MORTGAGE PROFESSIONALS CANADA

A Stark Reminder About My Own Limitations

Current events are reminding me very forcefully about the limits to my own knowledge and capabilities.

In the past, in these reports I have mainly provided backwards-looking comments about housing market and economic conditions. These can be useful because, much of the time, the recent past provides reasonable guidance on what we can expect for the near-future. Plus, I have offered some thoughts on how conditions might evolve (for example, my repeated comments that under-production of new housing will result in worsening shortages in future). Some smart and hard-working people are trying to create information that is useful in this moment, producing data on week-to-week changes in market activity. I confess that I am watching that closely and I find it really interesting. But, ultimately, I expect that this data is not going to help us answer the big questions, including how long is this going to last, how bad is it going to get, how much are prices going to fall, when will the recovery start, and what will be the shape of the recovery?

I also see some analysts offering forecasts. I look at those, but I confess that my reaction is deep skepticism. In another lifetime (on March 5), I gave a presentation in which I commented that when people do forecasts, they 10% tell us about the future and 90% tell us about the person who did the forecast.That might have been an exaggeration at the time, but today, I think it’s closer to being true.

I have a lot of opinions about how this might unfold. But, I understand that those opinions come from my biases and predispositions, rather than from real knowledge. So, at this moment, I am keeping those opinions to myself. We are going to get through this, marked by some bruises and some scars. The bruises and scars will be in multiple forms (emotional/psychological, financial, and to our bodies). Bruises heal quickly, and the housing market can bounce back quickly from them. But, scars heal much more slowly. I don’t know how badly we are going to be scarred by this, and therefore I have zero confidence that I can accurately predict what will happen in the housing market during the coming year.

That Said...

At this time, the most important economic discussions are about income security, as well as developing issues in financial markets. I am feeling very grateful to our governments for consulting very carefully with people in the front lines, and responding very rapidly to emerging issues. Eventually, the dangers will lessen and we can focus more on how to support economic recovery. The housing market is always a leading sector in upturns and downturns, and this time will be no different. Home buying and home building are very important generators of jobs, through their direct impacts and also through the activities that occur in industries that provide goods and services to the processes.

So, at some point we will need to, once again, talk about federal mortgage regulations. During the past decade, those policies have mainly inhibited home buying. (For discussion of this, you might look at “Annual State of the Residential Mortgage Market in Canada”, which can be found here: https://mortgageproscan.ca/docs/default-source/consumer-reports/housing-market-report---year-end-2019-(english).pdf).

I'm offering three thoughts to those future discussions.

Firstly, the mortgage stress tests, as currently defined, will be an unnecessary impediment that will prevent buying by some Canadians who will be very good candidates for home ownership. The tests will therefore impair the economic recovery. The arguments I've made in the past continue to apply now and during the recovery, including:

- The stress tests are based on an unreasonably high interest rate.
- They do not consider that income growth and repayment of principal will mute the impacts of future mortgage renewals.

In consequence, I suggest that the stress tests can reasonably use a qualifying interest rate of the greater of 3.5% or the contract rate plus 0.5%.

Secondly, 30-year amortization for insured mortgages continues to make sense. Even with 30-year amortization, repayment of principal is a very aggressive forced-saving plan. For example, at a rate of 2.7% (my opinion-estimate of today's typical "special offer" rate for a 5-year fixed rate mortgage):

- With 25-year amortization, 51% of the first payment is principal repayment.
- With 30-year amortization, 45% of the first payment is "forced saving" via principal repayment.

Thirdly, the OSFI requirement to stress test mortgages that are transferred between lenders has become even more of a hazard. **The Minister of Finance should direct OSFI to remove that requirement**. **This can and should be done immediately.**

I realize that there will be some very strong negative responses to these comments. At this time, I'm seeing lots of comments from people who have long had bearish attitudes towards home buying and mortgage borrowing. They are now feeling quite vindicated. I'm not going to fault anyone for failing to foresee a 100-year pandemic. I continue to believe that a vast majority of Canadian owner-occupant home buyers have been careful and thoughtful and made decisions that were in their best interests (investment buyers might be a different matter). The government should continue to trust us to make good decisions. If it doesn't, the economic recovery will be a lot more painful.

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