No housing bust here: CD Howe

Canada is unlikely to see a “massive wave of defaults” in the housing market as the market cools, the CD Howe Institute wrote in a report Wednesday.

The report comes day after the Canadian Centre for Policy Alternatives released a report saying six Canadian cities – Vancouver, Calgary, Edmonton, Ottawa, Toronto and Montreal – were due for a correction because prices have increased beyond what’s justified by the broader economy.

“Recent swings in Canadian house prices have raised concerns that a U.S.-style housing bust looms on the horizon,” wrote Jim MacGee, an associate professor of economics at the University of Western Ontario.

“A comparison of housing market policies in Canada versus the U.S., however, suggests that there is little likelihood of a U.S.-style surge in foreclosures or a collapse of house prices in Canada.”

He said a decline in underwriting standards was key to the dramatic bust in the United States, which saw prices plummet up to 50 per cent in the last three years in some markets. Although both countries have kept interest rates at historic lows, regulations regarding who could get in on the market differed significantly.

“During the U.S. housing boom, both private insurers and government-sponsored enterprises facilitated looser underwriting standards by increasing their exposure to high-risk mortgage products such as low-documentation, interest-only and adjustable rate mortgages,” he said.

“This buildup was a key factor in the U.S. housing market crash, since when house price appreciation slowed (and then reversed) many borrowers found themselves unable to meet their monthly mortgage bills or to rely on higher prices to refinance. The resulting rapid rise in foreclosures, in turn, seems to have played a role in driving the large decline in U.S. house prices since 2006.”

Canadian officials didn’t give in to the temptation to ease qualification criteria, he said, which means fewer homeowners should find themselves in a position where they can’t pay to keep their homes. Indeed, after a short period of looser standards from 2003-2006, the government clamped down and forbade zero-per-cent-down mortgages with amortization periods longer than 35 years.

It further tightened standards this year, insisting buyers qualify for mortgages at the five-year rate instead of the lower variable rate, and insisting on higher down payments for investment properties.

“Canadian housing policies, which avoided the sharp decline in underwriting standards seen in the U.S., worked well in reducing the possibility of a housing bust in Canada during 2008-2009, and continue to mitigate the risk of a massive wave of defaults in the future,” he wrote.

“To the extent that current policies impose on taxpayers a significant exposure to mortgage insurance guarantees and, therefore, some of the aggregate risk of a decline in housing prices, it will be in the interest of all Canadians if policy makers recall the lessons of the 2008-2009 experience should pressures to relax underwriting standards reoccur in the future.”