Minister of Finance Ministre des Finances

Ottawa, Canada K1A 0G5

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The Honourable Wayne Easter, P.C., M.P.
Chair of the House of Commons Standing Committee on Finance
House of Commons
Ottawa, ON
K1A 0A6

Dear Mr. Easter:

Pursuant to Standing Order 109 of the House of Commons, I am pleased to respond on behalf of the Government of Canada to the recommendations made in the Fifteenth Report of the Standing Committee on Finance (FINA) entitled: *Canada's Housing Markets: Benefits, Barriers and Bringing Balance,* tabled in the House of Commons on April 13, 2017.

The Government would like to thank the Committee for its detailed study of Canada's housing markets. The Government appreciates both hearing and reading the insights provided by the diverse and distinguished series of witnesses who offered their testimony before the Committee.

The Government's policy framework for housing finance seeks to appropriately balance a number of objectives, including:

- stability of the financial system and the economy;
- access to housing finance; and
- competition and efficiency in the provision of housing finance.

Overall, the Canadian housing finance system is sound, with strong foundations that promote stability, including robust regulation, prudential supervision of regulated financial institutions, and high underwriting standards. However, some households are carrying high debt loads and there are pockets of risk in certain regional housing markets.

That is why over the past two years, our Government has taken a wide variety of actions to address household sector vulnerabilities, including changes to mortgage insurance rules and income tax changes relating to the capital gains exemption on the sale of a principal residence. Moreover, the Government has made investments to improve housing data availability. These actions were taken to help sustain financial and economic stability, and to promote a more stable and accessible housing market for current and future homeowners.

In addition to safeguarding stability, the Government has also taken significant action to support the key policy objective of affordability. Budget 2016 committed to invest $2.2 billion over two years, to give more Canadians access to more affordable housing. To supplement these initiatives, Budget 2016 also provided funding for low-cost loans and new financing tools to encourage the development of more affordable rental housing. Building on these efforts, Budget 2017 proposes to invest more than $11.2 billion over 11 years in a variety of initiatives as part of a new National Housing Strategy. The new strategy seeks to build, renew and repair Canada's stock of affordable housing and help ensure that Canadians have affordable housing that meets their needs. Budget 2017 further commits to preserve baseline funding related to the expiry of long-term social housing operating agreements, so that Canadians have access to housing options that are affordable and meet their needs.

Ultimately, the Government's approach is designed to protect the financial security of middle class Canadians and the Canadian economy.

Detailed responses to the Committee's recommendations are provided below.

Recommendation 1: ***The Government of Canada work with its provincial/territorial counterparts to ensure that – when needed – they implement responsible measures that will result in stable, affordable regional housing markets.***

The Government agrees with the Committee on the need for effective inter-governmental cooperation with respect to housing markets. Fostering conditions that support stable and affordable housing markets is a shared responsibility across all levels of government. While market forces play the central role in determining house prices, federal government policy has a role in promoting stable and well-functioning housing markets, working with provinces, territories, and municipalities to provide affordable housing to meet the needs of our most vulnerable citizens, and ensuring that institutions and individuals are conducting their business fairly and by the rules. The Government of Canada has been actively engaged across all these fronts.

In October 2016, the Government announced a set of preventative measures to bring greater consistency to mortgage rules and reduce risk for taxpayers.[i] In particular, the more robust mortgage rate stress test for insured mortgages is meant to ensure that Canadians across the country are taking on mortgages that they can afford, even if interest rates go up, or if their income drops in the future. Other changes were also made to target the support the government provides for mortgage funding towards safer forms of lending.

Provincial and municipal governments also have important policy tools for housing markets. Measures can be designed and implemented by a particular jurisdiction in conjunction with other levels of government or on a stand-alone basis. An example of the former is the coordinated approach on affordable housing initiatives between the federal government and the provinces and territories through the National Housing Strategy (NHS) announced in Budget 2017. It will seek to establish federal leadership in affordable housing by mobilizing partnerships with provinces and territories to leverage investments and align strategies across the housing system. As part of the NHS, the renewed federal/provincial/territorial partnership will provide long-term predictable funding to support shared priorities and attract more investment.

Distinct policy levers at provincial or municipal levels of government, such as land use regulation and taxation, can often be better tailored to local market conditions, whereas federal policies that apply at the national level may not be able to address the diverse and complex set of factors operating in regional housing markets. To this end, various provincial and municipal governments have recently taken action to address local market conditions.[ii]

Working with our counterparts from other jurisdictions is, therefore, important to help ensure housing policy actions by each level of government work in a complementary fashion and provide the best policy outcomes for Canadians.

For this reason, in June 2016, I announced the creation of a Federal-Provincial-Municipal Working Group on Housing with jurisdictions implicated by housing issues in the Greater Toronto (GTA) and Vancouver (GVA) Areas.[iii] The working group provides officials from all levels of government with a forum to share data, examine factors that affect supply and demand for housing, and discuss potential policy solutions. The group has held a number of productive discussions.

Additionally, on April 18, 2017, I convened a meeting with the Honourable Charles Sousa and His Worship John Tory to discuss our shared concern of housing affordability in the GTA. We agreed to continue to share data and analysis and refrain from introducing new measures for buyers which would impact housing prices in the GTA by boosting demand.[iv] Moving forward, we will meet on a quarterly basis to discuss GTA housing issues.

Recommendation 2: ***The Government of Canada examine increased support for first-time homebuyers.***

The Government agrees that first-time homebuyers have unique needs that require attention. The Government maintains significant programs to facilitate homeownership in general and for first-time homebuyers in particular through both tax policy and housing finance policy. At the same time, the Government is focused on setting prudent rules that promote sustainable homeownership outcomes and the long-term stability of the financial system and economy.

Tax measures that directly benefit first-time homebuyers include the Home Buyers' Plan and the First-Time Home Buyers' Tax Credit.[v]

Under Canada's housing finance framework, the Government supports access to housing finance for first-time homebuyers and promotes financial system stability by backing mandatory mortgage insurance for high loan-to-value ratio mortgages.[vi] The Government's guarantee of mortgage insurance reduces risk for lenders, thereby enabling buyers to purchase properties with a down payment as low as 5 per cent and at mortgage interest rates comparable to those for buyers with much larger down payments. First-time homebuyers account for the majority of new high loan-to-value ratio mortgages insured each year.

The Government's support for housing finance remains significant, and the home ownership rate in Canada of 69 per cent[vii] is among the highest across the G-7 group of countries. Additional Government support for home ownership, especially in the context of housing markets experiencing rapid price growth and restricted housing supply, are likely to be counter-productive. Policies to further boost homeownership by stimulating demand would exert more pressure on house prices, with little or no positive impact on housing affordability.

Recommendation 3: ***The Government of Canada use Statistics Canada to address the gaps in housing-related data by creating a nationwide database that incorporates research from provincial/territorial and municipal governments, as well as research organizations. Such a database should provide data on home purchases and sales, homes purchased with cash, non-primary mortgage lending, foreign ownership of homes, loan-to-value statistics in relation to Canadian homes, Canada's rental markets, investors in Canada's housing markets, and the demographic profile of homeowners.***

The Government agrees with the Committee's emphasis on the need to strengthen housing-related data. Over the past few years, the increasing divergence in housing market conditions across Canada has emphasized the importance of having more comprehensive and timely housing sector data to better understand the range of complex factors driving prices and activity. For that reason, Budget 2017 includes initiatives to establish a Housing Statistics Framework and strengthen research in housing.

To address data gaps in current nationwide housing data, Budget 2017 proposes to provide \$39.9 million over five years, and \$6.6 million per year thereafter to Statistics Canada to develop and implement a new Housing Statistics Framework (HSF). The HSF will be a nationwide registry of the stock and flow of all properties in Canada, creating links between key variables relevant to the housing market for the first time. Consistent with FINA's recommendation, the HSF will provide information on purchases and sales, the degree of foreign ownership, homeowner demographics, financing details, and property characteristics. This will provide a significant improvement in the quality and type of data available and will yield significant ongoing benefits by enhancing the ability of housing participants, commentators and policy makers to monitor and analyze the housing market.

Work is presently underway by Statistics Canada to acquire data, with Toronto and Vancouver as areas of priority. The Government will aim to phase in publication of HSF data, with the first release expected before the end of 2017.

As part of the National Housing Strategy, Budget 2017 also provides \$241 million over the next 11 years to the Canada Mortgage and Housing Corporation (CMHC) to improve data collection and analytics. This will strengthen CMHC's ability to identify gaps and provide a continuum of flexible policy and program responses built upon best evidence of what will produce desired outcomes.

Recommendation 4: ***The Government of Canada ensure that further changes to Canada's mortgage regulations do not occur until sufficient time has passed to assess the effects of the 3 October 2016 changes to those regulations.***

The Government acknowledges that it will take time for the full impact of the changes announced in October 2016, as well as measures introduced by other levels of government, to materialize, and is carefully monitoring market developments.

The Government has a responsibility to identify and contain risks in the household sector to promote the financial security of individual Canadians and the broader stability of the housing market, financial system and economy. Adjustments to mortgage insurance rules also protect taxpayers who ultimately back government-backed mortgage insurance.

The overall Canadian housing finance system is sound. There is a strong regulatory framework in place for mortgage lending in Canada, with prudential regulation applying to a vast majority of mortgages, and strong underwriting standards. Nevertheless, high levels of indebtedness warrant proactive and prudent management of evolving housing-related vulnerabilities and risks.

Highly-indebted households are the most vulnerable to changes in economic conditions, such as unemployment, that could see them have difficulty making their debt payments and consequently have to reduce their consumption or risk losing their housing. Highly-indebted households are also more sensitive to potential declines in house prices. International research has found that highly-indebted households cut-back their spending to a greater degree in response to declining house prices than those with lower debt levels. Declining spending among these households results in feed-back effects on the broader housing market and economy, which could lead to further declines in consumption and economic activity.

As the Bank of Canada describes in its regular *Financial System Review*, high household debt and housing market imbalances are vulnerabilities that could exacerbate the impacts of an adverse shock to the economy. While the probability of a severe shock occurring is considered low, if it materialized, the impacts of the shock could be significant given the pre-existing vulnerabilities in household balance sheets and housing markets. This is why the Government has been actively engaged in monitoring these vulnerabilities and has taken measures to contain them.

Preliminary data received since the Government implemented its most recent adjustments to mortgage rules in October 2016 suggest that the rule changes are having their intended effect. A decline in the share of new insured loans issued to highly-indebted borrowers suggests that the quality of credit is improving in the high-ratio mortgage market. This development helps to ensure that Canadians are taking on mortgages that they can afford.

The Government is aware that market participants require time to adjust to the evolving regulatory framework and intends to continue to monitor developments in Canada's housing and mortgage markets. The Government will also continue to consult regularly with a broad range of stakeholders, including large and small lenders, mortgage insurers, and other parties active in the housing sector, as well as with the various federal financial sector agencies and CMHC. Stakeholders may also submit their view to the Government at any time.

Recommendation 5: ***The Government of Canada endeavour to ensure that mortgage regulations treat all mortgage lenders fairly.***

The Government agrees with the Committee that robust and sustainable competition is an important feature of a healthy housing finance environment. Competition in mortgage markets can increase innovation in mortgage products, drive efficiencies and help borrowers benefit from lower mortgage pricing.

The Government maintains significant support for the housing finance system to foster competition. Mortgage insurance and CMHC's securitization programs are available to many lenders, but particularly benefit smaller lenders with less diversified or cost-competitive private funding sources through low-cost reliable funding. This allows these lenders to continue to compete in the Canadian mortgage marketplace. Other features of CMHC's securitization programs are structured in a manner to support small lenders, such as through its allocation methodology and the pricing structure for guarantee fees. These elements remain in place following the October changes, and continue to promote mortgage market competition.

One element of the Government's set of measures announced in October 2016 aimed to bring consistency to mortgage insurance rules by standardizing eligibility criteria for high-ratio and low-ratio mortgages. The revised eligibility criteria will help target the funding support provided by government-backed low-ratio mortgage insurance towards safer forms of lending. Lenders will continue to be able to access government-sponsored securitization programs for mortgages that conform to the updated eligibility criteria. Lenders can also continue to provide loans that do not meet the new requirements, but will have to use non-government backed funding channels. This will promote the assessment and pricing of potential housing risks by the private market, provide greater market discipline, and could foster the development of private mortgage funding markets.

The Government is committed to making sure that Canada's housing policy framework remains healthy, competitive and stable, and protects Canadians and the economy from potential excess housing market volatility. Ultimately, the long-term financial security of Canadian families depends on sustainable debt levels and stable housing markets.

I would like to thank the Committee for its consideration of this important matter.

Sincerely,

The Honourable William Francis Morneau, P.C., M.P.

[i] *Minister Morneau Announces Preventative Measures for a Healthy, Competitive and Stable Housing Market*, October 3, 2016:
https://www.fin.gc.ca/n16/16-117-eng.asp

[ii] Government of British Colombia – *Additional Property Transfer Tax* (announced in July, 2016):
http://www2.gov.bc.ca/gov/content/taxes/property-taxes/property-transfer-tax/understand/additional-property-transfer-tax
City of Vancouver – *Empty Homes Tax* (announced in September, 2016)
http://vancouver.ca/home-property-development/empty-homes-tax.aspx
Government of Ontario – *Fair Housing Plan* (announced April, 2017)
https://news.ontario.ca/mof/en/2017/04/ontarios-fair-housing-plan.html

[iii] The working group consists of representatives from the federal government, two provinces (Ontario, British Columbia) and two municipalities (Toronto, Vancouver). Federal participants include the Department of Finance, the Bank of Canada, the Office of the Superintendent of Financial Institutions, the Canada Mortgage and Housing Corporation, and Statistics Canada.

[iv] In addition, the Canada Revenue Agency will dedicate resources to ensuring compliance of the real estate sector in the GTA with tax laws, and will work with the Province of Ontario to obtain enhanced land registry data to help support tax compliance activities in the GTA. Through the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), the Government is also working to ensure compliance with anti-money laundering rules.

[v] The Home Buyers' Plan allows first-time buyers to withdraw up to $25,000 from their Registered Retirement Savings Plan (RRSP) to buy or build a qualifying home. Unlike regular RRSP withdrawals, Home Buyers' Plan withdrawals are not included in taxable income when withdrawn. Amounts withdrawn must be repaid to an RRSP over a period of no more than 15 years.

The First-Time Home Buyers' Tax Credit is a $5,000 non-refundable income tax credit amount to assist first-time home buyers with the costs associated with the purchase of a qualifying home providing maximum federal tax relief of $750.

[vi] The Government backs 100 per cent of the mortgage insurance obligations of the Canada Mortgage and Housing Corporation (CMHC), a federal Crown corporation, and backs private mortgage insurers' obligations to lenders, subject to a deductible charged to the lender equal to 10 per cent of the original principal amount of the loan.

[vii] As per the National Household Survey (2011).