Ontario Real Estate Association

99 Duncan Mill Road
Don Mills, Ontario M3B 1Z2
Telephone: 416-445-9910
Fax: 416-445-2644
Toll Free: 1-800-265-OREA (6732)
www.orea.com

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

Dear Mr. Easter:

We are writing to the Standing Committee on Finance, and to you as Chair, to share our perspective on making home ownership affordable and accessible to Canadians, and on the need for reforms in mortgage regulation to achieve this.

The May 23, 2019 letter submitted to your Committee by Mr. Evan Siddall, President & CEO of the Canada Mortgage and Housing Corporation (CMHC), criticized the views of the Ontario Real Estate Association (OREA), Mortgage Professionals Canada (MPA) and the Canadian Home Builders' Association (CHBA) on several mortgage-related topics, and offered his opinion that our proposals would not benefit Canadians.

Since then, it has been reported that MPs continue to express interest in the kinds of changes we have recommended, and Mr. Siddall has made additional public comments on the same matters. Given the continued interest in these issues, we believe that your committee, and the public, deserve to hear our proposals and the reasoning behind them, directly from us. We hope that a more thorough explanation of our case can be helpful if the government addresses these issues over the summer, or alternatively as all parties take positions on home ownership and affordability in the coming election campaign.

In his letter, Mr. Siddall also claimed we have bad motives for advancing our policy recommendations, and he has done this even more pointedly in other forums. We believe that our observations and recommendations are supported by solid evidence and reasoning, and ask only that you consider them on their merits. We will address Mr. Siddall's position and arguments on the same basis.

Mr. Siddall focused on two areas of policy: 30-year amortization terms for insured mortgages, and the damaging consequences of the OSFI "stress test" for home buyers. Before addressing each of these specifically, it is important to note that the barriers to home ownership are not imaginary. To the contrary, they are having broad, measurable consequences across Canada, especially in large housing markets.

In the decades following World War II – and in fact even before that – the rate of home ownership in Canada grew, year after year. This reflected growing prosperity, as Canadians have always overwhelmingly chosen to own a home when they could afford to do so. Indeed, home ownership is the biggest financial dream of millions of Canadians, and the reason they work so hard in the first place. Political parties shared a consensus – we believe they still do – that encouraging home ownership is a valid and important public policy goal, because it matters to Canadian families, and because home ownership is associated with a host of beneficial economic and social outcomes.

But very recently, that generations-long trend of increasing home ownership reversed. In 2016, for the first time in most of our lives, StatsCan reported that the rate of home ownership had <u>fallen</u>, to 67.8%, down from 69% five years earlier. This was not a cyclical downturn; it occurred during a period of economic growth. It was not prompted by high interest rates; on the contrary, interest rates were at historic lows.

Rather, Canadians, especially young Millennial families looking to buy their first homes, now face structural barriers to home ownership that won't go away on their own. Canadians recognize that the dream of home ownership is slipping away for too many. In Ontario, 81% agree that owning a home is more difficult for young people than it used to be. And the evidence shows they have good reason to believe that. Nearly half of Ontario Millennials between 20 and 34 years old are living at home with their parents. In fact, for the first time in over a century, living with Mom and Dad is *the most common* living arrangement for adults in that age group.

The decline in home ownership has multiple causes and getting home ownership growing again is going to take a coordinated program of policy changes, at every level of government. That program of support for home ownership should start with urgent action to reverse policy changes that deliberately and unnecessarily made it harder for families to borrow responsibly to buy a home.

Supporting choice: restoring the option of 30-year insured mortgages

The federal government can start by acting immediately to restore the option of 30-year mortgages for people with insured mortgages. 30-year mortgages are common in other countries. In fact, they are common in Canada, with about half of uninsured borrowers opting for 30-year amortization.

What is the public policy reason to deny insured borrowers a 30-year option? Mr. Siddall says in his letter that allowing 30-year mortgages would "stimulate increased borrowing". But this is simply begging the question. When government removes <u>any</u> arbitrary and unnecessary barrier to buying and financing homes, that leads to more buying and financing of homes. The relevant question is whether the barrier is justified on its own merits, and this one is not.

Compared to uninsured borrowers, insured borrowers are disproportionately younger families, and disproportionately people buying their first homes – people with more years in the workforce still ahead of them. It is entirely reasonable for some of them to consider a longer amortization period in order to become home owners earlier. And there is certainly no policy reason why uninsured borrowers are capable of making that choice for themselves, but insured borrowers somehow are not.

We support measures, including appropriate stress tests, to ensure that people do not take on mortgages they cannot afford. However, a blanket prohibition on 30-year insured mortgages, even for people who demonstrably can afford them, is not a targeted or well-supported way to achieve that. On the contrary, the ban on 30-year insured mortgages is unjustified and should be eliminated at the earliest opportunity.

Mortgage stress tests need to be reconsidered

There is little question that the expansion of harsh mortgage "stress tests" has had a negative effect on home buyers. Housing resales in Canada were 11% lower in 2018 than in 2017. While different analyses reach different conclusions about the extent to which this was exacerbated by stress tests, no one denies that stress tests have been a meaningful factor, or that the impact has been negative. Mr. Siddall himself was recently quoted in the *Globe and Mail* acknowledging that the stress test has contributed to the decrease in home sales, although in his personal view "[t]he fact that people are getting laid off in the long run doesn't make it a bad thing".

What Mr. Siddall fails to acknowledge is the negative impact of dramatically slower home resales on home buyers, especially Millennials looking to buy their first homes. When fewer families upgrade, fewer existing starter homes are available for new home owners entering the market. This compounds the shortage caused by insufficient new housing starts. There are many reasons why housing starts are too low to generate adequate new housing supply, some of which we will address later. But the decreased buying power caused by harsh stress tests is certainly one relevant factor, and the effect is certainly negative.

Unlike the prohibition on 30-year insured mortgages, which we believe is entirely unwarranted, we believe that mortgage stress tests address a legitimate public policy goal – it is appropriate to set standards to ensure that Canadians do not take on mortgages they cannot afford. However, the implementation of the stress tests has been disastrously flawed. The federal government should act quickly to fix the damage in two ways: by removing the stress test for mortgage renewals, and by moving to a more flexible and reasonable test than the current one that tests an arbitrary two per cent hypothetical interest rate increase.

Stress tests for mortgage renewals should be eliminated

The story told by supporters of harsh stress tests is that they prevent families from defaulting, or from otherwise becoming financially overextended, by taking on mortgages they cannot afford. But applying a stress test to the renewal of an existing mortgage has the opposite effect. The purchase is already made, and the owner is already in the home. When a family renews a mortgage, they're shopping for the best rate and terms for an existing obligation. If that family fails to clear the regulator's arbitrary stress test – a test invented long after the family likely bought the home – the effect is merely to prevent competition, by locking the family into renewing with the current lender, at whatever rate that lender offers. Even if the family could have gotten a better rate from another willing lender by shopping around, the stress test prevents this, *thus making the mortgage payments even less affordable*.

Mr. Siddall complains in his letter that we have not given him and other proponents of this policy the benefit of the doubt, by calling this an unintended consequence of an over-broad scheme. On the contrary, he insists, making mortgage renewals more expensive for people who fail a stress test is a <u>deliberate</u> consequence of the policy. He says that while "at first glance, this seems unfair", in fact he believes it is appropriate. We take him at his word that this is what he believes and foresaw, but strenuously disagree with his conclusion.

His argument is not that we are wrong that the effect is to suppress competition, and to charge people higher rates for mortgage renewals. Indeed, Mr. Siddall says "OSFI doesn't want to stimulate competition" for mortgage renewals by people who do not pass the current stress test, and that "lenders must… re-price these exposures" (which is to say, they must raise people's interest rates and mortgage payments). This is positioned as a quid pro quo for requiring the incumbent lender to offer renewal terms, rather than "refusing to renew."

But it is cold comfort to the financially stressed family that their bank can offer them an unaffordable payment instead of none at all, nor are they likely to be grateful that the government is protecting a bank's ability to charge them more, instead of their opportunity to shop for the best rate. Remember, what the regulator is forbidding that family to do is to renew at the best rate a willing lender is prepared to offer; in other words, it is enabling (indeed, encouraging) the incumbent bank to charge an <u>above-market</u> rate. If this is consumer protection, it has gone badly awry.

Stress test calculations should be more flexible

While we agree with the concept of stress tests for new mortgages, the design of those stress tests is critically important. The current design, testing people's current income against an interest rate two percentage points higher than current rates, is far too harsh, especially for people who opt for longer-term, fixed-rate mortgages. There is no reason to insist that someone with a five year, fixed-rate mortgage must be able to pay, with their income right now, a rate two points higher than what they've just agreed to pay for the next five years.

This reflects sound economic analysis. Will Dunning, Chief Economist for the Mortgage Professionals of Canada, notes: “the stress tests are concerned with mortgage borrowers’ ability to make payments once they renew their mortgages (which will usually occur in five years). The tests include a low-probability event (that in five years interest rates will be two points higher) but ignore a high-probability event (that the borrower’s income will be at least 10% higher).” Indeed, Mr. Dunning notes that over the last 20 years, the average Canadian wage has increased every year, with an average annual growth of 1.6%, yet “the stress tests assume that there will be no income growth”. And the improbable scenario in which the economy is so strong that interest rates increase two per cent makes it *even more likely* that incomes would grow.

Of course, an individual borrower’s future income is not entirely unforeseeable, or wholly at the mercy of broad economic trends. Some families reasonably expect higher future incomes; for example, resuming full-time employment after a maternity leave. They judge their expectations and risks in this respect when they buy a home and take out a mortgage, just as they consider the risk of losing their job, or any of a hundred other factors not directly considered in a mortgage stress test. For the government to make rules based on the assumption that your income in five years will be identical to your income today (not even growing with inflation) is flatly wrong at the level of the overall economy, and unacceptably clumsy at the level of an individual family.

What should be done? First, the stress tests should be made more flexible, especially by recognizing that different kinds of mortgages have different levels of risk. A five-year fixed rate mortgage should not be subject to the same risk assessment and stress test criteria as a short-term, variable rate mortgage. Indeed, the main reason to choose the fixed rate mortgage is to manage risk.

Second, the overall stress test should be much less harsh, for the reasons Mr. Dunning and other analysts have identified. No analytical support has been provided for the two per cent threshold, and Mr. Siddall himself has recently defended it merely on the dubious grounds of simplicity, saying “when you’re trying to convince a minister to make a decision, you ought to make it simple… and you don’t want to have to go back and have the conversation too many times.” We find it difficult to believe that the Minister of Finance would be unwilling to offer the time required to approve the best-supported policy, especially on a rule that affects hundreds of thousands of families making the biggest financial decisions of their lives. And when the original, arbitrary decision is causing harm, it should be revisited, even if that injures a public servant’s pride.

The government needs to act quickly, to begin to reverse the damage of the current, excessive stress tests, which reduced buying power for home buyers by 20 cents on the dollar. Even in an otherwise strong economy, these stress tests have contributed to a dramatic slowdown in resales of homes and have put negative pressure on housing starts. At the same time, they have driven more buyers to alternative lenders that are not federally regulated. Whether or not this result was unintended, it certainly undermines the stated goal for the stress tests of reducing risk for borrowers, and for the overall economy.

Canada needs a bold program to restore the dream of home ownership

Both of the measures we have discussed here, restoring the option of 30-year terms for insured mortgages, and fixing the broken mortgage stress tests, can play a big role in reversing the recent decline in home ownership rates. But they are not enough.

At the same time, Canada needs decisive action to increase housing supply. In Greater Toronto, builders started 50% fewer ground-related housing units in 2016 than in 2002. All levels of government have a role to play in encouraging more supply. The federal government can contribute by offering underused federal lands for housing, and by providing incentives to expand infrastructure to support new housing development.

Other incentives to help families become home owners can also play a role. The First-Time Home Buyer Incentive is an encouraging step, although the eligibility criteria are likely to exclude most of the homes that are actually available in the markets where affordable housing is hardest to find. The catch-up increase in the RRSP savings that can be used for first-time home purchases is welcome; to prevent it falling behind again, the limit should be indexed to inflation.

Enabling more families to achieve the Canadian dream of home ownership has long been a goal shared by all parties, because it's a goal shared by nearly all Canadians. Seeing the rate of home ownership decline for the first time in living memory should be a wake-up call to us all. There are important steps for every government to take to reverse this alarming decline, including allowing 30-year mortgages for uninsured borrowers, and fixing the mortgage stress test. We look forward to working with all federal parties to get home ownership growing again.

Thank you for taking the opportunity to provide our recommendations to the Committee and please accept our best wishes.

Yours sincerely,

Tim Hudak, CEO
Ontario Real Estate Association

cc: Evan Siddall, President & CEO
CMHC