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Reassessing the Growth of HELOCs in Canada Using New Regulatory Data

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Abstract

Using new regulatory data on residential secured lending from Canadian banks, we assess the growth rate of home equity lines of credit (HELOCs). The new dataset is the first of its kind to provide information on individual components of combined mortgage-HELOC plans. These combined plans are an increasingly popular credit product. We find that the credit growth has been concentrated in the amortizing mortgage component of the combined plans rather than the non-amortizing HELOC component. In addition, the total outstanding balance of HELOCs has contracted over the past year, which is consistent with rising interest rates and a slowdown in the growth of household consumption.

Bank topics: Credit and credit aggregates; Financial institutions; Recent economic and financial developments; Financial stability
JEL codes: D1, G21, G28

Résumé

Dans cette étude, nous évaluons le taux de croissance des marges de crédit hypothécaire à l’aide de nouvelles données réglementaires sur les prêts des banques canadiennes garantis par un immeuble résidentiel. C’est la toute première fois qu’un ensemble de données détaille les différentes composantes des prêts hypothécaires conjugués à des marges de crédit hypothécaire, qui connaissent un succès croissant. Nous constatons que la croissance du crédit s’est concentrée dans la composante « prêt hypothécaire », qui est amortie, plutôt que la composante « marge de crédit hypothécaire », qui n’est pas amortie. De plus, le solde des marges de crédit hypothécaire a diminué au cours de la dernière année, ce qui cadre avec la montée des taux d’intérêt et le ralentissement de la croissance de la consommation des ménages.

Sujets : Crédit et agrégats du crédit; Institutions financières; Évolution économique et financière récente; Stabilité financière
Codes JEL : D1, G21, G28

The growing importance of combined mortgage-HELOC plans

Home equity lines of credit (HELOCs) are revolving credit products secured against the value of a residential property, typically with no fixed schedule of principal payments. For many homeowners, HELOCs represent a flexible and relatively low-cost means of accessing cash. Funds drawn from HELOCs can be used to purchase investments, to finance home renovations and big-ticket items, and to consolidate and pay down other existing debts (Dunning 2019).

HELOCs are often promoted as part of combined plans, offered with a mortgage and, sometimes, other credit products, such as personal loans and credit cards.[1] A combined plan can typically be broken down into a HELOC component, which is non-amortizing, and a mortgage component, which is amortizing.[2] In addition, a portion of the mortgage component in a combined plan may be readvanceable, even though it is amortized. The borrowing limit in combined plans is typically tied to local house prices. As house prices increase, households can borrow more. In recent years, combined mortgage-HELOC plans have grown in importance. Currently they account for close to 40 per cent of outstanding residential credit on the books of chartered banks.

Combined plans are relatively complex products, compared with traditional mortgages or HELOCs. The reporting practices for combined plans vary across financial institutions, and the mortgage component of combined plans may be reported as either a mortgage or a HELOC. This presents challenges for the measurement of credit aggregates. For this reason, in recent years the Bank of Canada has reported only the combined growth of loans secured by residential real estate.[3] That said, we can obtain an estimate of the growth rate of HELOCs from existing regulatory filings, and public reports based on these data suggest HELOC growth has recently outpaced mortgage growth (**Chart 1**).[4, 5]

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[1] For information on the evolution and marketing of these products, see Financial Consumer Agency of Canada (2017).

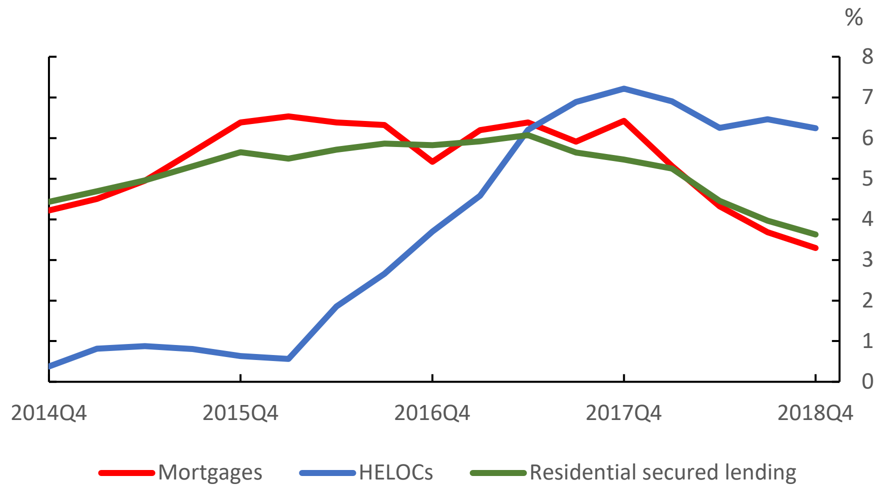
[2] More technically, the non-amortizing HELOC component requires only an interest payment, whereas the amortizing mortgage component requires both principal and interest payments. Principal payments result in the loan being fully repaid over a certain fixed length of time.

[3] In recent editions of the *Financial System Review* and the *Monetary Policy Report*, the Bank reports the annual growth rate of total real estate secured lending, whereas the Bank's website includes all reported lines of credit (including HELOCs) as part of consumer credit. The Bank had not published the growth rate of HELOCs alone before this analysis.

[4] Existing reports include the Balance Sheet (M4) regulatory filings of Canadian banks submitted to the Office of the Superintendent of Financial Institutions.

[5] Estimates can be found in DBRS (2019). The report is featured in a Bloomberg article by E. Duarte (February 21, 2019).

Chart 1: Growth of HELOCs has recently outpaced growth of mortgages, according to regulatory data
Year-over-year growth



Note: HELOCs are approximated by non-mortgage loans to individuals secured by residential property.
Sources: Regulatory filings of Canadian banks (M4 return) and Bank of Canada calculations

A new reporting requirement for HELOCs

A new regulatory return has been established to standardize the reporting on HELOCs.[6] The return is the outcome of a years-long collaborative effort between the Bank of Canada, the Office of the Superintendent of Financial Institutions and Canadian banks to improve the monitoring of financial stability issues.[7] The new filing categorizes residential secured lending into stand-alone HELOCs, traditional mortgages and combined mortgage-HELOC plans. As well, it provides a breakdown of the combined plans into individual HELOC (non-amortizing) and mortgage (amortizing) components.[8] The data are available for five quarters, ending in the fourth quarter of 2018, allowing for a year-over-year assessment.

The new report confirms strong growth in combined mortgage-HELOC plans, at 6.7 per cent year over year (**Table 1**).[9] These plans appear to be taking market share from the traditional stand-alone mortgages and HELOCs; stand-alone mortgages grew by a modest 2.0 per cent, while stand-alone HELOCs contracted by 7.6 per cent. In addition, the new information on components of combined plans shows that the growth of these plans is driven by the

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[6] See Home Equity Lines of Credit (HELOCs) Report (J2) and Fournier and Hertzberg (2019).
[7] Previous outcomes included modifications to the Report on New and Existing Lending (A4) and the Mortgage Loans Report (E2).
[8] The return shows how these categories are reflected on the balance sheets of banks.
[9] The data are for Canadian chartered banks only, which hold close to 80 per cent of outstanding residential secured loans. There are no data tracking HELOCs extended by non-federally regulated financial institutions.

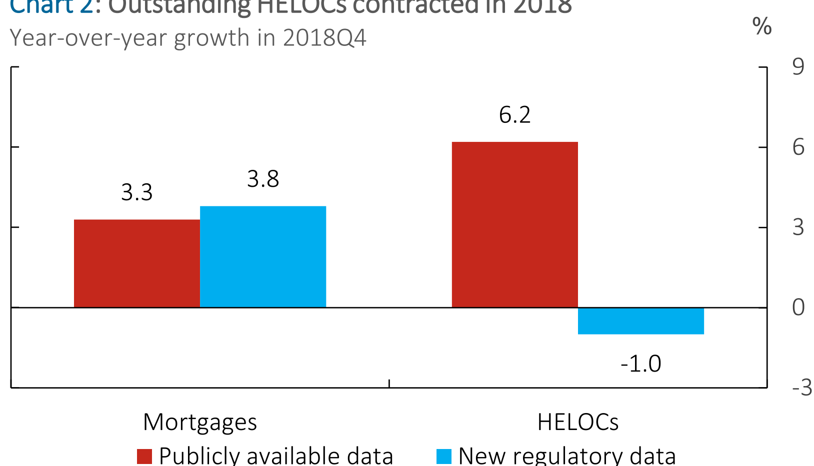
amortizing mortgage component, which grew by 7.7 per cent while the non-amortizing component grew by 3.3 per cent.

Table 1: Residential secured lending in the fourth quarter of 2018, by type

	Outstanding balance ($ billion)	Year-over-year growth rate (%)	Contribution to growth of total residential secured lending (%)
Home equity lines of credit (HELOCs) (stand-alone)	63	-7.6	-0.4
Mortgages (stand-alone)	767	2.0	1.1
Combined mortgage-HELOC plans	509	6.7	2.4
non-amortizing	110	3.3	0.3
amortizing	399	7.7	2.1
Total HELOCs = HELOCs + non-amortizing component of combined plans	173	-1.0	-0.1
Total mortgages = Mortgages + amortizing component of combined plans	1,166	3.8	3.2
Other lending secured by real estate	44	14.0	0.4
Total residential secured lending	**1,383**	**3.5**	

Note: "Other lending secured by real estate" includes multi-unit residential mortgages, as well as other non-business loans secured by residential property, such as home equity loans.
Sources: Regulatory filings of Canadian banks (J2 return) and Bank of Canada calculations

Altogether, the total outstanding balance of HELOCs (both stand-alone HELOCs and the non-amortizing component of combined plans) is $173 billion as at the fourth quarter of 2018, $70 billion below the previous publicly reported amount of $243 billion. The total balance of HELOCs contracted by 1 per cent year over year, whereas the total balance of mortgages (both stand-alone mortgages and the amortizing component of combined plans) grew by 3.8 per cent. The differences between the old and new estimates of HELOC and mortgage growth are summarized in **Chart 2**.



Sources: Regulatory filings of Canadian banks (M4 and J2 returns) and Bank of Canada calculations

Trends in HELOCs and combined plans warrant continued monitoring

Against the backdrop of rising interest rates, tighter mortgage qualification criteria and the slowdown in household spending throughout 2018, the data from existing regulatory filings show that HELOC balances grew faster than mortgages. This suggests that households were continuing to borrow against the value of their homes even as borrowing conditions tightened. However, the new regulatory report offers contrasting evidence. It demonstrates that once the components of the combined mortgage-HELOC plans are disentangled, HELOC balances contracted over the past year while mortgages grew.

Despite the newly documented trends, the ease of access to revolving credit provided by stand-alone HELOCs and combined plans could facilitate the accumulation of debt at the expense of gaining equity in one’s home. Given that the loan-to-value ratio moves with a local house price index, borrowers accumulating large amounts of debt secured by housing may find themselves with minimal (or even negative) housing equity if the value of their house falls. Home equity extraction may also be concealing emerging financial distress if borrowers are taking equity out of their homes to manage other debt obligations or to finance their daily expenses because they lack other sources of funds. These considerations warrant continuous monitoring and assessment of stand-alone HELOCs and combined plans.

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