

Canadian mortgages stay 'boring but beautiful'

By Bernard Simon

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As London debates ways to reinvigorate the UK home-loans market and a crisis of confidence batters Fannie Mae and Freddie Mac in Washington, an air of quiet self-congratulation has pervaded the mortgage-finance industry a few hundred miles north in Canada.

Delinquency and foreclosure rates have scarcely risen. Risky subprime mortgages, the scourge of the US housing market, make up less than 5 per cent of Canadian housing finance. Though prices are starting to soften, bidding wars are still common on desirable properties in Toronto, Vancouver and Calgary.

In contrast to the uncertainty surrounding Fannie and Freddie, the US government-sponsored mortgage agencies, demand for mortgage-backed bonds issued by the Canada Mortgage and Housing Corporation is at record levels.

CMHC's recent global issues have been among the biggest single-tranche bond offerings in history.

The Canada Housing Trust, CMHC's main borrowing vehicle, effortlessly raised C\$12.5bn (\$12.2bn) last month, bringing total borrowings to C\$157bn since its inception in 2001. Foreign investors typically buy about a third of each quarterly issue.

Five-year Canadian mortgage-backed bonds are trading at 20 basis points below the dollar-denominated Libor rate, versus a negative spread of only 15 points for equivalent Fannie Mae bonds.

"The spreads on this business are tight but the risks are low," says Peter Routledge, a banking analyst at Moody's in Toronto, who describes Canada's approach to mortgage finance as "boring but beautiful".

Andrew Fitzpatrick, analyst at DBRS, another rating agency, observes that while Canadians may be more liberal than Americans in most walks of life, "Canadian mortgage underwriting standards have tended to be more conservative. I think it comes down to culture."

The contrast is reflected in some crucial differences in the two countries' mortgage lending practices and housing finance policy.

Adjustable-rate mortgages, which have crippled many US homebuyers, are virtually unheard of in Canada. The instruments tease US borrowers with low interest rates for the first year or two, but the rates then rise steeply. In Canada, home buyers usually opt for fixed-rate mortgages with five-year maturities and a 25-year amortisation period.

The ratio of loans to home values is lower in Canada than the US. While this does not necessarily affect delinquency rates, Mr Routledge says that it contains lenders' losses by providing more collateral in the event that the house is seized.

"There's less innovation in the market in part because of the standards set by CMHC," he adds.

In the US, Fannie and Freddie are publicly traded companies whose support from the government was, until last weekend, vaguely defined - and, indeed, much-debated.

There is no such ambiguity at CMHC, a government agency whose bonds are backed by an explicit government guarantee, giving them a triple A credit rating.

"We don't have the perception of a conflict of interest between maximising shareholder value and being an instrument of government policy," says Mark Chamie, the CMHC's treasurer.

Another important difference with the US agencies is that lenders are required by law to take out insurance on all mortgages where the downpayment is less than 20 per cent of the value of the house. Insurance is provided by CMHC and by private insurers.

"We're not getting into the subprime or alt-A mortgages," Mr Chamie says, referring to the lowest-quality categories. "If [the lenders] want to do that, they have to do it on their own."

In a move to prevent the US meltdown spilling across the border, the finance department tightened the rules for government-backed mortgages last week. The maximum amortisation period has been cut from 40 to 35 years, and a minimum 5 per cent downpayment is now required.

Besides holding down borrowing costs and keeping the market on an even keel, Mr Chamie says CMHC has succeeded in broadening competition beyond the big six domestic banks that have long dominated the mortgage market.

Only about six institutions were funded by the housing trust when it started in 2001, while 25 - including credit unions and specialised mortgage lenders - drew on last month's bond issue.

Australia's securitisation industry has urged its government to adopt the Canadian model as a way of reviving the near-frozen domestic mortgage-backed securities market. "Australia would benefit by creating a new structure that would issue higher-quality, government-guaranteed mortgage-backed bonds," an industry body said this year.

CMHC is now looking at ways in which the system can be improved. Possible changes include issuing bonds in foreign currencies and with a wider variety of maturities to attract even more investors.

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