CANADA'S HOUSING MARKET

October 3, 2016

Canada's Finance Minister announces new measures to address housing risks

- Federal Finance Minister Bill Morneau today announced a series of measures that will set more uniform mortgage insurance standards, improve fairness of the tax system and seek ways to spread the federal government's housing market risk exposure.
- 'Stress tests' will be standardized for all insured mortgages. Qualifying standards for fixed-rate mortgages with terms of five years or more, as well as portfolio-insured mortgages will be the same as the standards for variable-rate mortgages and fixed-rate mortgages with terms less than five years
- Ottawa will close a loophole in the tax system allowing non-residents to claim the principal-residence exemption on capital gains from selling a home.
- The federal government will engage mortgage market participants to discuss risk sharing options.
- We believe that the new measures affecting mortgage insurance qualifications potentially could have a material cooling effect across all markets in Canada.

First set of rule changes arising from the 'deep dive' into housing

The 'deep dive' into Canadian housing matters announced in June by Finance Minister Bill Morneau has generated its first set of policy moves. Today, Minister Morneau announced "three complementary measures designed to reinforce the Canadian housing finance system, to help protect the long-term financial security of borrowers, and to improve tax fairness for Canadian homeowners". At first glance, the announced changes may look rather incremental; however, we believe that they have the potential to temper activity across all markets in Canada—not just Vancouver and Toronto.

Uniform rules for all insured mortgages

Starting on October 17, 2016, all new mortgage borrowers with a down payment of less than 20% and seeking mortgage insurance (high-ratio mortgages) will be required to qualify at the posted rate for a conventional mortgage for a five-year term (presently 4.64%) or the contract rate, whichever is higher. Currently, this qualifying requirement is imposed only on insured mortgages with a variable rate or a fixed rate with a term of less than five years. Moreover, effective November 30, 2016, the standards for low-ratio mortgage portfolio insurance will be same as those for insured high-ratio mortgages. This means that mortgages in a portfolio to be insured will be restricted to 25 year in length of amortization, a maximum of $1,000,000 in value, a credit score of 600 or higher, and a maximum Gross Debt Service of 39% and Total Debt Service of 44% calculated with the posted rate for a five-year conventional rate or the contract rate, which ever is higher.

Closing a tax loophole for non-residents

Minister Morneau announced changes to the tax system to close a loophole that allowed non-resident to claim the principal-residence exemption on capital gains from selling a home. These modifications will state that families are able to designate only one property as a principal residence and that non-residents will not be able to claim the exemption. Furthermore, going forward the government will require the sale of a property to be disclosed when filing income tax returns. The Canada Revenue Agency (CRA) currently does not require taxpayers to report the disposition of a property when a property is eligible for the full principal residence exemption.

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Launching consultations on sharing housing market risks

Finally, Minister Morneau announced the launch of public consultations on “how modifying the distribution of risk in the housing finance framework by introducing a modest level of lender risk sharing for government-backed insured mortgages could enhance the current system”. While there were no specific proposals in today’s statement, background material indicated that the announcement would be followed in the coming weeks with a consultation paper that presumably would provide more details on the sort of risk sharing that the federal government is contemplating. In recent past, the OECD has advocated for some form of deduction imposed on mortgage lenders on a defaulted loan.

Effects of qualifying rule changes could be material

Of the measures announced today, the changes to the mortgage insurance qualifying requirements have the potential to exert the most significant effect on Canada’s housing market in the near term. Imposing a higher qualifying rate on insured mortgages with a five-year term will affect the largest segment of Canada’s mortgage market. Fixed-rate mortgages represented a little more than 75% of new mortgages in Canada in 2015, according to Mortgage Professionals Canada, the majority of which were of a five-year term. The use the posted rate of 4.64% for five-year fixed-rate mortgages (as tabulated by the Bank of Canada) in the calculation of GDS and TDS ratios would raise the bar for mortgage insurance qualification. Because they tend to be the primary users of mortgage insurance, first-time homebuyers necessarily would be the most affected by the change. It is important to note that these changes will have implications not just in Vancouver and Toronto but all across Canada.