplace and the lending regulations allow the borrowers to make decisions that best suit their circumstances. Any artificial restrictions on choices could be harmful to the interests of the borrowers and by extension to the broader mortgage market, the housing market, and the Canadian economy.

Table 3-3
Mortgage Interest Rates for
Mortgages with Upcoming Renewals

	Time Until Renewal			
	Up to 0.5 year	*0.5 to 1 year*	*1.0 to 1.5 years*	*1.5 to 2 years*
Average Actual Mortgage Interest Rate	3.38%	3.02%	3.07%	3.11%
Distribution of Interest Rates				
Below 2%	0%	5%	2%	1%
2.0-2.49%	4%	17%	19%	21%
2.5-2.99%	32%	28%	32%	31%
3.0-3.49%	15%	20%	25%	15%
3.5-3.99%	31%	22%	13%	21%
4.0% or more	18%	9%	10%	10%
Total	100%	100%	100%	100%

Source: Maritz survey for CAAMP, spring 2014; analysis by the author.

Mortgage Rate Discounting

The average mortgage interest rate reported here (3.37%) for fixed rate mortgages is well below the typical posted (advertised) rates that have been available during the past year. Since the start of 2013, posted rates for five year terms have averaged 5.18%[3]. The much lower actual rates found by the survey confirm that there is a substantial amount of discounting in the mortgage market.

This section uses the survey data to generate an estimate of the extent of discounting.

The study group includes a wide range of mortgages, including a full range of lengths of term to renewal, fixed rate versus variable rate mortgages, and the mortgages have been originated over a prolonged period. This results in a wide range of mortgage rates.

[3] Source: For posted rates, data are obtained from the Bank of Canada, using "Conventional mortgage" rates (estimated as of each Wednesday).

In order to produce a meaningful summary of the interest rates, one subset of the study group was selected for further analysis:

- Mortgages that were initiated, renewed, or refinanced since the beginning of 2013.
- With fixed rates, rather than variable rates.
- With 5-year terms.

For this group of mortgage borrowers:

- For those mortgages, the average mortgage interest rate is 3.23%. In contrast, the average posted 5-year mortgage rate over the same period was 5.18%. Based on this data it appears that Canadians negotiated mortgage rate discounts averaging 1.95 percentage points (for 5-year terms).
- Every mortgage within this subset of the database had an actual interest rate lower than the average posted rate. In fact, only 8% of the mortgages had interest rates of 4% or higher.
- In other words, a vast majority of these borrowers received discounts greater than one percentage point versus the average posted mortgage rate.

Housing Equity

The consumer survey provides data that can be used to generate estimates of home equity in Canada: the equity amounts are calculated by comparing the current value of owner-occupied homes in Canada with the associated mortgages and home equity lines of credit (known as “HELOCs”).

The table below shows the estimates of equity positions for four groups of home owners. In the current survey, the overall equity position is estimated at 73%. In other words, for every $1,000 in house value in Canada, there is about $270 of debt (mortgage or HELOC) and $730 of home owner equity.

The estimates from past surveys have varied slightly over time (ranging from 66% to 70%). We have to expect these small variations with any survey. The overall message is that the surveys are consistently finding very high equity ratios in Canada.

Two further finding that has been consistent across the surveys are:

- For all home owners, more than 80% have equity ratios of 25% or higher (this includes owners with housing related debt and those with no housing related debt).
- Even among the 5.60 million homeowners who have mortgages (with or without a HELOC), more than 70% have equity ratios of 25% or higher.

Table 3-4 ***Equity Ratios for Canadian Home Owners, as of Spring 2014***					
Equity as Percentage of Home Value	*HELOC only*	*Mortgage only*	*Mortgage and HELOC*	*Neither Mortgage Nor HELOC*	*Total*
Negative Equity	0%	1%	1%	0%	1%
0-4.99%	0%	2%	1%	0%	1%
5-9.99%	0%	2%	2%	0%	1%
10-14.99%	0%	4%	4%	0%	3%
15-24.99%	0%	19%	8%	0%	9%
25-49.99%	9%	29%	34%	0%	18%
50-74.99%	21%	24%	33%	0%	17%
75-99.9%	70%	19%	17%	0%	15%
100%	0%	0%	0%	100%	36%
Total	100%	100%	100%	100%	100%
Number of Households	500,000	3,850,000	1,750,000	3,450,000	9,550,000
Average Equity Ratio	81%	51%	54%	100%	73%
Source: Maritz survey for CAAMP, spring 2014; analysis by the author.					

Equity Take-out

The survey data indicates that 11% of all home owners holders took out equity from their homes or increased the amount of the mortgage principal within the past twelve months. The average amount of equity take-out is estimated at about $51,000.

Various findings from the survey can be combined to estimate total equity take-out by Canadian mortgage holders:

- At present there are about 9.55 million homeowners in Canada.
- 11% of them have taken out equity during the past year (slightly over one million households).
- The average amount taken out was about $51,000.
- Combining these factors, the total amount of equity take-out is calculated as $53 billion during the past year.

Those who took out equity were asked what they used the money for. Some people indicated more than one purpose. Based on the responses, it is estimated that:

- $16.9 billion (32%) of the money would be used for debt consolidation or repayment.
- $13.4 billion (25%) would be used for renovation or home repair.
- $6.6 billion (12%) would be used for purchases (including spending for education).
- $12.5 billion (24%) is for investments.
- $3.3 billion (6%) is for “other” purposes.

4.0 Consumer Sentiment

Since the fall of 2010, some editions of the CAAMP/Maritz consumer surveys have investigated attitudes on some current issues related to housing markets and mortgages. The respondents were offered various statements and asked to indicate the extent to which they agree or disagree with each, on a 10 point scale. A response of 10 would indicate complete agreement and a response of 1 indicates complete disagreement. Average responses of 5.5 out of 10 would indicate neutrality.

The statements are about current issues, some of which have been widely discussed in the media. CAAMP has added others with lower profiles that it considers worthy of examination. To minimize the risk that the ordering of the propositions might affect responses, they were presented in randomized order.

The list of questions has evolved over time. The next table summarizes responses – showing the average scores – for the questions asked in the current survey.

- Most consumers agree with the first proposition (that "low interest rates have meant that a lot of Canadians became homeowners over the past few years who should probably not be homeowners"), and the degree of agreement has not changed much over time.
- But, while consumers believe other people have been irresponsible, the responses to other questions (discussed below) show that they believe their own behavior has been responsible. It isn't clear how we can reconcile the paradox of widespread positive beliefs about "selfs" versus widespread skepticism about "others" (this same challenge has emerged on other occasions when these questions have been asked). It is likely that beliefs about other people are shaped by messages in the media and from pundits.
- Canadians have become more confident over time about their ability to weather a downturn in the housing market (as the average scores for the second question have increased over time).
- Canadians have agreed with the proposition that real estate is a good long-term investment, and the amount of agreement has strengthened over this period.
- There is a moderate level of confidence about the economy, although the current average score of 6.31 is not very much above the neutral mark of 5.5.
- The proposition "I regret taking on the size of mortgage I did" has been asked only for mortgage holders. The average scores for this have been well below the midpoint. There is not a clear trend for these responses over time. But, we can say there has not been a rise in "regret". Looking at the current responses in more detail, mortgage holders who have purchased recently (during 2010 to the present as well as during 2005 to 2009) have average scores identical to the overall average, indicating that recent buyers are just as comfortable with their decisions as were earlier buyers.
- On the over hand, there is strong agreement that mortgages are "good debt", with the average score at 7.13 this fall. Just 8% gave dissenting scores (1 to 4) and 66% indicated degrees of agreement (scores of 7 to 10).

Table 4-1 ***Summary of Consumer Responses to Topical Questions*** ***(Average Scores on a Scale of 1-to-10)***					
	Fall 2010	Fall 2011	Fall 2012	Fall 2013	Spring 2014
Low interest rates have meant that a lot of Canadians became homeowners over the past few years who should probably not be homeowners	6.88	7.11	7.01	7.04	7.01
I/My family would be well-positioned to weather a potential downturn in home prices	6.54	6.72	6.67	6.93	6.98
Real estate in Canada is a good long-term investment	7.13	7.27	7.26	7.44	7.34
I am optimistic about the economy in the coming 12 months	N/A	6.02	6.13	6.36	6.31
I regret taking on the size of mortgage I did	3.86	4.04	3.88	3.82	3.68
I would classify mortgages as "good debt"	N/A	7.07	7.05	7.20	7.13
Source: Maritz survey for CAAMP, fall 2010 to spring 2014; estimates by the author.					

Consumers were also asked for their predictions for changes in the values of homes and condominiums during the next five years. The next table summarizes the responses, in total and by age group.

- More than one-half of consumers expect a relatively stable environment (that prices will either be flat or increase slowly). The expectations do vary by age group: older age groups are more likely to expect relative stability than are younger groups.
- On the other hand, while less than 10% expect that a housing bubble will burst, that expectation is stronger for young groups than for older groups.
- One-fifth expect that prices will decline slowly.
- Very few expect rapid growth in valuations.

Table 4-2 ***Consumers' Predictions About Changes in Valuations for Homes and Condominiums During the Next Five Years, by Age Group***							
	18 to 24	25 to 34	35 to 44	45 to 54	55 to 64	65+	All Ages
The bubble will burst	16%	12%	10%	9%	6%	5%	9%
Slow decline in valuations	30%	19%	27%	17%	18%	20%	20%
Stable (values will stay the same)	25%	24%	26%	26%	24%	20%	24%
Slow growth in valuations	9%	28%	24%	34%	37%	45%	33%
Rapid growth in valuations	7%	3%	4%	3%	3%	2%	3%
Unsure	12%	15%	10%	12%	12%	8%	12%
Total	100%	100%	100%	100%	100%	100%	100%
Source: Maritz survey for CAAMP, spring 2014; estimates by the author.							

A new question in this edition of the CAAMP/Maritz survey asked home owners whether they are happy with their decision to buy the home. This question found a very high degree of satisfaction with home ownership. Three optional responses were available:

- By far, home owners indicate that they are happy with the decision to buy their home (91%).

- A tiny minority (less than 2%) indicated that "I regret my decision – I wish I did not choose to own a home".
- In addition, 7% indicated "I regret my decision – I wish I had purchased a different home/property".

The next table presents the responses in more detail. This data indicates that for owners who purchased during the past decade (the two categories spanning 2005 to 2009 and 2010 to the present) there is twice as much regret about the particular home that was purchased than there is for earlier purchasers. However, in terms of regret about the decision to purchase a home in general, the amount of regret for recent buyers is essentially identical (that is, extremely low) for both recent buyers and earlier buyers.

Table 4-3
Home Owners' Attitudes to their Purchase Decisions

Period of Purchase	I am happy with my decision	I regret my decision – I wish I did not choose to own a home	I regret my decision – I wish I had purchased a different home/property	Total
Before 1990s	94%	2%	4%	100%
1990s	93%	2%	5%	100%
2000-2004	95%	0%	5%	100%
2005-2009	87%	2%	11%	100%
2010-Present	90%	3%	8%	100%
Total	91%	2%	7%	100%

Source: Maritz survey for CAAMP, spring 2014; estimates by the author.

A question that generates lively discussion in the media (and especially in on-line discussion boards) is: to what extent do people see their homes as investments? In the spring 2014 CAAMP/Maritz survey, home owners who purchased during the past decade were asked an experimental question: "how you think of your home from these two perspectives [as a place to live versus as an investment]? These two numbers should add to 100%." The responses indicate that on average homes are viewed 69% "as a place to live" and 31% "as an investment". We don't have a benchmark that we can use to say whether this is reasonable. But, we can use the data to look at variations for different buyers. Dividing the data roughly in thirds:

- Purchasers who bought during 2003 to 2006 see their homes as 71% a place to live and 29% an investment.
- For purchasers who bought their homes during 2007 to 2010, the allocation is 68% versus 32%.
- For the most recent buyers (2011 to the present) the allocation is 69% and 31%.

In other words, these different groups of buyers have similar attitudes about the extent to which they see their homes as investments. This will be interesting to watch over time.

The survey asked consumers about their emotions around their various debts. The table below compares the percentage of respondents who are "comfortable" and "nervous" with various types of debt. A very high 65% indicated that they are "comfortable" with their mortgages. The degree of comfort with auto loans was not far behind, at 62%. Degrees of comfort were lower for other forms of debt. In terms of "nervous" feelings, mortgages were in the middle of the pack.

Table 4-4 ***"Comfortable" and "Nervous" Feelings About Various Types of Consumer Debt***		
Type of Debt	"Comfortable"	"Nervous"
Mortgage	65%	15%
Auto Loan	62%	9%
Overdraft	57%	14%
General Line of Credit	51%	16%
Unsecured Bank Loan	50%	22%
Other	47%	33%
Loan for a purchase	44%	11%
Loan from family/friend	41%	12%
Credit Card	38%	24%
Student loan	34%	21%
Source: Maritz survey for CAAMP, spring 2014; estimates by the author.		

Looking at the data in more detail, the next table shows that the buyers who have purchased most recently are slightly below average in their comfort levels, but are very close to average in reporting that they are nervous about their mortgages.

Table 4-5 ***"Comfortable" and "Nervous" Feelings Among Mortgage Holders, by Period of Home Purchase***		
Period of Purchase	"Comfortable"	"Nervous"
2004 or Earlier	68%	14%
2005 or Later	64%	15%
Total	65%	15%
Source: Maritz survey for CAAMP, spring 2014; estimates by the author.		

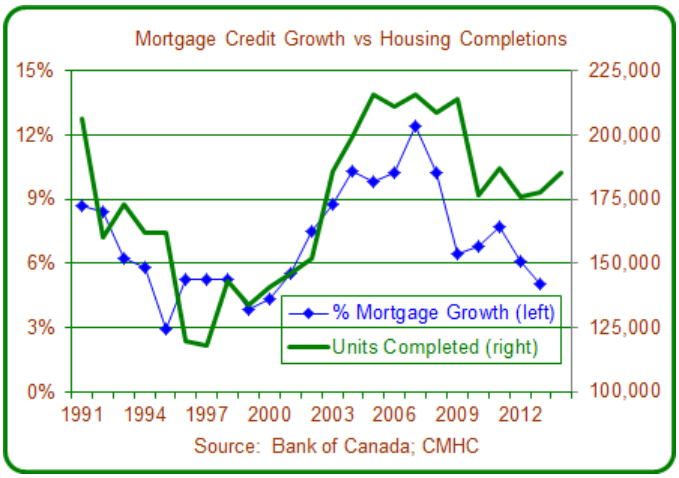
5.0 Outlook for the Mortgage Market

The Housing Market Background

During the past two decades, there have been wide variations in the rate of mortgage credit growth in Canada. During the second half of the 1990s, growth was typically about 5% per year. There was a strong peak of growth during 2004 to 2008, when annual growth rates exceeded 10% per year. More, recently, growth has slowed during the post-recession period, and is now at 5% per year.

Many factors influence the growth of mortgage credit.

- One factor, which is a long-term, persistent trend, is that Canadians move away from slow growth communities (which have relatively low house prices) into communities with stronger job markets, which also have higher house prices and larger associated mortgage amounts. This factor alone may account for about one-quarter of mortgage credit growth in Canada. So long as there are economic disparities across Canada, which cause Canadians to move in search of economic opportunities, this factor will make a sustained contribution to growth of mortgage credit.
- Trends in housing activity – in the resale market and in the new construction arena - also affect mortgage demand.
- Growth of mortgage credit is highly related to completions of new homes, as can be seen in the chart to the right. As new homes and apartments are completed and are ready to be occupied, there are usually new mortgages attached. But, this chart also shows that the relationship may have broken down recently. Not exactly "broken down" – there is another important factor that has caused mortgage credit growth to slow, and that factor has become stronger.



- Very low levels of interest rates mean that Canadians are paying less interest and have more money available that they can use to repay their mortgage principals. CAAMP's surveys have found that Canadians are making significant efforts to repay their mortgages more rapidly than they have to. Therefore, a statistical analysis shows that reductions in interest rates in Canada tend to reduce the rate of mortgage credit growth; conversely, rising interest rates lead to increased mortgage growth. On a statistical basis, each one point change in mortgage interest rates affects the rate of credit growth by about one-half of a point per year.
- Trends in the resale housing market (including the rate of price growth and the total dollar value of sales) are also statistically related to mortgage credit growth, but the impacts are less strong. The reason is that when a resale property is purchased and a mortgage is obtained there is often an existing mortgage that will be discharged. Therefore, on a "net" basis, resale activity is less important compared to construction of new dwellings.

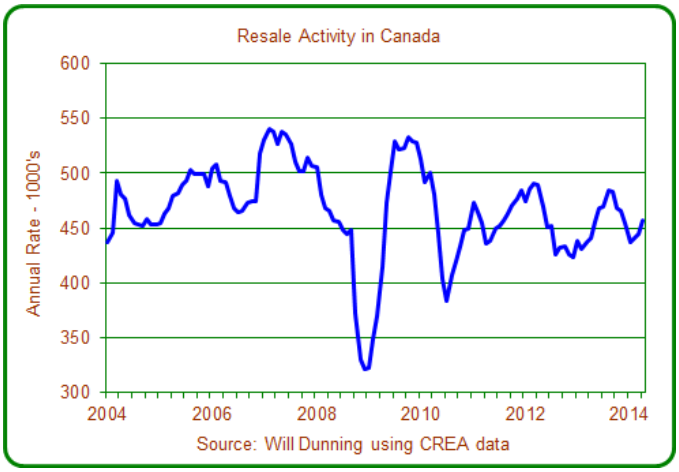
However, resale activity is very important to mortgage demand, in an indirect way. Evolving conditions in the resale market influence how much new housing will be constructed: when there are shortages in the resale market and/or prices are rising, there is a need for more new construction. More new homes will be sold. These sales will lead to increased housing starts and subsequently housing completions will rise.

This process occurs over quite a lengthy period. Previous issues of these semi-annual reports discussed a change in mortgage insurance policies that took effect in July 2012, and the reports speculated about how that policy change would quite slowly have negative impacts on various impacts of the housing market. We have seen changes in the housing market that are more-or-less in line with these expectations. Therefore, this issue of the CAAMP report continues to explore the evolution of the housing market (including the impacts of mortgage insurance criteria) and the consequences for the mortgage market.

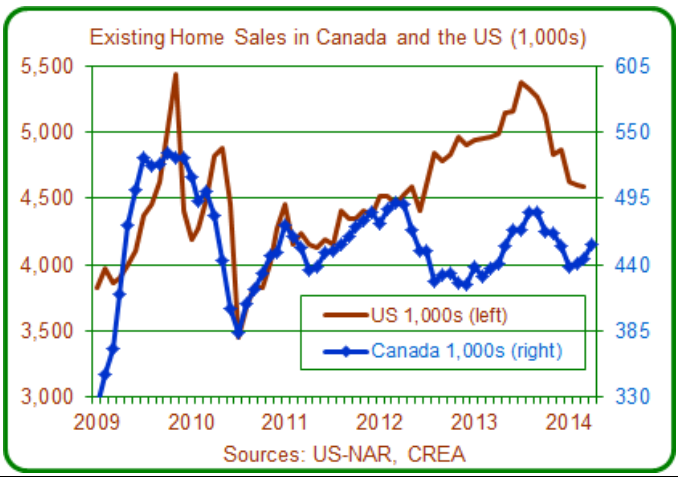
The message has been – and remains – that prior to the July 2012 policy change Canadian housing markets were entering a period of stability (at lower levels of demand) in which price growth was slowing and mortgage credit growth would eventually slow. The policy change would cause a further deceleration of housing activity, which would ultimately cause the Canadian economy to be weaker than it needed to be.

Resale Markets

During the past decade, resale activity has shown wide variations. Most of these swings (with one important exception) can be explained as the results of economic conditions – changes in job creation (or expectations), as well as changes in mortgage interest rates. The major exception is the drop that occurred at mid-2012: there were no economic events that would have caused this drop.



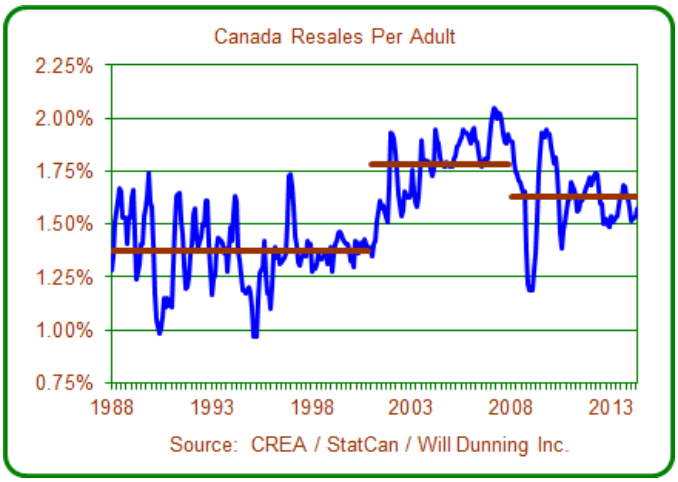
Canada's population is equal to 11% of the US's. The chart to the right contrasts resale market activity in Canada and the US using that 11% factor. It shows that resale activity in the two countries was closely matched on a proportional basis from early 2009 until mid-2012. But, at that time, activity expanded in the US (based on slight reductions in interest rates combined with on-going moderate job creation). The



same conditions existed in Canada: sales in Canada should have maintained a proportional relationship to the US. More recently, there was a spike in activity during last summer: interest rates rose unexpectedly, which caused a rush into the housing markets. This wave of activity can be seen in both countries. As that rush has abated, sales activity has retreated in both Canada and the US. There is still some similarity between Canada and the US in the direction of activity, but, as the chart above illustrates, since mid-2012 the level of sales in Canada has remained well below the US on a proportional basis.

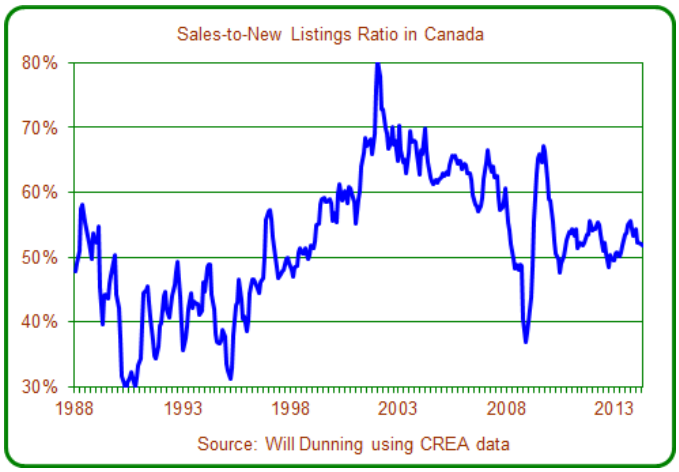
Why is this? It is because of policy changes for mortgage insurance in Canada that took effect in July 2012. Those changes caused an immediate reduction in housing activity in Canada. The comparison of sales in Canada and the US indicates strongly that the depressing effects have persisted: because of these policy changes, resale market activity in Canada remains substantially lower than it should be. This artificial suppression of housing demand in Canada has negative consequences for the Canadian economy, as will be explored in a moment.

We should expect that resale market activity will expand over time. Population growth means there is a growing number of potential buyers. In addition, a growing housing inventory expands the number of homes that could be available for sale. The chart to the right therefore looks at resale activity in terms of sales per adult (covering the period for which the Canadian Real Estate Association provides data on monthly sales). In this chart, three eras are obvious, and the solid red/brown lines show the averages for the eras.



- For the first half of the period, sales were weak because of slow economic growth combined with relatively high interest rates (a “too cold” period).
- This was followed by “too hot” period, when the Canadian economy was very strong.
- After the recession, resale activity was “just right” on average, until mid-2012, when the change in mortgage insurance policy began to depress activity. Since then, activity (based on sales per adult) has been below the post-recession average.

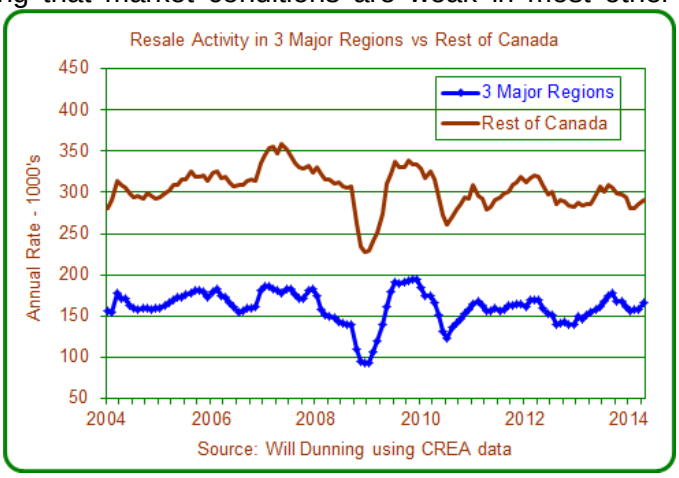
The state of the resale market can also be characterized via the sales-to-new-listings ratio (using data from the Canadian Real Estate Association). The author's analysis suggests that the resale market in Canada is "in balance" when the ratio is slightly above 50% (at that point, prices will tend to increase at about the same rate as overall inflation). In this chart we can, once again, see three eras: one in which the ratio was substantially below 50% and price increases were weak or non-existent, a second period in which the ratio was far above the threshold and prices increased rapidly, and a third period (post-recession) during which the ratio was (on average) close to the threshold and in many areas of Canada prices have increased at or slightly faster than the overall inflation rate.



However, during this third period, the average resale house price for Canada has increased by considerably more than the overall inflation rate. There are two reasons for this: activity has shifted to the most expensive markets and this has created an artificial bias in the average price. Secondly, there are a few major market areas in which prices have increased very rapidly, and this has more than offset slow growth that is occurring in most other communities. Both of these effects have been persistent, with the result that even though sales have slowed and the sales-to-new-listings ratio is at the balanced threshold, the average price for Canada continues to increase very rapidly.

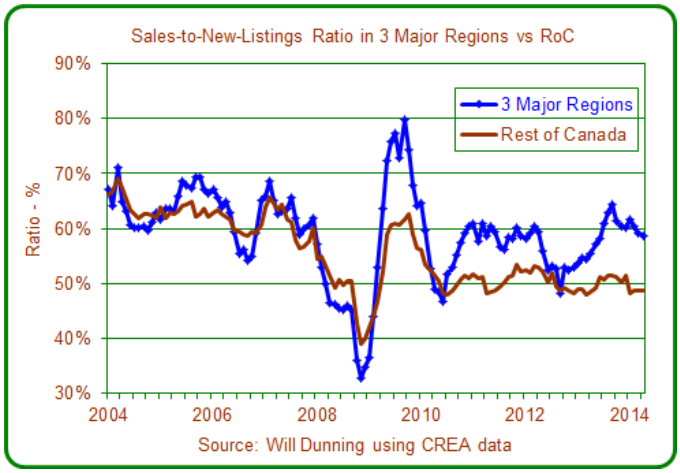
Three market areas account for most of the increase in the national average price: the Greater Toronto Area (plus the Hamilton area), the Greater Vancouver Regional District, and the Calgary area. In the first two cases, there are critical issues of land shortages: there is not enough "development-ready" land on which new single family homes could be built and these shortages are resulting in price pressures. In Calgary, rapid growth of house prices can be attributed to very strong job creation, which is attracting in-migration and resulting in very strong housing demand.

Three charts compare resale market indicators for these three major market areas versus the rest of Canada, illustrating that market conditions are weak in most other communities in Canada. This weakness extends to almost all communities east of the Greater Toronto Area, as well as many market areas in central and western Canada.

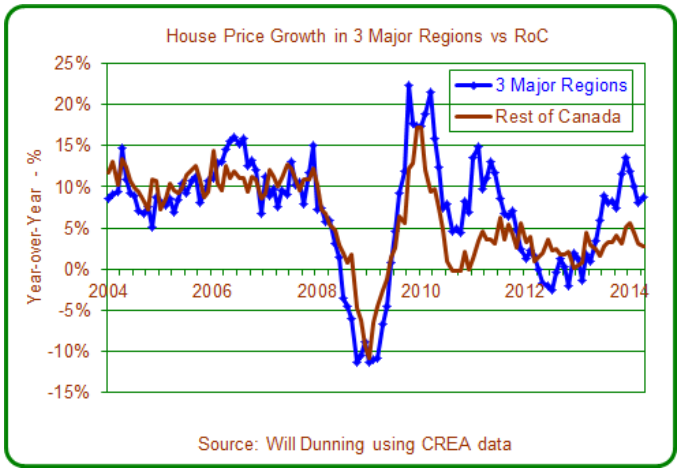


Firstly, during the past three years the trend for sales has been roughly flat in the three major markets. But, sales are now trending downwards in the rest of Canada.

The second chart looks at the sales-to-new-listings ratios. In the rest of Canada, the ratio is low and is below the balanced market threshold (having averaged just 49.5% since the summer of 2012). Moreover, the ratio appears to be trending downwards. In the three major market areas, on the other hand, the ratios show that these market areas are indeed badly under-supplied.



The third chart illustrates that in the rest of Canada growth in the average resale price has been muted during the last four years. In the three major market areas, on the other hand, the average price has increased at rapid rates during that period. As of April 2014, the average price shows a year-over-year rise of 8.2% for the major markets versus 2.9% for the rest of Canada.



To sum up: prior to the July 2012 policy change, most areas of Canada had balanced housing markets; subsequently, many market areas are weaker than balanced and are at risk of decline. This is due at least in part to the policy change,

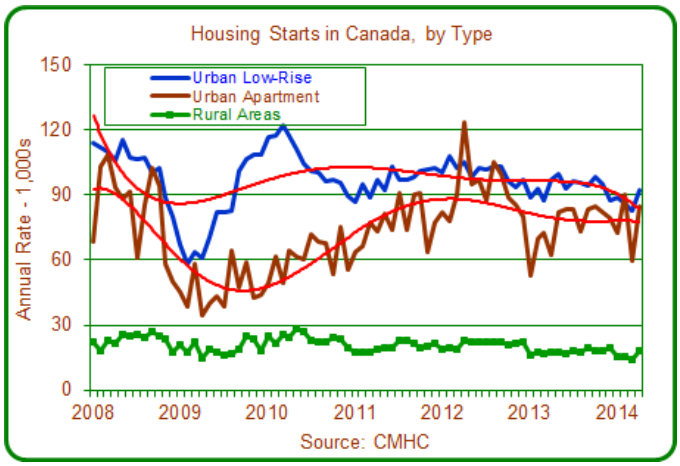
The July 2012 policy change was made in response to conditions on the supply side of the housing market that affected only a few communities. In response to the narrowly focused supply issues, steps have been taken to deliberately reduce housing demand in all of Canada. This lack of symmetry between the supply-side issues and a demand-side policy response is inappropriate and may even be dangerous, not just for the housing market, but also for the broader economy. It would be more appropriate to address these supply-side issues with supply-side policies.

New Housing Construction

Previous issues of this report have explored the relationship between resale market activity and subsequent changes in the new construction arena.

In particular, the spring 2013 issue concluded that the July 2012 policy change would cause housing starts to fall. The drop would occur first for low-rise housing types (single-detached, semi-detached, and row homes). The slowdown for apartments would occur later.

The chart to the right suggests that housing starts are evolving roughly as we expected. The trend for low-rise starts began to fall late in 2013. So far, the drop in the low-rise trend has been in the range of 15%. For apartments, starts are highly volatile from month-to-month. It appears that the trend has been flat for some time. We expect that the trend for apartments will begin to fall late this year, continuing into 2015. By the time adjustments are complete (later next year) total housing starts will have fallen by at least 20% compared to the levels seen during 2011 and 2012. This reduction in housing starts will have been largely due to the changes in mortgage insurance policies.



Economic Impacts

Housing is a major generator of jobs. And, during the post-recession period housing arguably played the leading role in taking the Canadian economy out of recession and into expansion.

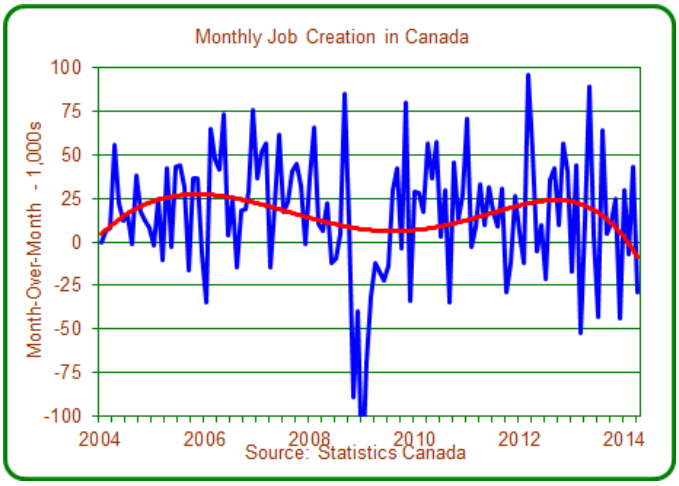
There are two major channels:

- There are direct effects. Housing activity creates jobs in construction, but also in industries that support construction activity (including manufacturing of materials used in construction, as well as financial services, professional services that assist the development and building industries, legal services, moving and storage, etc.). Each new single-family home built in Canada results in 2.0 to 2.5 "person years" of employment; each apartment results in 1.25 to 1.75 jobs.
- As well, changes in house prices (up or down) affect consumer confidence and willingness to spend money. Therefore, there is a "wealth effect" from house prices that makes important positive or negative contributions to the overall economy. A policy that aims to slow house price growth is therefore also going to slow the pace of job creation.

While the direct effects are most obvious, the indirect effects ("wealth effects") are probably just as powerful as creators (and potentially destroyers) of jobs in Canada. During the post-recession period, interest rates have been deliberately kept low to stimulate job creation. It happens that the housing sector is one of the most interest rate sensitive parts of the economy. Therefore, low interest rates have mainly affected the economy via housing activity – through the direct impacts of construction on jobs as well as via the indirect wealth effects.

A government policy that attempts to slow the housing market and the rate at which house prices increase is at odds with the government's attempts to stimulate the economy.

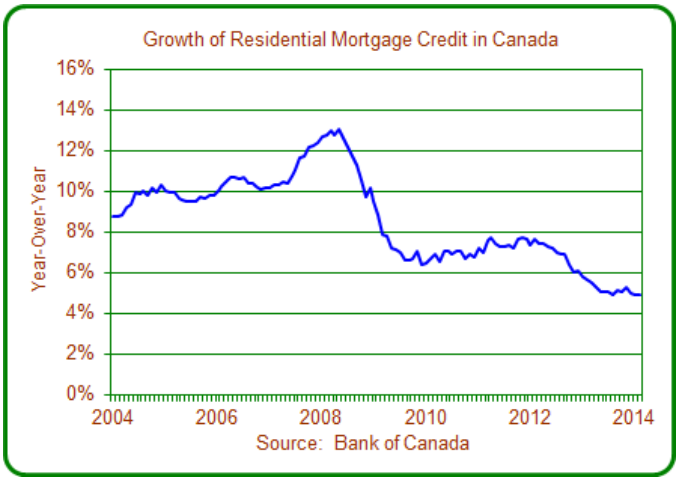
Earlier reports from CAAMP concluded that the July 2012 policy change would result in a significant reduction of job creation in Canada: during the two years up to mid-2015, job creation might be 150,000 less than it would otherwise be. Based on population growth, we might expect that during the two year period about 475,000 jobs should be created (an average of 19,800 per month). As a result of the policy change actual job creation might be only 325,000 over that same period (13,500 per month). It is still early days to review this conclusion. But, recent data on employment in Canada is consistent with this opinion: during the past 12 months (up to April 2014) Statistics Canada reports indicate that job creation has averaged 12,400 per month (the chart to the right shows monthly job creation rates and adds a trend line – the trend of job creation has clearly slowed during the past year). We cannot say that this slowdown is entirely due to changes in the housing market, but the downshift of housing activity and the weakening of house price trends in many communities have no doubt been influential.



There is a strong two-way interaction (a "feedback loop") between the housing market and job creation. If this slowdown in job creation persists, it will start to weigh on housing demand later this year and into 2015. Housing markets that are now generally "in balance" could be tipped into "buyers' market" states in which prices weaken, which could further impair job creation.

Forecast of Mortgage Activity

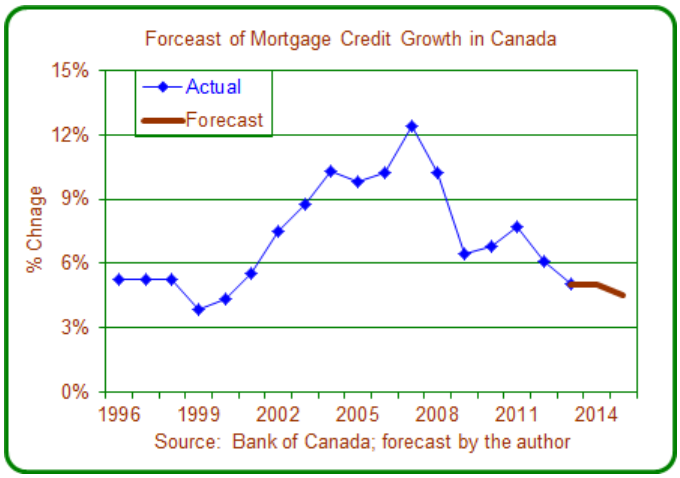
During the past decade, residential mortgage credit in Canada has expanded at an average rate of 8.4% per year. The moderation of housing activity since the recession has resulted in slower growth of mortgage credit. For the past five years, growth has averaged 6.4% per year. The year-over-year growth rate currently appears stable, at 5.0% (the most recent data is for February). The volume of outstanding residential mortgage credit in Canada is $1.23 trillion.



Key factors suggest that there will be little change in the growth rate in the near-term:

- Housing completions will be roughly flat during 2014, with gradual reductions during 2015 (and further reductions during 2016 and 2017).
- Canadians will continue to move away from communities with low-cost housing into communities that offer more job opportunities and commensurately have higher housing costs and larger associated mortgages.
- Resale market activity is widely anticipated to remain close to the 2013 level during 2014 and 2015.
- Low interest rates will continue to allow mortgage holders to make extra efforts to repay their mortgages, through lump sum payments and, more importantly, to regularly pay more than they are required to (based on their contracted amortization schedules).

Based on these factors, mortgage credit growth should remain at about 5.0% for the remainder of this year, and then slow gradually, to 4.5% by the end of 2015. Looking farther out, falling numbers of housing completions should result in further gradually slowing of mortgage growth during 2016 and 2017.



By the end of 2014, total outstanding residential mortgage credit would be in the range of $1.28 trillion. By the end of 2015, the level might be $1.34 trillion.