December 11, 2015

TD Economics

Data Release: Tighter mortgage regulation unlikely to be a game changer

- The Government of Canada announced further changes to qualifying rules for insured mortgages this morning – targeting the required down payment. Under the new rules, the required down payment on homes valued at $500K or less will remain at 5%. However, borrowers purchasing a home between $500K-$1 million will have to put down 5% on the first $500,000 and 10% on the value of the home in excess. Insurance is already not available for homes valued at $1 million or more. The rules are to come into effect in February 15, 2016.

Key Implications

- The government has been looking for ways to target Canada's hottest and most expensive markets – Toronto and Vancouver. Clearly, today's change is consistent with that objective. Toronto and Vancouver are the only two major markets where the average sales price on a home is above $500,000. As an example, a homebuyer trying to purchase an average priced home in Toronto ($625,000) will now be required to put up $31, 250 (5% of $500,000+10% of $125,000) compared to the $25,500 currently required.
- Still, the impact on housing activity is likely to be relatively modest and short-lived. TD Economics has been forecasting a gradual cooling in these fast-growing markets beginning in 2016, owing to recent – and some likely further – erosion in affordability. On a national basis, we are expecting average existing home price growth to moderate to a low single digit rate next year and to fall modestly in 2017. While we are inclined to tweak the near term sales outlook, especially as some sales get brought forward, this rule change will not lead us to alter our view significantly.
- Notably, the share of overall mortgage lending caught under the new rule is likely to be small. According to CMHC data, the average loan on newly issued insured mortgages as of September 2015 was $251,262 and only 6.4% of insured borrowers were issued on a loan of more than $600,000 at that time. (The disaggregation of CMHC data doesn't allow us to break out loans less than the $500,000 threshold.)
- Furthermore, while past rule changes have helped to bring credit growth more in line with income growth, historical experience suggests that past measures have had a notable, but only temporary impact on housing market activity. The market adjusted to the new measures and bounced back within 4 to 6 quarters. And, even with four rounds of past tightening, concerns remain about excessive price growth, albeit in a shrinking number of markets. Note that the first round of changes in 2008 included an increase in the down payment from 0% to 5% on all mortgages.
- Indeed, the changes made today could be less impactful than the changes made between 2008 and 2012. Hot markets in Ontario and B.C. are being driven by purchasers with larger down payments, whether it be millennials getting help from their parents, move up buyers, and/or domestic or foreign investors. Past tightening rounds have also created a shift into more conventional mortgages. Between 2008 and 2012 insured mortgages accounted for roughly 60% of the increase in chartered bank new mortgage. In 2015, the ratio has been flipped, with conventional (uninsured) mortgages now accounting for 60%.
- Still, today's moves will represent another step in protecting homebuyers from taking on too much mortgage debt relative to the value of their home in a low interest rate environment. As well, the likely

continued shift away toward conventional financing will further reduce financial risk on the Canadian taxpayer.

- The government elected to not directly target investor activity, such as recent changes undertaken in New Zealand. The lack of hard data on speculation and investor activity could have been an impediment to action on that front. Nor do the rules address concerns that borrowers have increasingly been relying on less regulated non-banks and private lenders, or so called shadow banking. Further regulation may only push first time homebuyer activity to these lenders. Lastly, home price growth in Toronto and Vancouver has been the result of tight supply conditions, in the wake of strong demand. These rules do not help alleviate supply-related pressures.

Derek Burleton, VP & Deputy Chief Economist, 416-982-2514
Diana Petramala, Economist, 416-982-6420

@TD_Economics