In recent times the US mortgage meltdown issue seems to be a conversation that creates a whole range of differing theories and points of view, particularly in regard to the effects it will have on not only our mortgage market here in Canada, but also the potential spill over affects it may have on our local and national economy.

While the jury is out on the exact answer, I feel the best way to make your own informed decision is to look at the FACTS. By studying the facts it allows one to look past all the hype out there, and understand what's happening in each respective country.

For this reason, I wanted to share with you the best research I have found to date on the fundamental differences between the Canadian and US mortgage market.

Canadian mortgage markets are fundamentally healthier than the U.S.

1. Canada's subprime market is small (5-6% of outstanding mortgages) whereas the U.S. share peaked at about three times that. As a share of originations, 20-25% of new mortgages in the U.S. were subprime over the 2004-06 period. So Canada isn't anywhere near as exposed to the products that caused most of the damage in U.S. housing markets.

2. Not only is Canada's subprime market much smaller, but it isn't even really subprime per se. Canada's subprime market is more like the U.S. near-prime market, whereas the U.S. subprime market often lent to borrowers with extremely impaired quality.

3. Adjustable rate mortgage (ARMs) resets also caused many of the problems stateside, but those resets occur much more suddenly in the U.S. By contrast, the closest Canadian product parallel is the variable rate mortgage, but they get constantly repriced so that people aren't caught off-guard years later. Furthermore, in Canada, some variable rate products adjust the principal, not the payment. On
balance, the shock effect from payment resets in Canada is nowhere close to what has caused much of the problem in the U.S.

4. Canada's mortgage equity withdrawal market isn't like the U.S. We've seen secured home equity lines of credit (Helocs) grow in Canada as a way of withdrawing equity, but nothing like the U.S. withdrawals picture. U.S. homeowners' equity has been in free-fall with mortgage debt growth outpacing housing assets since the early 1990s. Canada, by contrast, retains much higher homeowner equity, and while it may have reached a plateau, the figure has risen in recent years while the U.S. position has deteriorated (chart 3).

5. Mortgage interest is deductible against taxes in the U.S. It generally is not in Canada. That creates vastly different incentives to leverage oneself in the two markets.

6. The nature of the products has been very different in Canada versus the U.S. Examples of Canadian innovation like long- amortization mortgage products are absolutely nothing like Ninja mortgages. Mortgage innovation was needed in Canada, but has been relatively more conservative.

7. Further to this latter point, long-amortization mortgage products actually extend the Canadian credit quality cycle. Long amortization periods of over 25 years have been dominant as a share of new mortgage originations since the 40-year mortgage was introduced almost two years ago. However, there is still an overwhelming majority of Canadians who face the option of extending from the previously standard 25-year product into longer amortization products in a manner that lowers their payments in the face of shocks. Even though insured 40 year mortgages now banned in principle, 35 year mortgages still provide this flexibility.

8. Investor mortgages were among the first products to default in the U.S. where they account for about 9% of all outstanding mortgages, similar to the UK (9.5%) and Australia (10%). In Canada, however, they are about 2-3% of all outstanding mortgages. There are problems in the investor segment the world over, but the magnitude of the exposure in Canada is far less significant.

9. If there is an imminent problem brewing, then it's not showing up in terms of industry-wide mortgage delinquency patterns. Mortgages 90+ days in arrears in Canada remain at 27 basis points which is the range around which they've been floating since mid-2004. By contrast, even when the country had double digit variable mortgage rates and double digit unemployment rates in the early 1990s, the peak rate of delinquency was about 65 basis points. We're of the opinion that delinquencies will deteriorate going forward, but will be nowhere close to the U.S. experience.

10. The extent of runaway house price inflation was much more muted in Canada than in many other countries. Canada's priciest market is Vancouver, and prices have gone up by about 80% since the mid-1990s start of the global housing cycle. London England, by contrast, went up by about 270% over this time period. Canada's house price appreciation was, on average, significantly below the U.S. experience since then, and much below the experience of many European countries.

Canadian mortgages are funded, underwritten, and enforced in a totally different manner

1. Canada's funding model is completely different from the U.S. The majority of mortgages are held on balance sheet in Canada, with only 24% having been securitized. Thus, much more of Canada's mortgage book is funded by on-book retail deposits than is the case in the U.S. That also makes the banks more conservative about the products they are originating since they are mostly stuck on balance sheet.

2. Further, the majority of the securitized totals have been done through the CMHC — a Crown corporation with explicit government backing — thus avoiding the problems in the U.S. caused by the ambiguity of GSE liabilities. Other insured securitizations have been done through private insurers that also receive explicit government backing for the underlying assets through the Canada Mortgage Bond program.

3. Furthermore, Canadian financial institutions are not as reliant upon short-term lines

extended by other financial institutions. The degree of reliance upon such funding in the U.S. is what caused excessive exposure to short-term swings in market sentiments, not to mention adverse incentive effects.

4. Mortgage-Backed Securities (MBSs) were not placed in off-balance-sheet SIV and CDO structures as in the U.S. So, Canada MBS investors do not face the same heavily leveraged investor risks. This is perhaps the most important point, since origination mistakes in the U.S. were bad enough, but what really caused the problems were dollops of leveraging that occurred after the mortgages were originated.

5. Unlike many U.S. banks, Canadian banks continue to apply prudent underwriting standards. In other words, they have always checked, and continue to check, incomes, verify job status, ask for sales contracts, etc., such that all those questions your banker asks in Canada have a purpose that somehow got lost on many American bankers. The no-income- no-job-no-asset ("Ninja") style, here-are-the-keys-to-your-brand-new-home lending just didn't take hold in Canada.

6. Appraisal standards are generally higher in Canada, where appraisals are more likely to low-ball estimates of property value before making the final decision on how much to lend.

7. Finally, enforcement of Canadian mortgages is not as tilted in the borrowers' favour as it is in the United States. In the U.S., lenders have little recourse — they can take the keys and settle relatively quickly, or sue and go through great expense for a potentially lengthy period. Alberta is similar to the U.S. treatment in this regard. But the rest of Canada provides greater recourse to lenders than in the U.S.

Scotiabank Group