May 7, 2021

Jeremy Rudin, Superintendent
Office of the Superintendent of Financial Institutions (OSFI)
255 Albert Street
12th Floor
Ottawa, Ontario K1A 0H2

Re: Consultation on the Minimum Qualifying Rate for Uninsured Mortgages

Dear Sirs/Mesdames;

The Canadian Mortgage Brokers Association (CMBA) wishes to make comments concerning your consultation on the proposed implementation of a qualifying rate for uninsured mortgages at a rate which is the greater of the contractual rate plus 200 basis points or 5.25 per cent.

Rational for the Proposal

The rationale stated in the OSFI consultation for implementing the qualifying rate is that the COVID-19 environment has created economic uncertainty combined with soaring house prices. Record low interest rates are likely to bounce higher with a post pandemic recovery, leaving indebted homeowners vulnerable to over indebtedness. The qualifying rate is proposed as consumer protection to ensure that mortgage borrowers are more likely to withstand the shock of interest rate increases.

We offer the following comments and recommendations on your proposal:

The Proposal Should Address Consumer Debt

One of the most evident challenges with the proposal is that it is exceptionally narrow in its scope and does not address more pressing personal debt issues for consumers. In fact, personal lenders can be very aggressive and indiscriminating in flogging their loans to consumers.

Personal loans are issued by a myriad of lenders, including OSFI regulated financial institutions, most notably in the form of car loans or credit cards. Personal debt generally attracts excessive interest rates, especially when compared to rates on mortgages, and is readily given without the rigorous underwriting scrutiny as is undertaken by mortgage lenders and brokers. Incredulously, credit cards and dealership financing are usually issued without any income verification at all. In addition, credit card limits are increased based on utilization and repayment without any regard for the borrower’s growing debt burden. You may wish to know that many lenders grant unsecured lines of credit to compliment mortgages. Had these lines of credit been active prior to consumers obtaining their mortgage, a significant number of these mortgages would never have been approved. These are all examples of egregious and irresponsible lending practices, which should clearly be the focus of the government's regulatory actions to curb consumer debt.

We further note that as a standard practice, consumer debt issued by federally regulated lenders is often secured against the borrower's real estate in the form of a collateral mortgage, which then renders the stress test on insured mortgages moot. Under collateral mortgage instruments, easily obtained personal debt can be readily added to a borrower's mortgage obligations, thereby creating undue financial hardship and adding to the risk of foreclosure.

We recommend that the OSFI focus regulatory efforts to ensuring that financial institutions are more accountable for how they issue personal debt, and set limits and guidelines on the amount of debt which can be given to consumers. In particular, we recommend a review of collateral credit practices amongst federally regulated financial institutions to ensure that these practices do not usurp OSFI's purpose of ensuring that borrowers can afford their mortgages.

Where do People Live if they don't Pass the Stress Test?

It goes without saying that people have to live somewhere: if they are not able to purchase housing, they must rent. In doing so, they are no longer paying down a mortgage on their appreciating asset, but instead that of their landlord. However, most federal government policies, such as OSFI's proposed new uninsured mortgage stress test, which are intended to promote economic stability by curbing consumer debt, only have only a singular, narrow focus on the economy. These policies fail to consider that housing affordability problems impact both lower and middle income households, renters, first time buyers, and even established homeowners. Persons without the ability to purchase a home must rent at a time when vacancy rates are at an all-time low and rents are accordingly, at an all-time high. Pushing potential homeowners who fail the stress test into the rental market serves to increase the demand for scarce rental housing, thereby raising rental rates.

We further note that the current housing shortage was an issue prior to COVID 19, and urge the government of Canada to work on programs to assist with housing development. In addition, we further urge OSFI to examine any unintended consequences or impacts which its proposed policy may have on the rental housing market and any potential upward pressure on rental rates, prior to implementing its policy.

Requirement for a More Targeted Approach to Stress Testing

At a time of record setting property price escalation where home buyers are challenged by multiple offer competition, blind bidding processes and numerous financing hurdles, the stress test puts an even greater divide between the haves and have-nots. Instead of implementing blanket stress tests to all mortgage borrowers under all circumstances, perhaps OSFI should consider targeting its stress test to scenarios involving speculation or investment. For example, currently the City of Halifax is witnessing a trend from out of province buyers who purchase Halifax real estate with all cash offers for the purpose of flipping or renting.

A more nuanced stress test targeted at mortgage applicants who are purchasing multiple properties or buying in a province which is not their province of primary residence would more appropriately serve the goals of the proposal. We therefore recommend that OSFI consider fine-tuning the proposal in such a manner.

Response from Members

In response to OSFI's proposal, CMBA received a significant number of detailed, thoughtful responses from its members, which I have attached as an addendum to this letter. We ask that you consider the perspectives presented by our members.

We are most appreciative and thank you for the opportunity to provide input on your proposal. We would be pleased to discuss the above recommendations in more detail if you wish.

Yours truly,

Samantha Gale

CMBA-BC, CEO

CMBA – BC

CMBA-Atlantic

CMBA-Ontario

CMBA-Quebec

Addendum – CMBA Member Input

The “qualifying rate” only makes sense for mortgages with a term of 5 years or less. Should a Mortgagor seek financial stability with term longer then 5 years the qualifying rate possess a “huge” hindrance. When a 10 year term mortgage matures roughly 32% of the principal has been paid off. In this scenario where is the so called risk that rising interest rates will impact the ability to make future payments? Why should a Borrower penalized in the need to use the so called “qualifying rate” when they are seeking long term financial stability? In fact Borrowers should be encouraged to go long term, not discouraged!

That is 3% higher than actual and ensures new home buyers are the most targeted to not get in the market. Canada should be a country for homeowners not renters. Insane in my opinion. This hurts the most vulnerable home purchasers as usual. They should be lowering it as they had promised to do in the first place at 2% over average. What happened to that. Disgusted with the manipulation of the population and the demographics of this country. You should be allowed to own a home in large cities. You should not need to live in rural areas to easily qualify where a bump in rate would have no impact. It is the Canadian dream, and this government is ruining it. Stop putting the goal post out further and further. Just when you think you are going to make, they take it away. Everyone wants a home.

How is this going to cool the market? We’re already in a situation where today’s buyers are limited to last year’s financing maximums.

All I’ve seen from buyers this year is more cash in, rather than a request for more financing. Where gifted down payments were typically in the $100000 to $200000 range, I’m now seeing gifts of $300000 to $800000.

There is no value in this change except for optics sake in an election year!

I am not opposed to rules that regulate those buyers and homeowners who have a bigger impact on driving price. I do have an issue when those rules squeeze out first time home buyers and the average Canadian.

I can support changes that include speculation taxes, income tax confirmation for residents who bring money into the country and don’t file taxes, etc. that may slow the activities by some that down the line effect everyone. This takes more conversation, consult and listening by the government with industry professionals. It is not as simple as a stroke of a pen to make a decision without a comprehensive review from the street level and up not just across a boardroom table or Zoom meetings.

Many Canadians and especially the first time buyers have been unable to afford a home in many cities for some time. My personal book of business includes fewer high ratio buyers since the benchmark rule changes were implemented. The same is true for most of team of 85 brokers. We can't continue to tie the hands of these buyers. Unless they have a gift from a family member most are unable to get into the market. Further tightening of rules will have a negative long term impact as many of these families will be forced to continue to rent and remove them from the right to own property and gain equity through their home. Where will they be in 10-20-30 years? As fixed rates have risen those with rate holds prior to February 25th will use them in the coming months. Once this ends, I wonder if we may see things settled a bit as the frenzy of sub-2% rates subside for conventional borrowers. A change to the benchmark in June may be in line with that time frame anyway. Lenders are also increasing their discounts on variable rates. This has created a bigger gap between fixed and variable shifting people to variable. That is something that may put some homeowners at risk with a false sense of security holding a current lower rate that could change significantly in the coming 1-2 years. While all of this takes place credit card companies continue with aggressive marketing to consumers with high interest offers, easy approval and allowing people with little or no income verification to access large approval limits. I am just working with a client who makes under $50K per year who has over $150K in unsecured debt. I know people have to be responsible for their actions. However, that access to unsecure debt is putting people into a situation where they are now taking on a larger mortgage. The government needs to review and address that issue. They are allowing credit card companies to operate in a way that is a risk to Canadian families. If the government is truly concerned about the finances of Canadians they need to dig deeper and make some meaningful changes in key areas. Rule changes for mortgage financing will not address the underlying problems. This of course is only my observation and opinion for what it is worth. I am sure you will have many comments from other members. I hope it all helps if the leaders are willing to listen and learn.

I feel this qualifying benchmark is way too high. It's not realistic. When clients are able to demonstrate their ability to manage higher rent payments and yet we can't qualify them for equal mortgage payments? That makes no sense. There was a time when we used to use common sense to lend. Now it's all drop-down menus and boxes that get smaller and smaller. I've been lending for 30 years now, 16 in mortgages. Our government and our Lenders are often salaried and don't know what it's like to run a business. We relegate BFS and inconsistent incomes to the lowest of a 2-year average. That does little to no good for someone who on paper appears to have little sustainable income when the current numbers are what they're working with when buying and that's not even considered. I tell my clients not to apply logic to mortgage lending, that what's their reality isn't what we represent on paper. I understand the concept of being conservative and protecting our investors but in 1954 CMHC's mandate said homeownership should be for all Canadians. Now we're quickly approaching the new reality that it's only for salaried, wealthy Canadians who likely already had a leg up to begin with.

As someone who is priced out of a new home due to a change of business venture, the two year average of net incomes, and the stress test, it's quite frustrating to be stuck on the sidelines while every day I approve the homeownership dreams of Canadians. We need to fight for those who can pay their bills and have the credit to prove it.

As an independent mortgage broker in my 16th year in business, it is my opinion that the act of increasing the Stress Test will target the wrong group of home buyers. It will predominantly affect First Time Home Buyers. This is not the group of purchasers who are driving up home prices. OSFI should focus their attention on property speculators (both foreign and domestic) and house flippers while ensuring they don't unintentionally target legitimate investment property purchasers who intend to supply affordable rentals to increase the shortage of rental stock.

This seems ridiculous to raise the BoC as a blanket policy since the people who are fueling this market seem to be unconditional cash buyers or “land barons / multi single family property owners” who are willing or able to come in at 10 – 15 % above real fair market list prices. Those with a $ 100k combined family income are already hamstrung with the safety measures at 4.79 % and are limited to purchasing in the hottest markets which seem to be sub $ 600k.$ 100k nets a family with 5 % down payment a home of $ 515,000.00 which is absurd. What about a tiered BoC qualifying rate for those that are purchasing in specific price ranges such as $ 600k, $ 750k & beyond … Wouldn’t that make sense ? Why wouldn’t we place a much heavier qualification or limit on single family home purchases to keep multi property owners “land barons” from taking all of the low end available housing and pumping up rents ? This BoC increase is only going to tighten the rental market which is already stressed.

I don’t believe increasing the qualifying rate again will help I believe it will only decrease the amount of affordability for local buyers and sellers. This will mean less people can qualify for the next step up so they will reno and stay which means less product on the market to buy, which means increase in pricing.

I don’t believe changing the qualification rate will do much. And it does nothing for FTB at all. I would rather see something like stepped payments. For example: client has a 2% fixed rate for 5 years. First year, payments based on that. Year 2 base on at 2 ½%. Year 3 by another ½ of 1% and so on to end of term. Owners would build some equity and not be as shocked if something happened to interest rates at the end of the term.

Was this not a big factor in the US when the bubble burst? The subprime lenders were allowing lower initial payment to be reset in 3 years. I do recall an interview on CNN with a lady that was losing her home. When she bought it, she applied for mortgage. Lender basically said, “what can you pay”. She said $700. When the reset came, it went up to about 2,500. Ended up losing her home and there were a lot like that.

We had the subprime lenders here. The difference was that when we signed up a client, they know what their payments would be starting the next month. No reset. So, --not the same issues here.

It appears as if the government intends to punish First Time Home Buyers, who are struggling to find a reasonable home for their families. Not only do they struggle with the higher real-estate prices, now they are being punished with an increased Qualification Rate.

The result is that many of them will be locked out of the market for years to come.

The new Qualification Rate will not help the vulnerable and is absolutely unnecessary.

Once the evening news will broadcast a looming increase of the Qualification Rate, a frenzy of last minute buyers will push the prices even higher.

Vancouver and its region are on the world stage and buyers with deep pockets will displace our young generation through a significant demographic shift.

Conventional files should not be underwritten with the same stress-tested rates. Rates move upwards gradually, so the stress-tested rate should also be reasonable and move up gradually for 1 to 5/10 year terms. For example:
1 year term: Contract rate + 0.20%,
2 year term: Contract rate + 0.40%
3 year term: Contract rate + 0.60%
4 year term: Contract rate + 0.80%
5 year term: Contract rate + 1.00%.

I don’t believe qualifying rate for mortgages will affect anything but hurt the ones who are first time buyers.

The bidding wars are a result of cash down not mortgages. The CMHC appraises the lending value to be mortgaged. If people are putting down 300,000 over asking this amount is not insured or reasonable.

No idea how to regulate that, but raising qualifying rate is like punishing a student for the failing grade of another.

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1) For the previous 7-8 years in Canada we have seen a very serious detachment of the relationship between income and shelter cost in major markets particularly in major centre markets like Vancouver, Victoria, Toronto. This rate increase will make it much more difficult for Canadians to own a home. It already is difficult enough.

A single detached home in the Lower Mainland suburbs currently sells for 900k and up. Much more in Vancouver proper. Let's consider a house listed and sold at 1MM. At 5% down, a mortgage of 950k even without the insurer premium capitalized would need just over 200k of household income in order to qualify proper for purchase of this property.

The median Canadian individual income for individuals between the age of 25-54 in 2019 was reported by Stats Can as being $46,900 / annum. This means that in order to currently qualify for a single detached home in these markets you would need 4.3 adults making a median income. This is hardly affordable, or sustainable for that matter.

After consulting with clients with these facts, most are very disappointed. They realize that in order to actually get into a property that suits their families' needs they will have to partner up with other adults, have additional income (rental or other), even have their parents or children on application, or have a VERY significant down payment to realize homeownership. For the average family in Canada, this is both unacceptable, and unrealistic. Increasing the qualifying rate to 5.25 will put homeownership for an average Canadian family even further out of reach. Much more than it already is.

2) Currently there is 3.5 point (percentage) spread between qualifying rate and the current going 5 year variable / arm rate. What that translates to is a massive difference between what is going on in real life versus what is going on for application and qualification purposes. There is roughly a 3 point spread between the qualifying rate and market norm for 5 year fixed rates. For each100k needed in borrowing amount, an additional $17,700 is being lost in income for qualification. Factored in as a "buffer" already. This translates to an additional 38% income buffer factored into qualification of a mortgage for Canadians currently in place. This is a pretty substantial buffer already.

To put this in perspective, on a "margin of err" scale, an AACI designated, qualified appraiser for example is mandated to be within 15% of either side of what an actual market value of a property is. Now granted we are talking about comparing valuation vs. potential default. Nonetheless though, 38% is far too high. How high does the margin of err need to go in order to mitigate the risk? Certainly not over 40%.And what next? Now we have to qualify for one and a half times of what is actually being borrowed? A massive difference when we consider scalability and the magnitude of mortgage size in major markets, and what is happening on paper vs. real life.

3) If the intention is to cool off major markets, legislating changes is not the way to do this. The markets control the markets. The government cannot control the market. Not only will we see a substantial number of unintended consequences when attempted, we will more than likely see detrimental social consequences, and a much higher risk of shelter fraud. Further OSFI intervention on the qualifying rate will undermine the

integrity of the real estate and mortgage markets in this fashion. This proposed increase is intended as a measure to protect banks and institutions. Not promote homeownership among Canadians. In fact putting shelter costs of more average income earning Canadians further out of reach.

4) The rental market and rent amounts are directly tied to housing prices in these markets. This will affect tenants and landlords in a detrimental way. When a homeowner purchases a single detached property in any of the major markets, given the amount of income needed to currently debt service a purchase, they find that their incomes are not sufficient to qualify due to the significant detachment between the relationship of household income and qualifying for shelter. In-law suites, coach homes, laneway housings, and other secondary dwellings are needed not just for qualification but as market appropriate housing, and are all ways to add income to a households borrowing paradigm when seeking a mortgage. These are secondary shelters that have rental income generation attached, and for the most part can be used in mortgage qualification. Since the individual incomes of the borrowers are not changing, the only variable in the equation is the rental income generated from the property. Borrowers are well aware of this. The landlords, homeowners are well aware of this. This will mean that in an already extremely competitive rental market, tenants will see rent amounts increase. Yet their incomes are not increasing in relationship to their shelter costs. It has been standard for decades to spend no more than a third of annual gross income on shelter. In some major markets, we are seeing the percentage as high as half of the household income spent on shelter. In order to meet the debt servicing needs of a property in major markets, more than likely Canadians in these major markets will see conflict between the Residential Tenancy Acts which mandate a prescribed maximum rental increase, and what the rent amounts need to be increased to in order make qualification of financing purchasing or refinancing a property a reality. This puts the landlords in further risk of contravening the RTA's in these markets, and tenants facing higher shelter costs. Residential Tenancy Acts already dictate conservatively the permissible rent increase per annum.

Higher rents also usually means higher turnover for tenancies. Currently in major markets like Vancouver and Victoria according to CMHC stats, there is already less than a 1% vacancy rate in most municipalities. This hasn't changed in roughly 8 years. A normalized vacancy rate is 3-5%. Lenders with programs for investors factor in 5% vacancy in many cases on rental spreadsheets to help evaluate individual covenants of borrowers with multiple rental properties in a portfolio. That is part of their buffer and risk mitigation process. A legislated change to the benchmark qualifying rate by OSFI will have a detrimental effect on Landlords(homeowners) and tenants.

The qualifying rate does not need to be increased. Canada enjoys a very stable housing market and has for a long time. Consistent conservative underwriting practices continue to support this. We do not have a "default problem" or risk of one currently in Canada. Canada has always had conservative underwriting practices. It's one of the reasons Canada was somewhat insulated from the 2008-2009 global financial crisis. We are not at risk of massive defaults and financial market collapse currently either.
Particularly with "the greater of a 2% addition to contract rate or the benchmark 5 year rate" used in mortgage qualification by law, substantial buffer is already priced in. Hence there is already a substantial measure of safety buffered in for the protection of borrowers and institutions.

As a very seasoned professional in the mortgage landscape, I understand intimately the market forces that contribute to the mortgage landscape, the economics involved, how the real estate and finance market forces are intimately connected, further some of the drivers behind the real estate and mortgage markets. It is and has been my job to know for over a decade now. I have witnessed countless cycles, and the trickle down effects of monetary policy. In conclusion, for these reasons, I am not in support of OSFI's proposal to raise the benchmark qualifying rate from 4.79% to 5.25% in June of 2021.