Canada needs $9-billion fund to shield it from severe housing crash, C.D. Howe warns

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Ottawa needs to build a fund of up to $9 billion that would cover taxpayer losses from mass defaults and stanch the effects of a U.S. style housing collapse, new report urges. Getty Images

Canada needs to be better prepared to weather a housing crash that would leave taxpayers and mortgage insurers on the hook, according to a report.

The country should build a fund to cover taxpayer losses of as much as $9 billion, which the government could tap in case of mass defaults, according to a report from the C.D. Howe Institute scheduled for release Wednesday. The fund would build up reserves over 50 years through an additional charge on mortgage-insurance products, be overseen by the government and have a quasi-regulatory role.

The sole purpose of the agency would be to staunch the effects of a U.S.-style housing collapse. The fund could issue bonds secured by future fee premiums in case a crash occurs before sufficient reserves have been built up.

"These big events happen, they don't happen very often, but they're costly when they do," James MacGee, one of the report authors and associate professor of economics at Western University, said by phone. "What we want to do is redesign the Canadian mortgage-insurance infrastructure."

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A severe housing crash with a 30 per cent drop in prices and "high unemployment" could mean a $17 billion loss for mortgage insurers, leaving the federal government on the hook for $9 billion, according to the report. Canada suffered a 21 per cent real decline in home prices from 1981 to 1985 while U.S. prices fell 43 per cent from 2006 to 2012, according to the report.

The report comes as Canada's housing market remains in overdrive with Toronto home sales reaching a record for the third month in a row in June, according to figures released Tuesday, and transactions jumping 28 per cent in Vancouver in the same month over the prior year. Agencies from the International Monetary Fund to Fitch Ratings Inc. have raised concerns about soaring prices.

CMHC, Canada's largest mortgage insurer, had C$543 billion of mortgage insurance in-force, or total insured mortgages, at the end of 2014, according to financial documents. Genworth MI had C$365 billion in insured loans as of March 31, according to a quarterly report. Canada Guaranty Mortgage Insurance Co. doesn't disclose insurance in-force.

The government requires mortgages with less than 20 per cent down to be insured. There is C$1.2 trillion in residential mortgage credit held outstanding by banks and non-banks as of March, according to the Bank of Canada. CMHC is government-owned and its products are 100 per cent backstopped by the government in the case of a default, while Genworth and Canada Guaranty's products are 90 per cent backed.

More than half of outstanding mortgage debt is now covered by federally backstopped insurance, the C.D. Howe report said.

The report also recommended that the fund would be able to increase or lower premiums to cool the market when needed.

The Bank of Canada has said prices are overvalued by 30 per cent and a dip remains the single biggest risk to the economy. The IMF has said the country's residential real estate is about 12 per cent overvalued, while Fitch said the Ontario market is 25 per cent overvalued and condo prices may decline as much as 10 per cent.

"Instead of hitting people in the middle of a crisis with one really big bill, you say 'look, we recognize this event can happen,'" MacGee said. "Let's gradually smooth that over."
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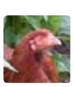

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What's the saying? Socialize loss and privatize profit. Sorry, but why should Canada be back stopping any bank or mortgage? The gov't should put CMHC assets into general revenue and dissolve the entity.

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