Economics

How Shadowy is Mortgage Lending in Canada?

Benjamin Tal

Avery Shenfeld
(416) 594-7356
avery.shenfeld@cibc.ca

Benjamin Tal
(416) 956-3698
benjamin.tal@cibc.ca

Peter Buchanan
(416) 594-7354
peter.buchanan@cibc.ca

Andrew Grantham
(416) 956-3219
andrew.grantham@cibc.ca

Nick Exarhos
(416) 956-6527
nick.exarhos@cibc.ca

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In its December 2014 Financial System Review, the Bank of Canada stated that *"low interest rates may not only encourage some households to take high levels of debt, but they may also encourage some financial entities to lend to riskier borrowers."* More specifically, the Bank highlighted the potential risk associated from increased lending activity by less regulated lenders. Since then, the Bank lowered those low interest rates, and by doing so, may have increased those risks.

But how significant are those risks? We utilize three different measures aimed at assessing alternative/non-prime lending in the Canadian mortgage space. We utilized information from Revenue Canada (via Statistics Canada), from CMHC, via its securitization database, and most importantly, from the Teranet mortgage registration database, that enables us to classify mortgage originations by type of lenders and actual mortgage rates.

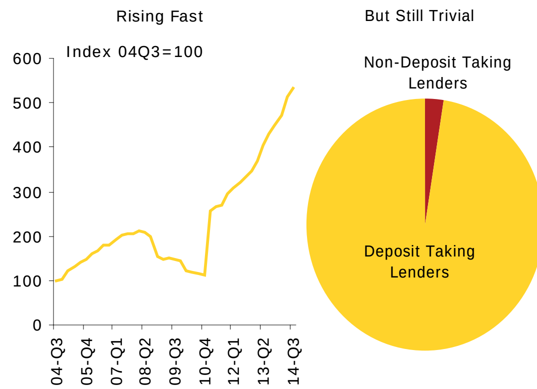
And the bottom line is… well, you will have to continue reading to find out.

Measure 1: Non-Depository Credit Intermediations

This one is relatively straightforward. As part of its quarterly survey of financial statements, Statistics Canada provides information on the asset position of non-depository financial entities. Therefore, we can obtain information on the amount of mortgage credit provided by those lenders. While this, by no means, suggests that all non-depository lenders should be seen as alternative lenders, it is nevertheless a good starting point. Chart 1 tells the tale. Since 2012, the amount of lending by those entities has doubled. And as of the third quarter of 2014, it was still rising by a year-over-year pace of more than 20% (Chart 1, left). However, you can never talk about a rate of growth of anything, without referring to its relative size. And the chart to the right suggests that despite this meteoric ascent, the share of non-depository players in total mortgage outstanding is still a trivial 2.5%.

Chart 1

Mortgage Lending by Non-Deposit Taking Financial Entitles



Source: Statistics Canada, CIBC

CIBC World Markets Inc. • PO Box 500, 161 Bay Street, Brookfield Place, Toronto, Canada M5J 2S8 • Bloomberg @ CIBC • (416) 594-7000
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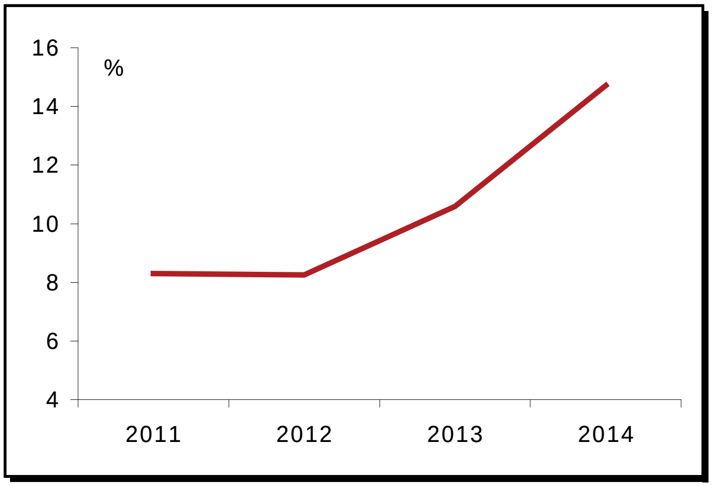
Chart 2

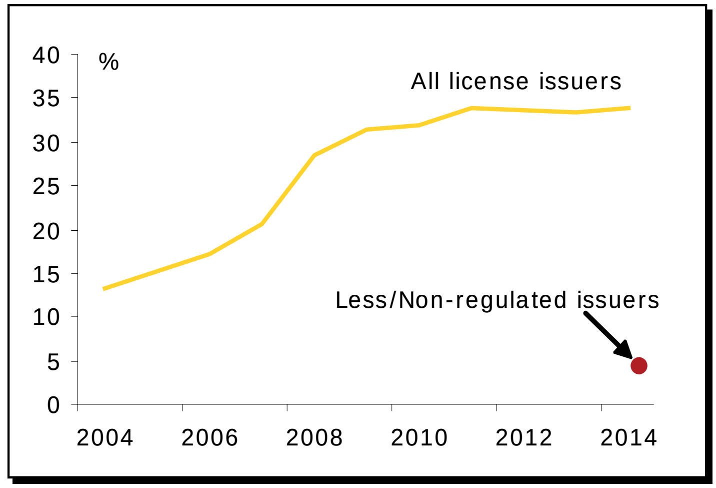
Share of NHA-MBS Issuance by Less/Non-Regulated Entities



Source: CMHC, OSFI, CIBC

Chart 3

Share of NHA-MBS Outstanding in Total Mortgage Outstanding



Source: CMHC, OSFI, Bank of Canada, CIBC

**Measure 2:
NHA-MBS Issuance by Non/Less Regulated Players**

The focus on non/less regulated players is important in the context of today's market. It is hardly a secret that the regulatory requirements facing major lenders in the post-recession era are much more restrictive than in the past. Simply put, in many cases, banks and other major financial institutions are more restricted in their ability to lend to potentially high-risk borrowers. That creates a vacuum in the market that may lead to a transfer of risk from regulated players to unregulated players. Chart 2 illustrates the share of issuance by entities that are not regulated by OSFI in total NHA-MBS issuance. While, the jump in 2014 was largely due to adjustments made to the NHA-MBS program that ensured that all lenders have equal access to the program, the trend is clearly up, suggesting increased lending by less regulated lenders.

But again, we have to put this information in perspective. NHA-MBS outstanding accounts for only one-third of total mortgage outstanding. This means that the share of the less regulated entities in the mortgage market as a whole is less than 5% (Chart 3).

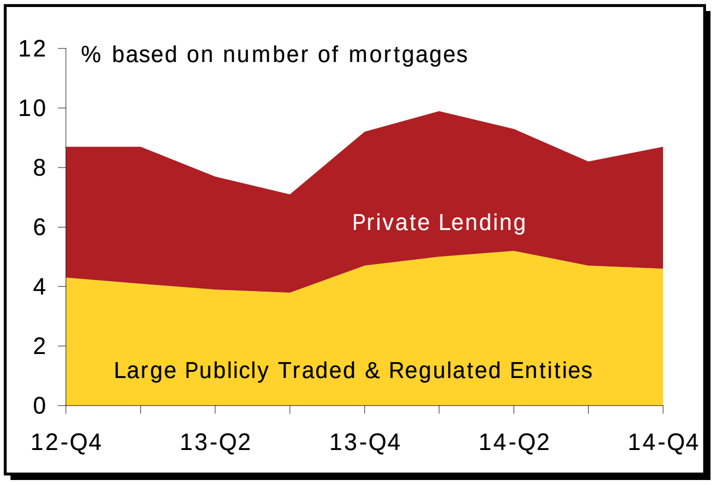
**Measure 3:
The Mortgage Registry**

This one is the mother of all measures. It is direct since the database is the actual mortgage registry information, as opposed to indirect assessments such as those presented in the previous two measures. We obtained the registry data for Ontario from Teranet with the focus being the share of non-prime lenders in total mortgage originations in the province.

Here it's important to distinguish between non-prime lenders that are large public companies and regulated by OSFI, and other small private lenders in the non-prime space, which among other players, include Mortgage Investment Corporations (MICS). As illustrated in Chart 4, when measured in terms of the number of mortgages, non-prime originations account for just over 8% of the total number of new mortgages in the province, with that share split almost evenly between private lenders and larger players.

Chart 4

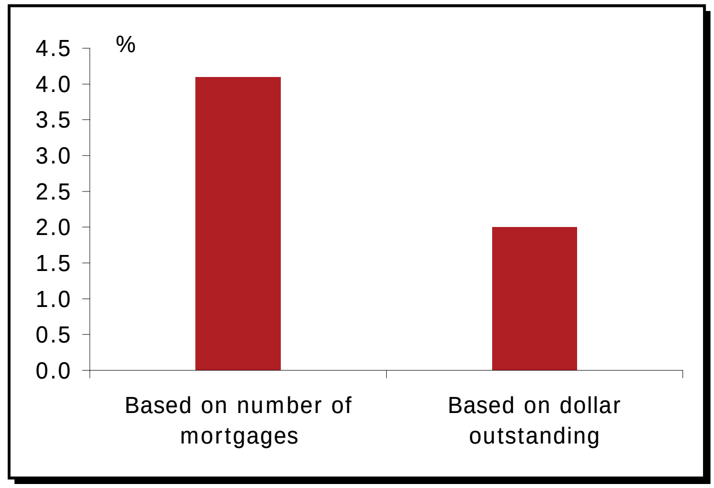
Non-Prime Originations as a Share of Total Originations (Ontario)



Source: Teranet, CIBC

Chart 5

Private Lending Mortgage Originations as a Share of Total Originations (Ontario)



Source: Teranet, CIBC

Zooming in on the private lender portion of that space we might get some extra information regarding the nature of that credit. Note that when we look at the share of originations in terms of dollar outstanding as opposed to the number of mortgages (Chart 5), that share is much smaller. That is a reflection of the fact that the average size of a mortgage provided by those alternative players is notably smaller than seen among more traditional lenders. In fact, since those private lenders don't face the same restrictions as regulated entities when it comes to providing homebuyers with credit aimed at supplementing their down-payment, the trajectory here can shade some light on that practice.

The bottom line is that regardless of how you measure it, alternative/non-prime lending, while rising, is still an extremely small portion of total mortgage activity in Canada—probably smaller than perceived by many. That is not to suggest that the system is risk free. Our third measure of alternative lending (mortgage registry) provides information only for the province of Ontario. It is possible that in other regions (mainly Western Canada) the role of private landing, in general, and MICs in particular is more significant. And the risk we are facing today is that increased regulations on major financial institutions combined with even lower mortgage rates may work to widen those shadowy margins.