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CMHC move draws fire

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CanWest News Service

Monday, August 21, 2006

Canada Mortgage and Housing Corp. recently announced moves that critics say will drive many homebuyers to the poor house, as it were, and could leave Canadian taxpayers on the hook.

CMHC is offering mortgage insurance for interest-only loans and on amortizations up to 35 years, while also scrapping the typical \$165 application fee on highratio loan products for people with less than 25 per cent down payment.

With an interest-only loan, a borrower can pay interest only for the first 10 years, then pay both interest and principal. Payments are initially low, but since the entire loan must still be paid off within the original amortization period, payments balloon as the principal starts being paid down, and again if interest rates rise.

The first issue is whether a government agency like CMHC should be competing with private companies like Genworth Financial in the business of offering mortgage insurance on interest-only loans. If CMHC has to pay out a rash of defaults, the money will come out of Canadian taxpayers' pockets. The argument has also been made that mortgage insurance protects the money lender, not the homeowner.

A recent report by CIBC World Markets noted that outstanding residential mortgages rose by 10.9 per cent during the year ending this past April, adding that "the current wave of growth in mortgage outstanding is of a higher risk," and that the moves by CMHC imply that "we will see increased default risk in the mortgage market." The second issue is the wisdom of making mortgages easier to get by Canadians who are already in a massive hole of debt, with a savings rate that has fallen from 16 per cent in 1985 to negative 0.5 per cent in 2005, meaning they are now spending more money than their current disposable income.

Many people have pooh-poohed that concern, saying much of the money being spent is on mortgages, and that Canadians are actually building up equity in their homes, which is a form of savings.

Indeed, borrowing money to buy an appreciating asset is generally "good debt," as opposed to paying rent with no return. But a survey released recently by BMO Financial Group showed that while 80 per cent of baby boomers own homes and 19 per cent have a second house, only 30 per cent intend to sell their assets to fund retirement.

Furthermore, the concept of good debt doesn't necessarily hold in the case of interest-only mortgages. If a person spends 10 years paying down only interest, they save nothing if the value of their house doesn't appreciate during that period. In fact, many people are now buying at the top of a housing boom, particularly in Western Canada, and face the likelihood of selling after the market has cooled off.

Said the Edmonton firm Hendrickson Financial in a recent commentary: "When home prices begin declining, homeowners who have recently purchased with 100 per cent financing will have to come to terms with owing more than their home is worth."

Debtors are always punished more severely in a declining economy since they are less able to service their debt and the value of the assets they have collateralized are also falling." That's when you get people walking away from their homes -- when they have no equity to lose and can start all over with a cheaper house that will require smaller payments.

"I understand the government is trying to encourage people to get into the housing market and that, in rising housing markets, this may be of assistance for them," said Ottawa bankruptcy lawyer Stanley Kershman, author of *Put Your Debt on a Diet*. "But I think that encouraging people to do this only works if they have planned this whole process out." For example, with a \$190,000 mortgage at six per cent over 25 years, a person paying interest only the first 10 years will spend \$222,000 on interest (\$410,400 overall), while a person paying principal and interest will spend \$177,300 on interest (\$367,300 overall).

Kershman said we're seeing people declare bankruptcy for the second, third, fourth and fifth time, and cites a judge who over the years has had a father, son and now a grandson appear before him facing bankruptcy.

"They're getting in too deeply, with too much debt, and as people go to either renew their mortgages or consolidate mortgages, they're going to end up paying higher and higher interest rates.

"We are a society of minimum-downpayment people. Once they've got themselves four or five or six of these minimum- down-payment things, and all of a sudden the rates rise, they're saying 'I can't afford the minimums anymore.' " (Edmonton Journal)

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