April 14, 2023

Office of the Superintendent of Financial Institutions
255 Albert Street
12th Floor
Ottawa, Ontario K1A 0H2
Delivered via email: B-20@osfi-bsif.gc.ca

Re: Public consultation on Guideline B-20: Residential Mortgage Underwriting

On behalf of the close to 70,000 REALTOR® Members of the Toronto Regional Real Estate Board (TRREB), I would like to thank you for the opportunity to share our thoughts on the current review of Guideline B-20: Residential Mortgage Underwriting.

As the largest real estate board in Canada, TRREB has been very engaged with all levels of government in providing insight and recommendations regarding public policies impacting housing markets. Specifically, on the B-20 Guideline, we have consistently called on the Office of the Superintendent of Financial Institutions (OSFI) to review the Guideline with an eye to more flexibility depending on where we are in economic and related interest rate cycles. There should also be more flexibility surrounding a federally regulated lender's ability to lend on a case-by-case basis depending on individual households' unique situations. Changes to the Guideline should be considered from a flexible and holistic viewpoint leading to both a stable financial system and a balanced and affordable housing market as the Canadian and, by extension, Greater Toronto Area (GTA) population is expected to grow at a record pace in the coming years. All of these newcomers will require a place to live. With an extremely tight rental market, including double-digit rent growth, an increased number of households will turn to homeownership. A fair and accessible mortgage market will be important to support this demand and associated regional economic development.

OSFI is seeking stakeholder feedback on the following debt serviceability measures, including impacts they may have on borrowers and lenders:

- **Loan-to-income (LTI) and debt-to-income (DTI) restrictions** – i.e., measures that restrict mortgage debt or total indebtedness as a multiple, or percentage, of borrower income.
- **Debt service coverage restrictions** – i.e., measures that restrict ongoing debt service (principal, interest and other related expenses) obligations as a percentage of borrower income.
- **Interest rate affordability stress tests** – i.e., a minimum interest rate that is applied in debt service coverage calculations to test a borrower's ability to afford higher debt payments in the event of negative financial shocks.

When it was introduced in a historically low interest rate environment, the Minimum Qualifying Rate (MQR or, as it is often referred to, the "stress test") was needed to ensure that borrowers would continue to be able to service their mortgage debt in case interest rates were to increase. This measure still has its merits, especially in Canada's most expensive markets: Toronto and Vancouver, but in the current environment, there needs to be more flexibility built into the calculation and application of the MQR.

Concerns raised by OSFI regarding record consumer indebtedness, temporary unsustainable home valuations (collateral risk), a potential recession (unemployment risk) and a 15-year high in mortgage rates need to be considered in balance with maintaining access to a healthy market, particularly in markets like Toronto and the GTA.

Increased borrowing costs represent a short-term shock to the housing market. Over the medium- to long-term, the demand for ownership housing will pick up strongly because of tight labour market conditions and record population growth which will be pointed at the GTA and the Greater Golden Horseshoe (GGH) in the coming years, and all of these people will require a place to live, with the majority looking to buy. The long-term problem for policymakers will not be inflation and borrowing costs, but rather ensuring we have enough housing to accommodate population growth.

What we are proposing in this submission will not only address the debt concerns raised by OSFI, but will also take into consideration any unintended consequences in order to minimize the economic impact on the housing market.

The following considerations should be kept in mind while reflecting making changes to the stress test:

- Major regulatory shocks have unforeseeable impacts;
- More research needs to be done about how moving higher-risk borrowers to non-federally regulated financial institutions (FRFIs) indirectly creates bank risk;
- Defaults are still near record lows in Ontario despite one of the harshest rate hike cycles in history; and
- Existing fundamentals ensure substantial equity.

Proposal #1: Loan-to-income (LTI)/debt-to-income (DTI) restrictions
OSFI has noted that LTI ratios have surged despite the stress test, and the proposed policy changes are looking to limit the share of LTIs over 450% and limit DTI which would restrict how much a bank can lend to borrowers whose mortgage, or total debts, exceeds a certain percentage of their gross income.

TRREB Recommendations:

- LTIs naturally fall on their own under the weight of high rates and lower home prices. In fact, we have seen a dramatic fall-off in median LTIs since the Bank of Canada commenced its aggressive rate tightening cycle in March 2022;
- Propose no more than 30% to 33% (one-third) of a lender's originations at 450% initially, especially given the finding above that LTI impact magnifies as rates fall.

This recommendation would mean that first-time homebuyers would be less impacted and borrowers in general would not migrate to riskier non-regulated lenders;
- Calibrate LTI or the share of high-LTI loans at least annually (at the same time as the stress test) to ensure the economy benefits from Bank of Canada stimulus (falling rates) and is not hamstrung by artificially restrictive lending;
- OSFI should consider practical exemptions from LTI restrictions, including:
  - non-prime loans with sufficient equity (e.g., 35%) which have little correlation with bank stress;
  - higher LTI on amortizations of 25 years or less (lower amortizations demonstrate debt serviceability); and
  - higher LTI on lender switches (i.e., straight switches with no increase in borrower risk);
- During this review of B-20 Guideline, consider only LTI limits, not both LTI and DTI limits, in order to reduce market shock.

Proposal #2: Debt ratio restrictions

There is concern about lenders creating workarounds to the stress test through higher debt ratio limits, exemptions or calculation loopholes, leading to proposed policy changes that would limit gross debt service (GDS) and total debt service (TDS) ratios and would standardize lender's debt ratio calculations.

TRREB Recommendations:
- Propose standardized 39%/44% GDS/TDS calculations for prime conforming uninsured mortgages;
- Propose an exception bucket wherein 20% of FRFI mortgages could have above-standard GDS/TDS ratios (this would allow for otherwise well-qualified borrowers to still retain financing if assets or other risk mitigants supported it);
- Propose allowing higher GDS/TDS limits for borrowers with high credit scores; and
- Propose an exemption for non-conforming loans (those with 35%+ equity).

Proposal #3: Adjust the minimum qualifying rate (MQR)

OSFI has expressed concern about the MQR (stress test) not being suitable to borrowers in riskier terms like variable rates, and the following policy changes are being considered: applying different MQR formulas to higher-risk terms and applying an MQR to non-mortgage debt.

TRREB Recommendations:
- An MQR should better protect short-term borrowers while still allowing people to qualify and take advantage of falling rates at cycle peaks;
- Consider a quarterly revised MQR that applies to variable and short-term rates. An adaptive MQR – for example using a 300 basis points MQR buffer minus half the difference between prime and its 5-year average – would help ease the buffer at cycle tops, when variable rates are most beneficial to borrowers and the probability of falling rates is highest;

- Exempt straight switches (those with no net increase in system-wide risk) from the minimum qualifying rate. That way, borrowers can access competitive terms with new lenders to reduce their debt servicing risk, one of OSFI's stated objectives.
  - The MQR in the current high interest rate environment is trapping more people at their lenders, forcing them to pay higher interest and creating financial risk. This creates an uncompetitive and potentially less-affordable lending environment. Allowing transferring borrowers to qualify at their contract rate, or contract rate plus a smaller increment, effectively adds no material risk to the overall lending system; and
  - Renewing borrowers who have paid as agreed, and meet all other underwriting criteria, show prima facie empirically-supported evidence of their insignificant default risk. Hence, competitive lenders that attract such renewal business would not take on meaningful portfolio exposure. Moreover, all such lenders would still be incentivized to minimize arrears given OSFI supervision and investor demands;
- Propose to exempt 10-year fixed mortgages from the minimum qualifying rate.

Policy Considerations and Implications

It is important to remember that housing is local, and inflexible policies that do not account for a changing regional, economic and monetary environment could lead to unintended and asymmetric consequences, potentially destabilizing the housing market and broader economy. We are at a point now where sales and home prices have bottomed in the GTA and are starting to recover on a monthly basis. This recovery will once again shine a spotlight on the persistent lack of housing supply in the region. As a result, competition between homebuyers will increase in the coming months, exerting renewed upward pressure on home prices. If the increase in home prices butts up against inflexible mortgage lending policies, overall affordability will suffer. As we have seen double-digit rent increases over the past year, the notion that the rental market will act as a relief valve is a fallacy.

Over the medium- to long-term, if people and business from around the world come to see high housing costs as a sustained impediment to moving to or investing in the GTA, they will look elsewhere. And, elsewhere may not be in Ontario or other parts of Canada, but rather other parts of the world. There is an economic development imperative to have a mortgage lending environment that is both conservative and fair in recognizing that a one size fits all approach over the course of an economic cuticle does not make sense.

Final Thoughts

- If the stress test is going to be changed, it should be structured to incent and reward borrowers to lock fixed rates for longer periods of time. That creates certainty for their payments, allowing them to build equity and positions them to refinance should they need to do so.
- Make the minimum qualifying rate more adaptive to high-interest-rate environments. These periods have less potential for continually rising rates and more need for housing demand to absorb property value losses.

- Borrowers who switch lenders should be exempt from the stress test. While OSFI believes borrowers renewing with the same company are not penalized by that lender, what is missed or not considered is that borrowers could potentially access better terms at new lenders to reduce their debt servicing risk, one of OSFI's stated objectives. As it currently stands, the system disincentivizes competition and traps borrowers at high interest rates at their current lenders.
- As noted in the 2023 Federal Budget, lenders and insurers should be encouraged to offer workouts to distressed borrowers (skip a payment, extended amortizations) to get borrowers to affordable payments.
- Lenders are well regulated already and Canadians have shown that they are responsible and pay their mortgages. So long as lenders are adequately capitalized, they should be able to apply their own sound approaches to assessing borrowers and transactions, including home valuation, borrower income, credit scores, ability to repay mortgages, and all other factors that combine to give the lender the ability to assess the unique factors that go into any mortgage application.
- The government should not cap the percentage of higher debt-to-income borrowers any lender has as this can be an expression of lender specialization. It also misses that higher debt-to-income borrowers could be of high quality for other reasons – i.e., young and upwardly mobile, more than one income earner on the mortgage, long proximity to retirement, high credit score, size of their down payment, strength of their real estate, etc.
- Policymakers should carefully analyze the system-wide side effects of relegating a large segment of today's prime borrowers to the non-prime market. Besides less profitability and retained capital in the banking system, such a move would result in higher lending costs, less consumer spending, and a greater incidence of borrower instability. The end result is greater banking risk amid financial shocks. That outcome is a potentially severe unintended consequence, one that cannot be dismissed and one that demands published research. Until such research is conclusive, it's reasonable to err towards moderation when tightening policy.
- The most valuable thing the government can do on income verification is to move ahead with income verification of tax return data, i.e., CRA NOA Line 150. Someone dodging taxes will understate their income. Someone trying to get a mortgage they can't afford/otherwise fraudulently will try to inflate their income. Using CRA verification could help mitigate risk of income misrepresentation, thus reducing both fraud and fraud for shelter.

We hope you find our views helpful. We are here to help and encourage you to contact us if we can be of further assistance.

Sincerely,

Paul Baron
President
Toronto Regional Real Estate Board