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CMHC's growth fuels worries over new risks

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The federal government has quietly given **Canada Mortgage and Housing Corp.** more financial muscle, raising concerns the multibillion-dollar agency is expanding at an unprecedented pace with little oversight.

For the second time since the beginning of 2008, Ottawa has raised the amount of mortgage insurance CMHC can have outstanding. The increase moves the cap to \$600-billion, up from \$450-billion and nearly double the \$350-billion limit in place at the end of 2007.

CMHC is by far the largest provider in Canada of default insurance on mortgages, which home buyers are legally required to have if their down payment is smaller than 20 per cent. As home prices rise and smaller down payments become the norm, CMHC is selling more insurance each year.

That trend, combined with a ramped-up program of buying mortgages from banks as part of the government's strategy to spur the home-loan market, has turned the Crown corporation into one of the country's largest financial institutions. With \$203.5-billion in assets last year, CMHC dwarfs the country's sixth-largest bank, National Bank of Canada, and its growth is blistering.

CMHC projects that its assets will hit \$345.3-billion in 2009. Bank of Montreal had \$415-billion in assets as of July 31.

Critics charge that such growth demands more oversight, pointing to the fact that even though CMHC is now central to the financial system, it is not regulated by the financial industry's main watchdog, the Office of the Superintendent of Financial Institutions. It's also a risk for taxpayers, because while CMHC sets aside billions as a cushion against losses, and is very well capitalized, Canadian citizens are ultimately on the hook for losses on its insurance should the housing market falter and those reserves prove too small.

"We need a debate, which I don't think we've had in my lifetime, about the role of the CMHC vis-à-vis our financial institutions and our housing market," said Ian Lee, the director of Carleton University's MBA program and a former mortgage manager at Bank of Montreal.

The government and many economists credit CMHC for helping to pull the economy through the credit crisis of the past two years.

"The Canadian financial sector and housing market have remained sound throughout the recent crisis," a

spokesman for Finance Minister Jim Flaherty said.

"This has been in large measure due to the effectiveness of the roles played by federal institutions, including CMHC, in supporting markets, backstopping risks and sustaining the availability of credit."

Canadian Imperial Bank of Commerce senior economist Benjamin Tal describes CMHC as the "secret weapon" that has now been revealed. "One of the main reasons we did not need a bailout [of banks] is because of CMHC, and the ability to provide cheap credit through its facilities," he said.

"Did CMHC help to improve house prices today? Yes, they did because they gave cheap credit to bank and banks were able to provide credit and low mortgage rates, which I think is the main reason why house prices are rising now. That's a reflection of a system that works, in my opinion," Mr. Tal said.

CMHC insurance helps to keep borrowing costs down for people with small down payments who would otherwise face higher interest rates from banks. That enables would-be buyers to bid more for houses, knowing that they won't be penalized for having a small down payment, and adds fuel to the housing market's soaring prices.

CMHC's securitization programs, through which it effectively buys swaths of mortgages from lenders, free up space on banks' balance sheets, allowing them to give out more mortgages than they otherwise could.

In an e-mailed response to questions, CMHC said housing affordability has improved over the years. The monthly mortgage payment on an average-priced house has decreased as a share of workers' incomes, the agency said.

As of the second quarter of this year, the mortgage payment on an average-priced house was 29 per cent of disposable income per worker, down from just under 39 per cent at the end of 2007.

The company attributes the need for the increases in the insurance cap to "a number of successive strong years of activity in the mortgage markets."

CMHC also points to a trend of banks buying insurance for mortgages that aren't required to be insured, enabling them to sell the loans to investors to raise cash.

Whatever the reason, critics like Mr. Lee say that the institution's stunning growth deserves new scrutiny. Yet, because CMHC enables more people to buy homes, it's unpalatable for politicians to criticize it, Mr. Lee said.

"That value is embedded in the Canadian consciousness," he said. "It's not as sacred a cow as health care, but it's right up there."

Ottawa created CMHC in 1946 to house returning war veterans. Its main objective is now to facilitate access to more affordable and better quality housing for Canadians.

The two main programs it uses to achieve that goal - insurance and securitization - have ballooned in the past year. CMHC planned to insure 578,539 housing units last year for \$86-billion in 2008. Instead it insured 919,790 units for \$148-billion.

It guaranteed 2.5 times more mortgage securities than planned, an extra \$64-billion, which is nearly double the 2007 level. Part of the reason for that is the emergency mortgage purchase program that Mr. Flaherty unveiled at the height of the credit crisis in October, 2008, to help ease the banks' funding costs. But even prior to that program's launch, CMHC's securitization activities were on a steep upward trajectory.

Canada Housing Trust, which carries out CMHC's securitization activities, has seen its assets grow by more than 20 times since it was established in 2001, according to Moody's Investors Service.

The opposition Liberal Party says the cap increases and the surging size of CMHC may warrant more attention.

"It's a lot of money and it could justify debate in Parliament," said John McCallum, the Liberal finance critic. However, he acknowledged that suggesting the reins be pulled in on CMHC is ticklish for politicians and said that CMHC should be able to continue growing "as long as they're prudent."

"I don't think we want the government to be rationing Canadian home-buying."

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