Comparing the Canadian and U.S. subprime and alternative mortgage markets.

Why the U.S. subprime fallout is a U.S.-only phenomenon

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Mortgage Architects™

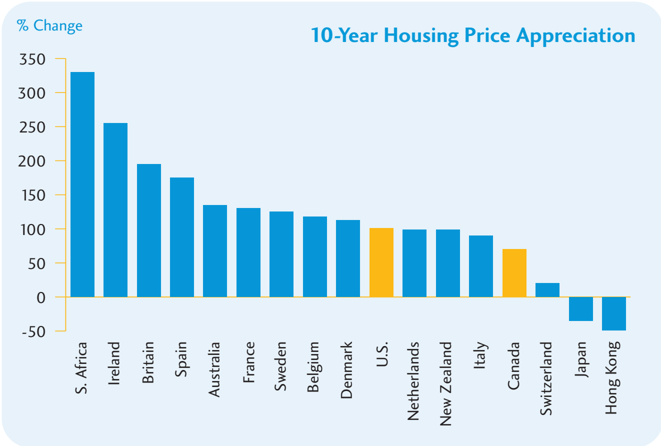
U.S. Non-Conforming vs. Canadian Non-Conforming.

Given recent negative developments in the U.S. non-conforming mortgage market, we thought it would be valuable to examine the differences between the Canadian and American marketplace. The downturn in the U.S. housing market, characterized by increasing inventory of unsold homes and significant price depreciation, has caused arrears to soar to 12 to 14 per cent and default rates to hover at approximately eight per cent. As a direct result, 44 lenders have failed in the last six months. The non-conforming mortgage market in Canada is less saturated, comprised of smaller lenders which mostly rely on securitization for funding such as myNext Mortgage Company, Xceed, GMAC Residential Funding, Home Trust, Equitable Trust, First National, and FirstLine, to name a few. We do not expect any of the negative fallout we are witnessing in the U.S. to make its way into Canada.

What factors make Canadian non-conforming different from U.S. subprime?

1 Regulatory

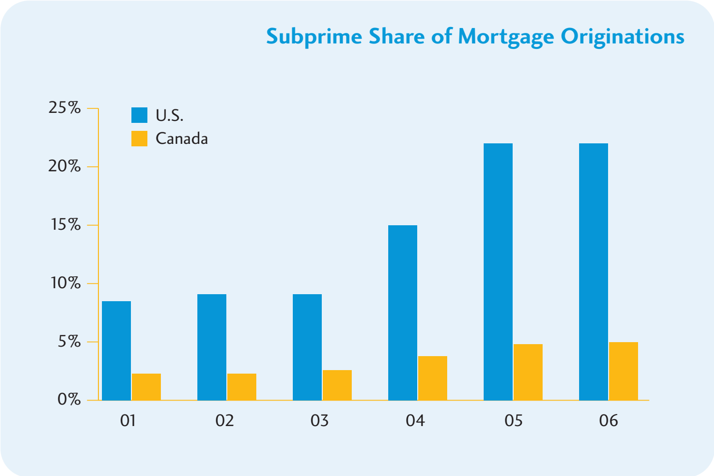
- In Canada, lenders are paid for deficiency on sale, and can pursue wage garnishing among other creditor friendly options to make the lender whole on foreclosure.
- Mortgages cure themselves in approximately 50% of the defaults in Canada, i.e. the lender is made whole without having to foreclose on the property (borrower sells property or borrows money elsewhere).
- Due to fundamental differences in tax law (mortgage interest deductibilty), there exists a disincentive to build and retain equity in a principal residence in the U.S., which drives higher loss severity upon foreclosure (see below), i.e. the borrower is tax incented to maximize the size of their mortgage.
- Partly as a result of these structural factors, the housing market in Canada has not experienced high appreciation rates similar to other industrialized nations (see right).



Source: The Economist

2 Volume

- Subprime originations in the U.S. were $570 billion in 2006. $450 billion of that amount was securitized. The subprime market in the U.S. has experienced exponential growth in the past 5 years (22% of originations in 2006), while Canada's non-traditional market remains small at 5% of total originations (under $10 billion) in 2006 with less than $5 billion of mortgages securitized to-date.



Source: CIBC World Markets

3 Product Differences

Underwriting Standards	Canadian Subprime	U.S. Subprime
No income/no asset verification	No	Yes
Stated income / low documentation	<10%	>40%
ARMs with teaser rates	No	Yes
Interest-only mortgages	No	Yes
Second mortgages	Limited	Yes
Maximum LTV	100%	125%
Typical mortgage amortization	25 to 35 years	30 years to 50 years
Appraisals	Full	Practice varies
Personal covenant	More prevalent	Limited
Rural properties	Limited	Yes
Computer-model approval process	No	Yes
Skip payments	No	Yes

- Data in the U.S. is not representative of the Canadian industry and economic trends. The primary differences driving the superior performance are that there are no interest only mortgages, no negative amortizing mortgages and no prepayment options without penalties in Canada.

- Loans underwritten using less than full documentation standards comprise more than 50% of the subprime sector in the U.S. and non-owner occupied mortgage loans represent 8% of originated subprime loans.

- Hybrid ARMs: the low initial fixed rate(teaser) is particularly appealing to borrowers in the U.S. but are more vulnerable to payment shock risk at the ARM reset dates. Hybrid Interest-Only ARMs: allow the borrower to pay interest only on the mortgage for a specified period.

- 40-Year Hybrid ARMs: loans with a 40-year amortization period are increasingly popular at 8% of total subprime volume in 2006 in the U.S.

- Second Liens: piggyback second liens have historically been used by prime or Alt-A borrowers to avoid mortgage insurance. The product is popular among first-time and subprime buyers who would otherwise be unable to make the traditional down payment of 20% of the purchase price.

4 Consumer Differences

- While the U.S. has experienced escalating deficits in recent years, Canada has run budget surpluses. The number of consumer bankruptcies in Canada fell by 6.4% in 2006 following a 0.2% increase in 2005. Mortgage arrears in Canada are currently at record-lows – which are in clear contrast to the U.S. where delinquency rates are now at levels not seen since the 1991 recession. Total American household debt rose by just under 70% over the past four years, notably faster than the 40% increase seen in Canada.

- Borrowing against home equity: in both 2004 and 2005, borrowing against home equity mushroomed to a record high of 8% of disposable income in the U.S. In Canada, borrowing against home equity played an important role in overall mortgage market activity, but represented roughly 4% of disposable income.

- In the past 3 years, the U.S. has averaged roughly 33% variable rate mortgages and Canada has averaged 22%. The U.S. consumer is also more vulnerable to rate hikes as teaser rates were much lower due to the FED Funds rate bottom of 1% in 2003.

5 Performance/Risk Profiles

- Subprime delinquency rates in the U.S. are 12% vs. Canadian subprime delinquencies of 3.8%. The strong performance of Canadian mortgages reflects the relatively conservative Canadian credit environment; subprime lending in Canada accounts for 5% of originations vs. 22% in the U.S.

- myNext's WA beacon scores of approximately 700 are significantly higher than subprime levels(<620), and are expected to experience superior performance levels as a result.

- 20% of mortgage originations in the U.S. were IO and one third of adjustable rate loans were IO. In 2006 IO loans represented only 1% of total originations in Canada.

- Default rates: the subprime market in the U.S. is running at an 8% default rate while Canada is running at approximately 2%. We expect defaults to remain between 1-2% going forward in Canada, but continue to increase into the 10-12% range in the U.S. for subprime mortgages.
- Loss severity experience in the U.S. is dramatically higher. Depending on LTV, recoveries in the U.S. run as low as 38% on 100% LTV properties. Loss severity in Canada is consistently below 5% (95% recoveries on average).

Conclusion

The Canadian Mortgage market is much stronger than the U.S. In the U.S., appreciation in the past two years was artificially driven by product innovation and irresponsible borrowing. While exotic mortgages are making their way to Canada, their share of the market is too small at this point to have any material impact. Regulatory, market share, products and consumer taste differences combine to form a solid foundation from which the Canadian non-traditional mortgage market should thrive going forward.

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