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Canada won't fall victim to foreclosure wave: Report

By John Shmuel, Financial Post May 31, 2010

Canada's housing market is expected to cool off this year and next, but isn't at risk of falling victim to a U.S.-style foreclosure crisis anytime soon, according to a new report by debt-rating firm DBRS Ltd.

DBRS said in the report that Canada will continue to fare well in comparison to its neighbour to the south when the Canadian housing market corrects itself and interest rates are tightened. That is because lending practices here are much more sound than in the U.S.

"The likelihood of us having the kind of situation they had in the U.S. is extremely low," said Jerry Marriott, managing director of structured finance at DBRS . "It's a combination of the lending practices prior to the peak in 2007 — they were more restrained, so there were better underwriting practices in Canada. We also think there are a number of factors in the Canadian market which have lent themselves to more prudent lending."

Those factors includes less aggressive lenders in the market, as well as systems designed to keep people paying their mortgages.

Mr. Marriott said that a cooling effect is gradually taking hold in the housing market as credit availability begins to tighten, and the HST factors into home buying decisions in Ontario and British Columbia.

That means there's a greater likelihood this year that there will be a correction in housing prices rather than a continued increase. Mr. Marriott said the DBRS expects the market to cool throughout the year and continue to cool into 2011. That echoes analysts expectations, who also expect prices to drop as well. A recent report by TD Bank predicts prices will fall by 2.7% in 2011.

"If you add up the factors you would look at as to whether there's going to be further price increases or the potential for a correction, we don't see there's a lot of factors supporting further price increases," Mr. Marriott said. "But there are a number of factors that show there might be some moderation in housing prices."

That may bode well for potential buyers after a report by CIBC this week said that on average, Canadian home prices are currently 14% over their "fair" value — that represents about 1.5 million homes, or 17% of all dwellings.

The report also highlights that Canadian households continue to have a particularly high level of debt, something that the DBRS notes is part of an ongoing trend. But it tempers that by adding that household debt is not as worrying as some analysts have suggested.

"We think the measurement of household leverage is subject to a fair amount of interpretation," said Mr. Marriott.

For instance, the debt-to-disposable income shows Canadians are generally more indebted than Americans — however, the report outlines that this doesn't reflect certain differences between the two countries that affect income, such as the fact that the U.S. has lower taxes but that Americans pay more money toward their health-care bills.

"At the end of 2009, Canadian households remained financially less leveraged by 10% to 45% compared with U.S. households," the report said. Overall, after adjustments, Canada had a household liabilities-to-total gross income ratio of 116.8% at the end of 2009, while the United States's ratio was 161.5%.

But Canadian household debt is growing faster. Household liabilities increased by 29.5% in Canada between 2007 and 2009. In the use, household debt grew just 5.3% during the same period.

Overall, mortgage lending in Canada reached $958.8 billion at the end of 2009. That's more than double the $414.1 billion ten years ago. When including home equity lines of credit, outstanding mortgage-related credit was more than $1 trillion.

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