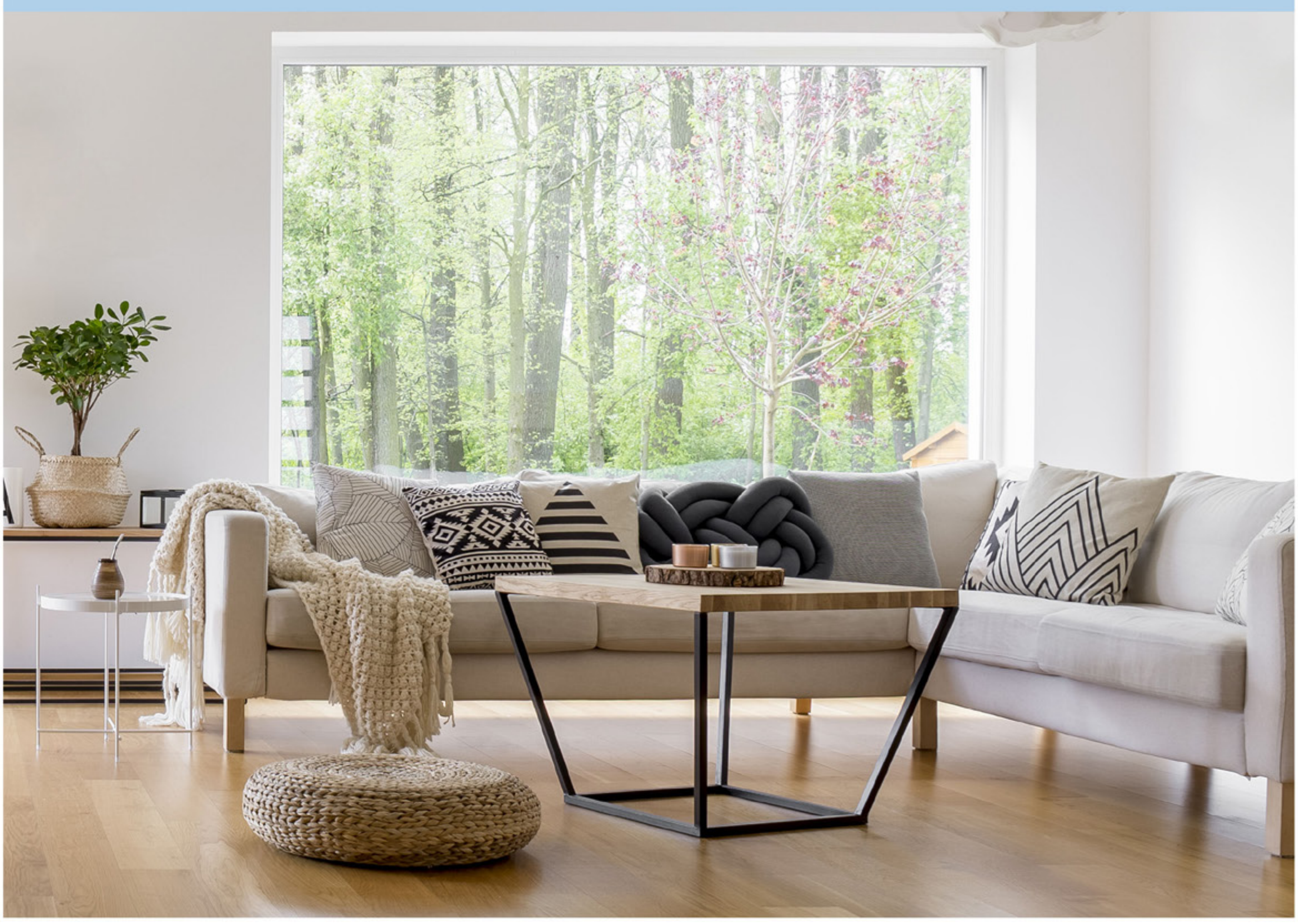
CMHC Tightens Mortgage Qualification Rules.

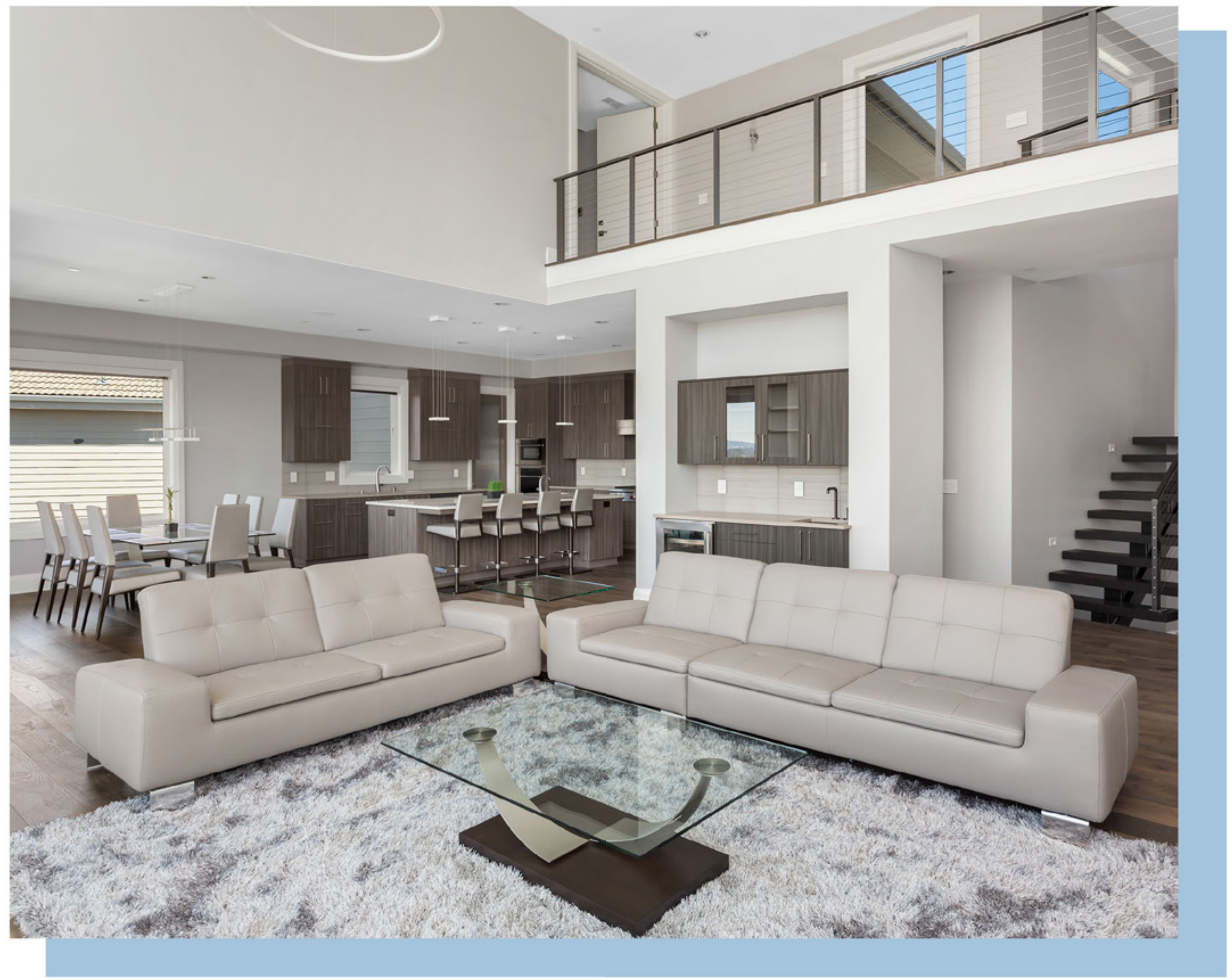
WHAT DOES IT MEAN FOR YOU?



On June 4th, 2020 CMHC announced it will be tightening its mortgage qualification guidelines effective July 1st, 2020. What's changing and how could it impact you? Let's dig into the details:

Backgrounder: Who is CMHC and what do they do?

- CMHC (the Canadian Mortgage Housing Corporation) is a crown corporation that among other things, helps to provide mortgage liquidity in the real estate market. For a cost (premium), CMHC provides a guarantee to the lender that they will cover any losses if the client defaults on their mortgage. This is called "mortgage default insurance". The existence of this insurance allows lenders to issue more mortgages and help more Canadians than they otherwise could.
- If a lender wants to insure a mortgage, the borrower and subject property must meet CMHC's mortgage lending guidelines.
- For mortgages with under 20% down payment ("Insured Mortgages"), the borrower/client pays the cost of the mortgage default insurance.
- For mortgage with 20% or more down payment ("Insurable Mortgages"), if the lender wants the default mortgage insurance protection, the lender will typically pay for the cost of the mortgage default insurance.
- Typically, Insured or Insurable mortgages will have a lower mortgage interest rate than uninsured mortgages because of the default protection guarantee.
- In addition to CMHC, there are two private corporations that also offer mortgage default insurance – Genworth and Canada Guaranty. Their qualifying lending guidelines are very similar to those of CMHC because the government provides a level of protection to these companies as well.



What is changing on July 1st?

In summary, CMHC is concerned that home prices could see a significant decline in the near term given the impact of COVID. While many forecasts have called for a general housing price decline across Canada, CMHC had the most negative forecast when compared to the Big Banks, Real Estate Industry participants, and even the Bank of Canada.

Time will tell who's forecast reigns supreme, but CMHC is taking action now to try and protect itself.

What specifically is changing? Effective July 1st, CMHC will make it more difficult to qualify for insured mortgages. While we are awaiting confirmation, but it is believed that these changes will apply to both Insured and Insurable mortgages:

- Maximum gross debt service (GDS) ratio* is dropping from 39% to 35%
- Maximum total debt service (TDS) ratio* is dropping from 44% to 42%
- Note: definition of GDS/TDS is provided as the last bullet point. Essentially CMHC is reducing the size of the mortgage (and other specific expenses) you are allowed to have as a percentage of your income.
- Minimum credit score required will rise from 600 to 680 (for at least one borrower)
- Borrowed down payments will be disallowed (i.e., unsecured personal loans, unsecured lines of credit and credit cards). However, the following sources will still be permitted: savings, the sale of a property, non-repayable financial gift from a relative, funds borrowed against their liquid financial assets, funds borrowed against their real property, or a government grant.

*GDS ratio is the percentage of a borrowers' income used to pay certain housing related costs including the mortgage (calculated at the Benchmark Qualifying Rate), property taxes, heat, and 50% of condo fees, if applicable. As of July 1st, CMHC will tighten their policy by capping these expenses at 35% of a borrowers' income vs. the 39% ratio currently in place.

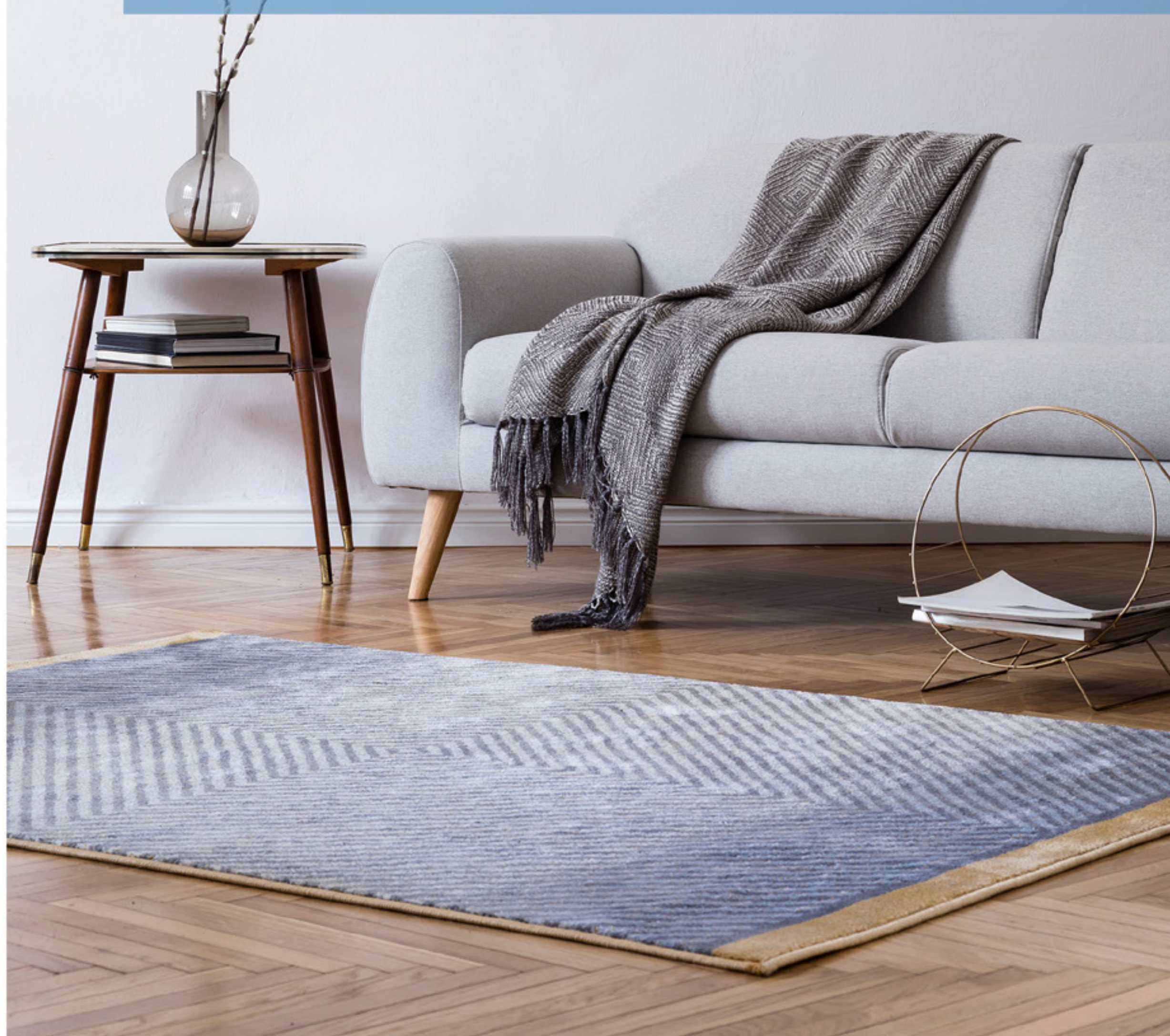
*TDS ratio is calculated the same way as GDS, but factors in additional expenses such as credit card payments, car payments, line of credit payments, etc. As of July 1st, CMHC will tighten their policy by capping these total expenses at 42% of a borrowers' income vs. the 44% ratio currently in place.

How could these changes impact you?

While it is difficult to forecast how these changes will impact the real estate market in general, it will definitely have an immediate impact on clients looking to purchase a home with less than 20% down, and may also impact those with more than 20% down if they want an insured mortgage (to take advantage of insurable rates). We estimate the impact will be about a 10% reduction in purchasing power.

- For example, if a couple with minimal amounts of debt were pre-approved for a purchase up to $850,000 with $60,000 down payment (i.e., the minimum amount allowed*), as of July 1st their striking power would be reduced to just under $770,000 or an approximate drop of 10% in purchasing power.

*Note: for a purchase of $850,000 the client would need 5% down payment for the first $500,000 ($25,000) and 10% for the remaining $350,000 ($35,000) = $60,000.



Will the other Mortgage Default Insurance Companies follow the CMHC changes?

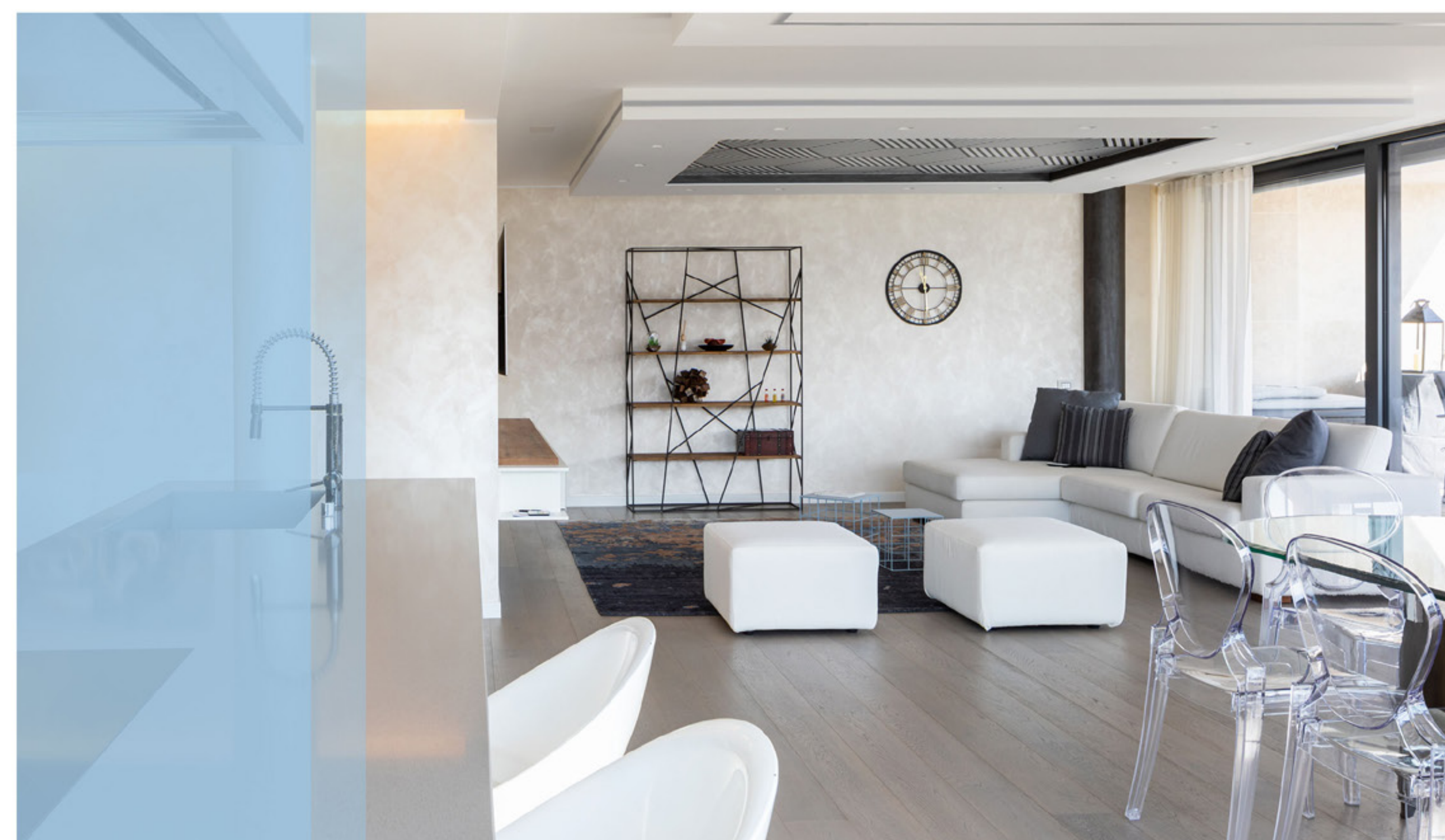
As mentioned above, in addition to CMHC, Genworth and Canada Guarantee also offer Mortgage Default Insurance. Typically when CMHC makes a change to policy the others follow suit. However, in this case, we are hearing that Genworth and Canada Guaranty may have the flexibility to decide which changes they want to implement. Further, even if those companies keep their policy as is, the lenders/banks themselves may decide to adopt the stricter underwriting measures.

We expect to learn a lot more about these changes during the week of June 8th and will post them to our Outline Financial blog as/when they become available.

What can you do to prepare?

If you think these changes could impact you, it would be a great idea to discuss the circumstances with your realtor and mortgage advisor. We can determine how much this could impact you, and work out the specific numbers for your purchasing power now and after July 1st. As a mortgage broker, we offer an added benefit of having access to multiple banks, credit unions, mono-line lenders from one convenient point-of-contact, which can provide a significant benefit where lender policies differ.

To get in touch with a member of our team, please email hello@outline.ca or call 416-536-9559.



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