Federal government tightens mortgage lending rules again

Both of these trends have caused concern. The financial system meltdown which began in the United States in the fall of 2008 was triggered when thousands of overextended homeowners defaulted on their mortgages. Canada, by virtue of its more stringent regulatory environment and more conservative lending practices, did not have the same experience. Nonetheless, the federal government moved in the summer of 2008 to tighten Canadian mortgage lending rules even further, by eliminating "no down payment" mortgages and by reducing the number of years over which a mortgage could be amortized, as well as establishing a consistent minimum credit score requirement for would-be borrowers and more stringent income and property value documentation requirements.

Since the summer of 2008, both house prices and the amount of debt assumed by Canadians have continued to increase. The Department of Finance has reacted by announcing new rules which will apply to government-insured mortgages issued after April 18, 2010. Those new rules are as follows.

- When lenders assess a potential borrower's ability to repay a mortgage, they look at the percentage of his or her income which mortgage payments (principal and interest), property taxes and heating costs will require. In making that determination, the interest rate used to calculate mortgage payments is the rate levied at the time for three-year fixed rate mortgages. However, under the new rules, the rate applied to determine that debt repayment amount will be the rate used for five-year fixed rate mortgages, which is generally higher.

- Many Canadians have taken advantage of recent increases in real estate values by borrowing against the equity they have in their homes, often using home equity lines of credit. Their ability to do so will be somewhat curtailed after April 18, as the maximum mortgage (or home equity line of credit) amount that can be borrowed will be limited to no more than 90% of the value of the property. The current borrowing limit is 95% of a property's value.
- The final change announced by the Minister of Finance will affect only those Canadians purchasing certain rental real estate properties. Right now, any purchaser of residential real estate must put down a minimum 5% down payment, and that rule will not change for owner-occupied residential real estate. However, where the purchase involves a small (1-4 unit) non-owner occupied residential rental property, the required down payment will increase to 20% of the cost of the property.

The Minister of Finance has indicated in the past that where the federal government perceives a risk or threat to the stability of Canada's housing or lending markets, it will step in to make what it sees as necessary changes. This most recent set of changes may not be the last.