MORTGAGE RULE CHANGES JANUARY 1, 2018

QUOTE: From The Office of the Superintendent of Financial Institutions

- **"These revisions to Guideline B-20 reinforce a strong and prudent regulatory regime for residential mortgage underwriting in Canada," said Superintendent Jeremy Rudin.**

IF YOU ARE THINKING ABOUT BUYING A HOME OR REFINANCING, PLEASE READ CAREFULLY AND SPEAK TO YOUR MORTGAGE BROKER IN ORDER THAT YOU ARE FULLY INFORMED WITH ALL OF YOUR OPTIONS.

……..ROB D.

Dear Friends

I just wanted to share the most recent changes coming into effect with regards to the Mortgage Qualification Rules.

The OSFI (Office of the Superintendent of Financial Institutions) announced they would impose more mortgage rule tightening for all mortgages that were UNDER 80% loan to value. These changes will come into force by Jan. 1, 2018. Here's a summary of the changes and how they will impact consumers, homeowners, and the real estate market:

- A new minimum qualifying rate for uninsured mortgages. The 'stress test rate' will be your contract rate + 2.00% or the 5 yr posted fixed rate, whichever is greater
- Federally regulated financial institutions must establish and adhere to appropriate Loan to value limits that are reflective of risk and updated as housing markets and the economic environment evolve
- Federally regulated financial institutions are prohibited from arranging with another lender a mortgage, or combination of a mortgage and other lending products, in any form that circumvents the institution's maximum Loan to value ratio or other limits in its residential mortgage underwriting policy.

Examples of qualifications under the new OSFI guidelines:

SCENARIO 1: Bank of Canada five-year benchmark qualifying rate

- In this case, the family's mortgage rate, plus 200 basis points, is less than the Bank of Canada five-year benchmark of 4.89%.
- A family with an annual income of $100,000 with a 20% down payment at a five-year fixed mortgage rate of 2.83% amortized over 25 years can currently afford a home worth $726,939.
- Under new rules, they need to qualify at 4.89%
  They can now afford $570,970
  A difference of $155,969 (less 21.45%)
- Monthly Payment for 726,939 at 2.89 % over 25 Yrs is $3405.78 per month
- Monthly Payment for 570,970 at 2.89 % over 25 Yrs is $2675.05 per month

SCENARIO 2: 200 basis points above contractual rate

- In this case, the family's mortgage rate, plus 200 basis points, is greater than the Bank of Canada five-year benchmark of 4.89%.
- A family with an annual income of $100,000 with a 20% down payment at a five-year fixed mortgage rate of 3.09% amortized over 25 years can currently afford a home worth $706,692.
- Under new rules, they need to qualify at 5.09%
  They can now afford $559,896
  A difference of $146,796 (less 20.77%)
- Monthly Payment for 706,692 at 3.09 % over 25 Yrs is $3384.39 per month
- Monthly Payment for 559,896 at 3.09 % over 25 Yrs is $2681.37 per month

Below I have included a copy of an Article by Ralph Fox, columnist for Real Estate Magazine(REM). It is to the point and a good read. (Scroll Down)

By Ralph Fox

“As of Jan.1, 2018 there will be a nation-wide stress test that demands a new minimum qualifying rate for uninsured mortgages – those with a deposit of 20 per cent or more. The guideline requires federally regulated financial institutions to vet applicants for all uninsured mortgages using a minimum qualifying rate equal to or greater than the five-year benchmark rate published by the Bank of Canada or their contractual mortgage rate plus two percentage points.

This announcement, by superintendent Jeremy Rudin of the Office of the Superintendent of Financial Institutions (OSFI), argues that the stress test is needed to reduce the risks associated with high household debt across the country because of “frothy housing markets” in Vancouver and Toronto.

There have been countless attempts in the last five years from multiple levels of governments to slow pricing in these markets. In the past, these new measures have only proven to adversely affect the housing market and curtail already restricting inventory levels.

What does this mean?

Let’s consider a scenario in which an average household making $150,000, with minimal debt and a deposit of 20 per cent or more, gets approved for a mortgage rate that is more than two percentage points below the current Bank of Canada five-year benchmark of 4.89 per cent. If they were to apply for this same mortgage after Jan. 1, they would see their approved mortgage limit drop from approximately $850,000 to $650,000 based on the new guidelines.

One notable aspect of the guideline change is that purchases firming up prior to Jan. 1 will most likely be grandfathered in, including all pre-construction purchases. All existing mortgages will be also grandfathered from any stress test on renewals as long as the mortgage holder stays with the same institution.

How did we get here?

As I have written and argued time and time again, the challenges surrounding affordability in Toronto and Vancouver are primarily the result of issues surrounding lack of supply. Thus far, over the course of the last decade and a half, all government attempts to rein in demand in those cities have failed miserably. As past examples have shown, increasing taxes (land transfer/ foreign investor/ HST), instituting rent controls and constricting lending and development policies have not been successful in the way successive government and policymakers have hoped.

In fact, most of these instances have had the exact opposite effect, with pricing continuing to drive up. More notably, in October 2016, OSFI instituted a two-per-cent stress test for all insured mortgages (less than 20-per-cent deposit) and almost overnight, prices in the GTA condo market shot up by 20 per cent and have not looked back since, leaving a lot of first-time buyers priced out of the market. This clearly was not the stated intent of the OSFI at the time.

Given that the OSFI didn't achieve its intended objective in 2016, it's taking another kick at the can using a policy that is intended to slow down the housing markets of Toronto and Vancouver but may, as a result, slow down the entire economy and in turn run the risk of dampening consumer spending confidence. The two top-performing pillars of the Canadian economy have been the housing market and consumer spending. You can't essentially double interest rates in the course of less than a year without it potentially impacting the overall economy.

In a recent report by Benjamin Tal, chief economist of CIBC World Markets Inc, he warns that a slowdown in consumer spending and the housing market could bring on a recession, noting that "given current momentum in the market, it might be advisable to rethink the timing" of new stress tests for uninsured mortgages.

Which brings the question: is it really worth risking a national recession or economic slow down to curtail regional housing price-growth in Toronto and Vancouver? Clearly the OSFI thinks it is. I would argue that opening supply and reducing taxes and development restrictions without risking harm to the overall economy would be a far more logical path to follow.

In principle, given the current climate of historically low interest rates, I don't have an issue with the implementation of stress testing our mortgage industry. However, the tests should have been brought in a lot earlier and in smaller increments, with the ability to increase as need be. The current measures are like using a hammer to kill a fly – it's overkill.

What is even more interesting is that the day after the announcement was made, Canada Mortgage and Housing Corp. indicated that all insured mortgage holders (those with less than 20 per cent down) can withstand a 31-per-cent decrease to the housing market in the face of extreme scenarios such as natural disasters or a sharp housing correction. Given this information, do we really need an additional test on those putting down 20 per cent or more?

In the last six months, we have seen the Liberal government propose increased taxes on small businesses and corporations, implement significant increases in minimum wages – which leads to inflation – and two successive interest rate increases; all at a time when there are real concerns out of the U.S. that NAFTA may fall apart. Clearly, this is not good timing.

Currently the Toronto housing market appears to be balancing and the delinquency ratio (in arrears 90+ days) on mortgages hasn't changed in 15 years – it's been at 0.45 per cent since 2002. That includes the 2009 financial crisis when the rate rose to five per cent south of the border. The timing and the aggressive nature of this latest move by the OSFI just does not make sense.

What are the repercussions?

There are many factors that will drive the performance of our economy and the impact of the new OSFI guidelines remains to be seen; however, there will be direct and immediate impact on the Toronto market. Here's what to expect:

We will likely see a run-up as borrowers who are actively looking will speed up their home searches to secure a mortgage prior to Jan. 1 and take advantage of the current rules.

The greatest immediate impact will be on the Toronto rental market. We are currently experiencing a zero-per-cent vacancy rate with bidding wars on rentals becoming commonplace, often going to the highest bidder. Adding more renters into the mix (those priced out of the housing market and those with a wait-and-see attitude) is only going to further drive up rental rates, which are already sky-rocketing. All existing landlords are going to benefit by a continuous tightening of the market. New investors will have a harder time qualifying, which means even less inventory coming online, which in turn means even higher rents. The days of rental affordability are long gone and are not coming back.

Because of mortgage renewals being grandfathered in, if you stay with the same institution, banking competition will be even further restricted as those renewing mortgages will not have the ability to shop around. Another great win for the banks!

Many Torontonians will continue to see the benefit of owning versus renting, especially over the long term with our growing population and dwindling housing supply. Expect demand for the mid-market houses under $1 million to balloon and demand for condos to remain robust. Look for a short-term dampening in the $1-million to $2-million housing range until the market adjusts from the shock of these new rules.

The bottom line

At the end of the day, compared to most major cosmopolitan cities, Toronto remains relatively affordable. We are all going to have to come to terms with the fact that living in a big city is expensive and in cities like New York and London, the majority of its populations that choose to live there rent due to affordability reasons. In a not-too-far-off future, there will be nine million people living in the GTA and whether we'd like to admit or not, the majority of the GTA's inhabitants will be renters, and not by choice.

The housing situation in Toronto is never going to be fair, but then again, life isn't fair either. The moment our elected officials and our collective consciousness stop trying to "be fair" and opt for intelligent housing policies that will stimulate supply, the better off our cities and country will be." **End**

If you have any questions please call me at 519-657-9970 or email me at rob@robdiloreto.com

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