MORTGAGE PROFESSIONALS CANADA

Consumers' Perspectives on Homebuying in Canada

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1.0 Introduction and Summary

Introduction

For more than a decade, Mortgage Professionals Canada has produced semi-annual reports on the housing and mortgage markets in Canada. The reports are based largely on consumer surveys. The objective for the reports is to create and share data that would not otherwise be available, on mortgage activity and consumers' attitudes, to offer interpretations of trends in the housing and mortgage markets, and to comment on government policies related to mortgages and housing.

This edition of the report takes a quite different approach: it is focused on consumers' attitudes that will affect the decisions they make when buying a home.

As we state in this report, we don't know what are the "correct" attitudes for consumers to hold.

What interests us is the variations that occur across the country and for different groups within the population. Do people in "high pressure" communities (the Toronto and Vancouver areas) have different attitudes compared to Canadians who live elsewhere? If they do, the result could be riskier behavior in those high pressure markets, which could add to the economic risks associated with housing activity. Similarly, do first-time buyers think differently than three other groups: move-up buyers, move-down buyers, and recent buyers?

We are reassured to find that in key respects attitudes are highly similar across the country, and for first-timers compared to other buyers. This survey data tells us that high pressure is not resulting in recklessness.

Attitudes and Expectations about Homebuying

In this section, consumers were asked nine questions about their personal opinions (chiefly related to housing and mortgages).

Four of the questions explored the trade-offs they would make in buying a home. In each of these questions, the consumers were shown pairs of statements. For each pair, they indicated which one comes closer to their own feelings (on a 100 point scale, where a score of 1 would mean complete agreement with one position and 100 would mean complete agreement with the alternative).

Results have been compiled for seven regions of Canada (two of these are the highly pressurized areas of Greater Toronto and Greater Vancouver) and four different groups of consumers. Our chief interest is in determining if potential homebuyers in the Toronto and Vancouver areas are more willing to take risks compare to the other five regions. Similarly, are "next generation buyers" (who currently rent or live with their parents) more or less willing to take risks than the other groups (who already own homes)?

On the question of urgency (to what extent should one buy as soon as possible, because prices are only going to go up, versus basing the timing of a purchase on personal circumstances), opinions leaned towards personal circumstances.

> There were no material differences across the seven regions: in Toronto and Vancouver, potential homebuyers attach as much importance to personal circumstances as in the five other regions. Considering the different groups, we might expect that next generation buyers might have a greater sense of urgency compared to the other groups. The survey found that next generation buyers do not have greater urgency.

To what extent do homebuyers plan head? Are their decisions about how much to pay for a home, on the one hand, based solely on what they can afford at present, or on the other hand do they take into consideration what may happen in future?

> The responses were very close to the middle of the 100 point range, and there were no substantial variations across the seven regions or the four groups.

How much are they willing to borrow? Do they intend to "max out" and get the best possible home (on one hand) or borrow the least amount that still meets their needs?

> All of the regions and groups indicated that they lean towards minimizing the amount they borrow. This sentiment may be slightly (but only slightly) less strong in the Toronto and Vancouver areas compared to the other five regions. For next generation buyers, attitudes are very similar to the other three groups.

What balance are consumers seeking in terms of housing costs versus other living costs? On one hand, are they willing to cut corners on other living costs in order to get the best possible housing versus, on the other hand, will they settle for less expensive housing, so that they don't have to sacrifice on other areas?

> In the Toronto and Vancouver areas, compared to the other regions, potential buyers have a slightly larger (again, very slight) willingness to sacrifice on other costs of living. Next generation buyers might lean very slightly towards sacrificing on other costs.

A fifth question used the same format, and asked consumers to rate themselves as "confident" or "anxious" about buying a home at present. The responses showed distinct differences.

> The stress levels are highest in Toronto, followed by the rest of Ontario and Vancouver. The lowest stress levels are in Atlantic Canada and Quebec. Across the buyer types, the stress level is much higher for next generation buyers than for the three other groups. These results make sense, as responses to the situations in which people find themselves.

> We learn in life that stress is not entirely a bad thing. High stress in difficult situations helps us protect ourselves.

In addition to these questions on trade-offs, the consumers were asked to what extent they see their housing as a place to live versus as an investment. Responses were highly similar across the seven regions and across the four groups of potential buyers: Canadians see their homes as: 70% a place to live and 30% an investment. Prior editions of our surveys have found the same result.

The survey explored four other topics.

On the question of whether now is <u>a good time or a bad time to buy</u> a home or condominium (in their own community), on average, opinions were just slightly above the neutral level. There were distinct differences.

> Opinions were negative in the Toronto and Vancouver areas, as well as in the rest of Ontario. But, they were favourable in the other areas, especially Atlantic Canada and Quebec. Opinions were more negative for next generation buyers than for the other three groups.

Is real estate a <u>good long-term investment</u>?

> Responses were strongly positive. And average scores were roughly equal across the regions. There were no negative responses (averages below the midpoint of the range) among the buyer groups, although next generation buyers are slightly less optimistic than the other groups.

The consumers are slightly optimistic about the <u>economic outlook</u> (at an average of 6.09 on a scale for which the mid-point is 5.5 out of 10).

> Across the seven regions, the average scores were close to the average in five. The two exceptions were in Quebec (notably above average) and the Vancouver area (notably below average). Next generation buyers have a lower degree of optimism (just 5.74, versus the overall average of 6.09).

Are mortgages "<u>good debt</u>"?

> All of the buyer groups, in all of the seven regions, see mortgages as good debt, with the average scores well above the neutral level of 5.5. The weakest levels of agreement were found for next generation buyers in Vancouver and Toronto (scores of 6.07 and 6.18 respectively).

The Impacts of the Mortgage Insurance Stress Test

In this section, consumers generously provided personal information, on their home purchase expectations as well as their incomes, which allowed us to simulate whether they could qualify for the mortgages that they would need. In the analysis, we are especially interested in buyers who would have a down payment of less than 20% of the purchase price. These buyers would generally require mortgage insurance. Due to a new policy that was announced by the federal government on October 3, they would be subjected to a "stress test" that calculates whether they could afford the mortgages at an interest rate of 4.64% (which is far above the interest rates that can be obtained in the marketplace).

These simulations indicate that:

- Among the potential buyers who have down payments of less than 20%,
- Who <u>could afford</u> their required mortgages at an actual "market" interest rate of 2.6%,
- <u>20% would fail the stress test</u> and therefore be unable to obtain the financing they require.
- On average, the shortfall between the mortgage amounts that the buyers would need, versus the "approvable" amounts would be $56,000.

Those who were negatively affected were asked what they might do. More than one response could be selected (and therefore the responses total more than 100%):

- 45% would increase their down payment amount.
- 45% would buy a less expensive home than hoped for.
- 20% would buy a home further away than originally intended,
- 39% would delay their purchase.
- 5% would do something else and 7% did not know what they would do.

The stress test would mean that a considerable number of potential homebuyers would become unable to borrow as much as they need to complete their desired purchase (even though they can afford the actual costs associated with that purchase). There is uncertainty about how many of these affected people would be able to make changes in order to make a purchase (buying a less costly property, increasing their down payment, or finding a borrowing alternative that does not require mortgage insurance) and how many would have to delay buying (and for how long).

Data from Canada Mortgage and Housing Corporation indicates that there has been a substantial reduction in insured mortgage lending (a drop of 23% for "Transactional Homeowner" loans, compared to a year ago). On the other hand, data on resale market activity and mortgage lending (which includes insured and uninsured lending) suggest that homebuying and lending activity have not been reduced materially. This may be in part due to favourable economic conditions that would tend to boost demand (thus to some degree masking negative effects caused by the stress test), as well as what appears to have been a short-lived wave of "panic-buying" in Toronto and surrounding areas. But it is also apparent that many buyers who would have required mortgage insurance and then would have failed the stress test, have found alternative solutions.

There are multiple factors in play in the housing market at present and it is too soon to draw conclusions on the impacts of the stress test policy.

The data suggests a possibility that, to date, the stress test has been neutral (or reasonably close to neutral) with respect to its impacts on the housing market and mortgage lending. But, that does not mean it has been risk-neutral. That depends on what work-arounds have been employed by people who no longer qualify for the insured market mortgage that they need, and have made different financial arrangements that allow them to proceed:

- For buyers who have been able to increase their down payments to more than 20% through gifts or loans from family members, the financial impacts on the parties depend on arrangements that have been made with respect to interest rates and repayment obligations. It seems reasonable to assume that these arrangements have resulted in some shifting of risk away from the buyers and towards the family members who provided the assistance, and that in these situations the overall level of risk has not been changed very much.
- However, some of the buyers who have managed to avoid the stress test have done so by taking actions in the marketplace that have undoubtedly raised their own risk levels:
  - If they obtained the additional down payment via a loan from a financial institution (second mortgage, line-of-credit, another kind of personal loan, or as a far extreme, by a credit card advance, etc.) it is most likely at an interest rate higher than the rate that would have been obtainable for an insured mortgage. In addition, depending on repayment obligations for that loan, the required monthly repayment of principal may exceed the amount that would be repaid via a mortgage, and this would place additional strain on their personal finances (reducing their abilities to fund their other living expenses), as well as reducing their resilience in the face of future negative surprises.
  - For buyers who obtained the amount of mortgage that they need, but through a lender that does not require mortgage insurance, the interest rate might be substantially higher than the interest rate they could have obtained via an insured mortgage, and this adds strain to their financial situations (as discussed above).
  - In these situations, in addition to the higher costs (higher interest costs and possibly higher repayment requirements) there are also likely to be greater risks associated with a future renewal (or refinance) of the loans: there is risk that when the initial terms of these financings have ended, they won’t be able to refinance at reasonable costs.

For the people in these situations (and it is highly likely that there are already considerable numbers of them, with more to be added every month), there are financial pressures and financial risks associated with not being able to access an insured mortgage. From their perspective, their housing needs and aspirations are reasonable and would be affordable to them via an insured mortgage. Due to the stress test, they have been forced to find some other means to meet those reasonable needs, but at a cost that is higher and entails more personal risk.

These increased personal costs and risks are aggregating firstly, into reduced consumer spending power in Canada, and secondly, into increased risk for the Canadian economy. As time goes by, these costs and risks will escalate.

Economic Risks Associated with the Stress Test

At this time, it is possible that the stress test is not achieving its intended objective (which is to slow the growth of mortgage indebtedness).

If the stress test (or some future policy) does achieve its objectives, then there are substantial economic risks.

If successful, the policy would suppress housing demand, which would reduce house price growth. In communities that are already weak economically, and in which housing markets are commensurately soft, with limited growth of house prices, the suppression of demand could result in outright declines of house prices.

Falling house prices are dangerous to the economy, because of the negative effect on consumer confidence, and thus on consumer spending and the overall economic situation.

The risk associated with the stress test policy is that if it does achieve its intended objective, it will weaken some local economies on Canada, particularly those that are already weak. As those communities buy fewer goods and services from the rest of the country, local economic weakness can spread more widely.

About Mortgage Professionals Canada

Mortgage Professionals Canada is the national mortgage broker channel association representing the largest and most respected network of mortgage professionals in the country. Its membership is drawn from every province and from all industry sectors. Through its extensive membership database, Mortgage Professionals Canada provides consumers with access to a cross-country network of the industry's most respected and ethical professionals.

The association ensures an effective and efficient mortgage marketplace by:

- Promoting consumer awareness of the benefits of dealing with the mortgage broker channel
- Advocating for member interests on legislative and regulatory issues

- Developing, monitoring and promoting responsible mortgage industry standards and conduct
- Providing timely and relevant information to members and mortgage consumers

About the Author

Will Dunning is an economist, and has specialized in the analysis and forecasting of housing markets since 1982. In addition to acting as the Chief Economist for Mortgage Professionals Canada, he operates an economic analysis consulting firm, Will Dunning Inc.

About Bond Brand Loyalty

Bond Brand Loyalty is a wholly owned subsidiary of Maritz Inc., the largest performance improvement company in the world, headquartered in St. Louis, Missouri. For more than 20 years, Maritz Inc. has been one of the largest providers of customer satisfaction research in North America, and a major supplier of research, helping clients understand Choice, Experience, and Loyalty to their brand. In Canada, Bond Brand Loyalty has been developing marketing research solutions for Canadian clients under the Thompson Lightstone and Maritz brands since 1977, and has grown to become one of Canada's largest full-service marketing research consultancies.

Disclaimer

This report has been compiled using data and sources that are believed to be reliable. Mortgage Professionals Canada, Bond Brand Loyalty, Will Dunning, and Will Dunning Inc. accept no responsibility for any data or conclusions contained herein.

The opinions and conclusions in this report are those of the author and do not necessarily reflect those of Mortgage Professionals Canada or Bond Brand Loyalty.

2.0 Attitudes and Expectations about Homebuying

This section uses data from a consumer survey to obtain opinions of consumers, chiefly related to homebuying. The survey was conducted by Bond Brand Loyalty, for Mortgage Professionals Canada, during May 2017.

In the consumer survey, seven geographic areas were defined:
- The four provinces of Atlantic Canada.
- The province of Quebec.
- The Greater Toronto Area.
- The rest of Ontario.
- Manitoba plus Saskatchewan (referred to below as the Prairie provinces).
- The Greater Vancouver area.
- The remainder of British Columbia plus Alberta.

Four different buyer groups were defined:
- "Down-sizers" (home owners who are currently looking to purchase a smaller or less expensive home, or to move to a rental dwelling or care facility).
- "Move-up buyers" (home owners who are currently looking to move to a more expensive home).
- "Next generation buyers" (renting or living with parents or other family members, and born in 1964 or later).
- "Recent buyers" (purchased a home in February 2016 or later).

The combination of seven geographies and four buyer groups resulted in 28 different groups. Approximately 150 consumers were surveyed for each group. The sample size was 4,146.

Table 2-1
Sample Sizes in Spring 2017 Consumer Survey

	Buyer Group				*Total*
Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	
Atlantic Canada	153	151	151	146	601
Greater Toronto Area	150	155	154	152	611
Greater Vancouver Area	153	151	151	103	558
Prairies	150	150	150	112	562
Quebec	151	152	153	150	606
Rest of BC and Alberta	150	152	151	150	603
Rest of Ontario	153	149	153	150	605
Total	1,060	1,060	1,063	963	4,146

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.

In one section of the survey, the objective was to investigate "risk attitudes" (for want of a better term) towards homebuying. Consumers were offered statements that show extremes of opinions, and the consumers were asked to show their own opinions within that range (by indicating a score from 1 to 100).

In discussing these results, we aren't offering any opinions on what are the "correct" attitudes that Canadians "should" have. We are interested in the variations that can be found across Canada, and across the different groups of potential homebuyers: we might expect that there is more risk-taking in some areas than in others (that perhaps the highly-pressured markets of Toronto and Vancouver are leading to different attitudes than elsewhere). We might also expect that potential first-time buyers have different attitudes compared to the groups that already own homes. Furthermore, we might expect that people who think house prices are likely to rise rapidly in their communities would have different attitudes compared to people who expect slower price growth or even price declines. Similarly, we might expect that attitudes depend upon people's expectations about their own economic futures.

The results are surprising: there is much greater similarity than might have been expected. The survey doesn't tell us conclusively whether or not Canadians are taking too much risk in the housing market, but it does indicate that "risk attitudes" show very little variation across the country and across different segments of the homebuying public.

This survey has not investigated an element of risk that is cause for concern, if it occurs at a non-trivial level: "speculation" is purchasing that is driven entirely by expectations that there will be rapid price growth (speculators usually intend to hold the properties for only short periods of time; in fact, some may never own the property at all, as they sell their right-to-purchase before the closing date). There are two main reasons for not investigating speculators in this survey. Firstly, we are much more interested in the thoughts and actions of people who buy for the purpose of living in the dwellings. Secondly, we expect that there are not very many speculators active in the Canadian housing market, and it would be very difficult to complete a reliable survey of them (first of all, even finding them and getting them to take part in a survey, and then obtaining reliable information from them). Thus, this survey is concerned with Canadians who hope to buy homes in which they will live.

Sense of Urgency

A major element of risk in the housing market is whether people's decision-making is inordinately influenced by expectations concerning prices (for example, if they buy earlier than they should for "fear of missing out", or if they buy a larger, more expensive home than they would otherwise because they think that would be a good investment). The first question in this section investigates the "fear of missing out". The consumers gave a point rating in the range from 1 to 100 to indicate which position comes closer to their own:

"The best time to buy a home..."
At one end, the positon is "...is as soon as possible regardless of my personal circumstances, because prices are only going to go up" (complete agreement with this would be scored as 1).
The other extreme is "...will depend solely on my personal circumstances and life events, regardless of how house prices are moving" (complete agreement would be scored as 100).

The average of the scores was 63, which indicates that there is a tendency to base the timing on personal circumstances moreso than on market conditions.

As was stated earlier, our interest is not so much in the average score as in the variations that occur, across regions and across groups within the population. The table below shows the average scores for each of the 28 groups in the survey. We might have expected the average scores would be below average (indicating a greater sense of urgency) for the most heated market areas (Toronto and Vancouver), and perhaps for next generation buyers. Yet, the responses show a considerable amount of similarity across the groups[1]: the average scores are only fractionally below average in Toronto and Vancouver (suggesting a slight compromise away from personal circumstances towards urgency), and fractionally above average in the other regions. Considering the very substantial differences in housing market conditions across these regions, the great similarity in the responses is surprising. The stability across the 28 groups indicates that buyers are managing to stay grounded in the hot markets. Furthermore, the data indicates that next generation buyers do not have any greater sense of urgency compared to the other groups (if anything, the responses suggest they have fractionally less of a sense of urgency).

The lowest average scores are for recent buyers, especially in Toronto and Vancouver, which suggests that the people who have bought in these two regions have a slightly greater sense of urgency than their peers (in their own communities and across the country). It does make some sense that the people who actually have purchased have more of a sense of urgency than those who have not purchased. Yet, the differences do not strike us as egregious (scores in the 20s or 30s would be concerning, but the scores in the 50s, indicate that in making their purchase decisions, these buyers still lean towards actual personal circumstances rather than market pressures).

[1] Across the entire sample, the standard deviation is 25, meaning that in this table none of the groups is statistically different from the average: on a statistical basis, the responses are virtually identical.

Table 2-2 *Average Scores for "The Best Time to Buy a Home…"*					
Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	68	64	67	59	64
Greater Toronto Area	65	55	66	52	59
Greater Vancouver Area	61	56	62	55	59
Prairies	73	63	65	59	65
Quebec	65	58	65	66	63
Rest of BC and Alberta	66	64	67	63	65
Rest of Ontario	69	61	73	61	66
Total	67	60	66	59	63
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.					

These responses were also analyzed relative to the consumers' expectations about growth of house prices in their community during the next five years.

In this table, a column on the right shows the total shares of the samples that hold the various expectations about price growth: there are very few who expect prices to fall sharply (just 1% expect a fall of more than 20% and only 3% expect prices to fall by 11% to 20%). 8% expect moderate price drops (1 to 10%). In total, 12% expect prices to fall to some degree in their community. 14% expect no change in house prices. 74% expect house prices to rise to some extent during the coming five years.

This analysis yields a pattern that we might expect: people who expect that house prices will fall will attach more importance to personal circumstances (their average scores on this question are above the average score of 63). Conversely, among those who expect the most rapid price growth, the scores are slightly below the average, signaling a slightly greater sense of urgency. Even so, for those with the highest expectations about price growth, the average score of 57 is not far below the overall average of 63 (and is still very far from portraying a strong sense of urgency – it is still the case that personal circumstances are dominant).

Interestingly, there is little variation for next generation buyers, regardless of their expectations about price growth: their attitudes are clearly weighted towards their personal circumstances. On the other hand, for move-up buyers and recent buyers, there is much more variation, and price expectations do affect the degree of urgency: again, these results do not show any egregiousness as to the impacts of price expectations, since personal circumstances continue to dominate.

Table 2-3 *Average Scores for "The Best Time to Buy a Home…"* *Versus Expected Growth of House Prices in the Next Five Years*						
Price Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	**	**	**	**	76	1%
Decrease by 11-20%	70	71	75	**	73	3%
Decrease by 1-10%	69	64	70	70	68	8%
Stay the Same	66	63	66	59	64	14%
Increase by 1-10%	67	60	66	62	64	37%
Increase by 11-20%	66	59	67	59	62	22%
Increase by more than 20%	64	54	62	51	57	15%
Total	67	60	66	59	63	100%
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author. Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)						

The next table looks at the responses in relation to expectations about income growth (for their household for the next five years). The column on the right shows that 11% of consumers in the sample expect that their household incomes will fall during the next five years (most of these are down-sizers – 23% of this group expect that their incomes will fall. In the other three buyer groups, 7% expect that their incomes will fall.) 30% of the consumers in the total sample expect that their incomes will be unchanged, and 59% expect their incomes to rise to some degree.

Expectations about income growth have very little influence on attitudes about the best time to buy a home.

Table 2-4 *Average Scores for "The Best Time to Buy a Home…"* *Versus Expected Growth of Household Income in the Next Five Years*						
Income Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	68	**	**	**	67	3%
Decrease by 11-20%	76	**	**	**	71	2%
Decrease by 1-10%	68	63	68	66	67	6%
Stay the Same	66	60	65	58	63	30%
Increase by 1-10%	66	60	67	59	63	36%
Increase by 11-20%	62	58	67	58	62	13%
Increase by more than 20%	63	59	67	62	64	10%
Total	67	60	66	59	63	100%
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author. Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)						

Planning Ahead

The second investigation of risk attitudes explored:

> *"In calculating how much I can afford to pay for a new home, I would make the decision based on… "*
> *"What I can afford today, because you can't predict what the future may hold" (score of 1 if agree completely"), versus*
> *"What I may be able to afford in the future, taking into consideration potential changes in interest rates, my personal circumstances or life events" (score of 100 if agree completely).*

Reponses in this section were very close to the middle of the range. As noted before, we don't know what score is the "correct" one (so long as the responses are not extremely skewed to a present-only position, which would be shown by very low scores). The data is most useful in exploring differences across the regions and the buyer groups. The analysis finds that there are only small variations across the regions and buyer groups. The most notable exception is that recent buyers in Vancouver gave the lowest average score, suggesting a tendency to downplay the future. Looking at the overall averages for Vancouver and Toronto, the conclusion is that living in a highly pressured market area has not caused buyers to lose sight of the need to leave themselves some room to accommodate future surprises.

Table 2-5
Average Scores for "In Calculating How Much I Can Afford to Pay…"

Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	53	48	47	43	48
Greater Toronto Area	46	46	49	43	46
Greater Vancouver Area	51	47	47	39	47
Prairies	49	47	46	49	48
Quebec	48	49	46	42	46
Rest of BC and Alberta	48	48	49	43	47
Rest of Ontario	53	43	47	41	46
Total	49	47	47	43	47

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.

The analysis of these responses, relative to expectations about growth of house prices also shows no substantive variations. In other words, we do not get any sense that buyers are expecting that future price growth will give them any cushion to deal with future surprises.

Table 2-6 *Average Scores for "In Calculating How Much I Can Afford to Pay…"* *Versus Expected Growth of House Prices in the Next Five Years*						
Price Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	**	**	**	**	49	1%
Decrease by 11-20%	57	47	53	**	52	3%
Decrease by 1-10%	49	47	50	43	48	8%
Stay the Same	49	48	44	47	47	14%
Increase by 1-10%	49	47	47	42	46	37%
Increase by 11-20%	49	48	47	43	47	22%
Increase by more than 20%	53	43	48	41	46	15%
Total	49	47	47	43	47	100%
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author. Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)						

It is possible that expectations about income growth will influence responses to this question, although it is not clear in advance what effect we should expect. The survey data indicates that expectations about income growth do not materially affect attitudes on this question.

Table 2-7 *Average Scores for "In Calculating How Much I Can Afford to Pay…"* *Versus Expected Growth of Household Income in the Next Five Years*						
Income Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	46	**	**	**	45	3%
Decrease by 11-20%	53	**	**	**	53	2%
Decrease by 1-10%	47	57	48	53	50	6%
Stay the Same	50	47	46	42	47	30%
Increase by 1-10%	50	46	45	42	45	36%
Increase by 11-20%	52	50	46	40	47	13%
Increase by more than 20%	49	41	55	45	49	10%
Total	49	47	47	43	47	100%
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author. Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)						

How Much to Borrow?

"In terms of the value of my mortgage, I would borrow…"
The low end of the scoring range (1) is "…the maximum amount the lender will allow, so I can get the best possible home"

and the high end of the range (100) is "...the least amount that still allows me to purchase a home that meets my needs"

The responses indicate that all of the buyer groups will shy away from borrowing the maximum amounts (with the average scores consistently above the middle of the range). This tendency is strongest for down-sizers. For move-up buyers, there is a slight tendency in the direction of borrowing maximum amounts, but the scores still show greater weight for their needs versus the opportunity to borrow more.

The responses do no not show much variation across the seven geographic areas, although the scores are slightly below average in the high pressure market areas of Toronto and Vancouver.

Table 2-8
Average Scores for "In Terms of the Value of My Mortgage, I Would Borrow..."

Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	73	58	62	63	64
Greater Toronto Area	66	54	58	53	58
Greater Vancouver Area	67	54	58	57	59
Prairies	74	58	59	65	64
Quebec	73	64	63	67	67
Rest of BC and Alberta	72	58	63	68	65
Rest of Ontario	71	62	63	67	66
Total	71	58	61	63	63

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.

Looking at the responses relative to expectations about growth of house prices (the table is on the next page), there is a tendency that people with expectations of price reductions will give above-average consideration to their needs rather than to the approvable mortgage amounts. For people (the majority of those surveyed) who expect prices to rise to some degree, the expected amounts of price rise do not appear to materially affect their attitudes in this area.

Table 2-9 *Average Scores for "In Terms of the Value of My Mortgage, I Would Borrow…"* *Versus Expected Growth of House Prices in the Next Five Years*						
Price Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	**	**	**	**	79	1%
Decrease by 11-20%	76	69	71	**	72	3%
Decrease by 1-10%	70	64	65	68	67	8%
Stay the Same	67	58	60	59	61	14%
Increase by 1-10%	72	57	59	65	64	37%
Increase by 11-20%	69	56	62	63	63	22%
Increase by more than 20%	73	57	57	61	61	15%
Total	71	58	61	63	63	100%
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author. Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)						

The survey data indicate that people who expect income reductions during the coming five years will be slightly more conservative, with slightly more emphasis on borrowing based on need rather than on how much is available.

Table 2-10 *Average Scores for "In Terms of the Value of My Mortgage, I Would Borrow…"* *Versus Expected Growth of Household Income in the Next Five Years*						
Income Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	74	**	**	**	72	3%
Decrease by 11-20%	75	**	**	**	71	2%
Decrease by 1-10%	72	61	58	70	68	6%
Stay the Same	70	58	61	64	64	30%
Increase by 1-10%	70	57	62	61	62	36%
Increase by 11-20%	67	56	61	61	60	13%
Increase by more than 20%	75	63	59	69	63	10%
Total	71	58	61	63	63	100%
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author. Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)						

Balancing Needs

To what extent are Canadians prepared to make sacrifices in other areas in order to raise the quality of their housing?

"Thinking about creating a balance between housing costs and other living costs…"
The low end of the range (score of 1) is "…I am willing to reduce the amount I spend on other living costs in order to buy the best possible home"
The high end of the range (100) is "…I am not willing to reduce the amount I spend on other living costs, I will settle for a less expensive home"

Once again, we don't have an opinion on what is the "correct" answer, so long as it isn't highly skewed towards the low end (too little consideration of other needs). We are interested in the variations across the geographic areas and the buyer groups.

The data indicates that down-sizers are less willing to compromise on other needs (this makes sense, since these are people who want to reduce their housing costs). For the three other buyer groups, attitudes are highly similar. We find it interesting that next generation buyers are not more likely to sacrifice on other costs compared to move-up buyers and recent buyers.

There is a slight tendency for consumers in Toronto and Vancouver to be willing to sacrifice on other living costs compared to the other five geographic areas.

Table 2-11
Average Scores for "Thinking about Creating a Balance Between Housing Costs and Other Living Costs…"

Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	62	49	51	49	53
Greater Toronto Area	52	47	43	46	47
Greater Vancouver Area	51	43	47	46	47
Prairies	61	47	47	50	51
Quebec	62	56	50	56	56
Rest of BC and Alberta	61	48	48	52	52
Rest of Ontario	61	52	46	51	53
Total	59	49	48	50	51

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.

This question gets at a question of whether there is an "investment motive" and how strong it is: do people who expect rapid growth of house prices buy "more house" than they would based on their needs alone? The survey data suggests that people who expect prices to fall will spend slightly less on their homes (which seems a sensible position, and we would call it a "precautionary motive", as the opposite of an "investment motive"). But, for people who expect prices to rise, the amount of rise that they expect does not appear to materially affect how much they are willing to spend. This suggests that there is not a strong investment motive for Canadian homebuyers. If there is a strong investment motive in homebuying decisions, we would be concerned that it would have a destabilizing effect (it would increase demand in hot markets, adding to price pressures, and raising risks of a future correction). We take some comfort from these results.

Table 2-12
Average Scores for "Thinking about Creating a Balance Between Housing Costs and Other Living Costs…"
Versus Expected Growth of House Prices in the Next Five Years

Price Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	**	**	**	**	57	1%
Decrease by 11-20%	62	55	55	**	56	3%
Decrease by 1-10%	61	50	49	50	53	8%
Stay the Same	60	53	47	51	52	14%
Increase by 1-10%	59	49	46	51	51	37%
Increase by 11-20%	56	46	49	49	50	22%
Increase by more than 20%	58	48	45	49	49	15%
Total	59	49	48	50	51	100%

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.
Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)

Similarly, the survey data indicate that expectations about income growth do not materially alter people's willingness to sacrifice on other costs.

Table 2-13
Average Scores for "Thinking about Creating a Balance Between Housing Costs and Other Living Costs…"
Versus Expected Growth of Household Income in the Next Five Years

Income Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	57	**	**	**	54	3%
Decrease by 11-20%	61	**	**	**	56	2%
Decrease by 1-10%	58	51	51	55	55	6%
Stay the Same	60	50	48	50	53	30%
Increase by 1-10%	58	47	48	49	50	36%
Increase by 11-20%	58	50	47	47	49	13%
Increase by more than 20%	43	52	47	57	50	10%
Total	59	49	48	50	51	100%

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.
Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)

Confident or Anxious?

> *"All things considered (including my personal circumstances, the evolving economic situation and conditions in the local housing market)…"*
> *The low end is 1: "…I feel confident about buying a home at present".*
> *The high end is 100: "…I feel anxious about buying a home at present".*

It is not surprising that there are higher levels of stress in the Toronto and Vancouver areas, and that the lowest levels of stress are found in Atlantic Canada and Quebec. It is also not surprising that next generation buyers are more anxious than the three other buyer groups. By far, the highest stress levels are for next generation buyers in Toronto and Vancouver, as well as the rest of Ontario (this may be influenced by heated conditions that are now spreading outwards from the Greater Toronto Area).

It is interesting that for recent buyers the anxiety levels are considerably lower than for the other groups (but this also makes sense, since for the people who bought homes, their lower levels of stress helped them make the purchase. Moreover, looking back in time, the process might now seem less stressful than it was at the time[2]).

Table 2-14
Average Scores for "All Things Considered …"

Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	45	43	56	35	45
Greater Toronto Area	56	57	73	51	59
Greater Vancouver Area	52	53	68	47	56
Prairies	51	47	59	41	50
Quebec	47	43	48	44	46
Rest of BC and Alberta	47	50	61	39	49
Rest of Ontario	54	51	73	46	56
Total	50	49	63	43	52

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.

The next table shows that stress levels are considerably higher for people who expect price reductions (who are a small minority) than for those who expect prices to rise. This is not surprising. One surprising result is that among next generation buyers, expectations about rapid price growth seem to contribute to higher stress levels.

[2] The author bought a house in Toronto in April 2016 and can personally attest to this suggestion.

Table 2-15 *Average Scores for ""All Things Considered …"* *Versus Expected Growth of House Prices in the Next Five Years*						
Price Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	**	**	**	**	74	1%
Decrease by 11-20%	69	58	79	**	67	3%
Decrease by 1-10%	57	53	64	46	56	8%
Stay the Same	48	50	55	45	50	14%
Increase by 1-10%	47	46	58	41	48	37%
Increase by 11-20%	50	48	65	43	51	22%
Increase by more than 20%	51	51	72	47	56	15%
Total	50	49	63	43	52	100%
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author. Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)						

Looking at the results relative to expectations about income growth, we might expect that people who expect more rapid growth of their incomes would experience less stress. This does seem to be true for down-sizers, but for the other three buyer groups, expectations about income growth have little or no impact on their stress levels.

Table 2-16 *Average Scores for "All Things Considered …"* *Versus Expected Growth of Household Income in the Next Five Years*						
Income Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	53	**	**	**	54	3%
Decrease by 11-20%	58	**	**	**	56	2%
Decrease by 1-10%	54	56	59	38	52	6%
Stay the Same	51	51	62	45	51	30%
Increase by 1-10%	47	48	65	43	51	36%
Increase by 11-20%	46	48	63	41	52	13%
Increase by more than 20%	39	46	60	42	51	10%
Total	50	49	63	43	52	100%
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author. Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)						

Housing as an Investment

In some previous issues of our semi-annual reports, we have asked Canadians to what extent they see their homes as "a place to live" versus as "an investment". Consistently, the answer has been (roughly) 70% as a place to live and 30% as an investment. The responses have been relatively consistent across different groups of Canadians. This edition of the survey allows us to further examine these attitudes.

The new data shows that the allocation has not changed, and that attitudes are remarkably similar across the geographic areas and the buyer groups.

Table 2-17
Average Scores (out of 100%) for Housing "As a Place to Live"

Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	67	70	70	70	69
Greater Toronto Area	65	70	70	70	69
Greater Vancouver Area	68	67	72	68	69
Prairies	69	68	68	66	68
Quebec	66	64	70	66	66
Rest of BC and Alberta	68	68	69	70	69
Rest of Ontario	68	70	71	70	70
Total	67	68	70	69	69

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.

Looking at the responses relative to expectations about price growth, there is a weak tendency that for the small minority of people who expect price declines, they are more likely to view their homes as places to live and therefore less likely to view them as investments. This finding is not surprising. We also see that among the majority who expect prices to rise, the amount of expected price rise does not seem to affect their views as to housing as a place to live versus as an investment: we might have expected that those who expect strong price growth would be more likely to view their homes as investments, but this is not the case.

Table 2-18
Average Scores (out of 100%) for Housing "As a Place to Live"
Versus Expected Growth of House Prices in the Next Five Years

Price Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	**	**	**	**	76	1%
Decrease by 11-20%	70	74	78	**	74	3%
Decrease by 1-10%	69	70	70	75	70	8%
Stay the Same	65	70	68	67	68	14%
Increase by 1-10%	67	67	69	69	68	37%
Increase by 11-20%	68	66	70	69	68	22%
Increase by more than 20%	67	69	73	68	69	15%
Total	67	68	70	69	69	100%

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.
Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)

The next table shows that expectations about income growth have no effect on the attitude to housing as a place to live versus as an investment.

Table 2-19
Average Scores (out of 100%) for Housing "As a Place to Live"
Versus Expected Growth of Household Income in the Next Five Years

Income Expectations For Next 5 Years	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*	*% of Sample*
Decrease by more than 20%	66	**	**	**	68	3%
Decrease by 11-20%	70	**	**	**	68	2%
Decrease by 1-10%	70	71	71	66	70	6%
Stay the Same	68	70	70	70	69	30%
Increase by 1-10%	65	68	70	69	68	36%
Increase by 11-20%	65	64	69	68	67	13%
Increase by more than 20%	67	69	71	68	69	10%
Total	67	68	70	69	69	100%

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.
Note: ** indicates estimate suppressed due to small sample size (less than 25 responses)

Is This a Good Time to Buy?

The consumers were asked whether this is a good time or a bad time to buy a home or condominium in their community. A response of 10 would indicate "Very Good Time" and a score of 1 would indicate "Very Bad Time". In this scale of 1 to 10, the midpoint (representing a neutral opinion) is 5.5.

Overall, the average shows that attitudes are barely above neutral[3]. For the most heated market areas (Toronto and Vancouver) the average scores are notably below the neutral level, and in the rest of Ontario (which is partly influenced by spillover from Toronto), the average score is also below neutral. The most positive responses were from Atlantic Canada and Quebec.

Looking across the buyer groups, recent buyers gave the most positive responses (which is not surprising since they actually have purchased). But, even in Toronto and Vancouver, the average ratings from recent buyers are slightly below neutral.

For down-sizers and move-up buyers, the average scores are slightly above the neutral level.

[3] Readers are cautioned against comparing these results (and in the two sections that follow) with those from prior editions of our reports. In prior editions, the samples were constructed and the responses weighted to represent Canada as a whole. In this edition, the intention is to compare different groups, not to represent all Canadians. Therefore, the opinions of "all Canadians" may be very different than the overall averages found here.

For next generation buyers, the scores are far below the overall average, weighed down by very negative reactions in Vancouver and Toronto, as well as in the rest of Ontario. Among next generation buyers in the remaining regions, the attitudes are above the neutral level, especially in Atlantic Canada and Quebec.

Table 2-20
Average Ratings (out of 10) for "Is this a Good Time to Buy…"

Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	6.51	6.72	6.15	7.46	6.70
Greater Toronto Area	4.39	4.57	3.82	5.34	4.53
Greater Vancouver Area	5.28	5.25	3.66	5.34	4.85
Prairies	5.69	6.26	5.69	6.59	6.02
Quebec	6.26	6.79	6.05	7.30	6.60
Rest of BC and Alberta	5.85	6.18	5.89	7.05	6.25
Rest of Ontario	5.41	5.32	4.22	5.83	5.19
Total	5.63	5.87	5.06	6.45	5.74

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.

Real Estate as a Long-Term Investment

The consumers in our survey rated real estate as a good long-term investment, with the average score of 7.16 well above the neutral threshold. There were few substantial variations across the regions and buyer groups:

- Recent buyers answered slightly more positively than the other groups.
- Next generation buyers were less positive, but in all regions their responses were above the neutral level of 5.5.
- Across all of the 28 groups, the lowest rating was given by next generation buyers in the Vancouver area.

The relative stability across the country may be surprising, considering that during the past decade there have been very sharp differences in rates of house price growth across the country.

Table 2-21 *Average Ratings (out of 10) for "Real Estate in Canada is a Good Long-Term Investment"*					
Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	7.16	7.38	7.00	7.30	7.21
Greater Toronto Area	7.53	7.30	6.79	7.42	7.26
Greater Vancouver Area	7.29	7.19	6.17	7.51	7.00
Prairies	7.31	6.81	6.99	7.54	7.14
Quebec	7.40	7.41	6.84	7.65	7.32
Rest of BC and Alberta	7.31	7.03	6.55	7.38	7.07
Rest of Ontario	7.31	7.19	6.65	7.27	7.10
Total	7.33	7.19	6.71	7.43	7.16
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.					

Optimism about the Economic Outlook

Opinions about the economic outlook are weakly positive, with the average rating of 6.09 out of 10 being slightly above the neutral level of 5.5.

Average ratings are above the neutral level in all seven regions. Opinions are least optimistic in the Vancouver area (barely above neutral), followed by the rest of Ontario, and most optimistic in Quebec, followed by Atlantic Canada.

Next generation buyers have the lowest levels of optimism (especially in the Vancouver area). In six out of seven regions (apart from Manitoba/Saskatchewan), next generation buyers have levels of optimism that are below the respective regional average.

Table 2-22 *Average Ratings (out of 10) for "I am Optimistic about the Economy in the Coming 12 Months"*					
Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	5.99	6.39	5.90	6.48	6.19
Greater Toronto Area	6.02	6.30	5.52	6.41	6.06
Greater Vancouver Area	5.99	6.03	5.19	5.93	5.77
Prairies	5.69	6.34	6.09	6.20	6.07
Quebec	6.40	6.61	6.01	6.77	6.44
Rest of BC and Alberta	6.23	6.04	5.87	6.29	6.11
Rest of Ontario	5.97	6.44	5.59	5.95	5.99
Total	6.04	6.31	5.74	6.31	6.09
Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.					

Mortgages as "Good Debt"

Overall, the consumers in our survey see mortgages as "good debt", as the average score of 6.85 out of 10 is well above the neutral threshold. The ratings exceed 6.0 for all of the 28 groups. The strongest degree of agreement is among recent buyers, and the weakest is for next generation buyers.

Table 2-23
Average Ratings (out of 10) for "I Would Classify Mortgages as Good Debt"

Region	*Down-sizers*	*Move-up Buyers*	*Next Generation Buyers*	*Recent Buyers*	*Total*
Atlantic Canada	6.94	7.36	6.64	7.68	7.15
Greater Toronto Area	6.69	6.94	6.18	6.88	6.67
Greater Vancouver Area	6.52	6.79	6.07	7.12	6.58
Prairies	6.65	6.89	6.69	7.02	6.80
Quebec	7.07	7.16	6.76	7.49	7.12
Rest of BC and Alberta	6.88	6.80	6.34	7.17	6.79
Rest of Ontario	6.87	6.93	6.34	7.25	6.85
Total	6.80	6.98	6.43	7.24	6.85

Source: Mortgage Professionals Canada survey, Spring 2017; Analysis by the author.

3.0 The Impacts of the New Mortgage Insurance Stress Test

On October 3, 2016 the federal government announced changes to Canada's mortgage insurance rules. The most significant consequence is that for many new mortgages, the borrower's ability to afford the payments must be assessed using the "posted rate", which currently is 4.64%. This is far in excess of the interest rates that can actually be obtained.

In this section of the report, we have used the consumer survey to assess the impacts on consumers who have down payments of less than 20% (who therefore require mortgage insurance and will usually be subjected to the stress test).

The Methodology

The survey participants generously shared personal information that allowed us to simulate the results of the stress test: the consumers' data covered expected home purchase prices, their expected down payments, their household incomes, and their other debt service costs, as well as their assumptions about costs for heating and property taxes.

The data (with the addition of expected costs for mortgage insurance premiums as well as a 2% allowance for closing costs) enabled us to calculate their required mortgage amounts.

We then calculated their likely Gross Debt Service (GDS) and Total Debt Service (TDS) ratios, assuming a mortgage interest rate of 2.60% (this rate is being advertised by major lenders for fixed rate mortgages with 5-year terms. We are aware that some borrowers may be able to negotiate interest rates that are even lower than 2.6%, and that lower rates are available for variable rate mortgages and for fixed rate mortgages with terms shorter than 5 years).

If the calculations yielded a GDS ratio of no more than 32% and a TDS ratio of no more than 40%, then we assumed that the consumer's mortgage requirement would be approvable.

In this survey, 48% of potential buyers expect that their down payments would be less than 20% of the purchase price. They would generally require mortgage insurance and would be subject to the stress test.

For those consumers whose expected down payments amount to less than 20% of the purchase price and mortgage insurance would be required, we recalculated their GDS and TDS ratios at the "posted rate" (which is currently 4.64%). If either of these amended GDS or TDS ratios exceeded the thresholds (32% and 40%), the mortgage would not be insurable.

In this discussion we are particularly interested in:

- Consumers who require mortgage insurance,

- Who would likely qualify for their required mortgage amount based on the actual mortgage interest rate of 2.60%, but
- Would likely no longer qualify for that mortgage based on the stress test at the 4.64% interest rate.

The Estimates

These simulations (using the personal data that has been provided by consumers) indicate that among the prospective homebuyers who can qualify for their required mortgage at the actual mortgage interest rate, 20% would be disqualified by the stress test (their recalculated GDS and/or TDS ratio would exceed the threshold for approvability).

Further calculations estimate that, on average, they would need to increase their down payments by $56,000 (in order to complete the purchase that they could have made in the absence of the stress test). Looking across the seven regions that have been defined in this study, the averages of the required additional down payments are:

- $25,000 in Atlantic Canada.
- $41,000 in the province of Quebec.
- $81,000 in the Greater Toronto Area.
- $41,000 in the rest of Ontario.
- $63,000 in Manitoba and Saskatchewan.
- $94,000 in the Greater Vancouver area.
- $52,000 in the rest of British Columbia plus Alberta.

For these consumers who were negatively affected by the stress test, and would now be unable to purchase the home that they had expected to buy, we asked how they would respond. Multiple responses were permitted (and therefore the total number of responses exceeds 100% - for example, a consumer might plan to save a larger down payment and delay their purchase).

- 45% would increase their down payment amount.
- 45% would buy a less expensive home than hoped for.
- 20% would buy a home further away than originally intended,
- 39% would delay their purchase.
- 5% would do something else and 7% did not know what they would do.

The consumers who indicated they would increase their down payments were asked how they would plan to do that (again, multiple responses were allowed, resulting in total responses exceeding 100%).

- 43% would delay their purchase.
- 30% indicated they would seek help from family members, as a gift and/or a loan.
- 16% would obtain a loan from a financial institution.

- 3% would obtain a loan from their employer.
- 31% would withdraw from an RRSP (this includes doing it via the Home Buyers Plan).
- 14% would use another method (usually selling investments or other assets or withdrawing from savings).

Since almost one-half of homebuyers require mortgage insurance, these survey results indicate that substantial numbers of potential homebuyers in Canada will be negatively affected by the mortgage insurance stress test that took effect late in 2016.

Many of these people will make adjustments so that the can buy a less expensive property or buy at a later date. However, it is unknown how much time they will need to make their adjustments. Given the large size of the required increases in down payments (as shown above), for many of those impacted the adjustment periods may be quite prolonged. As an illustration:

- The average required additional down payment is $56,000.
- Comparing this to the average incomes of the people affected, it amounts to 0.6 years of income.
- If their only means to obtain the additional down payments is through their personal savings, then, if they are able to devote one-tenth of their incomes to the task, it would take 6 years to save the additional amount (and this assumes that in the interim house prices won't rise or other adverse events – such as increased interest rates – won't interfere).
- Even if they could devote 20% of their incomes to the task (which very few people could do), it would take 3 years to save the additional down payment.
- On the other hand, some (unknown) proportion of these consumers will have find ways to avoid the test.

This survey data indicates that there is a potential for a non-trivial impact on homebuying in Canada, although the survey data does not give us a precise indication of the size of the impact on the housing market or of how it will evolve over time. A key factor in this will be the extent to which buyers are able to avoid the stress test.

Data on Mortgage Insurance Activity

We do know, via reporting from Canada Mortgage and Housing Corporation[4] that in 2017 there has been a very substantial reduction in insured mortgage lending:

- New activity for "Transactional Homeowner" loans was down by 23% in the first quarter of this year versus the same period last year. This is quite similar to the survey results,

[4] The CMHC data is in a statistical report, available here: https://www.cmhc-schl.gc.ca/en/corp/about/core/upload/mortgage-loan-insurance-business-supplement-march-2017.pdf

which indicate that among loans that previously might have been approvable, 20% would no longer be approvable, due to the stress test.

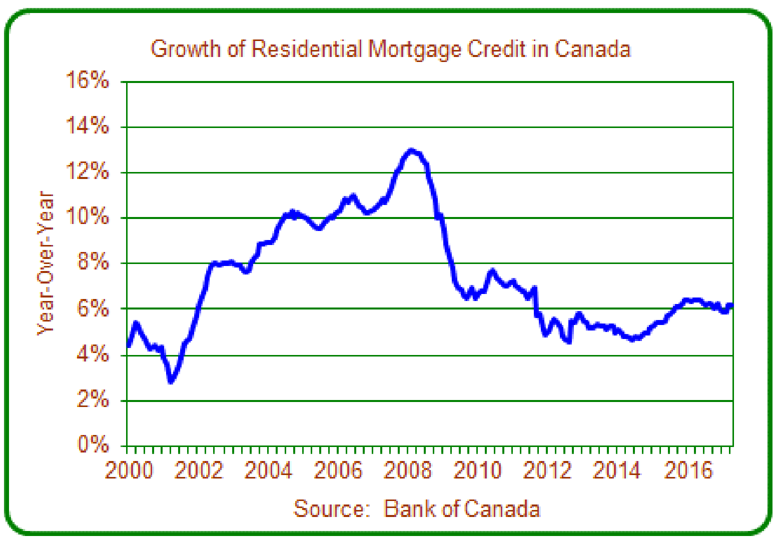
- Total insured activity was down by 41%, due to a very drop in Portfolio insurance (which fell by 84% for "New" loans and 90% for "Substitutions")

We don't know to what extent the drop in insurance activity is due to:

- A reduction in purchases that would normally require insurance or
- Consumer responses that enable them to avoid mortgage insurance (increasing their down payments via various means or borrowing from sources that don't require insurance). Mortgage insurance premiums have been increased significantly this year. Adding this factor to the stress test, mortgage borrowers have more incentive to avoid the insurance.

Data on Mortgage Lending Activity

Data on mortgage lending tells a different story compared to the CMHC data. The Bank of Canada provides data on residential mortgage credit outstanding. This data shows that as of April this year, the year-over year growth rate is 6.2%. This has not changed materially compared to prior to the October announcement: as of September, the year-over-year growth rate was 6.3%.



We can also look at the data to see if there has been any change in the growth rate over a shorter period of time. Based on the seasonally-adjusted estimates, as of April the six-month (annualized) growth rate was 6.3%, similar to the 6.3% rate as of September.

Meanwhile, in the Housing Market

There is an intriguing disconnect between, on the one hand, what we think might happen as the consequence of the stress test (and what CMHC reports on its mortgage insurance business) versus, on the other hand, what is actually happening in housing markets across the country. To date, the sales trend for resale market activity (for Canada as a whole) has not materially changed. For the six months since the new stress test policy came into effect (December 2016 to May 2017) the average sales rate in Canada is 0.6% higher than it had been in the 12 months prior to the announcement. Moreover, the sales rate is 11.6% higher than during the 5 years prior to the announcement.

This is not to say that the stress test has had no effect. Housing market activity is influenced by many factors, and some of the most important factors have become more positive in recent times. In particular, consumer confidence is likely strengthening:

- Economic indicators have become more favourable. For the past year, the rate of job growth in Canada is estimated at 1.8%, which exceeds the 1.1% rate at which the adult population is growing. An increasing percentage of us have jobs, which is a very encouraging indicator!
- Stock markets have surged. The main Canadian index (TSX 300) is up by 4% compared to the early fall. In the US, the S&P 500 is up by about 12% and the Dow Jones is up by about 15%. Rising stock markets reflect improved confidence, and they add to confidence.
- The Alberta economy appears to be stabilizing.
- In addition, late last year and early this year there were expectations that interest rates would rise, and this may have caused homebuyers to accelerate their purchases.
- In the Toronto, it appears that there was a wave of panic-buying starting in February (although it is now becoming obvious that the panic has subsided and activity has slowed sharply, as potential buyers take a wait-and-see position). For May, seasonally-adjusted sales in Toronto were down by 28% compared to the average for the prior five months. Reductions were seen in adjacent areas. The sudden turn in Toronto and surrounding areas contributed to a reduction in the Canada sales rate for May (which was down by 4.8% compared to the prior five months).

- In British Columbia, there was a sharp slowdown following the introduction of the foreign buyers' tax, as potential buyers took a wait-and-see attitude. It appears that this caution is now dissipating.

Looking at data for market areas across the country (in the long table at the end of this section), we can see that the recent trends are showing the most improvement in the areas that we would expect to benefit the most from the factors just discussed. On the other hand, trends are weak elsewhere:

- As noted above, in British Columbia the foreign-buyers tax has had a considerable dampening effect, in the short term. But, in a longer perspective, activity has been reduced to reasonable levels, from heated conditions that were seen a year ago.
- The strongest recent trends are found in Alberta, although as can be seen, activity in Alberta is still weak in a longer-term perspective. This pattern is most pronounced in the communities that produce energy (as opposed to the areas that have managerial roles).
- In Saskatchewan, sales were weakening before the October 3rd announcement and have weakened further.
- In Manitoba, changes in sales activity have roughly matched growth of the population.
- Within Ontario, trends have been quite strong in Toronto and in other southern Ontario communities that can be expected to receive overflowing demand from Toronto. However, as noted above, there has been a sudden turn in the Toronto-centred area. To the north and east, trends are weaker than for the province as a whole.
- Sales have strengthened in Quebec. This reflects a surge of job creation. For the past year, Statistics Canada's Labour Force Survey shows growth of 2.0%. This might be an over-estimate, but the other survey (Survey of Employment, Payrolls and Hours) also shows strong growth, at 1.6%. As was seen earlier, among the 7 regions defined in this study, optimism about the economic outlook is strongest in Quebec.
- Contrary to the national trend, sales have weakened in three of the four Atlantic provinces.
- In New Brunswick, the strong sales trend is not especially supported by job creation or population growth, but the combination of slow price growth (less than 1% per year) combined with falling interest rates have resulted in highly favourable affordability.
- Trends have weakened in Nova Scotia.
- Sales have dropped in Prince Edward Island (despite what appears to be a surge of job creation).
- The sales trend has weakened considerably in Newfoundland, reflecting the economic impacts of lower oil prices.

Conclusion

The impact of the stress test is not revealed by what actually happened in the housing market, but by what happened compared to what should have happened. We can't measure with any certainty what should have happened, although we can discuss key factors that would have influenced the outcome. At this time, the mix of factors is mostly positive, and we might have expected sales activity to have strengthened during the past few months. The sale trend did increase slightly. It is too soon to draw definitive conclusions about the extent to which the stress test might has affected activity.

It is possible that to this point, the impact of the stress test is negligible:

- Some potentially impacted buyers have adjusted their plans, to purchase less expensive homes, so that they require smaller mortgages and are able to qualify for those smaller mortgages.
- It is even more possible that substantial numbers of potentially impacted buyers have managed to escape the test by increasing their down payments, most often by receiving loans or gifts from other family members, or by borrowing from lenders.

During the coming months, some of these other factors will fade in importance (especially the panic-buying that occurred in the Toronto area earlier this year). The interpretation should become more definitive later this year.

Table 3-1 *Recent Sales Trends in Resale Markets Across Canada*			
CREA Area	*Average Sales Last 6 Months (Dec 2016-May 2017)*	*Last 6 Months vs 1 Year Prior to Stress Test*	*Last 6 Months vs 5 Years Prior to Stress Test*
Canada	**44,722**	**0.6%**	**11.6%**
British Columbia	**8,141**	**-17.1%**	**12.3%**
BC Northern	340	-3.0%	-3.5%
Chilliwack	309	-15.2%	36.0%
Fraser Valley	1,649	-19.7%	18.8%
Kamloops	268	5.6%	31.0%
Kootenay	266	13.9%	34.8%
Northern Lights	33	64.3%	6.5%
Okanagan-Mainline	765	-6.4%	27.6%
Powell River	31	-18.4%	10.4%
South Okanagan	204	1.5%	40.4%
Greater Vancouver	2,791	-26.3%	-2.7%
Vancouver Island	776	-11.1%	22.8%
Victoria	711	-14.4%	22.8%
Alberta	**4,754**	**9.6%**	**-7.3%**
Alberta West	101	22.3%	-7.2%
Calgary	2,057	10.7%	-9.7%
Central Alberta	319	0.0%	-16.8%
Edmonton	1,547	8.7%	0.5%
Edmonton (Board Total)	1,595	9.4%	0.0%
Fort Mcmurray	93	29.6%	-24.4%
Grande Prairie	184	19.1%	-16.5%
Lethbridge	210	-2.6%	6.5%
Lloydminster (AB)	50	29.6%	-24.6%
Medicine Hat	112	2.0%	-3.8%
North Eastern Alberta	48	33.5%	-12.6%
South Central Alberta	33	8.5%	-11.2%
Saskatchewan	**939**	**-4.5%**	**-13.9%**
Battlefords	34	-14.4%	-16.4%
Lloydminster (SK)	20	30.0%	-33.8%
Moose Jaw	54	-5.5%	-4.3%
Prince Albert	54	-3.5%	-9.6%
Regina	256	-9.6%	-14.7%
Saskatoon	389	-4.6%	-13.9%
SE Saskatchewan	38	6.8%	-28.7%
Swift Current	35	6.6%	-11.1%
Yorkton	60	5.8%	-0.5%
Manitoba	1,220	1.0%	4.6%
Brandon	119	3.9%	3.9%
Continued…			

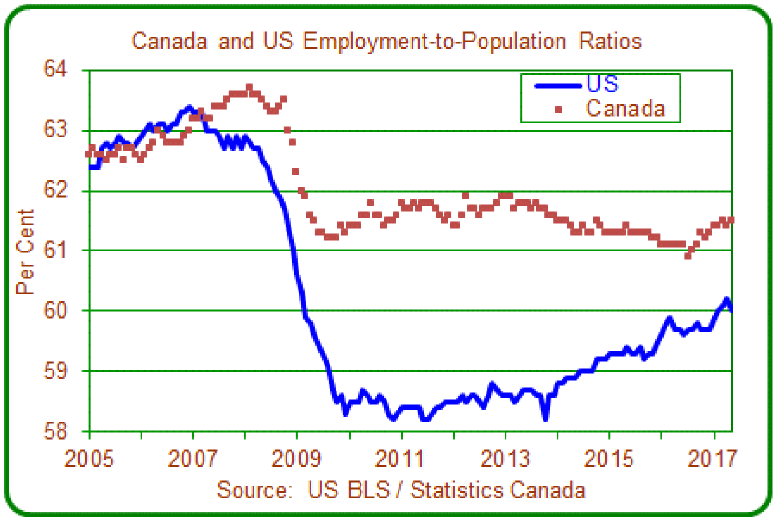
...Continued *Table 3-1* *Recent Sales Trends in Resale Markets Across Canada*			
CREA Area	*Average Sales Last 6 Months (Dec 2016-May 2017)*	*Last 6 Months vs 1 Year Prior to Stress Test*	*Last 6 Months vs 5 Years Prior to Stress Test*
Portage La Prairie	25	11.8%	9.7%
Thompson	2	-36.4%	-46.4%
Winnipeg	1,073	0.6%	4.7%
Ontario	**20,900**	**6.1%**	**20.4%**
Bancroft	33	4.3%	26.2%
Barrie	516	5.9%	24.6%
Brantford	243	21.0%	36.2%
Cambridge	217	8.3%	14.9%
Chatham Kent	125	9.1%	23.0%
Cornwall	117	-7.2%	-4.1%
Durham Region	1,029	4.1%	15.2%
Greater Toronto	9,432	2.4%	17.7%
Grey Bruce Owen Sound	267	7.7%	35.9%
Guelph	298	5.6%	16.9%
Hamilton-Burlington	1,308	8.5%	12.4%
Huron Perth	188	15.4%	27.8%
Kawartha Lakes	127	-8.0%	9.2%
Kingston	342	18.2%	27.2%
Kitchener-Waterloo	596	12.0%	29.1%
London and St Thomas	984	15.4%	32.4%
Mississauga	920	-5.1%	4.6%
Muskoka & Haliburton	288	12.6%	52.7%
Niagara Falls - Fort Erie	231	4.1%	39.6%
North Bay	110	10.3%	14.7%
Northumberland Hills	112	10.8%	22.8%
Oakville-Milton	468	8.6%	26.0%
Orangeville	59	0.9%	8.6%
Orillia	110	8.1%	25.7%
Ottawa	1,394	7.2%	13.7%
Parry Sound	57	17.9%	49.3%
Peterborough&the Kawarthas	256	-0.3%	12.5%
Quinte	348	27.5%	50.6%
Renfrew	117	2.8%	4.2%
Rideau-St. Lawrence	107	-1.7%	4.8%
Sarnia-Lambton	163	5.8%	13.4%
Sault Ste. Marie	117	-1.2%	0.8%
Simcoe	100	40.8%	44.3%
Southern Georgian Bay (east)	108	-4.3%	30.6%
Southern Georgian Bay (west)	191	-3.0%	15.8%
St. Catharines	340	20.0%	41.3%
Continued...			

...Continued Table 3-1 Recent Sales Trends in Resale Markets Across Canada			
CREA Area	*Average Sales Last 6 Months (Dec 2016-May 2017)*	*Last 6 Months vs 1 Year Prior to Stress Test*	*Last 6 Months vs 5 Years Prior to Stress Test*
Sudbury	198	2.0%	2.2%
Thunder Bay	199	3.4%	8.2%
Tillsonburg	53	-6.3%	17.1%
Timmins	90	-2.1%	-7.1%
Welland	157	10.8%	39.3%
Windsor-Essex	638	10.6%	33.9%
Woodstock-Ingersoll	156	30.0%	54.9%
York Region	1,755	-3.2%	13.6%
Quebec	**6,797**	**5.6%**	**9.6%**
New Brunswick	**634**	**8.9%**	**16.8%**
Fredericton	172	1.6%	10.0%
Moncton	225	16.1%	17.3%
Northern New Brunswick	66	3.5%	18.3%
Saint John	170	10.2%	23.4%
Nova Scotia	**819**	**-0.7%**	**2.3%**
Annapolis Valley	106	-7.1%	-0.4%
Cape Breton	59	3.2%	9.6%
Halifax-Dartmouth	427	0.7%	-2.6%
Highland	26	-8.6%	9.1%
Northern Nova Scotia	95	-4.0%	6.5%
South Shore	87	5.4%	21.8%
Yarmouth	20	-3.6%	7.6%
Prince Edward Island	**162**	**-3.6%**	**23.7%**
Newfoundland & Labrador	**301**	**-16.0%**	**-16.1%**
Northwest Territories	**20**	**-6.9%**	**40.7%**
Yukon	**35**	**14.5%**	**32.7%**
Source: calculations by the author, using data from the Canadian Real Estate Association			

4.0 Economic Risks Associated with the Stress Test

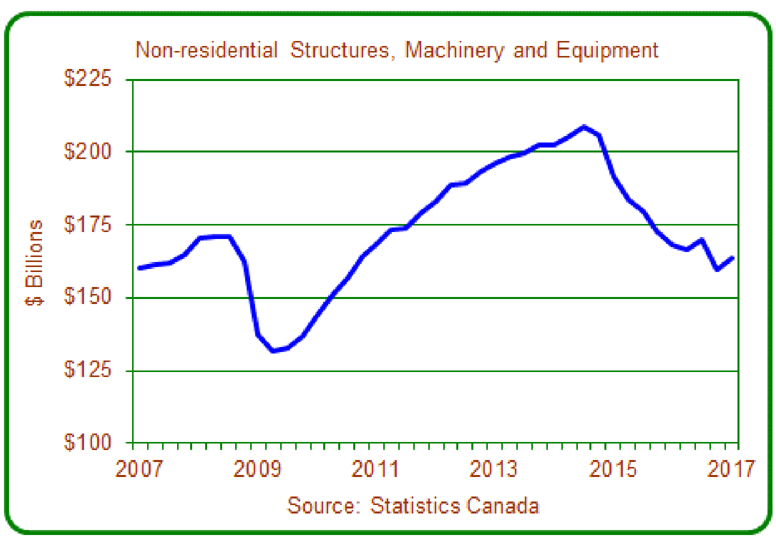
Interest rates have been exceptionally low for a long time, because economic conditions have been weak.

There are many economic indicators that can be used to characterize the state of the economy. The unemployment rate and the growth rate for Gross Domestic Product (GDP) are frequently used. This analyst prefers the "employment-to-population ratio" (the percentage of adults who have jobs). This is also sometimes referred to as the "employment rate". In both Canada and the US, the employment rates remain well below their pre-recession levels. Both Canada and the US saw slight recoveries for about three years, as they moved roughly in parallel during 2010 to 2012. That changed at the start of 2013. In the US, the pace of recovery improved starting in 2014, whereas in Canada there was a setback that started early in 2013.



Canadian GDP has recently shown an encouraging increase: during the past three quarters, growth has been at an annualized rate of 3.5%. However, growth is still largely based on consumer spending (56% of growth during the past three quarters). Housing activity remains a key driver (accounting for 11% of the recent growth). There has also been a large run-up in inventories (which has accounted for 23% of the growth during the period). However, changes in inventories are highly variable over time, and this artificially boosted the recent growth rate.

We are still not seeing the hoped-for resurgence of business investment in new productive capacity (buildings as well as machinery and equipment): the chart illustrates that while there was an increase during the first quarter of this year, this investment remains weak in historic terms. This in itself is a drag on current growth, but more importantly it limits the potential for future growth and sustained job creation.



The conclusion from this discussion is that while bond yields and interest rates do vary over time (bond yields are currently tending to increase, and it is possible that the Bank of Canada will raise its policy rate in either July or October), it is still too soon to expect a substantial and sustained rise.

Rising Debt Levels

Low interest rates benefit the economy through several channels. The most important of these is that they encourage consumers and businesses to borrow money in order to spend and invest.

For consumers, the greatest potential impact is through housing activity (purchases and renovations), which is highly interest-sensitive. Canadian data shows quite clearly that interest rates have worked as intended in the housing market.

Low interest rates should also stimulate increased investment by businesses. Unfortunately, responses have been muted in the business sector (as was illustrated in a chart, above).

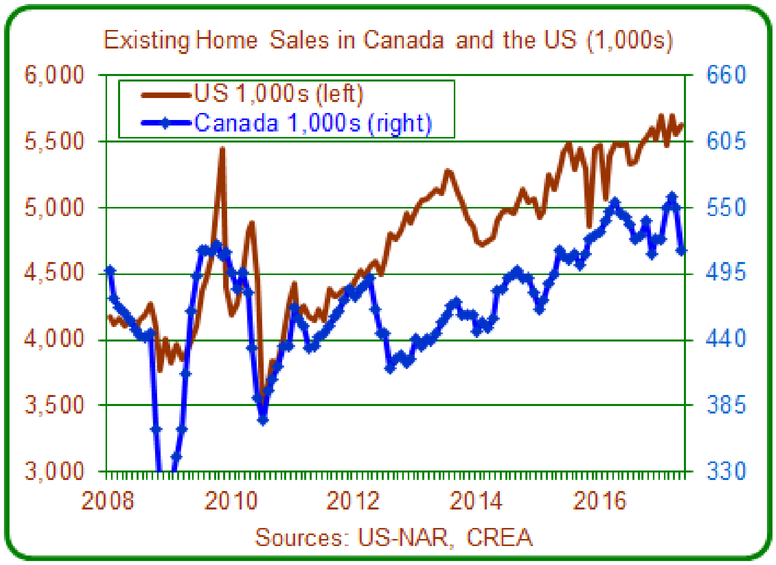
The consequences of this include:

- Our economic recovery has been weaker than might have been hoped-for and certainly has been weaker than has been expected by economists, and especially the Bank of Canada.
- Housing activity (and its indirect effects – especially the "wealth effect" that comes from rising house prices) has played an inordinate role in economic growth and job creation in Canada.
- In consequence of that, housing activity has resulted in very rapid growth of mortgage credit.

Low interest rates will promote economic growth only to the extent that they also result in increased borrowing. Policies that are intended to reduce borrowing can be expected to also weaken the economy. Relatedly, policies that are intended to reduce housing activity can also be expected to weaken the economy.

These points can be illustrated quite well in relation to mortgage insurance policy changes that were made in July 2012 (the chief change was the elimination of mortgage insurance for mortgages with amortization periods exceeding 25 years). The conventional wisdom argues that the July 2012 change had only a short-lived impact on the housing market. This analyst argues that the conventional wisdom is making a mistake: it is looking at <u>what happened</u> in the market whereas it should look at <u>what should have happened</u>:

- Interest rates fell shortly afterwards, and housing activity strengthened in response. But, it did not strengthen as much as it should have. Lower interest rates offset the effects of the policy change, masking the impact.
- This point can be illustrated by comparing housing market trends in Canada and the US during the post-recession period. At the time, the critical factors were similar in Canada and the US (in terms of trends for the employment-to-population ratios, as well as movements of interest rates). In consequence of the economic similarities, resale markets in Canada and the US moved in very similar ways, until the policy change was made in July 2012. Since then, the Canadian resale market has consistently under-performed compared to the US. This conclusion is contrary to the conventional wisdom, as it suggests the July 2012 policy change had a prolonged negative impact.



- (In this chart, the data for Canada is scaled at 11% of the US data, reflecting that the population of Canada is equal to about 11% of the US population. Until the policy change, resale activity in Canada had been very close to 11% of the US figures. After July 2012, sales in Canada fell to 9% of the US figures. The two percentage point drop in this ratio amounts to a 20% reduction. There has been a slight improvement, starting late in 2013, but even today the Canadian figures are still less than 10% of the US numbers.)

Another consequence can be seen in the employment data: as was commented earlier, the Canada and US employment-to-population ratios moved roughly in parallel during the post-recession period until the start of 2013, at which time the Canadian ratio weakened. This timing – six months after the policy change – is "about right" to have been influenced by a policy that constrained housing demand and thereby reduced the economic support that was being provided by the housing sector. The employment rate in Canada is still lower (by about one-half of a percentage point) than it was at the start of 2013. Meanwhile, the rate in the US has increased by about 1.5 points since then.

The point of this discussion is that <u>policy matters</u>. If a policy works as intended it will have consequences beyond the intentions. In the case discussed above, history shows that <u>a policy that was successful at suppressing housing activity also suppressed the economy</u>.

Risks Associated with House Price Declines

This analyst has written several critiques of the stress test. Among these is a personal submission made to the House of Commons Standing Committee on Finance[5].

The gist of the argument is:

- The greatest risk factor for the housing market (and one of the greatest risks to the overall economy) is a fall in house prices. Reduced house prices cause a loss of home equity, which can negatively affect confidence and alter consumers' actions in the economy, which impairs the broader economy.
- What starts as a small event – drops in prices and reduced spending by consumers – can snowball, into a large, widespread fall in prices and an economic downturn. This happened in the US: the economic crisis of 2008/09 started as a seemingly innocuous "correction" in local housing markets.
- If the stress test policy works as intended it will reduce housing activity, which in turn will weaken the economy. There is a risk that the house price reductions could snowball into something worse.
- The initial negative effects would emerge in communities that are already weak economically and have weak housing markets, and their reductions in spending would spread their pain across the country. The housing market data we have now (as discussed earlier) hints that this initial, localized pain may be present in some areas of the country. Conditions will continue to evolve.

The stress test is predicated on a scenario in which interest rates increase substantially (by about two percentage points from current levels) and the higher rates are sustained. At this time, it is difficult to make a case that this is a likely scenario.

- Any sharp rise in interest rates would dampen consumer spending and business investment, especially in relation to homebuying as well as investment in new buildings (residential and non-residential), which would impair the broader economy.
- It seems most likely that even if rates increased substantially, the increases could not persist.
- Therefore, a realistic scenario for sustained higher interest rates should be considerably less severe than the two percentage point rise that is assumed by the stress test.

[5] This document can be found on the author's personal website and at the Mortgage Professionals Canada site, here: https://mortgageproscan.ca/en/site/doc/40668

Two Mitigating Factors

Statistics Canada publishes data on debt service costs. The estimates are for "obligated" payments – for mortgages, the required payments based on the contracted amortization periods, and for other debts, the minimum monthly payments. But, we know that most mortgage borrowers pay more than they are required to: Mortgage Professionals Canada's fall 2016 report on the residential mortgage market estimated that Canadians are making actual mortgage payments totally $105 billion per year. By contrast the Statistics Canada data shows obligated mortgage payments of $76 billion. The difference of almost $30 billion could be labelled "voluntary excess payments".

The first mitigating factor is that their excess payments give most borrowers substantial amounts of room to make adjustments in the event that higher interest rates result in increased obligated payments. In fact, this $30 billion cushion is enough to accommodate a scenario developed by the Parliamentary Budget Office[6], in which the average mortgage interest rate rises to 4.8% by the end of 2021.

The second mitigating factor is that at today's low interest rates, mortgage principals are being repaid very rapidly. In the borrower's first payment, more than one-half is principal repayment. During the first five year term of a 25 year mortgage, about 15% of the principal will be repaid (if only the minimum required payments are made). In the event that a renewing borrower is unable to afford a higher interest rate, there should be room to reschedule payments, as an alternative to default.

It is quite possible that interest rates will increase to some degree during the coming years, but it seems unlikely that interest rates will increase to the level assumed by the stress test (by more than two percentage points above current levels).

On the other hand, if the stress test policy (or some other future policy) works as intended and reduces homebuying, it would weaken the Canadian economy.

If interest rates do increase to levels that are unaffordable to people renewing their mortgages, their difficulties can be often be addressed by extending their amortization periods. The consequence would be that it would take them longer than hoped-for to repay their mortgages, but at least they could stay in their homes, and continue to retire their mortgages.

Meanwhile, they will have been able to meet their own housing needs. On the other hand, if the stress test does achieve its intended objectives, it will unnecessarily prevent them from meeting their own legitimate needs at costs that they can afford.

The bottom-line is obvious: the government should, not be pursuing a policy which, if it works as intended, will impair the Canadian economy.

[6] The PBO report can be found here: http://www.pbo-dpb.gc.ca/en/blog/news/HH_Vulnerability