MARCH 27, 2024

Enhancing Efficiency of the Housing Finance System to Improve Affordability

CMHC (Canada Housing and Mortgage Corporation) plays a central role in supporting the stability and accessibility of the Canadian housing market, ensuring that Canadians have access to safe, affordable, and sustainable housing options. Its commercial activities primarily involve mortgage insurance and mortgage securitization. CMHC provides a guarantee of timely payment on National Housing Act Mortgage-Backed Securities (NHA-MBS) as well as Canada Mortgage Bonds (CMB) issued by Canada Housing Trust. For both, the underlying assets are residential mortgages, either single or multifamily, that are backed by mortgage default insurance.

Although these programs have provided funding and helped to support the non-bank sector to compete with banks, CMHC has shown little innovation in the past 15 years to improve the efficiency of the housing finance system. While the notion of government and efficiency may seem like an oxymoron, CMHC must prioritize efficiency improvements if it wants to improve housing affordability.

LINK TO ARTICLE

Forward market for NHA MBS. Mortgage-backed securities (MBS) are a type of 'pass-through' security – investors receive income generated by the underlying mortgage assets as it "passes through" to them. In the US, pass-through securities issued by housing agencies are traded in the "to be announced" (TBA) market, which allows for the forward settlement of MBS trades. In a TBA trade, not all the specifics of the securities are known upfront; instead, they're finalized later when the asset pool is constructed. This TBA setup makes trading in the MBS market smoother and provides liquidity. It also helps mortgage lenders manage their risk by allowing them to hedge their mortgage pipelines.

Multi-Issuer MBS Pools. Formally known as the Government National Mortgage Association (GNMA), Ginnie Mae is a government-owned corporation within the United States Department of Housing and Urban Development (HUD). It guarantees mortgage-backed securities issued by private institutions that are backed by pools of mortgages insured or guaranteed by federal agencies. Its two primary programs, Ginnie Mae I and Ginnie Mae II, both serve to provide liquidity to the mortgage market by securitizing government-backed mortgages, but they differ in the types of mortgages included, pooling process, and issuer requirements.

CMHC's NHA MBS program is based on the Ginnie Mae I program, which pools Federal Housing Administration (FHA)-insured and Department of Veterans Affairs (VA)-guaranteed mortgages. To support smaller issuers, it should also replicate part of the Ginnie Mae II program, which supports multi-issuer pools. This allows for the efficient aggregation of mortgage issuance across lenders.

Multi-Issuer Covered Bonds. The federal government has tasked CMHC to provide an administrative role to support the issuance of covered bonds. These are debt instruments issued by financial institutions and secured by a segregated pool of assets. While covered bond issuance serves as a means for banks to obtain on-balance sheet funding, other financial institutions have faced challenges in utilizing this avenue due to structuring issues. In order for smaller lenders to engage in covered bond issuance, they require access to a multi-issuer platform similar to those found in Spain.

MBS Repo. A repurchase agreement (repo) is a form of short-term borrowing for dealers and banks in the securities market. The dealer sells the security to an investor, usually overnight, and buys it back the following day at a slightly higher price. The price differential is an implicit interest rate. The Canada Mortgage Bonds (CMB) program has a repo facility that allows program participants to "sell" NHA MBA pools to the CMB program as a replacement asset. There has been no effort by CMHC to expand this facility beyond the CMB program. Creating a repo facility would improve the liquidity of the NHA MBS program. OSFI (Office of the Superintendent of Financial Institutions) and the federal government should want this type of facility, considering the significant amount of NHA MBS held by banks as a tier I asset for liquidity reserves

Insured Mortgage Repo. Insured mortgages are protected from credit risk by both the equity of the borrower and mortgage default insurance, making them low-risk assets for default. They represent the largest asset pool held by banks and credit unions. Like bonds, if mortgages were registered under a trust, it would provide a framework for trading mortgages within the registry without requiring them to be re-registered at land title offices. In a forthcoming note, we'll explore the technical considerations involved in establishing this registry and the necessary structuring of mortgage pools to enable efficient trading.

Each of these options can create a more liquid financing system for the Canadian housing market. With improved liquidity we would see lower mortgage costs and a safer banking system. In future notes, we'll delve deeper into each of these options.

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Kevin has had a long career in capital markets, housing finance, and public policy. He has worked as an economist for Alberta Treasury, Saskatchewan Policy Secretariat, the Bank of Canada, and the Department of Finance Canada. His work has included tax policy, economic forecasting, as well as monetary policy and debt management. While at the Bank of Canada, he authored two Bank of Canada Review articles on monetary policy tactics. Kevin has worked on a variety of debt programs from treasury bills to domestic and foreign bond issues, and interest rate swaps. He worked on building and managing the federal real return bond program, the Canada Savings Bond program, and built out the bond buyback program and a synthetic foreign funding program – two programs which are still in use today by the federal government. While at CMHC, Kevin managed the market funding program for social housing, built and managed the Canada Mortgage Bonds program, and expanded the products offered under the NHA MBS program. He has worked for several mortgage insurers including CMHC, Canada Guaranty, Triad Guaranty and Genworth. This work encompassed product development and risk management across housing markets in North America, Europe, Asia, Australia, and New Zealand. More recently he has had senior management roles with residential lenders managing underwriting, risk, product development, capital markets, and strategic planning.

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