Annual State of the Residential Mortgage Market in Canada

Prepared for:

Canadian Association of Accredited Mortgage Professionals

By:

Will Dunning

CAAMP Chief Economist

November 2011

Table of Contents

List of Tables		
Table #	*Contents*	*Page*

1.0 Introduction and Summary

This is the seventh annual report on the State of the Residential Mortgage Market in Canada. It has been prepared for the Canadian Association of Accredited Mortgage Professionals ("CAAMP") by Will Dunning, Chief Economist of CAAMP. It provides an overview of the evolving state of the residential mortgage market in Canada. Major sections of this report are:

- Introduction and Summary
- Consumer Responses to Topical Questions
- Consumer Choices and Satisfaction
- Outlook for Residential Mortgage Lending

Data used in this report was obtained from various sources, including an online survey of 2,000 Canadians. More than one-half of the sample (1,031 Canadians) were home owners who have mortgages and/or other debt on their property. The remainder included renters, home owners without debts on their properties, or others who live with their families and are not responsible for mortgage payments or rents. The survey was conducted for CAAMP by Maritz (a national public opinion and market research firm) from October 20 to 25, 2011.

Consumer Responses to Topical Questions

In the Fall 2010 and 2011 editions of the CAAMP survey, consumers' opinions were sought on several issues, related to housing and mortgages, that have taken on high profiles in the media. The consumers were asked to what extent they agree with various statements, on a 10-point scale: a response of 10 indicates that they agree completely with the statement and a response of 1 indicates they disagree completely. Average scores of 5.5 would indicate neutral opinions.

The table below summarizes the responses. Results are presented in substantially more detail in the body of the report (starting at Page 9).

For all of the questions, responses varied widely, and it is challenging to generalize about consumers' attitudes. Highlights include:

- The statement that found the highest degree of agreement (an average rating of 7.98 out of 10) is that "as a whole, Canadians have too much debt". Almost one-half (46%) gave ratings of 9 or 10, showing very strong agreement with this statement. This, coincidentally or not, has been asserted repeatedly by senior government officials and other voices in the news media.
- There is also agreement (average rating of 7.11 out of 10) that "low interest rates have meant that a lot of Canadians became homeowners over the past few years who should probably not be homeowners".
- However, different perspectives were found with several other questions.
- There is a widespread opinion that "real estate in Canada is a good long-term investment", which received the second highest rating, an average of 7.27 out of 10.

- Furthermore, there was a high degree of agreement that mortgage debt is "good debt (7.07 out of 10).
- In addition, in a statement that was asked for mortgage holders only, few agreed that "I regret taking on the size of mortgage I did". The average score of 4.04 was well below neutral. Just 7% agreed strongly with the statement; 37% strongly disagreed.
- Many Canadians believe that other people have taken on too much debt or have bought homes for which they are unprepared. But, when responses about their own situations are aggregated, most believe that they have been responsible. The contrast between these sets of responses is interesting. Actual behaviour by people and their beliefs about their own behaviour tells us more than does their beliefs about the behavior of other people: overall these responses suggest that prudence rules the land.
- Meanwhile, data on mortgage arrears indicates that there are very few Canadians who are not meeting their mortgage obligations, and estimates developed in this report indicate that a vast majority of Canadian mortgage borrowers are well-positioned to deal with potential increases of mortgage rates. Moreover, they are acting aggressively to pay off their mortgages, considerably more rapidly than they are required to.

Table 1-1
Consumer Responses to Topical Questions
Average Responses (10 = Completely Agree)

Topic	*Fall 2011*
Canada's housing market is in a "bubble"	6.07
I am concerned about a downturn in Canada's housing market in the next year	5.84
Canada's superior banking system will shelter us from significant downturns like the one experienced by the United States	6.11
As a whole, Canadians have too much debt	7.98
House prices in my community are at a reasonable level	5.62
Low interest rates have meant that a lot of Canadians became home owners over the past few years who should probably not be home owners	7.01
I/My family would be well-positioned to weather a potential downturn in home prices	6.72
Real estate in Canada is a good long-term investment	7.27
I am optimistic about the economy in the coming 12 months	6.02
I regret taking on the size of mortgage I did	4.04
I am delaying my retirement until my mortgage is paid off	5.38
I would classify mortgages as "good debt"	7.07
Source: Maritz survey for CAAMP, Fall 2011.	

Consumer Choices and Satisfaction

The survey found that Canadians remain highly satisfied with the terms of their mortgages, and their experiences in obtaining their mortgages:

- 13% indicate they are completely satisfied with the terms of their mortgages (giving a rating of 10 out of 10) and a further 58% are satisfied (ratings of 7 to 9 out of 10). Combining these results, 71% are satisfied to some degree.
- 21% give a neutral satisfaction rate (5 or 6 out of 10).
- Just 8% are dissatisfied to some degree (1 to 4 out of 10).
- On average, the satisfaction rate is 7.4 out of 10.

Satisfaction with mortgage experiences was very similar, and the average rating was fractionally higher, at 7.6 out of 10. Older age groups are more satisfied with their mortgages and their mortgage experiences than are younger age groups. There are some variations across different groups.

About one-third (32%) of home owners with mortgages had some form of mortgaging activity during the past 12 months: taking out a new mortgage (9%), or renewing or refinancing an existing mortgage (23%). The remainder (68%) did not have any mortgaging activity during the year.

Among those who renewed or refinanced an existing mortgage during the past 12 months, 21% changed lenders and 79% remained with the same lender. The rate of switching has edged upwards – two years ago it was 12%.

Concerning types of mortgages, fixed rate mortgages remain most popular (60%). A significant minority (31%) are variable and adjustable rate mortgages. For mortgages originated or renewed during the past year, an increased share (37%) has variable or adjustable rates. This shift may be due to the large spread between rates for fixed rate and variable rate mortgages (close to 2% during the past year). As well, it is increasingly expected that interest rates will remain low for a prolonged period. Both of these factors are encouraging borrowers to accept the risk that the payments will increase for variable rate mortgages.

With regard to mortgage amortization periods, 22% of mortgages in Canada have amortization periods of more than 25 years. The share is higher (38%) among home owners who, during 2011, took out a new mortgage on a newly-purchased home or condominium.

Looking at interest rates, the CAAMP/Maritz data indicates that:

- The average mortgage interest rate for home owners' mortgages is 3.92%, a drop from 4.22% a year earlier.
- For borrowers who have renewed or refinanced a mortgage during the past year, their current average interest rate is lower (by 1.24 percentage points) than the rates prior to renewal. Among borrowers who renewed, a large majority (78%) saw reductions, a smaller proportion (13%) saw their rates rise, and 9% had no change. Based on the survey data, it is estimated that among 1.35 million mortgage borrowers who renewed or refinanced in the past year, the combined saving was $2.7 billion per year.

Mortgage rate discounting remains widespread in Canada. During the past year, the average "posted" rate for 5-year fixed rate mortgages was 5.38%. Discounted rates are estimated at an average of 3.92%, implying an average discount of 1.46 points.
Given concerns that have been expressed about consumers' abilities to cope with potential rises in interest rates, this issue of CAAMP's "Annual State of the Residential Mortgage Market" asked mortgage holders to indicate "the amount at which, if your monthly mortgage payment increased this much, you would be concerned with your ability to make your payments". The average amount of room is $750 per month on top of their current costs. A vast majority of mortgage holders has considerable capacity to afford rises in mortgage interest rates. There is a sizable minority (12%, or about

650,000 out of 5.80 million) who would be challenged by rate rises of less than 1%. However, most of these have fixed rate mortgages: by the time their mortgages are due for renewal, their financial capacity will have increased and the amount of mortgage debt will be reduced. Moreover, most of these borrowers (88%) have 10% (or more equity) in their homes. There are about 75,000 borrowers who are susceptible to short term moves of interest rates and have limited home equity - less than 2% of the 5.8 million mortgage holders in Canada.

This study asked questions that generated estimates of home owners' equity.

- The total value of owner-occupied housing in Canada is estimated at $3.017 trillion. Mortgages and lines of credit on these homes total $982 billion, leaving $2.035 trillion in home owners' equity. The equity is equal to 68% of the total value of the housing.
- Among home owners who have mortgages and/or lines of credit on their homes, 2% might have negative equity, and a further 4% have estimated equity of less than 10%. More than three-quarters (78%) have 25% or more equity.

The survey data indicates that 10% of mortgage borrowers took equity out of their home in the past year. The average amount is estimated at $49,000. These results imply that the total amount of equity take-out during the past year has been $28.5 billion. The most common use for the funds from equity take-out is debt consolidation and repayment, which accounted for $11 billion. This part of the total equity take-out would result in corresponding reductions for other forms of consumer debt. Home renovations accounted for about $5 billion of the equity take-out, with $6 billion for education and other spending, $3.5 billion for investments, and $3 billion for "other" purposes.

Among borrowers who have taken out a new mortgage during the past year, 52% obtained the mortgage from a bank, 32% from a mortgage broker, and 16% from other sources.

Outlook for Residential Mortgage Lending

Gradual recovery from the recession of 2008/09 has brought stabilization of housing activity, but at lower levels than pre-recession. The consensus of forecasts is for a continued moderate rate of job creation, which is expected to result in housing activity similar to recent levels, for both resales and new homes. These levels of activity are strong enough to support stable or slowly rising housing values: the average of forecasts is for house price growth of about 1% in 2012, a slowdown from the very strong growth of 7.7% expected for 2011.

As of this August, there is $1.079 trillion of residential mortgage credit outstanding in Canada. This includes both owner-occupied and investor-owned residential properties.

Based on the housing market forecasts, the volume of residential mortgage credit outstanding is forecast to continue expanding. Growth is forecast at about 7.7% during 2011 ($80 billion) and 7.3% in 2012 ($81 billion). A preliminary look at 2013 suggests growth of 7.0% ($83 billion).

While the forecasts for the economy, housing market, and mortgage market are encouraging, there is, as always, uncertainty about the outlook. In Canada, the largest risk factor for the mortgage market is “loss of ability to pay” (that is, job loss or a reduction of wages).

Data published by the Canadian Bankers Association shows that the gradual recovery from the recession is resulting in a gradually falling rate of mortgage arrears.

An increasing level of uncertainty about economic prospects is creating uncertainty about the outlook for the housing and mortgage markets.

The risk factor that gets the greatest amount of attention in Canada might be characterized as “an unaffordable rise in mortgage costs”. CAAMP’s research has repeatedly found that this is a negligible risk factor for Canada at present.

Thus, there are risks of outcomes worse than these forecasts. If that occurs, the cause will have been events in the broader economy. The US’s enormous economic difficulties started in the housing and mortgage markets. That will not be the case in Canada.

About CAAMP

CAAMP is the national organization representing Canada’s mortgage industry. With over 12,300 members representing 1,750 businesses, its membership is drawn from every province and from all industry sectors. This diversified membership enables CAAMP to bring together key players with the aim of enhancing professionalism.

Established in 1994, CAAMP has taken a leadership role in Canada’s mortgage lending industry and has set the standard for best practices in the industry.

In 2004, CAAMP established the Accredited Mortgage Professional (“AMP”) designation to enhance educational and ethical standards for Canada's mortgage professionals.

CAAMP’s other primary role is that of consumer advocate. On an ongoing basis CAAMP aims to educate and inform the public about the mortgage industry. Through its extensive membership database, CAAMP provides consumers with access to a cross-country network of the industry’s most respected and ethical professionals.

About the Author

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

About Maritz

Maritz Research 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 the largest provider of customer satisfaction research in the United States and a major supplier of brand equity research. In Canada, Maritz Research has been developing marketing research solutions for Canadian clients under the brand Maritz-Thompson Lightstone 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. CAAMP, Maritz, 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 CAAMP or Maritz.

2.0 Consumer Responses to Topical Questions

In both Fall 2010 and Fall 2011, the Maritz/CAAMP study investigated consumer attitudes on some current issues related to housing markets and mortgages. The respondents were asked to indicate the extent to which they agree or disagree with various statements, on a 10-point scale. A response of 10 would indicate complete agreement and a response of 1 indicates complete disagreement. Average responses of 5.5 out of 10 would indicate neutrality. To minimize the risk that the ordering of the propositions might affect responses, they were presented in randomized order.

On most of the questions, answers were widely distributed across the 1-to-10 range, and this author is often unable to find consensus of opinion.

However, there are a few exceptions where attitudes are clustered. And, the author finds it very interesting that for questions for which there is the greatest amount of polarization, the responses might be inconsistent.

- In particular, Canadians largely agree with the proposition that “as a whole, Canadians have too much debt”.
- On the other hand, among Canadians who have mortgages, few agree that they “regret taking on the size of mortgage I did”. In addition, there is substantial agreement that mortgages are “good debt”.
- These answers portray opinions that “other people” have taken on too much debt, but as individuals most are comfortable with the debts that they have taken on. The gap between these perspectives is intriguing.
- CAAMP’s previous research on mortgage indebtedness has found that Canadians – both borrowers and lenders – have been prudent with regard to mortgages (see the January 2011 report “Revisiting the Canadian Mortgage Market – the Risk is Minimal”). It might be that the fearful opinions about overall debt have been influenced by statements in the media, moreso than by the actual behaviour of Canadians.

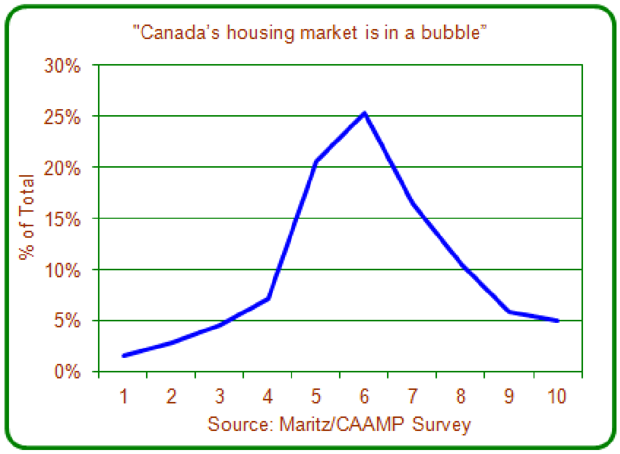
Another set of contrasting results is also interesting:

- A high percentage of Canadians agree with the proposition that “low interest rates have meant that a lot of Canadians became homeowners over the past few years who should probably not be homeowners”.
- But, even more of us agree that “real estate in Canada is a good long-term investment”. In addition, there is widespread agreement that “I/my family would be well-positioned to weather a potential downturn in home prices”
- Again, the author sees some inconsistency, and wonders whether statements in the media have influenced many Canadians to believe that <u>other people</u> (“but not me”) have been irresponsible.

Now, to the results.

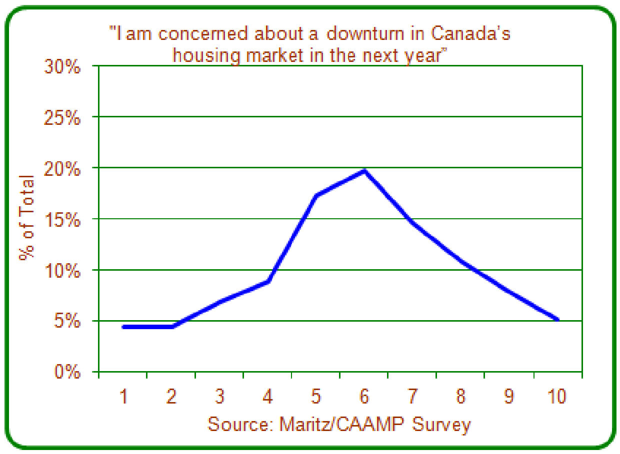
'Canada's Housing Market is in a "Bubble" '

On this proposition, opinions were slightly above neutral (average score of 6.07 out of 10). Almost one-half of the responses were neutral (46% gave neutral ratings of 5 or 6), and few consumers indicated either strong agreement or disagreement. On this issue, there has been a wide range of opinions expressed by "experts", and the neutrality of consumer responses is not surprising. On this question, opinions don't vary much across the country.



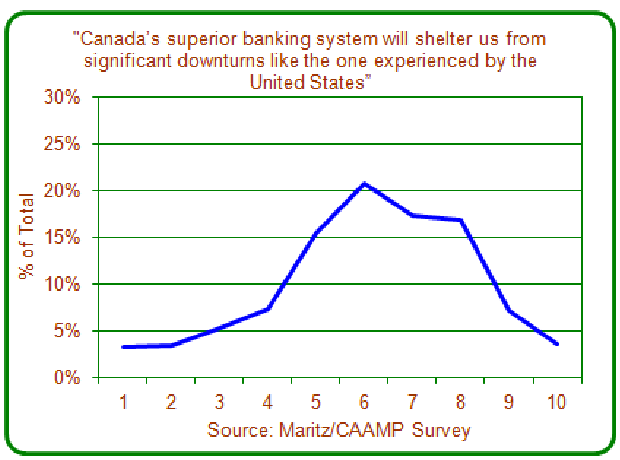
"I am Concerned about a Downturn in Canada's Housing Market in the Next Year"

Opinions are close to neutral on this question (averaging 5.84 out of 10). But, for this statement, we would hope to see a high level of disagreement (with most responses in the low range). These responses suggest weak confidence about housing market prospects. Across the country, the highest average responses (suggesting weak confidence) were found in Quebec, Saskatchewan, Ontario, and Manitoba). The lowest average score, indicating the strongest confidence, was in Atlantic Canada, followed by Alberta and British Columbia.



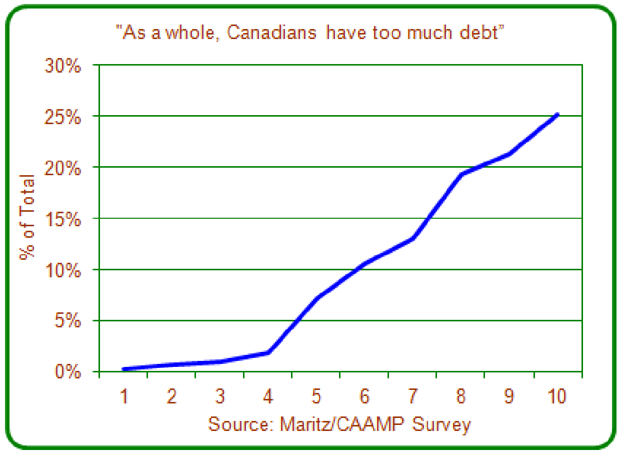
"Canada's Superior Banking System Will Shelter Us from Significant Downturns Like the One Experienced by the United States"

Opinions are slightly above neutral on this question (average response of 6.11 out of 10). Few Canadians gave extreme high or low responses. Detailed data indicates that home owners are more likely to agree to this proposition (average of 6.26) than are others groups (average of 5.79).



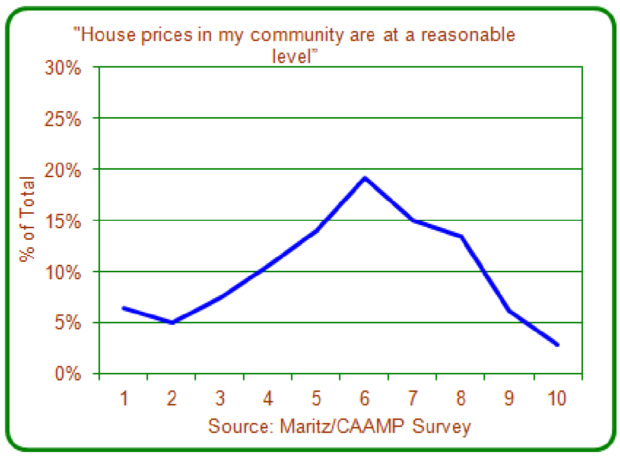
"As a Whole, Canadians Have Too Much Debt"

There was a very high level of agreement with this proposition (average response of 7.98 out of 10). As is discussed above, this topic has received a great deal of attention. The argument has been asserted repeatedly by senior government officials and other commentators, which has influenced opinions. Prudent mortgage borrowing (as is shown later) confirms that Canadians get the message.



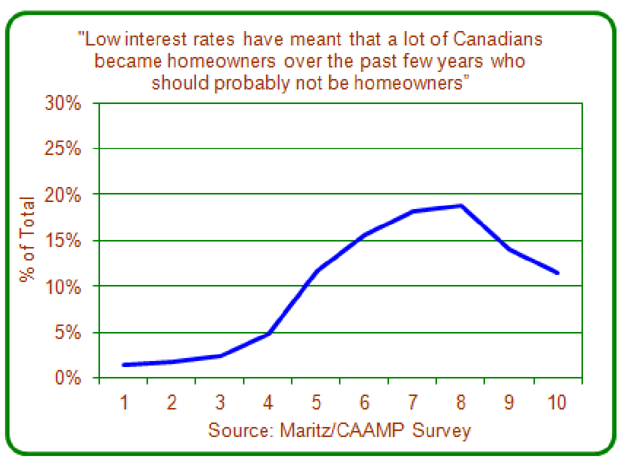
"House Prices in My Community Are at a Reasonable Level"

The average score (5.62) is very close to the neutral level of 5.5. The lowest scores are found in British Columbia (4.66) and Saskatchewan (4.77). In the remaining provinces, scores are close to 6 out of 10, indicating opinions that are just slightly above neutral. Only 1-in-10 Canadians strongly agree (9 or 10 out of 10) with this proposition, but the proportion that strongly disagrees (1 or 2 out of 10) is similar. Home owners answer more positively (5.97) than non-owners (4.86).



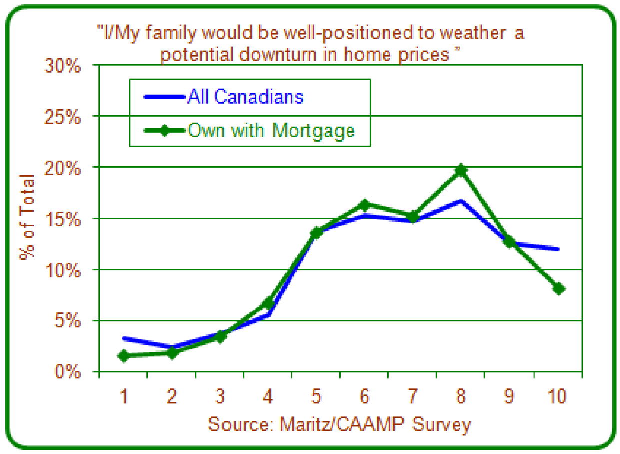
"Low Interest Rates Have Meant that a Lot of Canadians Became Homeowners Over the Past Few Years Who Should Probably Not be Homeowners"

This issue has not received a lot of attention for Canada, but it is well known that it has been a major contributor to the mess in the US. The proposition has traction with Canadians (average response of 7.01 out of 10). This concern seemingly contributed to the tightening of Canadian mortgage insurance criteria (on three occasions). Direct evidence for the proposition is lacking in Canada: CAAMP's research shows highly responsible behaviour by borrowers and lenders.



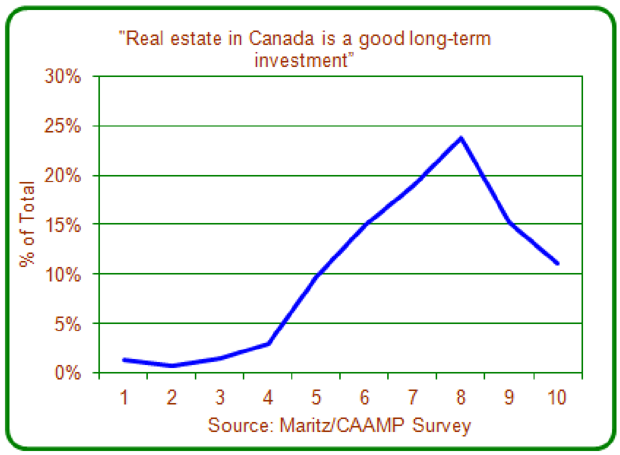
"I/My Family Would Be Well-Positioned to Weather a Potential Downturn in Home Prices"

Many different questions might have been asked about Canadians' abilities to deal with adverse economic events. Since the level of house prices and related risks has become a topic of conversation, we chose this question. The very small number of low responses suggests limited risks, and the average response of 6.72 is encouraging. For the most susceptible group (home owners with mortgages) the average response is very close to average, at 6.73. Non-home owners gave the lowest responses (5.84).



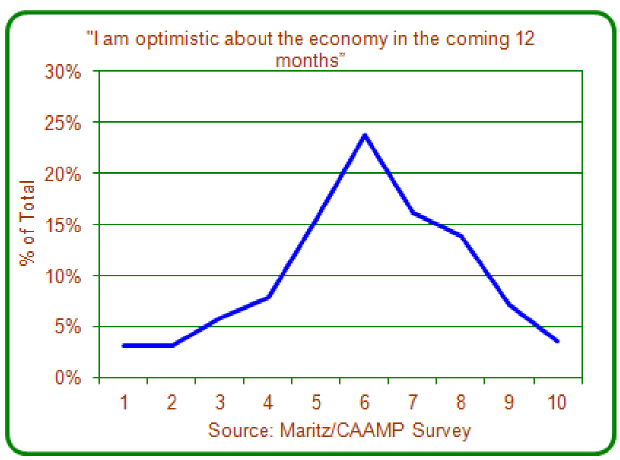
"Real Estate in Canada is a Good Long-Term Investment"

This proposition received a high degree of agreement (average response of 7.27 out of 10), with very little strong dissent (just 2% gave very low ratings of 1 or 2 out of 10). Home owners agree more strongly (7.49% out of 10) than non-owners (6.80). Responses were broadly similar across the country, exceeding 7 in all regions.



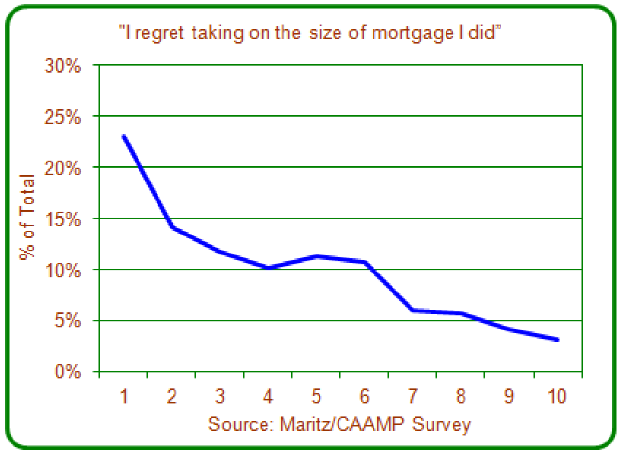
"I Am Optimistic about the Economy in the Coming 12 Months"

For this question we would hope to see a high share of positive responses. The average score of 6.02 out of 10 is slightly above neutral. Also considering the low shares for extreme responses (1 and 2, and 9 and 10), the suggestion is – at best – cautious optimism. The survey was conducted when uncertainty about the Greek debt crisis was at its peak, along with speculation about adverse consequences internationally.



"I Regret Taking on the Size of Mortgage I Did"

This proposition was put only to home owners who have mortgages. The average response was 4.04 out of 10. There were few strong agreements (7% gave scores of 9 or 10) or many strong disagreements (37% gave scores of 1 or 2). These responses suggest that the vast majority of mortgage holders are comfortable with their mortgages. Responses vary, depending on the length of time since the mortgage was originated.



For this question, an additional tabulation looked at variations, depending on the length of time since the mortgage was originated. This data shows that there are more regrets for the most recent mortgages, but even for this subset there were few strong regrets.

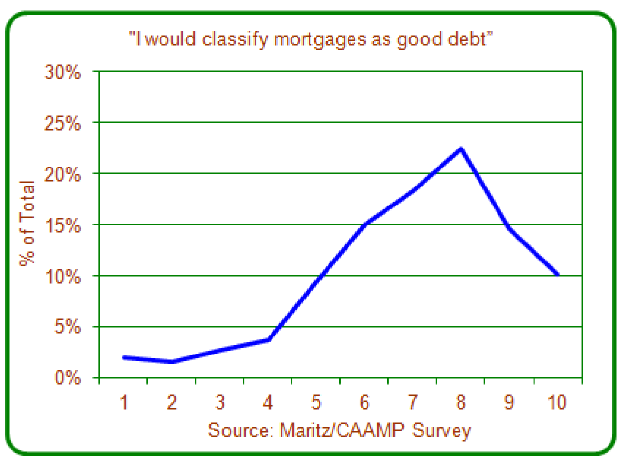
Table 3-1
Consumers' Responses to "I Regret Taking on the Size of Mortgage I Did", By Time Since Mortgage Originated

Response (out of 10)	*Less than 12 months*	*1 to 2 years*	*3 to 5 years*	*6 years or more*	*Don't know*	*All*
1-4	52%	56%	56%	66%	14%	59%
5-6	21%	23%	21%	20%	59%	22%
7-10	27%	20%	23%	14%	27%	19%
Total	100%	100%	100%	100%	100%	100%
9-10	13%	6%	7%	6%	13%	7%
Average	4.48	4.30	4.26	3.60	5.77	4.04

Source: Maritz survey for CAAMP, Fall 2011.

'I Would Classify Mortgages as "Good Debt" '

There is substantial agreement that mortgages are "good debt", with the average rating at 7.07 out of 10, very few strong disagreements, and most responses (two-thirds) above the neutral range. Home owners were more likely to agree with this proposition (average rating of 7.29 out of 10) than non-home owners (6.59).



3.0 Consumer Choices and Satisfaction

This section uses data from the consumer survey to highlight consumer choices in the mortgage market, including term selection, renewal activity, equity take-out, and research and shopping behaviour. It also provides data on amounts of home owners' equity, actual mortgage interest rates, and on consumers' satisfaction with their mortgages and the experience of obtaining their current mortgage. In this section, results are based mainly on a sub-sample of 925 households who own a home or condominium and have a mortgage.

Satisfaction with Mortgages and Mortgage Experiences

The CAAMP/Maritz survey found high levels of satisfaction with terms of mortgages and with mortgage experiences. Respondents were asked to rate their satisfaction on a 10 point scale, where 1 means completely dissatisfied and 10 means completely satisfied. In responding about the mortgage experience, the consumers were asked to consider that "this refers not only to the rate and terms, but the service you received from your Mortgage Professional and/or your Lender. This is your overall satisfaction with your entire mortgage experience".

On average, satisfaction with mortgage terms was rated at 7.4 out of 10. Ratings from the current survey are:

- 71% were either completely satisfied or satisfied to some degree (scores of 7 to 10).
- This includes 13% of respondents who indicated that they were completely satisfied (they provided a rating of 10). A further 58% Indicated that they were satisfied (a rating of 7, 8, or 9).
- 21% gave neutral ratings (5 or 6).
- Just 7% indicated they were somewhat dissatisfied (rating of 2, 3, or 4).
- Only 1% indicated complete dissatisfaction (rating of 1).

On average, satisfaction with mortgage experiences was rated at 7.6 out of 10.

On both questions, the data indicates that older Canadians express higher satisfaction ratings than do younger age groups.

Table 3-1
Average Satisfaction Ratings for Mortgages by Age Group

Age Group	*With Terms of Mortgage*	*With Mortgage Experience*
18-34	7.0	7.3
35-54	7.5	7.6
55 and Over	7.9	8.2
All Ages	7.4	7.6

Source: Maritz survey for CAAMP, Fall 2011.

Digging more deeply into the data:

- Those who renewed their mortgage during the past year reported above-average levels of satisfaction for mortgage terms (7.9) and the mortgage experience (8.0).
- Those who originated new mortgages during the year were not far behind, giving average ratings of 7.7 for mortgage terms and 7.8 for the mortgage experience.
- By type of mortgage, the highest satisfaction ratings were reported for variable or fixed rate mortgages (averages of 8.2 for the mortgage terms and 8.1 for the mortgage experience.

The consumers were asked "when your mortgage next comes up for renewal/renegotiation, how likely are you to place your mortgage through the same Lender (this is the financial institution that provided the funds for your mortgage)?" Not surprisingly, levels of satisfaction with mortgage experiences affect their expectations about renewal. For those rating their mortgage satisfaction as 10 out of 10, the average likelihood of renewing with the same lender is 8.9 out of 10. Those who rated their experience as 4 out of 10 or lower indicated a low likelihood of renewing with the same lender (average rating of 4.6 out of 10).

Mortgage Activity During the Past 12 Months

In the CAAMP/Maritz study, 32% of home owners with mortgages had some mortgage activity during the preceding 12 months, which could include:

- Taking out a new mortgage (this could include a mortgage on a newly purchased home/condominium or a new mortgage on a property that was already owned). This activity occurred for about 525,000 households, or 9% of households with mortgages. The average mortgage principal is $216,000 for a combined total of $114 billion.
- Renewing a mortgage. This occurred for about 1.35 million mortgage holders (about 23%). The average principal is $157,000, for a combined total of $213 billion.
- In combination, about 1.9 million mortgage holders had one of these activities during the past year, and the total principal involved was about $326 billion.

Out of 5.8 million home owners with mortgages, about 850,000 (15%) refinanced early (before the mortgage was due for renewal). About 500,000 mortgages were renewed on schedule. About 650,000 mortgage holders (11%) are currently considering an early renewal. A further 12% (about 700,000 mortgage holders) considered refinancing early, but decided not to.

Among those who renewed early, about one-half (53%) paid no penalty as they renewed with the same lender, 9% paid penalties of less than $1,000, 14% paid penalties ranging from $1,000 to $2,499, 6% paid $2,500 to $4,999, and the remainder (18%) paid $5,000 or more.

Mortgage Mobility

Consumers who have renewed a mortgage were asked if they remained with the same lender or switched to a different lender. Among those who renewed during the past 12 months a very large majority of borrowers stayed with the same lender (79%) and only 21% changed lenders. The share who switched has increased compared to a year ago (when it was 17%) and compared to two years ago (12%).

Fixed Rate Versus Variable Rate Mortgages

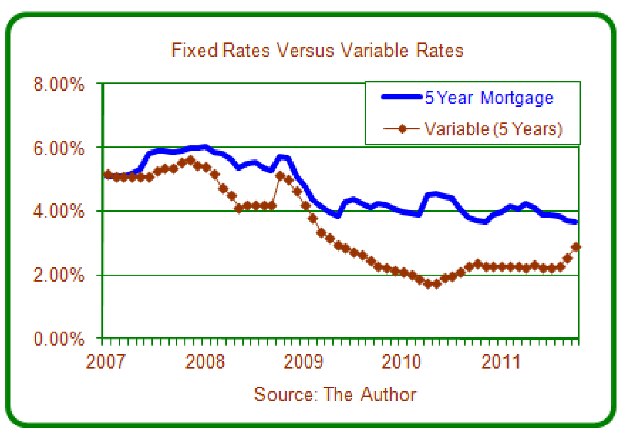
The CAAMP/Maritz study found that 60% of mortgage holders have fixed rate mortgages, 31% have variable and adjustable rate mortgages, and 8% have "combination" mortgages, in which part of the payment is based on a fixed rate and part is based on a variable rate.

For mortgages that were originated or renewed during the past year, the distribution is different, as the share for variable or adjustable rate mortgages is 37%.

Table 3-2
Percentages of Mortgages by Type

Mortgage Type	*All Mortgages*	*Active Past Year*
Fixed-rate	60%	56%
Variable or adjustable-rate	31%	37%
Combination	8%	7%
All Types	100%	100%
Source: Maritz survey for CAAMP, Fall 2011.		

Prior to this survey, the shares had been relatively stable. The recent shift towards variable and adjustable rate mortgages and (slightly) away from fixed rates has no doubt been influenced by the comparative costs.



The chart to the right shows the author's estimates of "typical discounted" mortgage rates. We can think of the difference between variable rates and fixed rates as the price of insurance that mortgage costs won't increase in the next five years. The cost of that "insurance" has been much greater during the past two and a half years than it was in the prior two years. Added to that, expectations are that rates will remain low for a prolonged period. The result is that more borrowers are deciding to forego the "insurance" that is provided by a fixed rate mortgage.

In the chart above, the rates for variable rate mortgages have increased in the last two months. However, this applies only to new mortgages: most variable/adjustable rate mortgages already in place have rates in the range of 2-2.25%.

New data from the Fall 2011 survey sheds additional light on switching of mortgage types.

Among those with fixed rate mortgages, 72% say that their mortgage has always been fixed rate; 28% have at some time switched from a variable rate mortgage (of which about one-half switched in the past 12 months – this group represents about 450,000 mortgages).

For those with adjustable/variable rate mortgages, only 33% say their mortgage was always of that type, and two thirds have switched from fixed rates. This includes 22% who switched during the past year (representing about 400,000 mortgages) and 45% who switched more than a year ago.

This data is partly explainable by the "insurance" theory and the widened spread between fixed and variable rates. It is also consistent with a notion of "mortgage life-cycles". Young home owners are most likely to choose fixed rates. Over time, as they become more experienced, and also as their finances strengthen, they become more inclined to opt for low rates rather than security.

Mortgage Amortization Periods

Mortgage holders were asked for the length of the "mortgage amortization when you first obtained your mortgage". At present, the federal government is no longer guaranteeing new mortgages with amortization periods greater than 30 years. For a few years, amortization periods of up to 40 years were eligible for guarantees. There is still – in theory – availability of longer amortization period for mortgages without mortgage insurance.

About one-fifth (22%) have amortization periods of more than 25 years. This share is unchanged compared to a year ago, but it is higher than two years ago (18%) and three years ago (16%). Most mortgages (78%) have amortization periods of up to 25 years.

The table below provides more detail, showing amortization periods depending on the period when the property was purchased by the current owner. The current mortgage may have been obtained at a different date (the mortgage might have been initiated earlier, if the buyer assumed an existing mortgage, or later, if the owner refinanced subsequently). For homes purchased in 2006 or later, 65% of mortgages have amortization periods of 25 years or less and 35% have amortizations exceeding 25 years. The bottom row of data concentrates on the most recent purchases, and finds that for homes purchased in 2011, 41% of mortgages have an amortization period longer than 25 years.

Table 3-3 Percentages of Mortgages by Length of Original Amortization Period, By Period of Property Purchase					
Period of Purchase	*0-25 Years*	*26-30 Years*	*31-35 Years*	*36-40 Years*	*Total*
Prior to 1990s	96%	2%	2%	0%	100%
1990s	94%	3%	1%	2%	100%
2000-2005	92%	4%	3%	1%	100%
2006-2011	65%	14%	12%	9%	100%
Total	78%	9%	8%	5%	100%
2011	59%	27%	8%	6%	100%
Source: Maritz survey for CAAMP, Fall 2011.					

Mortgage holders were asked to indicate the "year you expect to have your mortgage paid off (taking into account all anticipated changes to your mortgage, including refinancing, accelerated payments, etc.)".

The responses indicate that a large majority (close to 90%) of borrowers expects to considerably shorten amortization periods, and this applies to both traditional 25 year amortizations and the more recent extended amortizations. A minority (8%) expects that their amortization will be extended compared to the original intention, and this also applies across the board. Overall, the borrowers expected that their actual amortization periods will be about one-third shorter than the originally contracted period.

Table 3-4 Anticipated Changes in Amortization Horizons, by Original Amortization Period					
Expected Change in Horizon	*0-25 Years*	*26-30 Years*	*31-35 Years*	*36-40 Years*	*Total*
% Earlier	86%	84%	94%	93%	87%
% As Per Original	5%	11%	2%	0%	5%
% Later	8%	5%	4%	7%	8%
Total	100%	100%	100%	100%	100%
Average Change (Years)	-8.7	-9.6	-11.7	-14.1	-9.2
Source: Maritz survey for CAAMP, Fall 2011.					

Interest Rates

The CAAMP/Maritz study collected data on mortgage interest rates for current mortgage holders. The average mortgage interest rate is 3.92%.

For those who have financed a new mortgage during the past year, the average interest rate is 3.30%; for those who renewed or refinanced a mortgage during the year, the average rate is 3.39%.

By type of mortgage, the average rates (for mortgages financed or renewed during the past year) are: fixed rate mortgages – 3.86%; variable or adjustable rate mortgages – 2.96%, and combination type mortgages – 3.37%.

The survey also asked what the interest rate was prior to renewal. For those who have renewed a mortgage during the past 12 months, those rates have been compared to the mortgage borrowers' current rates. This analysis found that the interest rates increased for 13% of these borrowers, but were unchanged for 9%, and rates fell for 78% of these borrowers. On average, among borrowers who renewed a mortgage, the interest rate fell by 1.24 percentage points. The survey data suggests that the 13% of renewers whose rates increased represent about 175,000 out of 5.8 million mortgage borrowers.

Combining data from this study: among the 1.35 million mortgage borrowers who renewed mortgages in the past year the average change in interest costs was a reduction of about $2,000 per year. This indicates a total saving of about $2.7 billion per year, which the borrowers could apply to savings, accelerating their repayments, or to other spending. As will be seen below, mortgage borrowers are making substantial voluntary efforts to accelerate their mortgage repayment.

Mortgage Rate Discounting

The average mortgage interest rate reported here (3.86, for fixed rate mortgages negotiated during the past year) is well below the typical posted (advertised) rates that have been available during the past year. During the past year, posted rates for five year terms have averaged 5.38%.

An alternative view looks at the average spread between typical "posted" rates versus typical discounted rates (for fixed-rate mortgages with 5-year terms). During the year prior to CAAMP's Fall 2011 survey, the average rates were 5.38% for posted rates and 3.92% for discounted rates: the spread was 1.46 points[1].

Ability to Afford Interest Rate Increases

Given that interest rates in Canada have been at very low levels for a prolonged period, concerns have been expressed that many home owners may be unable to afford their payments when rates inevitably rise.

CAAMP has previously investigated this very important question, in prior editions of these semi-annual surveys, as well as in two special reports (published in January 2010 and 2011 - "Revisiting the Canadian Mortgage Market"). Those studies used large datasets of actual mortgage transactions to simulate the impacts on borrowers if mortgage rates were to rise to 5.25% (the 2010 edition) or 5.0% (2011).

- On those assumptions, the simulations showed that the vast majority of the borrowers had room to accommodate increased payments.

[1] Source: For posted rates, data are obtained from the Bank of Canada, using "Conventional mortgage" rates (estimated as of each Wednesday); discounted rates (also for 5-year fixed rate mortgages) have been estimated by the author.

- For example, the 2011 edition concluded that "among high ratio buyers whose mortgages were funded during 2010, about 2,000 to 2,500 might have TDS ratios of 45% or more, if interest rates rise to the extent assumed."
- Relative to the number of households in Canada (about 13.6 million) these are extremely small numbers.
- Moreover, the likelihood of interest rates rising to the extent assumed (to 5%) in the near future appears to be quite remote. Even with the assumption employed last January, the research concluded that the vast majority of borrowers had the capacity to afford the potential cost increases; calculations based on current expectations would show even smaller risks.

This issue of CAAMP's "Annual State of the Residential Mortgage Market" further explores the issue. It confirms, again, that a vast majority of Canadians have substantial capacities to afford higher interest rates. The survey asked mortgage holders to indicate "the amount at which, if your monthly mortgage payment increased this much, you would be concerned with your ability to make your payments". The responses indicate:

- The average amount of room is $750 per month on top of their current costs.
- Just 3% indicated that they have no room (the affordable increase is $0).
- A further 3% indicated their room is $1 to $49, and 2% indicated $50 to $99 per month.
- In combination, 8% indicate they cannot afford an increase of $100 per month or more.
- 8% indicated that their room is $100 to $199.
- 16% reported room in the range of $200 to $299.
- This leaves 68% whose capacity is $300 per month or more.
- Even for those who originated the mortgage within the past year, the distribution of answers is essentially the same: the average room is about $900 per month and just 5% say they cannot afford an increase of $100 or more.

Other data from the survey was used to calculate the rises in interest rates that could be tolerated. The next table applies those estimates to the 5.80 million mortgage holders in Canada. Once again, the data suggest that a vast majority of mortgage holders have considerable capacity to afford rises in mortgage interest rates. There is a sizable minority (about 650,000 out of 5.8 million, or about 12%) who would be challenged by rate rises of less than 1%.

For most of the mortgage borrowers who are potentially at-risk, there are mitigating factors:

- Most of them have substantial amounts of housing equity: 88% have 10% or more equity and have potential to call on their equity, either by selling or by refinancing. An estimated 12% (about 75,000) less than 10% equity in their home.
- For many others, time will be a mitigating factor, as about three-quarter of them have either fixed rate or combination mortgages: any changes in interest rates will not affect them until their renewal dates. By the time their mortgages come due for renewal, they will have seen some income growth and the amount of mortgage principal will have been reduced, and the future impact of interest rate increases will be less than it might be today.

Table 3-5 Estimated Numbers of Mortgage Holders by Thresholds for Unaffordable Rises in Mortgage Rates		
Unaffordable Interest Rate Rise	*% of Mortgage Holders*	*Number of Mortgage Holders*
< 0.25%	4%	225,000
0.25%-0.49%	1%	75,000
0.5%-0.74%	3%	175,000
0.75%-0.99%	3%	175,000
1.0%-1.49%	6%	325,000
1.5%-1.99%	4%	225,000
2% or More	79%	4,600,000
Total	100%	5,800,000
Source: Maritz survey for CAAMP, Fall 2011.		

Housing Equity

Data from the consumer survey has been used to generate estimates of home equity in Canada.

In prior reports, the equity amounts were calculated by comparing the value of owner-occupied homes in Canada with the associated mortgages. Starting with the Spring 2011 survey, data has also been collected on home equity lines of credit (known as "HELOCs"). This has resulted in an increase in the estimated amount of debt and a consequent reduction in estimated equity, compared to estimates prior to the Spring of 2011. This is an "accounting change", not a real reduction.

The estimates of housing values, related debt, and home owner equity are summarized in the table below. In addition to the total estimates, four categories are shown: owners with both mortgages and HELOCs, home owners with mortgages only (without HELOCs), owners with HELOCs (but without mortgages), and owners with neither mortgages nor HELOCs.

Based on data from the 2006 Census, updated using data on completions of new housing, the author estimates that there are currently about 13.6 million occupied dwellings in Canada. Of these, about 9.55 million are owner-occupied, including about 5.80 million with mortgages and 3.75 million without mortgages. CAAMP's Spring 2011 survey data has been used to further refine the estimates across four categories. The more detailed estimates of financing are shown in the first line of the table (the second line shows the percentages).

For Canadian home owners, the average dwelling value is estimated (by the occupants) at $316,000, which results in a total combined value of $3,017 billion (or $3.02 trillion).

Across all of the home owners (including those with and without mortgages and/or HELOCS), the average mortgage amount is $90,000 and the average HELOC is $12,000, for a combined average debt $102,000, and a total indebtedness of $982 billion. This total includes $858 billion in mortgages and $124 billion in HELOCs.

Contrasting the total value with total indebtedness, Canadian home owners have about $2.035 trillion in home equity (shown in the second last line of data). As is shown in the last line of the table, this is equivalent to 68% of with total housing value, which leaves a debt ratio of 32% of total value[2].

For the four categories of home owners, the equity ratios are:

- Home owners with both mortgages and HELOCs – 42%.
- With mortgages only – 51%.
- With HELOCs only – 81%.
- With neither mortgages nor HELOCs – 100%.

Table 3-6
Estimates of Home Owner Equity in Canada, as of Fall 2011
Mortgages and HELOCs Included

	Mortgage and HELOC	*Mortgage Only*	*HELOC Only*	*Neither Mortgage Nor HELOC*	*Total*
Number of Households	1,020,000	4,780,000	900,000	2,850,000	9,550,000
% of Home Owners	10.7%	50.1%	9.4%	29.8%	100.0%
Average Value of Homes	$350,000	$306,000	$314,000	$321,000	$316,000
Total Value ($ bn)	$357	$1,461	$283	$916	$3,017
Average Mortgage	$139,000	$151,000	$0	$0	$90,000
Average HELOC	$63,000	$0	$60,000	$0	$12,000
Average Combined Debt	$202,000	$151,000	$60,000	$0	$102,000
Total Combined Debt ($ bn)	$206	$722	$54	$0	$982
Average Equity	$148,000	$155,000	$254,000	$321,000	$214,000
Total Equity ($ bn)	$151	$741	$229	$915	$2,035
Equity Ratio (%)	42%	51%	81%	100%	68%
Source: Maritz survey for CAAMP, Fall 2011; estimates by the author.					
Note: Figures may not add due to rounding.					

Most Canadian home owners have considerable amounts of equity. Among the home owners who have some form of debt on their property (shown in the first data column of the next table), 2% (150,000 to 175,000) might have negative equity, and 4% (250,000) have equity positions from 0% to 9.9%. A further 16% (about 1.05 million) have equity positions in the range from 10% to 24.9%. More than three-quarters (78%, or 5.2 million) have 25% or more equity. In addition, about 2.85 million home owners who have neither mortgages nor HELOCs have 100% equity in their homes.

[2] The Spring 2011 survey yielded higher estimates for each of the components of equity, including the average home value ($336,000, versus the $316,000 figure for the Fall of 2011). The changes can be attributed to the variations that sometimes result from sample surveys. The two surveys yielded similar estimates of the equity ratio: 66% for Spring 2011 and 68% for Fall 2011.

Table 3-7 ***Equity Positions of Canadian Home Owners***			
Equity as Percentage of Home Value	*With Mortgage and/or HELOC*	*Neither*	*Total Home Owners*
negative equity	2%	0%	2%
0-4.99%	2%	0%	1%
5-9.99%	2%	0%	1%
10-14.99%	4%	0%	3%
15-24.99%	11%	0%	8%
25-49.99%	25%	0%	18%
50-74.99%	24%	0%	17%
75-99.9%	29%	0%	20%
100%	0%	100%	30%
Total	100%	100%	100%
Source: Maritz survey for CAAMP, Fall 2011; estimates by the author.			

The survey asked mortgage holders to what extent they are comfortable with their equity position (these mortgage holders might also have HELOCs; the question was not asked for owners who have HELOCs only or no debt on their residence). The consumers' responses showed that a small minority (5%) consider themselves "very uncomfortable" with their equity positions, and a further minority (16%) report being "somewhat uncomfortable". A substantial majority (74%) is comfortable - either "somewhat comfortable" (46%) or "very comfortable" (28%). The levels of comfort show minor variations across the regions of Canada: in all regions, large majorities are comfortable with their equity positions.

Table 3-8 ***Consumers' Comfort Levels With Their Current Equity Positions***								
Comfort Level	*Atlantic*	*Quebec*	*Ontario*	*Manitoba*	*Saskatchewan*	*Alberta*	*British Columbia*	*Canada*
Very Uncomfortable	4%	1%	5%	12%	10%	7%	11%	5%
Somewhat Uneasy	11%	13%	16%	20%	13%	23%	21%	16%
Somewhat Comfortable	42%	54%	44%	36%	33%	47%	42%	46%
Very Comfortable	35%	25%	31%	32%	40%	21%	22%	28%
Don't Know or No Opinion	8%	8%	4%	0%	3%	3%	4%	5%
Source: Maritz survey for CAAMP, Fall 2011; estimates by the author.								

Equity Take-out

The survey data indicates that 10% of mortgage holders took out equity from their homes or increased the amount of the mortgage principal within the past twelve months. The average amount of equity take-out is estimated at $49,000. Various findings from the survey can be combined to generate an estimate of the total amount of equity take-out by Canadian mortgage holders:

- At present there are about 5.80 million home owners with mortgages in Canada.
- 10% of home owners with mortgages have taken out equity during the past year.
- The average amount taken out was about $49,000.
- Combining these factors, the total amount of equity take-out is calculated as $28.5 billion.

Those who took out equity were asked what they used the money for. Some people indicated more than one purpose. Therefore, the following responses add to more than 100% - on average, 1.4 purposes were given:

- 62% indicated that the money would be used for debt consolidation or repayment.
- 40% gave renovation or home repair as the purpose.
- 22% mentioned making purchases or education as the purpose.
- 8% mentioned investments.
- 6% mentioned “other” purposes.

From the responses, it is estimated that 38% of the take-out (or about $11 billion) was for debt reconsolidation and repayment. Therefore, while the amount of outstanding mortgage debt would have increased by this amount, totals for other types of debt would be correspondingly reduced. About $5 billion was taken out for renovations, $6 billion for education and other spending, $3.5 billion for investments, and $3 billion for other purposes.

Voluntary Additional Payments

The survey data indicates that 36% of mortgage holders (about 2.1 million out of 5.8 million mortgage holders) have made additional voluntary efforts to accelerate repayment of their mortgages during the past year. As is shown in the next table, this includes 16% who increased their monthly payments (more than 900,000), 17% who made lump sum payments (almost one million), and 5% who increased the frequency of their payments (325,000). Some (about 6%) of these mortgage holders made more than one of these additional efforts.

Among borrowers who renewed their mortgage in the past year and experienced a reduction in their interest rate, 24% voluntarily increased their payments.

Looking in detail, depending on the periods when the properties were purchased, those who have purchased most recently (2006 to 2011) are making the most additional efforts to speed-up repayment of their mortgages.

Table 3-9 Consumers' Additional Efforts (During the Past Year) to Accelerate Mortgage Repayment, By Period of Home Purchase				
Period of Purchase	Increased Payment	Made Lump Sum Payment	Increased Payment Frequency	One or More Additional Efforts
Before 1990s	16%	10%	3%	28%
1990s	17%	8%	6%	29%
2000-2005	13%	15%	3%	31%
2006-2011	16%	19%	6%	37%
All Periods	16%	17%	5%	36%
Source: Maritz survey for CAAMP, Fall 2011; estimates by the author.				

Use of Mortgage Professionals

Homeowners with mortgages were asked "when you took out the mortgage that you currently have on your residence, which of the following mortgage professionals did you consult with?" They were able to name more than one type, with the result that the total adds to more than 100%. On average, 1.57 responses were given. The table below shows the percentages of borrowers who consulted with each of the major categories of mortgage professionals. In addition, the consumers were asked through which type of professional they ultimately obtained their mortgage, and the responses are summarized in the two right hand columns of the table. For this data, survey results are provided for both 2010 and 2011. The 2011 data show a small shift towards mortgage brokers (to 27% versus 25% a year earlier).

Table 3-10 Types of Mortgage Professionals Consulted When Obtaining Current Mortgage			
Type of Organization	Consulted With	Obtained From	
	Fall 2011	Fall 2010	Fall 2011
Representative from a Bank	69%	55%	55%
Mortgage Broker	45%	25%	27%
Representative from A Credit Union	22%	11%	10%
Representative from a Life Insurance/ Trust Company	14%	3%	3%
Other	7%	6%	5%
Source: Maritz survey for CAAMP, Fall 2011.			

The next table looks more closely, at borrowers who took out new mortgages during the past 12 months, who renewed or refinanced mortgages during the same period, and borrowers who did neither during the past 12 months. Among all mortgage holders, 55% obtained their mortgage from a bank. Mortgage brokers were the second most important source overall, accounting for one-quarter of all mortgages. For new mortgages, 52% were obtained from banks, 32% from mortgage brokers and about one-sixth (16%) of new mortgages were obtained from other types of mortgage organizations (including credit unions and life insurance companies).

Table 3-11
Types of Mortgage Professionals Through Which Current Mortgage was Obtained, By Type of Mortgage Activity in Past 12 Months

Type of Organization	*Took Out New Mortgage*	*Renewed/ Refinanced Mortgage*	*Did Neither*	*All Mortgage Holders*
Representative from a Bank	52%	67%	53%	55%
Mortgage Broker	32%	19%	27%	27%
Representative From A Credit Union	7%	8%	11%	10%
Representative from a Life Insurance/Trust Company	3%	0%	4%	3%
Other	6%	5%	5%	5%
Total	100%	100%	100%	100%
Source: Maritz survey for CAAMP, Fall 2011.				

4.0 Outlook for the Housing and Mortgage Markets

The Economic Background

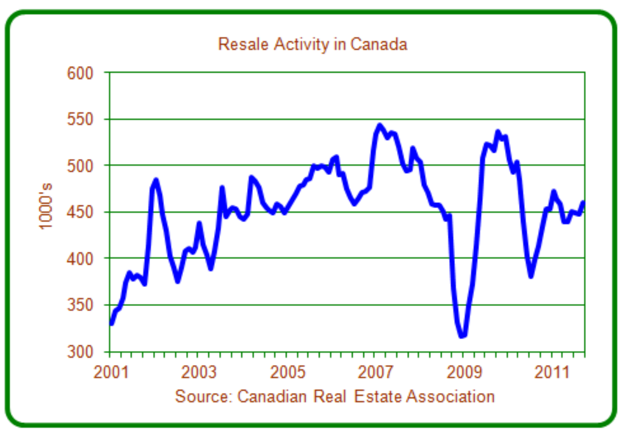
The Canadian economy is still recovering from the recession of 2008/09. As of this September, the total employment in Canada is about 225,000 (1.3%) higher than at the start of the recession. The percentage of the population that is employed (the "employment rate") remains well below the pre-recession level, but it is improving. On this measure, the recovery is incomplete, but the data is pointing in the right direction.

The chart of the employment rate shows that this recession was less severe (about one-half as sharp) compared to the two prior editions. This was a "made-in-USA" recession. The greatest impacts were on businesses that sell goods and services to the US. The very weak recovery in the US continues to weigh on our economy.

Otherwise, economic fundamentals in Canada are quite positive, especially with strength in resource-producing industries and many of our major service industries (including professional and scientific services, health and education, and financial services).

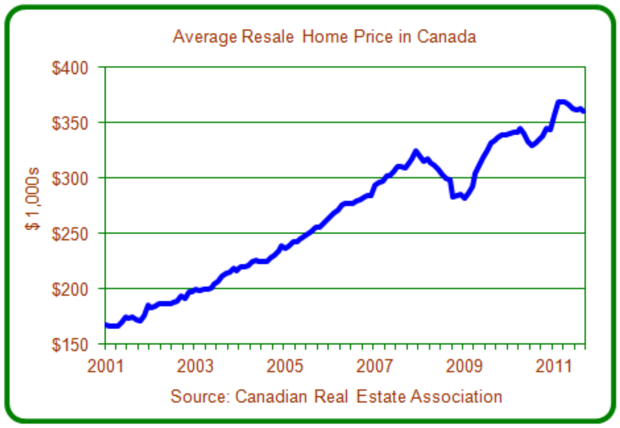
Housing Market Impacts

Housing markets across Canada were highly volatile during and after the recession, but have become considerably more stable. During the past year, the rate of resale activity (as reported by the Canadian Real estate Association) has been at an annual rate of about 450,000. This is lower than the peak levels seen during 2005 to 2007, but is similar to the 2003/2004 period.



Another way to look at the level of sales is in proportional terms, relative to the size of the population or as a share of the total housing inventory. Both the population and the inventory have expanded, so we might say that current activity is about 10% lower than during 2003/04 (relative to the size of the population) or about 15% compared to the peak levels of 2005 to 2007. This reduction in activity on a proportional basis is appropriate given the current post-recession economic environment.

House prices were also volatile during and after the recession. More recently, the average price rose late in 2010 and early 2011, but has subsequently settled – that increase and setback was due to a short-lived spike in the average price in Vancouver (which was reportedly caused by a surge of sales in the high end housing market). Apart from this, the data across Canada suggests that resale prices have been stable for almost a year.



As of September, the average resale house price in Canada is 11% higher than the pre-recession peak. By contrast, in the US, prices are one-third below the pre-recession peak. That factor largely explains the different economic performances in Canada and the US.

Combining the data on prices and sales, the dollar volume of sales has also stabilized this year, following two years of extreme volatility during and after the recession. The current volume is comparable to the peak seen during 2007, and is just slightly lower than the record level that was achieved (briefly) during the rebound from the recession. The recent level of about $14 billion per month is roughly four times the figures seen during the 1990s.

Concerning new construction of houses and apartments, housing starts respond less rapidly to changing economic conditions, because of the lag times that result from the need to pre-sell new units and then initiate the construction process. During the past year, housing starts have become slightly more stable, at a level that is about 15% lower than pre-recession. This is consistent with the moderate rate of job creation seen post-recession. But, activity is also being negatively influenced by shortages of building lots (for low-rise housing) in some major markets. On the other hand, apartment activity is very strong, in part due to strong demand from investors who are buying condominiums with the intention of renting them out.

Housing Market Forecasts

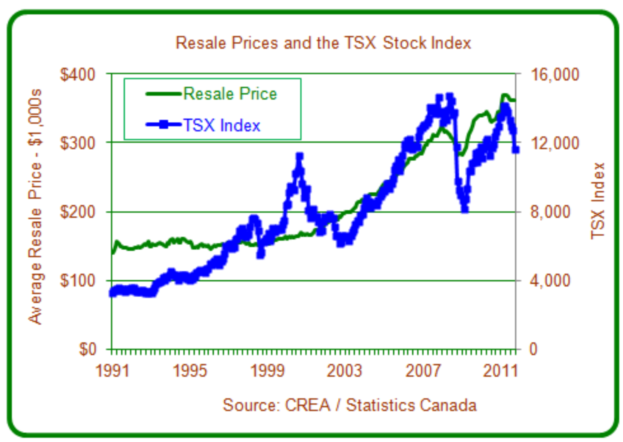
This author and most other forecasters suggest that the pace of economic recovery will remain modest during the remainder of this year and 2012.

Forecasts discussed here are taken from a survey of recent forecasts published by Canada's five largest banks as well as Canada Mortgage and Housing Corporation ("CMHC"), the Canadian Real Estate Association ("CREA"), and the author.

For the critical employment variable, the forecasters' expectations are quite similar for 2011 and 2012, suggesting that growth will be similar to the 1.4% growth rate seen in 2010. Job creation would be about equal to the rate of population growth, meaning that the employment-to-population ratio would be flat: that ratio is currently about 2 percentage points lower than prior to the recession and the forecasts suggest that the gap won't be appreciably closed.

For this author, there is a mix of positive and negative factors:

- Two of the most important factors contributing to the recovery in Canada have been the enormous wealth that is being generated by rising housing values and resurgent stock markets. These wealth effects bolstered confidence of consumers and businesses.
- Continued very low interest rates are also strongly supportive.
- Negative factors include the stronger Canadian dollar, which make it more difficult for Canadians to compete in the global economy, plus continued weakness in other major industrial economies (especially the United States).
- A further factor has been surging costs for commodities. Effects have been mixed across the country, depending on whether regions are producers or consumers of commodities.



While the two wealth effects are separate factors, house prices and the stock market often move in the same direction, as can be seen in the chart to the right. At this time, the available data indicates that the shaky confidence of investors has not yet affected housing markets: sales levels are steady and pricing is stable. But, there is a risk that "contagion" of the housing market could lead to negative impacts for the broader economy: there is considerable uncertainty about whether the wealth effects will be positive or negative for the Canadian economy in the coming months. Even without that source of uncertainty, with house price growth having slowed during the past year, it appears that the housing wealth effect will gradually become less of a positive force.

This mix of influences suggests to the author that the recovery is likely to remain weak, with jobs being created at about the same rate as the population is growing, but there are risks to the downside.

Concerning resale housing markets:

- For sales, the forecasters have broadly similar expectations. Taking the averages of the available forecasts, sales are expected to be virtually the same in 2011 and 2012 as in 2010 (about 447,000 sales).
- Prices are expected to increase by 7.7% in 2011, about $365,000. For 2012, the price forecasts vary, but none of the forecasters expects reductions or large increases. The average of the 2012 forecasts suggests a modest price rise (1%).
- Combining the forecasts for sales and prices, sales volumes are forecast to increase gradually, to $163 billion in 2011 and $165 billion in 2012 (for 2010, the total was $152 billion.

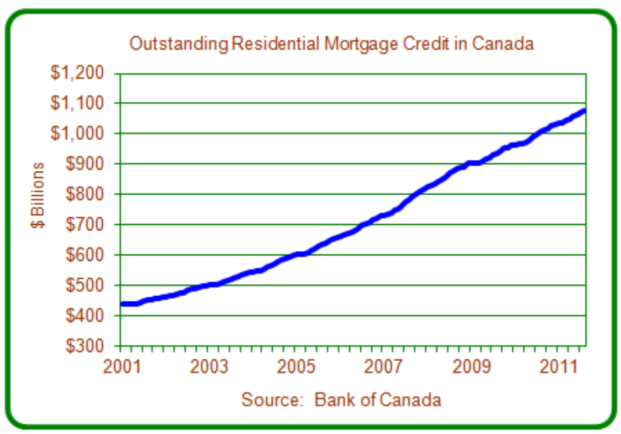
Concerning housing starts:

- For 2011, the forecasts are broadly similar, with an average expectation for 184,800 units, 2.7% lower than the 190,000 starts in 2010.
- For 2012, the average of the forecasts is for a small reduction (3.5%), to 178,500. The range of expectations is from 165,000 to 184,000.

Implications for Mortgage Lending

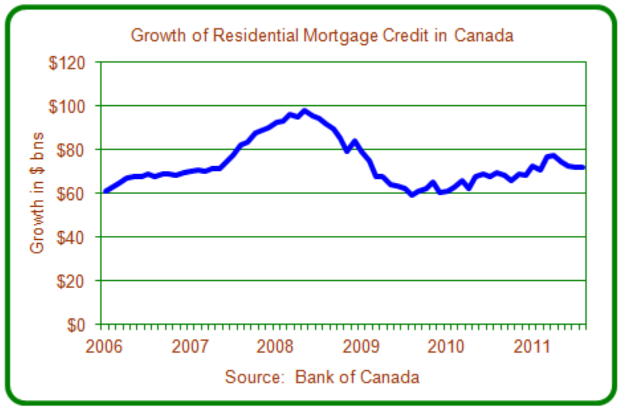
Residential mortgage credit in Canada continues to expand rapidly. The volume of outstanding residential mortgage credit passed the $1 trillion threshold in July 2010, and as of August 2011 has reached $1.079 trillion[3].

During the past five years, outstanding residential mortgage credit has expanded by 53%, or an average rate of 8.9% per year.

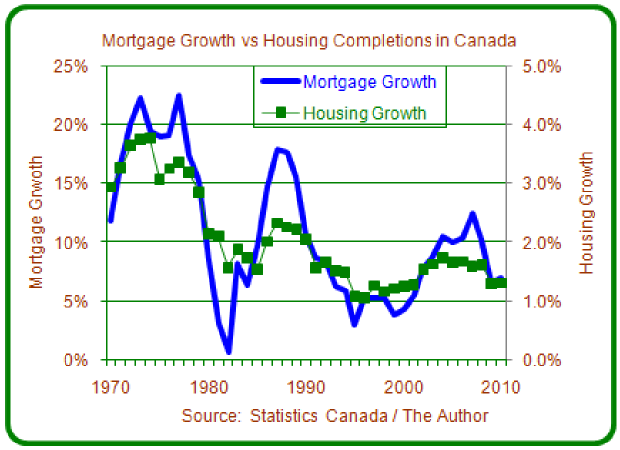


[3] This data from the Bank of Canada includes owner-occupied as well as investor-owned residential properties. Due to the inclusion of investor-owned properties, it exceeds the total estimated in the earlier discussion of housing equity ($858 billion).

In dollar terms, the growth rate has averaged $75 billion per year. The rate of growth peaked in the spring of 2008, at slightly under $100 billion per year. At present (as of August 2011), the year over year growth rate is $72 billion, or 7.2%



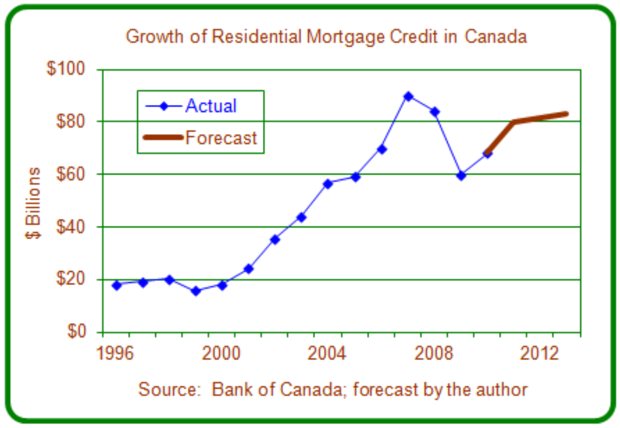
Growth of mortgage credit occurs through several processes. This section briefly discusses the processes.



- Expansion of the housing inventory. Completions of new dwellings increase the number of properties with mortgages. About 80% of new ownership dwellings (as well as resale purchases) result in mortgages. The chart to the right contrasts the rate of mortgage growth (percentage change per year) with the rate of housing completions (as a percentage of the existing housing stock). It illustrates quite clearly that growth of the housing inventory has been a major factor for growth of mortgage credit.
- Sales of existing homes represent a larger amount of housing activity, but the impact on mortgage demand is less substantial than for new housing, for two reasons. Firstly, average mortgage amounts are about 30% lower than for new homes. Secondly, a sale of an existing property often involves the discharge of an existing mortgage, which reduces the net impact.
- Equity take-out has been estimated via CAAMP's consumer surveys. The most recent estimate is that during the past year renovation activity resulted in $28.5 billion of equity take-out by mortgage holders..
- On the other hand, there are reductions in mortgage indebtedness through two main processes: monthly mortgage payments and lump sum payments.

Forecast of Mortgage Activity

Based on the housing forecasts discussed above, the author forecasts that mortgage credit will continue to expand rapidly. As is illustrated in the chart to the right, the volume of residential mortgage credit outstanding is projected to grow by 7.7% in 2011 (about $80 billion), followed by 7.3% growth in 2012 ($81 billion). A preliminary look at 2013 suggests growth of 7.0% ($83 billion). The total volume of the residential mortgage market would be about $1.11 trillion by the end of this year and $1.19 trillion at the end of 2012.



Risk

There are risks for the mortgage market (some we are aware of and of course there are other risks that cannot be foreseen). Broadly-speaking, these can be characterized as risks that borrowers will not be able to meet their payment obligations.

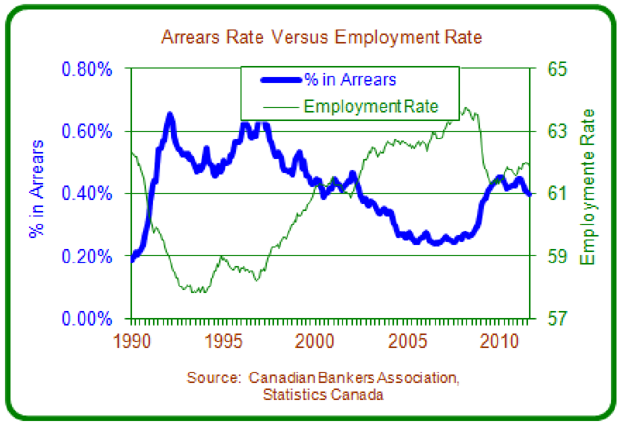
A great deal of attention has been given during the past three years to one aspect of "repayment risk": fears that when interest rates rise, large numbers of Canadians will be unable to meet their obligations. This concern has been a natural response to events in the United States, where mortgage defaults led to an economic crisis. In far too many instances in the US, mortgages were loaned to borrowers who could not afford to pay market interest rates.

In response, CAAMP has conducted research on the potential impacts of future rises in mortgage interest rates: can Canadians afford the mortgages they have taken on? CAAMP's research has concluded – repeatedly – that there is negligible risk from this factor.

Another risk factor is "over-building". In the US, excessive buying for investment was a significant factor in the housing market collapse. The risk is that if there is too much growth of the housing inventory, vacancies will rise and there will be insufficient income to meet payments and too few opportunities to sell when needed. The Canadian data, however, indicates that this has not been an issue here: vacancy rates in the rental market remain low (and are falling); in the ownership sector, the sales-to-listings ratio is comfortably within a "balanced market range". The available data indicates that rapid growth of mortgage credit in Canada has been due to strong demand for housing that resulted from job creation. There is no evidence that the growth has been "speculative".

A third aspect of repayment risk is "loss of ability to pay", which may occur due to job loss, wage reductions, or family breakdown. In the Canadian experience, this is the most significant risk. Two earlier recessions (early 1980s and early 1990s) resulted in considerable numbers of mortgage defaults: in both those instances, job losses were combined with unaffordable rises in mortgage rates. During the more recent recession, however, while there were job losses, they were less severe (the recession of 2008/09 was only one-half as severe as the two earlier versions), and we did not experience a sharp rise in interest rates. In consequence, the impact in the mortgage market was also less severe.

The chart to the right shows the mortgage arrears rate (as reported by the Canadian Bankers Association). It shows that during the recent recession the rise in the rate was one-half as large as during the prior recession. It also shows that the arrears rate has started to fall. The chart contrasts the arrears rate with the employment-to-population ratio: it shows a clear inverse relationship: a strengthening employment situation (as indicated by a rising employment rate) is usually followed by a fall in the arrears rate (and vice versa). This data supports the earlier suggestion that the most important risk for the Canadian mortgage market is “loss of ability to pay”.



In recent months there has been speculation about a recession in Europe, which would have negative impacts internationally. Thus, there are risks to the mortgage market. But, these risks don’t originate in the housing market or the mortgage market - they are related to increased uncertainty about the broader economic environment. The best means to support the housing and market markets are policies that promote a strong economy.