Intelligence MEMOS

From: Michael K. Feldman

To: Mortgage Policymakers

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Re: **The Many Benefits of Longer Mortgages**

Canadian residential mortgages could be improved if borrowers continue to have a penalty-free right of redemption at least every five years without requiring that the mortgage matures at least every five years. As I outline in my recent commentary for the C.D. Howe Institute, the result would be expanded consumer choice, encouragement of a private securitization market and reduced potential government mortgage risk.

Canadians are typically offered residential mortgages with maximum terms of five years and a 25-year amortization period. As a result, most homebuyers owe a large amount on the last day of their mortgage term, before it is fully paid off. Such payments are known as "balloon payments." There is a mismatch between mortgage term and amortization that creates a need for homebuyers to re-finance or renew the outstanding balloon payments at least every five years.

This creates a risk to both investors in mortgages and borrowers, if the lender is unable to renew the loan at maturity and the borrower is unable to find a new lender.

If the federal government could facilitate a shift to longer mortgage maturities, borrowers and investors would be better protected from mortgage lenders that become insolvent.

The best way to address the refinancing risk would be to introduce a residential mortgage product that matures when it is fully amortized. This product could include an interest rate reset and penalty-free right of redemption at least every five years in accordance with current Canadian practice. However, in the absence of agreement on an interest rate reset and the failure of the borrower to fully repay the mortgage at that time, the mortgage would become a floating rate mortgage until it matures or is repaid or until a new rate is set by agreement.

Introducing a longer-term mortgage product would assist in the development of a market for Residential Mortgage-Backed Securities for uninsured mortgages – often referred to as "private label RMBS. With private label RMBS, the investor – typically an institutional investor such as a pension fund, investment fund, mutual fund or insurance company – would invest directly in a pool of uninsured mortgages without any government backing for repayment.

A private label RMBS market would provide a funding alternative that might enable the federal government to tighten further the requirements for its support of residential mortgages through Canada Mortgage and Housing Corporation (CMHC) securitization programs.

Furthermore, it could lead to more competition in the mortgage market by providing a funding source for mortgages that do not conform with CMHC requirements or those of the Office of the Superintendent of Financial Institutions applicable to federally regulated financial institutions.

Under the current state of the law, the introduction of such a mortgage product would require an amendment to Section 10(1) of the *Interest Act*. If Parliament decides to amend the section, it should also consider lengthening the five-year penalty free redemption right to up to 10 years, which would make it easier for lenders to offer longer-term fixed-rate mortgages to borrowers who would prefer a longer interest rate lock-in period.

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