Borrowers at TD, BMO, CIBC see their mortgages balloon due to sharp rise in interest rates

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A house with a sold sign in Ottawa, on April 17.

LARS HAGBERG/REUTERS

Three major Canadian banks have disclosed that about 20 per cent of their residential mortgage borrowers - representing nearly $130-billion in loans - are seeing their balances grow as their monthly payments no longer cover all the interest they owe.

Mortgages have increased in size - a phenomenon known as negative amortization - because of the sharp rise in interest rates, financial reports from Bank of Montreal, Toronto-Dominion Bank and Canadian Imperial Bank of Commerce show. It is the clearest sign of the fallout from the rising interest rate environment and the potential stress borrowers face when they are required to increase their monthly payments to get back on track with paying down their mortgages.

BMO BMO-T (/investing/markets/stocks/BMO-T/) -0.34%,.. disclosed that mortgages worth $32.8-billion were negatively amortizing in the third quarter ended July 31. That is the equivalent of 22 per cent of the bank's Canadian residential loan book. For the second quarter ended April 30, the total was $28.4-billion, equivalent to 20 per cent of BMO's loan book.

TD TD-T (/investing/markets/stocks/TD-I/) -0.19% ,.. had mortgages worth $45.7-billion negatively amortizing in the third quarter, the equivalent of 18 per cent of its Canadian residential loan book. That was higher than the $39.6-billion, or 16 per cent of its loan book, in the fourth quarter of last year.

This marks the first time BMO and TD have provided detail on loans that were increasing in size. Until now, the two banks did not disclose the information to shareholders, which suggested it was immaterial. They repeatedly declined to disclose the numbers when The Globe and Mail asked earlier this year.

Asked why BMO changed its disclosure, spokesperson Jeff Roman repeated a statement he has made in the past, saying the bank's disclosures are consistent with international accounting standards as well as the rules of securities and bank regulators.

TD spokesperson Samantha Grant did not answer the question.

The BMO and TD disclosures come after CIBC CM-T (/investing/markets/stocks/CM-I/) -0.60% ,.. started reporting negatively amortizing loans in the fiscal fourth quarter of last year.

In this year's third quarter, CIBC had mortgages worth $49.8-billion, the equivalent of 19 per cent of its Canadian residential loan book, in negative amortization. That was higher than the $44.2-billion, or 17 per cent of its portfolio, in the second quarter, according to its financial results.

Mortgages are designed so borrowers pay down the loan balance over time. But because of the structure of most of Canada's variable-rate mortgage products, loans have grown with the rise in interest rates.

BMO, TD and CIBC offer variable-rate mortgages that have fixed monthly payments. With these fixed-payment loans, any increase in interest rates reduces the amount used for the principal. As a result, the amortization period extends because it will take a longer time to pay off the loan.

A big interest-rate increase- such as the Bank of Canada's move from 0.25 per cent to 5 per cent in less than two years - can result in the fixed payment not covering any of the loan balance, and it may not even cover all of the monthly interest owed. That unpaid interest is then added to the principal, which increases the size of the loan up to a certain threshold.

When these borrowers renew their loans, they will be required to revert to their original amortization schedule unless they refinance and take out a new mortgage.

"It's a potential pain point on renewal for many borrowers," said Mike Rizvanovic, financial services analyst with investment bank Keefe, Bruyette & Woods Inc.

On conference calls with analysts, bank executives said some of their borrowers with negative amortizations were either topping up payments, increasing monthly payments or switching to a fixed-rate mortgage, in which the interest rate remains the same over the term of the contract. BMO chief risk officer Piyush Agrawal said customers have been pro-active in making the changes. Over all, he said: "We are getting very good positive feedback."

TD's head of Canadian personal banking, Michael Rhodes, said, "We're having good uptake," according to a call transcript by AlphaSense, a financial research provider. Mr. Rhodes declined to disclose detail on how many borrowers were doing this except to say it was a "meaningful number."

CIBC chief risk officer Frank Guse said about 8,000 bank clients had increased their monthly payments and more than 1,000 customers were making lump-sum payments. The bank has removed them from negative amortization status.

Royal Bank of CanadaRY-T (/investing/markets/stocks/RY-Tl) -0.17%,..

RY-T (/investing/markets/stocks/RY-Tl) -0.17%,.. also offers the variable-rate mortgage with fixed monthly payments, but does not allow loans to increase or negatively amortize.

The four banks have repeatedly said they are working with borrowers nearing the point at which they have to make larger monthly payments. Some of those efforts can be seen. The share of the banks' borrowers with amortizations greater than 30 years has declined incrementally from the first quarter ended in January to the third quarter ended in July.

At BMO, the percentage of borrowers with longer amortizations was 29.8 per cent in the third quarter, compared with 32.4 per cent in the first quarter.

At TD, the share fell to 25.7 per cent from 29.3 per cent over the same period. At CIBC, the proportion declined to 27 per cent from 30 per cent. At RBC, the percentage decreased to 24 per cent from 27 per cent.