

TOUGHER MORTGAGE RULES What does this mean to you?

Canadians woke up on a Monday morning in mid-January to discover that Jim Flaherty, just as he had done the year before, was once again tinkering with the mortgage rules in an ongoing effort to 'protect the stability of the economy'. The announcement followed a volley of statements and concerns issued by the Bank of Canada that Canadian household debt levels were reaching historic levels. The result: another round of strategic rule changes from Ottawa, specifically targeting the biggest areas of concern:

1. Mortgage amortization periods will be reduced from 35 years to 30 years.
2. The maximum amount Canadians can borrow to refinance their mortgages will be lowered from 90 per cent to 85% of the value of their homes.
3. The government will withdraw its insurance backing on lines of credit secured on homes such as HELOCs.

So how will these new mortgage rules impact you? Let's take a closer look:

The first thing to keep in mind is that the only effect Ottawa can have is to change the rules at the Canadian Mortgage and Housing Corporation (CMHC) the Crown corporation that provides mortgage default insurance on high ratio mortgages in Canada, which according to the Canadian Bank Act, is required on any mortgage that has less than 20% equity. Rule changes in Ottawa do not have a direct effect on private default insurance companies (ie Genworth Financial) or conventional mortgages with 20% or more equity.

1. The change in amortization periods will make it more expensive for home buyers to afford a high ratio mortgage, but in the big picture, this will have a negligible impact. For mortgage of roughly \$300,000 with 5% down, your payments would increase by \$100 a month. The government logic is that, if \$100 is enough of a difference for you to no longer afford your home, then perhaps you are buying something you can't afford in the first place. Hard to argue with that logic. For those who will lament the days of being able to have a 35 year amortization on your mortgage – keep in mind that prior to 2006 you were only able to have a 25 year amortization – so in effect you're still ahead.

-Bottom Line: Yes, this will take a little bit more out of your monthly budget but will also help you pay off your mortgage sooner.

-Impact on the market place: This is the boldest of the three rule changes but the overall impact will be negligible

2. Changing the maximum amount Canadians can refinance their homes from 90% to 85% is a very prudent move that is directly aimed at preventing Canadians from using their home as ATM machines. Both the Bank of Canada and the Federal government have repeatedly expressed their concerns over the past several months that Canadian household debt has reached historic highs and most recently, it was noted that the level of debt to disposable income was higher in Canada than in the US. This debt was largely fueled by access to historically low mortgage rates which allowed homebuyers to use equity in their homes to make big ticket purchases such as cars, boats and flat screen TVs. Above all else, this was the biggest concern of for the government and an area they felt the need to address. Again, hard to argue with that logic.

-Bottom Line: This will only affect those households looking to refinance their homes and access equity. The majority of Canadians were doing this for the purpose of debt consolidation, home renovations or consumer purchases – not investing. As such, this rule change should have the desired effect of slowing down the ability for homeowners to re-access equity in their homes and encourage building up of equity.

-Impact on the market place: Negligible in terms of slowing down the real estate market. This is aimed at existing homeowners not purchasers.

3. Choosing to no longer insure home equity lines of credit is in tandem with rule #2 (see above). Mr. Flaherty's exact quote was: 'They're (those loans) used to buy boats and cars and big screen TVs... And that's not the business that home insurance was designed for.' Clearly, Ottawa wants to distance the crown corporation from being seen as backing and supporting the practice of using your home to subsidize your lifestyle. Spoken in that context, again it's hard to argue his logic. Having said that, there are few if any lenders out there who offer high ratio insured HELOCs, so it begs the question; who is he targeting here? My concern is that the answer is the non-bank lenders who rely on Mortgage-Backed Securities (MBS) for their source of mortgage funds. These lenders secure funds from third-party institutional investors to lend in the Canadian market place. These investors require that the mortgages be 'bulk-insured' on the back end by either CMHC or Genworth. It may be that these lenders will no longer be able to offer HELOC products.

-Bottom Line: Directly targeted at those who are using their home equity to subsidize their living expenses and support poor spending habits.

-Impact on Market: Negligible in the sense that that banks and credit unions no longer offer these products. However, the fact that the MBS-non bank lenders may no longer be able to offer them even at a conventional level will eliminate some market competition for the banks and that is not positive for the consumer.

Unintended consequences:

The beginning of 2011 is mirroring that of 2010. A year ago there was the exact same rhetoric around rising household debt; an over heated housing market and record low rates. Changes by Ottawa to address some of these issues has given Mr. Carney and the Bank of Canada some breathing room to leave rates unchanged in January but has given rise to further speculation that we may see rates rise at their next meeting in March. We need only look back to the Spring of 2010 to predict the outcome: Pending rule changes in April along with the fear of rising rates and the impending onset of HST resulted in the consumer market developing a 'Get in while you can!' mentality – resulting in a near record surge in housing activity driving prices to an all-time high in May of 2010.

The Bank of Canada's next rate announcement will be March 1st and there will be wide-spread speculation that they will start with a quarter point rise. The new mortgage rule changes will come into effect in March of this year. Combine these two factors and February 2011 may go down as one of the busiest months of the year for the real estate market. The traditional spring market may just have an early start this year.

Until next time;
Happy investing,

Peter Kinch

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