Low Ratio Mortgages in Canada, and B-20 Impacts

The Bank of Canada's (BoC) latest Financial Stability Report (FSR) and accompanying background research paper provided timely insight into the low-ratio mortgage market in advance of updated B-20 Residential Mortgage Guidelines, effective January 1.

The FSR includes an assessment of the potential impact of new OSFI guidelines, specifically the addition of a mortgage qualification stress test on low-ratio mortgages (those mortgages with loan-to-value ratios (LTV) of 80 per cent or less), which is similar to measures required of government-backed high-ratio mortgages in late-2016.

Secondly, using loan-level mortgage data, the BoC provided a deeper look low-ratio mortgage market (mortgages with loan-to-value ratios (LTV) of 80 per cent or less) over the 2014-2016 period, including borrower characteristics, loan-to-value distributions, and trends by major metro area. Their research examined mortgage data from federally regulated lenders, excluding credit unions, caisse populaires, other provincially regulated institutions, and other private lenders. Excluded mortgage information is more likely to be insured rather than uninsured, reflecting mortgage funding sources.

Data Highlights

The FSR provides a wealth of information related to the low-ratio market summarized below:

- Low-ratio mortgages market have risen as a share of new mortgage lending from 67 per cent in 2014 to 72 per cent in 2016, and closer to 75 per cent in 2017. Recent data points to a further shift to low-ratio mortgages following the late-2016 tightening of mortgage insurance requirements.
- Low ratio mortgages have more flexible underwriting criteria than insured product and eligible for extended amortization, and available for homes priced over $1 million which is important in higher priced markets like Toronto and Vancouver. The proportion of low-ratio mortgages clusters at about 80 per cent LTV, allowing buyers to save mortgage insurance fees and be eligible for looser underwriting criteria. This loosens debt constraints by lowering monthly carrying costs and allows allocation of income to other spending
- Demographics matter. Younger households are more likely to have high-ratio mortgages, reflecting lower incomes, less time to save down payments, lack of previous housing equity and relatively higher home values.
- Areas with strong house price growth exhibit higher proportion of low-ratio mortgages. One factor is higher share of homes valued over $1 million which is ineligible for mortgage insurance. Younger buyers are more reliant on family gifting.
- Regionally, low-ratio mortgage share is much higher in higher priced regions of Vancouver (90%) and Toronto (87%). Other regional markets show steady shares in 2016 relative to 2014 with Calgary at 64%, Montreal (68%) as examples.
- Vancouver (38%) and Toronto (34%) also have much higher loan-to-income ratios than the other cities examined, with Calgary at 21% being the next highest. The share of low-ratio mortgages in Vancouver and Toronto with amortization periods of greater than 25 years also dwarfs other markets.

Takeaways

OSFI B-20 Impacts

The Bank of Canada included an estimate of the potential impact of new stress test measures with a counterfactual approach. Based on data in the 12 months leading up to June 2017, the Bank estimated the number of mortgages which would not have qualified under the announced stress-test.

BoC estimated that 10 per cent of low-ratio mortgage loans nationally, would not have qualified under the announced stress test, with the ratio at 12 per cent in Vancouver and Toronto areas. The value of these mortgages nationally would be in the neighbourhood of $15 billion. In comparison, similar measures on government backed mortgages in 2016 impacted about 31 per cent of the high-ratio market, but represented a modestly higher $21 billion. This reflects a larger share of low-ratio mortgages in the overall market, and higher value of home sales. For the most part, those taking on low-ratio mortgages are not overextended, given the vast majority would still have qualified.

Stress tests ultimately lower risk of unsustainable household indebtedness and financial system risk but there are a number of caveats to the estimates. While stress tests will result in lower aggregate volume sales, the BoC has noted, as Central 1 has in the past, that buyer behaviour will adapt. Older households are better equipped to adjust, as they can draw on other savings or allocate other assets to bridge the down payment. Some households will buy lower priced homes, although others may delay purchases. That said, measures will likely hit low equity or first-time buyers harder in more expensive markets like Vancouver and Toronto.

Additionally, the measures do not explicitly disallow longer amortization for households although this would likely be frowned upon by OSFI. Borrowers may also shift mortgages to non-federally regulated institutions such as credit unions and caisse populaires which have about 17 per cent of the outstanding uninsured mortgages, or private lenders.

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