Guideline Impact Analysis Statement

Advisory - MICAT Total Requirements for FTHBI mortgages

Date: September 3, 2019

I. Background

The First-Time Homebuyer Incentive (FTHBI) comes into effect this fall and will allow eligible first-time homebuyers to apply to finance 5% or 10% of their home purchase through a 2nd position, non-interest bearing, shared equity mortgage with CMHC. In order to use the FTHBI program the combined borrower down payment and shared equity from CMHC must be less than 20% of the property value, i.e. the borrower will have a first position, high-ratio mortgage and will be required to purchase mortgage insurance. We refer to this first mortgage as a "FTHBI mortgage" throughout this document.

II. Problem Identification

The MICAT is not currently designed to capture the mortgage insurance risk associated with FTHBI mortgages compared to non-FTHBI mortgages with the same risk drivers, e.g., loan-to-value, outstanding balance.

We took the following steps to develop an approach to capture the risks associated with FTHBI mortgages and calculate their total requirements in the MICAT:

- Identified the risks associated with FTHBI mortgages.
- Measured the risks using the methodology we used to determine the total requirement formulas in the MICAT.
- Designed an approach to calculate total requirements for FTHBI mortgages that uses the existing total requirement formulas.
- Determined a suitable calibration for our recommended approach consistent with our measurement of the risk.

III. Objective

The objective of this advisory is to complement the existing MICAT Guideline taking risks of FTHBI mortgages into account.

- FTHBI mortgages will have probabilities of default that are different compared to non-FTHBI mortgages, all else being equal, because FTHBI mortgages will have different loan-to-value ratios.

- We have made updates to the methodolgy previously used to develop the existing total requirement formulas in the MICAT so that we can measure the risk of FTHBI mortgages consistently with the existing underlying theoretical framework. We are able to do this because the underlying probability of default methodology considers borrower equity.

- The output suggests that total requirements for a FTHBI mortgage should be in between the amounts required for a mortgage with a loan-to-value reflecting only the borrower's down payment and a mortgage with a loan-to-value reflecting the combined borrower's down payment and the shared equity component.

- We have developed a simple approach and formula that leverages the existing total requirement formulas, taking a weighted average of the two loan-to-value ratios associated with a FTHBI mortgage as an input. We have published an Advisory that describes this approach and formula.

IV. Recommendation

OSFI recommends the development of a sound, consistent and tailored solution that can be implemented before any FTHBI mortgages are funded. This solution gives the mortgage insurers time to update their systems and plan.

V. Implementation

The new advisory will come into effect on November 1, 2019. OSFI will monitor the effectiveness of the new advisory and make any necessary modifications.