Structure of the Canadian housing market and finance system

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Overview

1. Defining characteristics of the Canadian housing finance system

Historically, the housing finance sector has not been a major source of risk to financial institutions in Canada and, more generally, to the stability of the Canadian financial system as a whole.

The Canadian housing finance market is national - ie lending conditions and mortgage products are similar across the country - and is largely dominated by domestic lenders, especially by a few well capitalised banks. The mortgage credit culture in Canada is rather conservative, with a large majority of mortgages at fixed interest rates and a preference for mortgage terms of five years. Interest bearing term instruments sold to savers remain the primary source of funding for mortgage loans, which subsequently remain largely on the balance sheet of lenders.

While the government's influence in the housing market is limited, it is more significant in the housing finance system, essentially through the Canada Mortgage and Housing Corporation (CMHC). The various government initiatives in this area have aimed to increase the supply of mortgage loans from private lenders. These initiatives have impacted the Canadian housing finance system, as reflected by the current significant share of *high ratio* mortgages - ie, mortgages where the down payment is lower than 25% of the value of the property and which must be insured - and by the recent trend towards increasing off-balance sheet funding based on mortgage-backed securities created from insured mortgages.

The regulation of housing finance activities in Canada, although set by different legal frameworks and under the charge of different regulators according to the type of mortgage lender, provides consistent requirements among lenders, notably in terms of the disclosure requirements to provide consumer protection. Regulation also provides protection to lenders against borrower default, as failure to abide by the terms of a mortgage loan agreement may permit the mortgage holder to take legal action to foreclose the mortgaged property.

2. Main developments and trends over the last 10-15 years

Housing prices in Canada have increased in the past four to six years, after a long period of stagnation. This increase, while modest compared to those observed in a number of countries, has been supported by rising mortgage indebtedness. This, however, has been accompanied by a downward trend in the debt service cost in the context of decreasing interest rates, as well as by a decline in the rate of default.

As competition in the housing finance market became more intense in the past few years, notably with the entry of new competitors in the late 1990s, Canadian consumers benefited from increasing choice in terms of rate and term options and payment features for their mortgage loans. The past five years have been characterised by a rise in the proportion of variable rate mortgages and in the proportion of mortgages with a term shorter than five years, as well as by the development of the subprime mortgage market.

The past few years have also been characterised by an increasing reliance on off-balance sheet funding, essentially based on mortgage-backed securities (MBSs) created from pools of mortgages

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insured under the National Housing Act (NHA-MBSs). NHA-MBSs currently accounts for 12% of total residential mortgage outstanding balances, compared to less than 2% in the early 1990s. Securitisation of conventional mortgage loans, however, remains marginal, totalling only 2% of mortgage outstanding balances in 2004.

Risk management practices of Canadian financial institutions have improved over the past 10 years, in the context of explicit standards set by the Office of the Superintendent of Financial Institutions (OSFI). In the specific context of mortgage lending risk management, lenders have increased their focus on borrowers' creditworthiness.

3. Policy-related questions

While the Canadian housing finance system reflects a generally conservative mortgage credit culture supportive of financial stability, the recent trend towards shorter-term mortgages, the growing popularity of flexible rate mortgages and the development of subprime mortgage loans, in the context of rising household indebtedness, raise a number of questions with implications for financial stability:

- Could these developments lead (some) households to become more vulnerable to interest rate movements?
- Could they exacerbate cyclical peaks and troughs in housing prices?

Background notes

1. The housing market

After an extended period of flat housing prices in the 1990s - following the burst of the late 1980s housing bubble - inflation-adjusted housing prices in Canada have increased over the past few years: by 36% since 1997 for the existing housing price and by 10% since 2001 for the new housing price index (see Figure 1 in Appendix). Recent movements in disposable income and interest rates have supported rising housing prices: real disposable income per capita has steadily increased since 1997 (by more than 12%) and mortgage rates have gradually declined over the past decade, reaching historical lows in 2004.[2] This resulted in a sustained rise in residential mortgage credit (+38% over the past five years) and contributed to the steeper upward trend in the debt-to-disposable income ratio since 2001. Despite rising household indebtedness, the debt service ratio has been decreasing steadily over the past few years and currently remains near historical lows (see Figure 2 in Appendix).

The combination of tight rental markets (Table 1) and stagnant housing markets during the 1990s raised the relative cost of renting versus owning, as illustrated by the continual increase in the accommodation ratio during the 1990s (see Figure 3 in Appendix).[3] This, combined with low mortgage interest rates, made home ownership more attractive, and propelled more and more first-time buyers into the housing market, thereby contributing to rising housing prices.[4]

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[2] See the Bank of Canada *Financial System Review* of December 2004 for an assessment of housing price developments in Canada.

[3] The accommodation ratio is equal to the rented accommodation component of the CPI divided by the owned accommodation component of the CPI. The former is the total cost of renting - rent, tenant's insurance premiums and maintenance and repairs - and the latter is the total cost of owning - replacement cost, mortgage interest cost, homeowner's insurance premiums and maintenance, repairs and other owned-related expenses.

[4] It can be noted that, while first-time buyers are driving some local housing markets, the current strong housing markets across Canada are supported by both first-time buyers and move-up buyers (see, for instance, Royal-Lepage *First-Time Homebuyers' Report*, 2004 and 2005).

Table 1

Rental vacancy rates in privately initiated apartment structures with at least three units

In per cent

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Canada	4.8	4.9	4.7	4.5	4.5	4.5	4.0	3.2	2.2	1.7	2.1	2.2	2.7
Montreal	7.7	7.7	6.8	6.2	5.7	5.9	4.7	3.0	1.5	0.6	0.7	1.0	1.5
Ottawa	1.3	1.8	2.6	3.8	4.9	4.2	2.1	0.7	0.2	0.8	1.9	2.9	3.9
Toronto	2.2	2.0	1.2	0.8	1.2	0.8	0.8	0.9	0.6	0.9	2.5	3.8	4.3
Vancouver	1.6	1.1	0.8	1.2	1.1	1.7	2.7	2.7	1.4	1.0	1.4	2.0	1.8

Source: CMHC (*Canadian Housing Observer* 2004).

This resulted in a rise in home ownership, the most prevalent housing tenure form in Canada. The home ownership rate thus grew from 63.8% in 1996 to 66% in 2001, the largest increase for any five-year period dating back to 1971.[5]

The Canadian housing market is influenced by the various levels of government, especially by the federal government through CMHC. The direct influence of the government in the housing market, however, is relatively small in that a large majority - 94% - of the Canadian housing stock is owned privately (by individual owner-occupiers, private sector organisations and investors), while the social housing stock - composed of rental units targeted to low- and moderate-income households provided under a variety of programmes - represents only 6% of the Canadian housing stock.[6] A very small fraction of Canadian homeowners benefits from governments' direct subsidy assistance, which is targeted to low-income households in rural or remote locations.

The government, however, influences the housing market indirectly through several federal government minor "tax relief" measures to support home ownership. These measures include, notably, a rebate for part of the federal Goods and Services Tax (GST) on the purchase price (or cost of building) of a new house or of a substantially renovated house,[7] and the Home Buyers' Plan (HBP), which allows first-time home buyers to withdraw up to $20,000 from their Registered Retirement Saving Plans (RRSPs) without income taxation on these withdrawals.[8]

With respect to taxation, housing is treated as a consumer good when used for owner-occupancy purposes: there is no taxation on capital gain in the case of the sale of a property used as principal residence, there is no tax on imputed rental income, and property taxes and mortgage interest payments are not deductible from income. Houses used for rental purposes, however, are treated differently. First, mortgage interest payments and some of the fees associated with contracting a mortgage to buy or improve a rental property are tax-deductible. Second, rental loss can be deducted - under certain conditions - against other sources of income and rental income is subject to capital cost allowances. Finally, all or part of the capital gain made when selling a house used for rental purposes is taxable.

[5] While more recent data are not available, we can reasonably expect that the home ownership rate increased further in the past three years as many new homeowners entered the housing market during this period of time.

[6] The 1970s and 1980s marked the end of the era of public housing owned and operated by the Government of Canada. While the federal government - through CMHC - continues to be involved in measures to improve housing conditions for low-income and disabled Canadians, its approach to social housing is more indirect, essentially through housing assistance programmes which subsidise housing units managed by provincial and municipal housing agencies or by local non-profit organisations on a cost-shared basis with these agencies.

[7] Some provinces also provide rebates or partial exemptions of provincial sales tax for new housing construction.

[8] The withdrawals from the RRSPs must be repaid over a 15-year period.

2. Borrowing and contract types

The Canadian housing finance market is national - ie mortgage credit is accessible across Canada on similar terms and conditions - and is shared between various financial institutions: chartered banks, credit unions and caisses populaires, finance and non-deposit-taking companies, life insurance companies, pension funds and trust and mortgage loan companies.

Competition in the housing finance market became more intense in the past few years, notably as banks - the largest providers of mortgage credit - increased their focus on the retail sector and as new competitors entered the Canadian housing finance market. This resulted in greater choice for consumers in terms of rate and term options and in terms of payment features (Table 2).

Table 2

Mortgage characteristics

Characteristics	2000s
Terms and rates	Closed, open and convertible mortgages. Variable rate, multi-rate or fixed rate mortgages. Six-month, one-, two-, three-, four-, five-, seven- and ten-year mortgages.
Payment options	Monthly, biweekly, weekly and accelerated payment options.
Prepayment	Prepayment provisions included in mortgage contracts vary among lenders. Examples: annual lump sum of up to 20% of the outstanding balance, or doubling-up of a monthly payment or increase in the periodic payment amount. Total prepayment of the mortgage before the end of the term is possible but generally subject to a penalty.
Portability and blend-and-extend	Portability and blend-and-extend options, which were not available until recently, allow consumers to avoid prepayment penalties.

Mortgage loans in Canada are typically amortised over a 25-year period, with mortgage terms running from six months to 10 years. Five-year mortgages continue to be the most popular, but there has been a recent trend towards shorter-term mortgages (Figure A). This trend can be explained, at least partly, by the larger decrease in shorter-term mortgage rates - which are more directly influenced by the monetary policy rate - than in longer-term mortgage rates - which are priced off Government of Canada bond yields - in the recent past.

Another noteworthy trend supported by the decreasing interest rate environment is the growing popularity of variable rate mortgages, which now account for about 30% of all residential mortgages (compared to less than 5% in 1999). In this context, financial institutions developed mortgages with options offering protection against rising interest rates, eg capped rate mortgages or an option to lock into a non-variable fixed-term mortgage with no penalty at any time. Moreover, in making their credit decision, financial institutions use various interest rate scenarios to assess the sensitivity of borrowers to rising interest rates, to ensure that their customers would be able to face an increase in their financial obligations if interest rates were to rise.

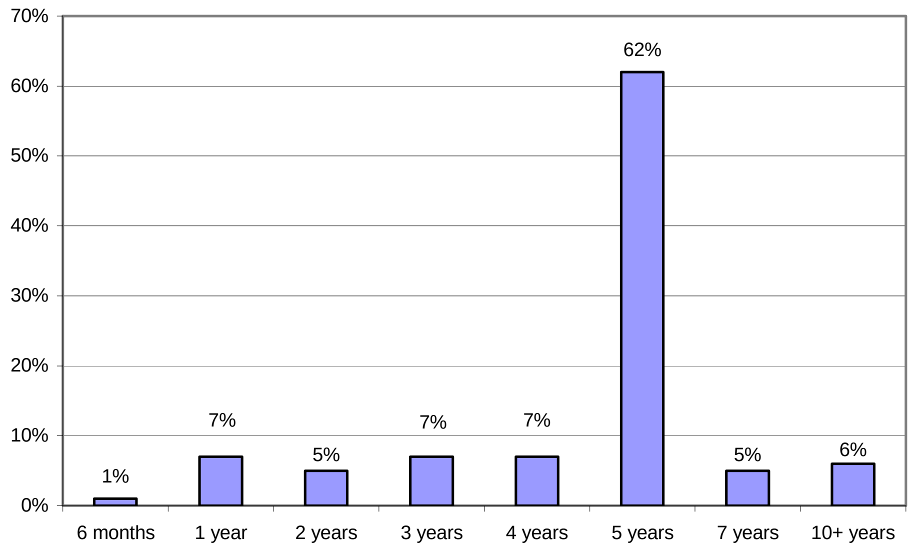
The entry of new competitors - virtual banks and mortgage brokers[9] - into the Canadian mortgage market has resulted in another trend in housing finance over the past five years: mortgage rate discounting. Whereas virtual banks and mortgage brokers use an “everyday low price” strategy, major Canadian banks offer *posted* rates, which they discount on a customer-by-customer basis. While discounts offered by major banks from their posted rates were modest in size (about 25 basis points)

[9] Mortgage brokers in Canada do not originate mortgage loans, but simply bring borrowers and lenders together. They are thus able to offer a competitive rate to customers without negotiation thanks to the volume pricing. In most cases, the ultimate lender is one of the six big Canadian banks. In 2003, 26% of all home buyers reported using a mortgage broker, compared to 14% in 1999, according to a CMHC survey.

and were offered to a minority of new customers in the early 1990s, mortgage discounting for big banks' customers has become standard practice and it is now relatively common for customers with good credit to obtain large discounts (of 125 basis points or more) from the posted five-year mortgage rate. At the same time, however, major banks' posted rates appear to have increased since the late 1990s. Therefore, the increase in discounts has not led to a decrease in the effective mortgage rate, ie the posted rate minus the discount. Rather, it seems that the maximum discounted rate offered by banks is now broadly in line with the rate offered without negotiation by virtual banks and mortgage brokers.[10]

Figure A

Mortgage term, as of June 2005[1]



[1] Includes variable and fixed rate mortgages by term of contract.

Source: Clayton Research and Ipsos-Reid, *FIRM residential mortgage survey.*

The final recent trend in housing finance in Canada relates to the development of the subprime mortgage market.[11] While subprime mortgage loans represent a small fraction of the mortgage market in Canada (estimated to be less than 2% of the total mortgage loan outstanding in 2005 Q1), many of the niche lenders which offer subprime mortgage loans have experienced rapid growth in the past five years.[12] To date, subprime lenders in Canada have mainly focused on the near-prime market, often referred to as "Alt-A" or "A minus", ie borrowers with a good credit history but limited documentation regarding their income or employment. This, associated with the current benign economic environment, may help to explain the low level of delinquency rates on subprime loans in Canada compared to those in other industrialised countries.[13]

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[10] For more details, see the Bank of Canada June 2005 *Financial System Review*, pages 26-28.

[11] For more details, see the Bank of Canada December 2005 *Financial System Review*, pages 18-19.

[12] The vast majority of subprime mortgage loans are made through mortgage brokerages and their network of agents.

[13] The level of delinquency at Canadian subprime lenders is two to four times the level of delinquency for prime loans at the major banks. In contrast, the delinquency rate on US subprime loans is seven to eight times greater than for prime loans.

3. Lending and funding

The structure of the Canadian housing finance system has been historically influenced by the federal government. While this influence was direct in the two decades following the Second World War (direct mortgage lending by the government and interest rate ceilings regulation), it became gradually more indirect with the overriding objective of increasing the supply of mortgage money available from private lenders.

By federal law, financial institutions are allowed to extend conventional mortgages up to 75% of the value of a residential property. For high-ratio mortgages, ie mortgages where the down payment is less than 25% of the value of the property, mortgage insurance is required to protect lenders against borrower default.[14] Mortgage insurance can be provided by either a government agency or a private insurer approved by the Superintendent of Financial Institutions. While the Bank Act states that the insurance should cover the amount of the loan that exceeds 75% of the value of the property, in practice mortgage insurers insure the total amount of the loan. The Canadian mortgage insurance market is presently shared between CMHC - a Crown Corporation wholly owned by the Government of Canada - and one private sector firm, Genworth Financial Canada, which entered the Canadian mortgage insurance market in 1995. Both CMHC's and Genworth Financial's obligations carry an explicit government guarantee. Over the past few years, several changes were implemented with regard to insured mortgages. First, the required minimum down payment was dropped from 10% to 5% in 1992, which resulted in an increase in insured mortgages as a share of total mortgages. Next, both mortgage insurers have recently[15] broadened the eligible sources of funds for the minimum down payment, allowing it to be borrowed as opposed to coming from the borrowers' unencumbered funds. This resulted in increased incentives from banks to attract new customers eligible for these new "zero down payment" programmes.[16]

The accessibility to insured mortgages is restricted by the use of eligibility criteria: the mortgagor must satisfy two flow measures of creditworthiness (see Table 3) and must be able to pay closing costs equivalent to at least 1.5% of the purchase price.

Table 3

Eligibility criteria for mortgage loan insurance

Criteria	Description	Value
Gross debt service (GDS) ratio	– Principal and interest payments – Property taxes – Heating costs – Annual site lease in case of leasehold tenure – 50% of applicable condominium fees	Up to 32% of the gross household income
Total debt service (TDS) ratio	All payments for housing and all other debts	Up to 40% of the gross household income

The cost of mortgage insurance involves, then, two components: a fixed application fee and a mortgage insurance premium calculated as a percentage of the loan. The insurance premium paid by the mortgagor varies with the loan-to-value ratio and with the mortgage type (+0.25% variable rate mortgage surcharge) and can be paid either in a single lump sum or be added to the mortgage and included in the regular payments on the mortgage. Mortgage insurance premiums currently charged by the two mortgage insurers are broadly similar.

14 In its 2005 budget, the Government of Canada announced its intention to review the statutory restriction on insurance for residential mortgages exceeding 75% of the value of the property.

15 In 2003 for Genworth Financial; 2004 for CMHC's "Flex Down" programme.

16 To date, however, this option is only marginally used by borrowers.

Table 4

Snapshots of CMHC's basic insurance premiums over the past 20 years

%

Loan-to-value ratio	Mid-1980s		December 1995	November 2000	July 2003	March 2005 (currently in force)
	Existing houses	New houses				
Up to and including 75%	1.00	1.50	0.75	0.75	0.65	0.65
Up to and including 80%	1.50	2.00	1.25	1.25	1.00	1.00
Up to and including 85%	2.00	2.50	2.00	2.00	1.75	1.75
Up to and including 90%	2.50	3.00	2.50	2.50	2.00	2.00
Up to and including 95%	n.a.	n.a.	2.50	3.75	3.25	2.75
"Flex Down" programme	n.a.	n.a.	n.a.	n.a.	3.40	2.90

Currently, insured mortgages represent about 45% of total residential mortgage outstanding balances from chartered banks, compared to less than 30% in the mid-1990s, but down from a peak at 57% in 2000, as the recent strong housing market and low interest rates resulted in a rise of conventional mortgages largely led by moving-up buyers.

The Canadian residential mortgage financing market is presently dominated by chartered banks.[17] In 2004, banks provided more than 80% of total mortgage loan approvals. On a stock basis, banks accounted for more than 63% of total residential mortgage outstanding balances in 2004, compared to 38% in 1990 (see Figures 4 and 5 in Appendix). The change in the respective shares of banks and of trusts and mortgage loan companies from 1990 to 2004 is explained by the fact that many of the latter faced financial difficulties in the first half of the 1990s following troubles in commercial real estate, and were subsequently acquired by banks.

Deposit-taking institutions traditionally rely on Guaranteed Investment Certificates (GICs) and other similar interest bearing term instruments sold to savers to fund mortgage loans. Life insurance companies rely on the premiums they collect from their clients, while pension funds rely on the contributions made by their clients. Finally, subprime mortgage lenders securitise a greater share of their mortgages than major banks do.

While on-balance sheet lending remains the main source of mortgage funding, the past six years have been characterised by significant growth of off-balance sheet funding, especially of NHA-MBSs, ie mortgage-backed securities created from pools of amortised residential mortgages insured under the National Housing Act.[18] As a result, NHA-MBSs represented almost 12% of total residential mortgage outstanding balances in 2004, compared to less than 2% in 1990. Securitisation of conventional residential mortgages expanded at a more moderate pace and decreased over the past four years, after five years of gradual increase. According to a Moody's report, however, MBSs other than NHA-MBSs are expected to increase in the future as a number of ALT-A lenders - ie lenders focusing on

[17] The Canadian banking system is largely dominated by six big domestic banks (Toronto-Dominion Bank, Royal Bank of Canada, Canadian Imperial Bank of Commerce, Bank of Montreal, Scotia Bank and National Bank of Canada).

[18] Since mortgage prepayment options in Canada remain limited, and since most mortgages have a term of five years or less, the risk of prepayment to investors and issuers of MBSs is smaller than in the United States. Moreover, to take the prepayment options of mortgage contracts into consideration, CMHC offers several NHA-MBS pool types which address the prepayment risk of these mortgages, at least partly, by requiring an indemnity to be paid to the MBS investor in certain instances of prepayments.

borrowers with good credit but non-standard aspects such as self-employment - are now operating in Canada.[19]

This increased reliance on off-balance sheet funding results in part from the federal government's initiatives to improve the supply of low-cost mortgage funds in Canada: the introduction of the NHA-MBS programme in 1987 and the introduction of the Canada Mortgage Bond Program in 2001. A key feature of both NHA-MBSs and Canada Mortgage Bonds that makes them attractive to investors is the CMHC guarantee - on behalf of the government - of the full timely payment of principal and interest, regardless of the amount, in the case of mortgagors' default and/or NHA-MBS issuers' default. NHA-MBSs and Canada Mortgage Bonds are available for retail and institutional investors. They are also attractive for foreign investors as they are exempt from withholding taxes that investors living outside Canada must normally pay on interest.[20]

To manage the risks associated with housing finance, Canadian financial institutions rely on a combination of criteria, including flow measures of creditworthiness similar to the eligibility criteria used for insured mortgages (recall Table 3) and "risk rating measures" such as FICO scores, which summarise the credit history information of the borrower.[21] It is estimated that close to 75% of Canadian consumers have a good credit rating - above 700 - which translates into low delinquency rates (below 2% for FICO scores of 750 and up).[22]

The risk management practices of Canadian lenders are supervised by the Office of the Superintendent of Financial Institutions (OSFI), which, in the context of its Supervisory Framework, provides assessment criteria for risk management.[23] Both OSFI and the Canadian Deposit Insurance Corporation (CDIC) provide risk management guidelines in the context of their respective *Standards of sound business and financial practices*, which were improved at the end of the 1990s to align more closely with current concepts of, and operational framework for, risk management. The increased focus on the credit risk of borrowers has certainly been facilitated by the development of measurement tools such as FICO scores. Moreover, the mortgage insurance required for high-ratio mortgages insulates lenders from the risk associated with these specific mortgage loans, this risk being supported by mortgage insurers and, ultimately, by the federal government since mortgage insurers benefit from a government guarantee. It can be noted that mortgage loans in arrears (three months or more) for both conventional and insured mortgages have been declining over the past few years (see Figure 6 in Appendix), which can be viewed as reflecting the combination of a low interest rate environment and the improved risk management practices of financial institutions.

Finally, financial institutions offer income protection insurance to their clients, in the form of mortgage life protection - to pay off the outstanding balance in the event of death (generally with a ceiling) - and accident and/or illness mortgage protection - to pay the regular mortgage payments in the event of a disability (generally subject to a monthly ceiling and to a maximum period of time).

4. Regulation

Any institution providing mortgage loans must be approved and then supervised and monitored by a specific regulator. Although the legal framework and the regulator vary with the type of lender, consumers are protected through the legal requirement of full disclosure of borrowing cost included in the acts regulating the various mortgage lenders.

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[19] Moody's Structured Finance Special Report, January 2005.

[20] NHA-MBSs are sold for the most part to institutional investors. However, since the securities are sold through investment dealers, more detailed information about NHA-MBS holders is not available. Of the $55 billion of Canada Mortgage Bonds issued to date, 57% has been bought by Canadian investors, 22% by European investors, 17% by US investors and the rest by Asian investors.

[21] FICO scores range from 300 to 900. The higher the score, the better the credit history.

[22] These delinquency rates cover both consumer credit and mortgage credit delinquency rates. Delinquency rates on consumer credit are higher than those on mortgage credit, as illustrated by the very low - and decreasing - delinquency rate on mortgage loans (see Figure 6 in Appendix).

[23] OSFI introduced a new risk-based supervisory framework in August 1999, which is fine-tuned over time to ensure that supervisory practices remain effective and efficient in a rapidly changing financial marketplace.

Chartered banks are regulated at the federal level by OSFI; their legal framework - the Bank Act - requires the full disclosure of information related to mortgage loans (notably of borrowing costs). Credit unions and caisses populaires are provincially incorporated and are therefore almost exclusively regulated at the provincial level; their legislative and regulatory framework, however, generally parallels that of federal financial institutions such as banks. Life insurance companies are largely regulated at the federal level (by OSFI); the Insurance Company Act sets the same requirements as those faced by banks in terms of residential mortgage activities (maximum loan-to-value for conventional mortgages, mortgage insurance, full disclosure of borrowing costs). The vast majority of trust and mortgage loan companies are federally regulated by OSFI, and the Trust and Loan Companies Act includes disclosure requirements. Mortgage broker activities are regulated by provincial Mortgage Brokers Acts, which also include the obligation of disclosure to borrowers.

The establishment in 2001 of the Financial Consumer Agency of Canada (FCAC) - an independent federal regulatory agency - can be viewed as an additional step towards increasing consumer protection since the FCAC is specifically charged with enforcing many of the federal laws that protect consumers in their dealings with financial institutions.

Failure to abide by the terms of a mortgage loan agreement may give cause to the mortgage holder to take legal action to foreclose the mortgaged property. There exist two foreclosure procedures in Canada: judicial sale, ie a sale conducted under the supervision and authority of the court after the lender receives the court's permission to sell the property, and power of sale, which allows the mortgage lender to sell the property without the involvement of the court. Power of sale is used as the mortgage lenders' primary recovery method in Newfoundland, New Brunswick, Prince Edward Island and Ontario, while judicial sale is preferred in Alberta, British Columbia, Manitoba, Quebec and Saskatchewan.[24] In Nova Scotia, the foreclosure process is a mix of power of sale and judicial sale.

In practice, mortgage lenders may decide to start a foreclosure procedure when mortgage loans are in arrears for more than three months. Nevertheless, since foreclosure procedures are expensive and time-consuming, lenders may first try to reach an agreement with the mortgagors on an individual basis.

As illustrated by Figure 6 (Appendix), foreclosures on residential properties have been on a declining trend since the mid-1990s.

5. International links

The Canadian housing finance market is largely dominated by domestic lenders, although a small number of foreign financial institutions provide residential mortgage loans in Canada. While foreign financial institutions' market share is limited, totalling less than 6% of residential mortgages provided by all banks in Canada at the end of 2004, it has slightly increased over the past few years (Table 5) and is largely dominated by two foreign bank subsidiaries.

Canadian banks' mortgage lending activities are essentially focused on the domestic market. While four of the six big banks offer residential mortgage products in some international markets, their exposure to foreign countries remains limited.[25] It can be noted that some Canadian banks have tried to benefit from the recent consolidation trend in the US financial sector, with the acquisition of US banks (Centura Bank by RBC, Harris Bank by BMO, and 51% of Banknorth by TD). To date, however, the results of these US strategies have been mixed.

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[24] The judicial sale procedures, however, vary from province to province.

[25] Scotia Bank is the most active in foreign markets: it offers residential mortgage products in a wide range of countries around the world (in Mexico, the Caribbean, Malaysia and many South American countries).

Table 5

Residential mortgages provided by foreign bank subsidiaries and foreign bank branches as a percentage of total residential mortgages provided by all banks in Canada

	As of 31 December 2000	**As of 31 December 2004**
Conventional residential mortgages	5.42%	6.34%
Insured residential mortgages	1.09%	4.62%
Total	3.08%	5.61%

Source: OSFI, consolidated monthly balance sheets.

Finally, as mentioned before, NHA-MBSs and Canada Mortgage Bonds are made attractive for foreign investors as they are exempt from withholding taxes that investors living outside Canada must normally pay on interest. While information about foreign holders of NHA-MBSs is not available, we know that, of the $55 billion of Canada Mortgage Bonds issued to date, 43% has been placed with foreign investors.

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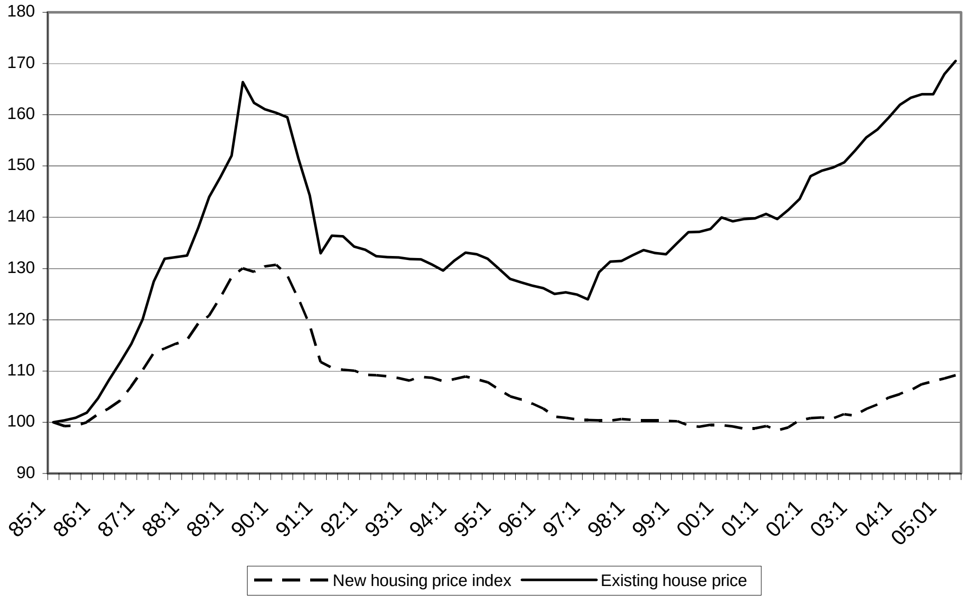
Appendix

Figure 1

Real housing prices

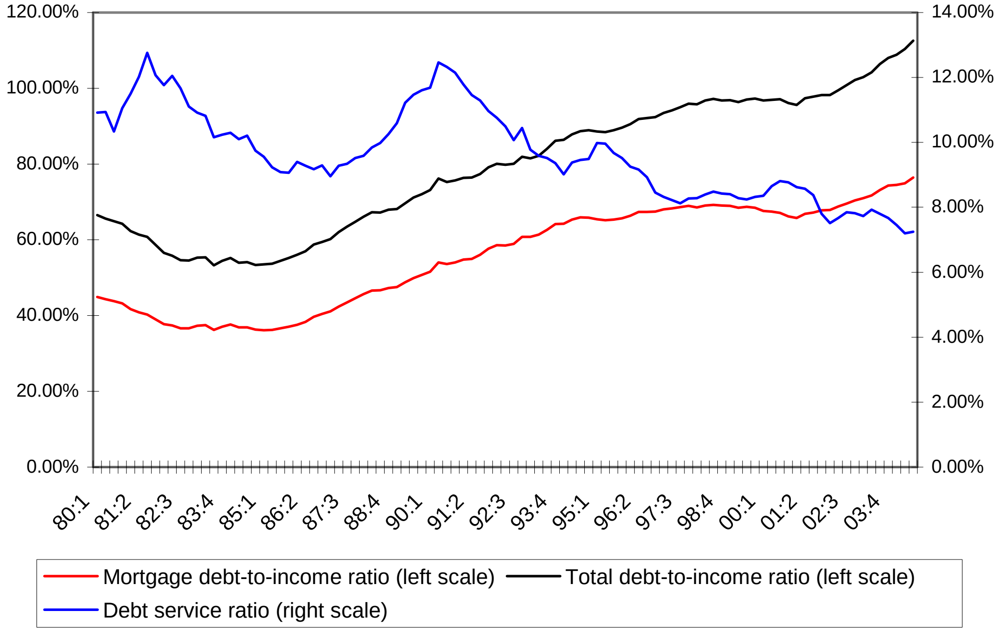
1985 Q1 = 100



Sources: Bank of Canada; Statistics Canada; Royal Lepage.

Figure 2

Debt-to-disposable income ratios and debt service ratio

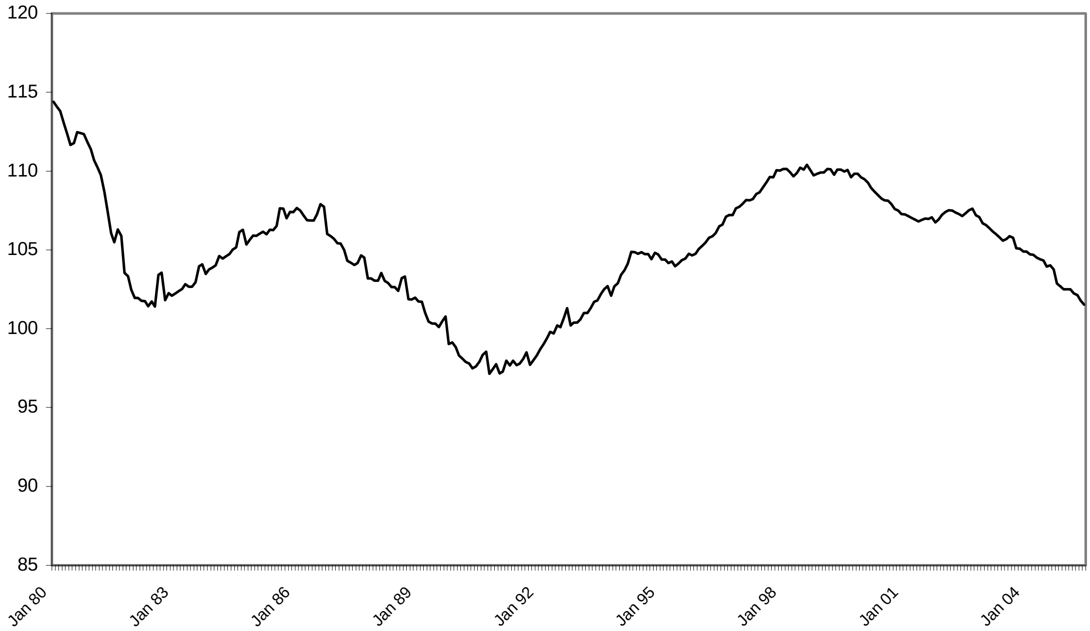


Source: Statistics Canada.

Figure 3

Accommodation ratio

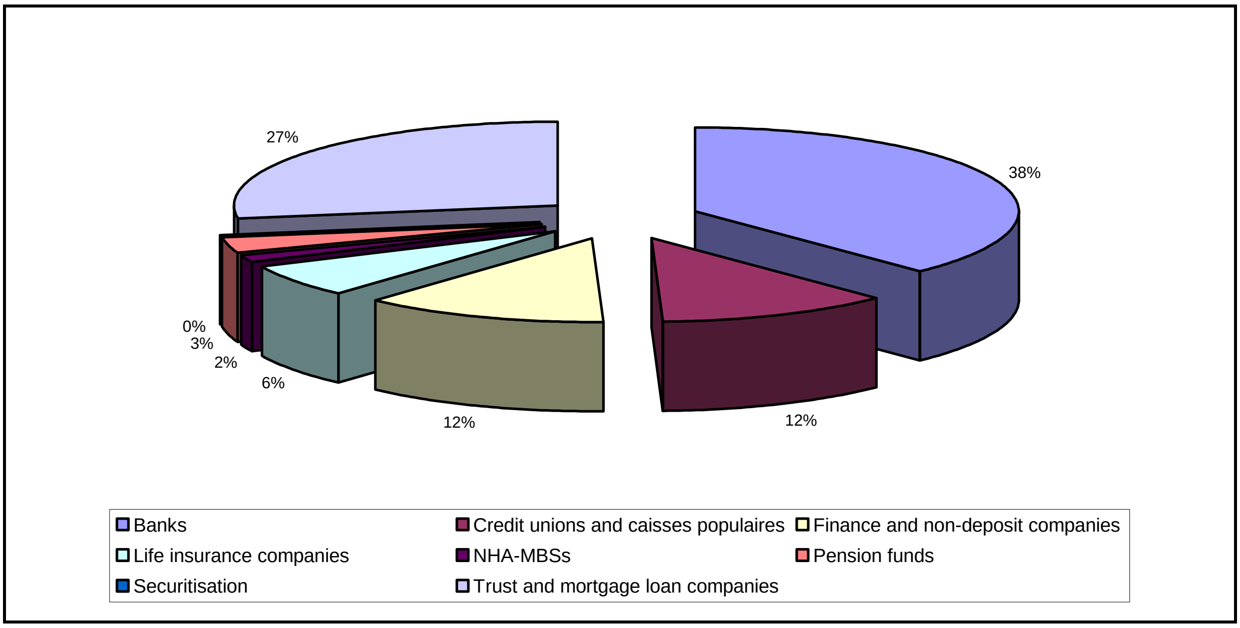
Rented accommodation to owned accommodation



Source: Statistics Canada.

Figure 4

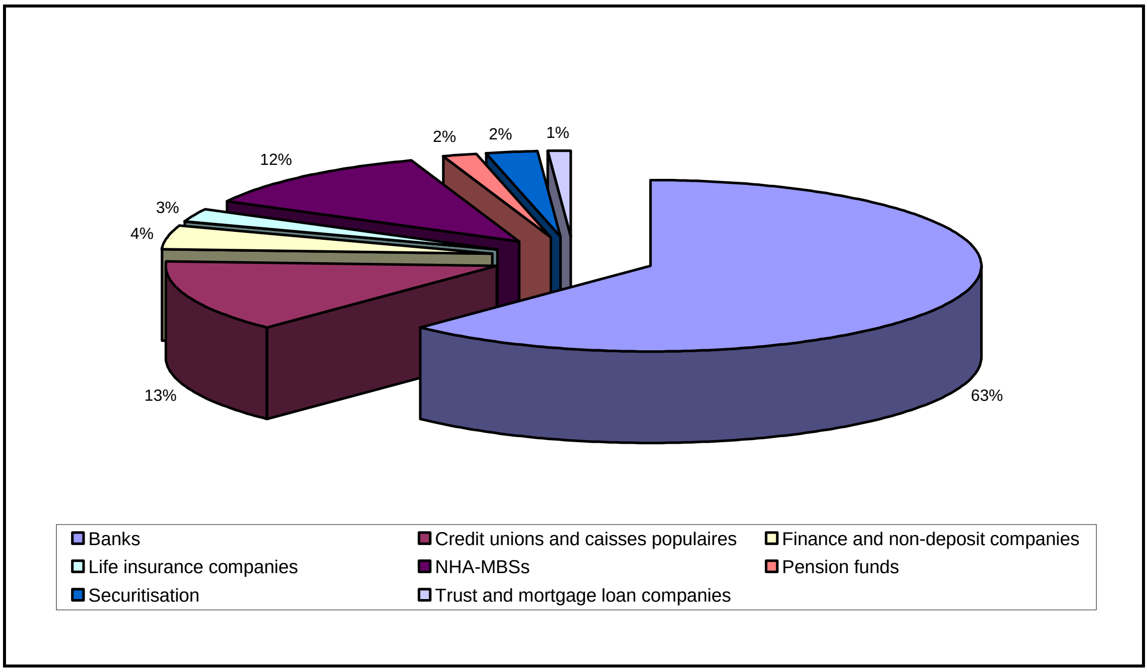
Residential mortgage outstanding balances by lender, 1990



Source: Bank of Canada.

Figure 5

Residential mortgage outstanding balances by lender, 2004



Source: Bank of Canada.

Figure 6

Delinquency measures on residential mortgage loans: mortgage loans in arrears (three months or more) and foreclosed mortgages