New Mortgage Rules - February 2016

Executive Summary

Bill Morneau, Federal Minister of Finance, announced late in 2015 that the minimum requirements for homeowners' down-payments will be increasing.

The rationale is clear: slowing down the white-hot rise in home prices that fuel ever increasing leverage by buyers will protect the Canadian public should a major market shock occur.

There are also significant political elements to this plan including: preventing the despair of a generation of home buyers who will never enter the market, preventing a soon-to-retire generation from funding their children's home ownership, encouraging greater in-flows of capital by foreign buyers who anecdotally are driving the increase for high-end homes.

Nonetheless, it is important for lenders to be protected and that owners have significant equity from the beginning so that a default doesn't erode the equity of lenders across the board.

This new legislation presents the opportunity for Advisors to counsel clients and their adult offspring through this process. Utilizing the Home Buyers Plan provisions of an RRSP for first time buyers, a TFSA and non-registered savings as well as the proceeds of a tax-free sale of a principal residence are intertwining elements of home purchase for some families.

The Details

The new rules specifically affect mortgages on homes with purchase prices between $500,000 and $1 million.

For the first $500,000 the minimum down-payment remains at 5%, or $25,000. That would leave a mortgage of $475,000.

For the next $500,000 in purchase price, up to $1 million, the required down-payment doubles to 10%, or $50,000, leaving a potential mortgage of $450,000.

Together a home with a purchase price of exactly $1 million requires a $75,000 minimum down-payment, leaving $925,000 as the mortgage amount.

A quick breakdown of these prices based on prevailing rates as of the enacting of this regulation, a $925,000 mortgage with a 5-year fixed term and monthly payments on its 25-year amortization period with required payments of $5,120. With property taxes included, the monthly commitment will exceed $6,000!

With special offers on fixed mortgages with terms of 5 to 7 years, and annual interest rates below 4%, a quick rule-of-thumb on a 25 year mortgage is $500 per month per $100,000 borrowed. Therefore a $300,000 mortgage would calculate to about a $1,500 monthly mortgage payment.

According to Canada Mortgage and Housing Corporation (CMHC) a household's principal, interest, property tax and heating (PITH) should not exceed 32% of income, and their Total Debt Service (TDS) ratio should not exceed 40% when all debt is included.

Assuming a mortgage payment (principal and interest) of $5,120, property tax of $800/month, and utilities of $250/month, the total annual obligation for PITH in a single family home is $74,040. And if PITH represents 32% of the household income, it must be at least $231,375.

At all levels of income, the 32% or 40% rules set out by CMHC are minimums, not prescribed amounts, or the goal. The questions should be:

- What can we reasonably afford?
- What are our current housing needs?
- What other financial commitments do we have beyond a mortgage?
- How does this home purchase address our long-term housing needs and retirement savings goals?

Bottom Line

In addition to the carrying costs, and repayment requirements, home buyers should expect closing costs to be about 1.5% - 4% of the purchase price of the home. CMHC also predicts that over the last 20 years (following the downturn of 1989 and recovery) Canadians have believed that they are being excluded from the property ladder. If that were true, then eventually the demand would slow and housing prices would stagnate until buyers' incomes caught up.

In major markets like Toronto and Vancouver (Calgary is excluded due to the last year's affect on the price of oil), market prices are affected by off-shore buyers, speculators and, recently, unscrupulous real estate agents.

If an entire, multi-generational family is absent from the housing market, are they completely and negatively affected by rapidly rising prices. Eventually, any increased wealth will flow to the next generation, at death or gifted after a windfall.

The Bottom Line

For "reasonable" home buyers, those who are qualified and able to save a "proper" down payment, this change will have little or no impact. For those that cannot, this regulation is specifically applicable. It represents a true opportunity for a regulation to affect only those it should.