Government of Canada Takes Action to Strengthen Housing Financing

The Honourable Jim Flaherty, Minister of Finance, today announced a number of measured steps to support the long-term stability of Canada's housing market and continue to encourage home ownership for Canadians.

"Canada's housing market is healthy, stable and supported by our country's solid economic fundamentals," said Minister Flaherty. "However, a key lesson of the global financial crisis is that early policy action can help prevent negative trends from developing."

The Government will therefore adjust the rules for government-backed insured mortgages as follows:

- Require that all borrowers meet the standards for a five-year fixed rate mortgage even if they choose a mortgage with a lower interest rate and shorter term. This initiative will help Canadians prepare for higher interest rates in the future.
- Lower the maximum amount Canadians can withdraw in refinancing their mortgages to 90 per cent from 95 per cent of the value of their homes. This will help ensure home ownership is a more effective way to save.
- Require a minimum down payment of 20 per cent for government-backed mortgage insurance on non-owner-occupied properties purchased for speculation.

"There's no clear evidence of a housing bubble, but we're taking proactive, prudent and cautious steps today to help prevent one. Our Government is acting to help prevent Canadian households from getting overextended, and acting to help prevent some lenders from facilitating it," said Minister Flaherty. "If some lenders aren't willing to act themselves, we will act. These measures demonstrate the Government is committed to taking action when necessary to support the long-term stability of a sector that is so vital to our economy and the financial well-being of Canadian families."

These adjustments to the mortgage insurance guarantee framework are intended to come into force on April 19, 2010.

Backgrounder

Canada's Housing Market Remains Strong

Canada's housing market remains healthy and stable. According to the International Monetary Fund, our housing market is fully supported by sound economic factors, such as low interest rates, rising incomes and a growing population. Moreover, mortgage arrears—overdue mortgage payments—have also remained low.

Today's announcement is part of the Government's policy of proactively adjusting to developments in the housing market that could take root and cause instability. These steps are timely, targeted and measured, and will reinforce the importance of Canadians borrowing responsibly and using home ownership as a savings mechanism.

Mortgage Insurance

Mortgage insurance (which is sometimes called mortgage default insurance) is a credit risk management tool that protects lenders from losses on mortgage loans. If a borrower defaults on a mortgage, and the proceeds from the foreclosure of the property are insufficient to cover the resulting loss, the lender submits a claim to the mortgage insurer to recover its losses.

The law requires federally regulated lenders to obtain mortgage insurance on loans in which the homebuyer has made a down payment of less than 20 per cent of the purchase price (also called high loan-to-value ratio loans). The homebuyer pays the premium for this insurance, which protects the lender if the homebuyer defaults.

The Government ultimately backs most insured mortgages in Canada. It is responsible for the obligations of Canada Mortgage and Housing Corporation (CMHC) as it is an agent Crown corporation. In order for private mortgage insurers to compete with CMHC, the Government backs private mortgage insurers' obligations to lenders, subject to a deductible equal to 10 per cent of the original principal amount of the loan.

In October 2008, the Government adjusted its minimum standards for government-backed, high-ratio mortgages, including:

- Fixing the maximum amortization period for new government-backed mortgages to 35 years.
- Requiring a minimum down payment of five per cent for new government-backed mortgages.
- Establishing a consistent minimum credit score requirement.
- Requiring the lender to make a reasonable effort to verify that the borrower can afford the loan payment.
- Introducing new loan documentation standards to ensure that there is evidence of reasonableness of property value and of the borrower's sources and level of income.

Measures Announced Today

Today, the Government announced three changes to the standards governing government-backed mortgages.

Qualifying at a Five-Year Rate

Current interest rates are at record low levels, which has improved the affordability of housing for Canadians. It is important that Canadians borrow prudently and are able to manage their debt loads when interest rates rise.

Lender and mortgage insurers look at two key ratios when assessing the ability of a borrower to make payments on a mortgage loan:

- Gross Debt Service (GDS) ratio—the ratio of the carrying costs of the home, including the mortgage payment, taxes and heating costs, to the borrower's income.
- Total Debt Service (TDS) ratio—the ratio of the carrying costs of the home and all other debt payments to the borrower's total income.

Currently, the interest rate used to determine the mortgage payment for these calculations is either the rate fixed for the term of the mortgage or, in the case of a variable-rate mortgage and mortgages with terms of less than three years, the greater of the contract rate and the prevailing three-year fixed rate.

The adjustments to the mortgage framework will require mortgage insurers to ensure that borrowers qualify for their mortgage amount using the greater of the contract rate or the interest rate for a five-year fixed rate mortgage when calculating the GDS and TDS ratios.

This measure is intended to protect Canadians by providing them with additional flexibility to support mortgage payments at higher interest rates in the future.

Limit the Maximum Refinancing Amount to 90 per cent of the Loan-to-Value Ratio

Borrowers seeking financial flexibility can currently refinance their mortgage and increase the amount they are borrowing on the security of their home up to a limit of 95 per cent of the value of the property. This type of refinancing lowers the borrower's equity in their home. The adjustments today will lower the maximum amount of the mortgage loan in a refinancing of a government-backed high ratio mortgage loan to 90 per cent of the value of the property, consistent with the principle that home ownership is a tool for savings.

Discouraging Speculation by Requiring a Minimum Down Payment of 20 per cent for non-owner-occupied properties

This measure will require a minimum down payment of 20 per cent for government-backed mortgage insurance on non-owner-occupied properties purchased for speculation. Currently, borrowers may purchase a residential property with a 5 per cent down payment. Today's change will require a 20 per cent down payment for small (i.e., 1- to 4-unit) non-owner-occupied residential rental properties. Borrowers purchasing owner-occupied residential properties which also include some rental units (e.g., borrowers purchasing a duplex to live in one unit and rent out the other) will still be able to access government-backed mortgage insurance with a 5 per cent down payment.

Moving to the New Framework

These adjustments to the mortgage insurance guarantee framework are intended to come into force on April 19, 2010. Exceptions would be allowed after April 19 where they are needed to satisfy a binding purchase and sale, financing, or refinancing agreement entered into before April 19, 2010.