CMBA CANADIAN MORTGAGE BROKERS ASSOCIATION

August 17, 2017

Office of the Superintendent of Financial Institutions
12th Floor
Ottawa, Ontario
K1A 0H2

Via email B.20@osfi-bsif.gc.ca

Dear Sirs/Mesdames:

Re: Draft Guideline – Residential Mortgage Underwriting Practices and Procedures

The Canadian Mortgage Brokers Association (CMBA) wishes to make submissions to OSFI concerning the Draft Guideline – Residential Mortgage Underwriting Practices and Procedures, which is identified as B-20.

About the CMBA

The CMBA is an inter-jurisdictional umbrella association consisting of provincial mortgage broker associations in Canada, including associations in Atlantic Canada (Nova Scotia, New Brunswick, Prince Edward Island and Newfoundland and Labrador), Ontario and British Columbia. We estimate that mortgage brokers in Canada fund over $70 billion in mortgages annually. According to the Canada Mortgage and Housing Corporation (CMHC) over 55% of first time buyers use a mortgage broker to finance their purchase. Mortgage brokers therefore represent a vitally important sector of the Canadian economy, and connect mortgage borrowers to the financial institutions (FRFIs) which lend to them.

Principal 2 - Purpose of the loan – Rentals

The Draft Guideline expands on the requirement of FRFIs to ascertain the purpose of the loan, as it considers the loan's purpose to be a key factor in assessing credit risk. For this reason, mortgages which rely on rental income to service the mortgage payments will require an evaluation by the FRFI of the rental market and credit risks in the location of the property.

The CMBA is of the view that the underwriting of rental properties should be different from that of owner occupied properties, and we would propose the adoption of already existing,

underwriting standards relating to rental properties. Rents should be treated differently depending on whether a property is:

1. A house with a mortgage helper (Basement suite or laneway), in which case a percentage of the rent can be used to boost income or a partial offset applied.

2. A property with standalone rentals to a maximum number of four, with the use of a rental spreadsheet to determine the rental surplus or monthly loss.

3. A property with five or more rental units, which can be underwritten as a commercial

Recommendation: Amend underwriting criteria for rental properties using the labelling and standards noted above.

Principle 3 – Imposing Contractual Terms, Penalties and Hidden Fees

The Draft Guideline explains that when extending loans to borrowers, FRFIs should impose contractual terms and conditions which preserve a variety of recourses should borrowers default.

The CMBA recommends amending this language as it is contradictory; "contractual terms" are by definition agreed to by all parties to the contract, whereas terms which are "imposed" are forced upon one party by another. In addition, FRFIs should ensure that mortgage terms and conditions, must be clear, specific, non ambiguous and fair. As an example, prepayment penalty provisions in many mortgage agreements have been vaguely worded, and a number of mortgage brokers and their borrowers have reported to CMBA that the FRFI will interpret ambiguous prepayment penalty provisions to unfairly maximize the size of the penalty.

If FRFIs are to build consumer confidence, they will need to recognize the power imbalance in the contract negotiation process relating to the mortgage agreement, and act fairly, clearly and with full and timely disclosure of costs, penalties, remuneration, hidden fees and other essential terms.

Recommendation: FRFIs should act fairly, clearly and with full and timely disclosure of costs, penalties, remuneration, hidden fees (including those earned by mortgage specialists) and other essential terms.

Principle 3 - Debt Service Coverage: New Stress Test for Uninsured Loans

The Draft Guideline sets out OSFI's expectations that FRFIs should perform a stress test on residential borrowers by qualifying them at a rate of 2% above the contract rate of the

mortgage, and contemplate both current and future conditions when considering qualifying rates and making appropriate judgements.

The proposed stress testing for uninsured mortgages is therefore significantly more onerous and subjective than that required by OSFI for insured residential mortgages, being the requirement to qualify insured borrowers at the Benchmark qualifying rate. There is considerable ambiguity in this approach.

Depending on the contract rate and term, the 2% premium may or may not be greater than the Benchmark qualifying rate. The proposal does not stipulate any parameters for a minimum term or any lender specials. For example, if applicants proceed with 2 year term at 2.74% and add the proposed 2% premium for qualifying, the qualifying rate is less than the Benchmark qualifying rate. However, the applicant has less time to pay down principal and in the event of rate increases would have a greater payment shock than applicants who proceeded with a fixed 5 year term. In addition, there is currently a lender offering a 5 year term at 2.49% for military personnel and brokers who buy down their rates. It is not clear what rate the 2% premium would apply to.

Adopting a Benchmark qualifying rate for both insured and non-insured mortgages would cause the least amount of implementation cost to FRFIs and make it easier for industry to navigate the rules while not compromising sound mortgage underwriting.

Recommendation: If a prescribed qualifying rate is to be applied for non-insured mortgages, it should be the same qualifying rate as that used for insured mortgages.

Principal 4 – Property Valuations in Areas of Rapidly Rising Prices

The Draft Guideline calls for FRFIs to use more conservative approaches to estimating property values for use in LTV calculations in areas experiencing rapid price increases, and they should not assume that house prices in these areas will continue to rise or remain stable. In addition, the Draft Guideline calls on FRFIs to critically review the sustainability of housing markets, like those of Greater Vancouver and Greater Toronto when underwriting for non-conforming loans and HELOCs. Mortgage underwriting in such areas may require more stringent, lowered LTV ratios and higher loan pricing if multiple high-risk loan factors are present in these kinds of applications.

However, FRFIs are already applying a sliding scale when underwriting for higher value properties, so that loans are segmented and the LTV is scaled down on the higher-level segments. For example, a lender might lend on 80% of the first million in property value, and then 50% of the second million in property value. FRFIs are already applying sliding LTV scales for HELOCs, which are 65% of the first million and 50% of the balance.

The challenge with requiring alternative property valuations in hot property markets is that it may not always be clear which markets are overheated; the definition is too broad and subjective to be applied with any predictability. In addition, markets are already segmented. In the Greater Toronto and Greater Vancouver areas, lenders already apply prudent exposure limitations in these areas. For example, more stringent underwriting criteria is applied for properties over one million dollars. These markets are further segmented into insured and non-insured mortgages. It will further complicate the underwriting process to add a third category of valuation to this paradigm.

In addition, not all property types in a hot market may be hot; is the rule to be applied equally to both single family homes and condominiums or will further adjustments to the rule be required? While this rule reflects a well intended prudence, it completely lacks a practical application as markets are never universally overheated and fluctuate.

According to the CREA July 2017 report, the average home price outside of the Toronto and Vancouver markets was $315,539. An alternative approach would be to provide relief from the application of more stringent qualifying rules in rural or smaller urban areas where house prices and mortgage principals are relatively low and present little risk to FRFIs.

Recommendation: Exempt all mortgages with principal amounts of $499,000 or less from the requirement to qualify borrowers at a qualifying rate, and permit qualification at the true contract rate associated with a 5 year fixed term

Principal 4 – Prohibition Against Bundled Mortgages with Other Lenders

Under the Draft Guideline, FRFIs are prohibited from arranging combined mortgages with other lenders which appear to circumvent the permitted maximum LTV ratios or other limits it establishes in its residential mortgage underwriting practices (RMUP).

This prohibition clearly appears to restrict the offering of bundled loans which, when combined, exceed an LTV of 80%. However, this underwriting prohibition appears to go further by prohibiting combined first and second mortgages which exceed RMUP. An FRFI might be more flexible in its loan approval at an LTV of 65% or less, and a mortgage broker can then arrange a top-up second which is disclosed and authorized by the first mortgage lender, wherein the total LTV does not exceed 75% or 80%. However, if the combined mortgages exceed permitted LTV's under the RMUP, the first mortgage lender, if an FRFI, can no longer accept the top-up 2nd as a concurrent mortgage. This will have an impact on some borrowers who are credit challenged, and force them to finance the entire loan through a private lender rather than have a lower cost first/second mortgage combination.

In addition, the Draft Guideline does not provide a rationale for the prohibition. If an FRFI underwrites mortgages under the provisions of the Draft Guideline, they are already ensuring that property valuations take into account fluctuations in market conditions, and the possibility of a downward trend in housing prices. First mortgage lenders are protected by conservative LTV protocols which assume market conditions worsening. The security of the first mortgage lender is therefore adequate to ward off risk of losses should borrower default occur. The risk assumed by the second lender does not fall upon the first lender. This measure appears to serve no purpose in ensuring prudential underwriting practices of FRFI's and appears to be unnecessary.

The Government of Canada has and continues to make efforts to ensure affordable housing for Canadians. The regulatory amendments to mortgage guidelines in October 2016 were a recent and valuable example a blanket "one size fits all" approach does not work. Small businesses are key to the success and growth of the country, and in some regions mandatory to prevent negative migration. Limiting the opportunity for bundle or second mortgages will not only delay home ownership from many Canadians, but will facilitate population growth in the "have provinces" and decrease that in the "have not provinces". This will result in a double negative impact by increasing housing demands in major urban centres and limiting employment and income opportunities in smaller urban centres and rural communities. It would also force motivated purchasers with less than 20% down who do not qualify under the guidelines to seek non FRFI's lenders at higher interest rates and fees.

Recommendation: Do not impose a prohibition on FRFIs from bundling first and second mortgages.

The CMBA appreciates the opportunity to provide comments and feedback on the Draft Guideline prior to its implementation, and wishes to thank OSFI for this opportunity. Please contact the undersigned if you have any comments or questions concerning this submission.

Yours truly,

Samantha Gale
Executive Director, the Canadian Mortgage Brokers Association