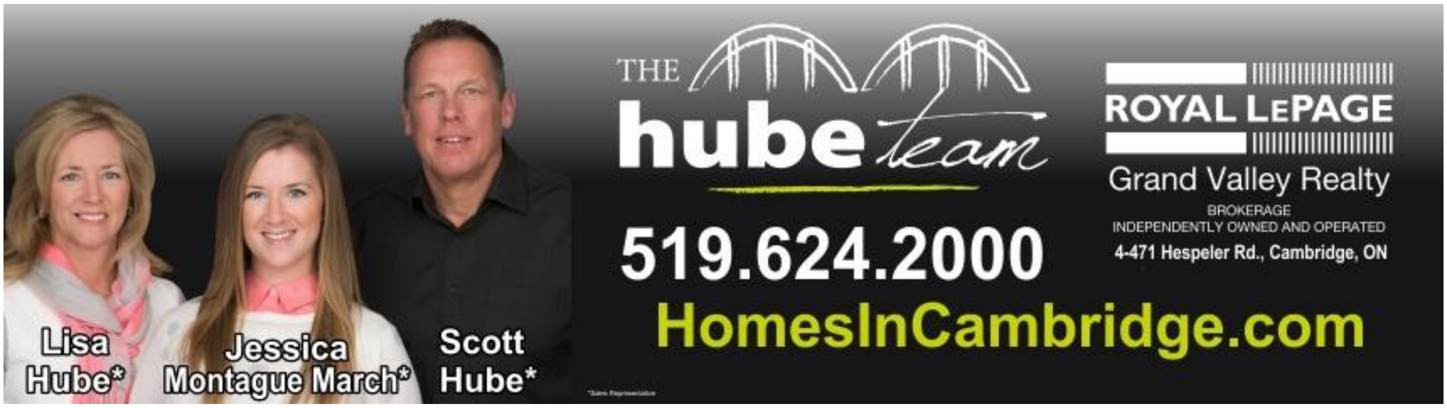

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Welcome to the October issue of the *Real Estate Journal*, which is designed to help keep you in the know regarding Real Estate and Mortgage related matters!

This month's edition we discuss the new mortgage rules and how these changes may impact you, as well as delving into the details of breaking a mortgage early. Please let me know if you have any questions or feedback regarding anything outlined below.

Thanks again for your continued support and referrals!

In This Issue

Dr. Sherry Cooper: Morneau's Big Guns Aimed At Housing

On Monday Ottawa unveiled major initiatives to slow housing activity both by potentially discouraging foreign home purchases and, more importantly, by making it more difficult for Canadians to

To qualify for mortgage insurance, a homebuyer must have a GDS ratio no greater than 39% and a TDS ratio no greater than 44%. Qualifying for a mortgage by applying the typically higher Bank of Canada posted rate when calculating a borrower's GDS and TDS ratios serves as a "stress test" for

DID YOU KNOW...

There are two types of debt: secured and unsecured. When you borrow money to buy a house, the bank can take back the house to recoup their money if you don't pay the debt. That means the debt is secured – it's being balanced against something that you want to keep, and gives the bank some measure of security that they're going to be able to recover the money they've loaned you.

Unsecured debt, on the other hand, means the bank can't reclaim the thing you're buying with the borrowed money. (Credit card debt is unsecured, and so are student loans.)

Click here to look at the impact of four key consumer loans, a mix of secured and unsecured debt, on your credit score – and, ultimately, your mortgage worthiness, courtesy of Forbes.

get mortgages. As well, the Finance Minister is limiting the degree to which mortgage lenders can buy portfolio insurance on mortgages with downpayments of 20% or more. Ottawa has clearly taken out the big guns to slow housing activity, which is widely considered to be too strong in Vancouver and Toronto. Ironically, home sales have already slowed precipitously in Vancouver in recent months and the BC government introduced a new 15% land transfer tax on foreign purchases of homes effective August 6, the effects of which are yet to be fully determined.

The measures announced Monday by Finance Minister Morneau are more far reaching than anything considered to date and could well have quite a significant impact. Not only are these initiatives intended to close loopholes for foreign investors, which might help to make housing more affordable for domestic purchasers, but they will actually make homeownership less attainable for the marginal borrower, which is often younger Canadian first-time home buyers.

Officials at the Department of Finance have been studying the housing market and have led a working group with municipalities and provinces, as well as federal agencies such as the Office of the Superintendent of Financial Institutions (OSFI) and Canada Mortgage and Housing Corporation (CMHC). This in-depth analysis has informed today's announcement.

- The income tax system provides a significant income tax benefit to homeowners disposing of their principal residence, in the form of an exemption from capital gains taxation.
- An individual who was not resident in Canada in the year the individual acquired a residence will not—on a disposition of the property after October 2, 2016—be able to claim the exemption for that year. This measure ensures that permanent non-residents are not eligible for the exemption on any part of a gain from the disposition of a residence.
- The Canada Revenue Agency (CRA) will, for the first time, require

homebuyers, providing new homebuyers a buffer to be able to continue servicing their debts even in a higher interest rate environment, or if faced with a reduction in household income.

The announced measure will apply to new mortgage insurance applications received on October 17, 2016 or later.

- **Tighter Mortgage Insurance Rules**

Lenders have the option to purchase mortgage insurance for homebuyers who make a down payment of at least 20% of the property purchase price, known as "low-ratio" insurance because the loan amounts are generally low in relation to the value of the home. There are two types of low-ratio mortgage insurance: transactional insurance on individual mortgages at the point of origination, typically paid for by the borrower, and portfolio (bulk pooled) insurance that is acquired after origination and typically paid for by the lender. The majority of low-ratio mortgage insurance is portfolio insurance.

Lender access to low-ratio insurance supports access to mortgage credit for some borrowers, but primarily supports lender access to mortgage funding through government-sponsored securitization programs.

Effective November 30, 2016, mortgage loans that lenders insure using portfolio insurance and other discretionary low loan-to-value ratio mortgage insurance must meet the eligibility criteria that previously only applied to high-ratio insured mortgages. New criteria for low-ratio mortgages to be insured will include the following requirements:

1. A loan whose purpose includes the purchase of a property or subsequent renewal of such a loan;
2. A maximum amortization length of 25 years;
3. A **maximum property purchase price below $1,000,000** at the time the loan is approved;
4. For variable-rate loans that allow fluctuations in the amortization

all taxpayers to report the sale of a property for which the principal residence exemption is claimed.

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Measures Affecting All Homebuyers

The Finance Department says in its press release that, "Protecting the long-term financial security of Canadians is a cornerstone of the Government of Canada's efforts to help the middle class and those working hard to join it." This is a "Nanny State" measure to protect people from themselves, as the Bank of Canada has long been concerned about the growing number of households with excessive debt-to-income ratios. It will make housing less attainable, at least in the short run. If it, therefore, substantially reduces housing demand, home prices could decline, ultimately improving affordability. This, of course, is not what the 70% of Canadian households that already own a home would like to see.

- **Broadened Mortgage Rate Stress Tests:** To help ensure new homeowners can afford their mortgages even when interest rates begin to rise, mortgage insurance rules require in some cases that lenders "stress test" a borrower's ability to make their mortgage payments at a higher interest rate. Currently, this requirement only applies to a subset of insured mortgages with variable interest rates (or fixed interest rates with terms less than five years). Effective October 17, 2016, this requirement will apply to all insured mortgages, including fixed-rate mortgages with terms of five years and more.
- A buyer with less than 20% down will have to qualify at an interest rate the greater of their contract period, loan payments that are recalculated at least once every five years to conform to the original amortization schedule;

5. A minimum credit score of 600 at the time the loan is approved;
6. A maximum Gross Debt Service ratio of 39 per cent and a maximum Total Debt Service ratio of 44 per cent at the time the loan is approved, calculated by applying the greater of the mortgage contract rate or the Bank of Canada conventional five-year fixed posted rate; and,
7. A property that will be owner-occupied.

These tighter mortgage insurance regulations will reduce the supply of mortgages and/or increase their cost to the borrower.

Consultation on Lender Risk Sharing

The Government announced that it would launch a public consultation process this fall to seek information and feedback on how modifying the distribution of risk in the housing finance framework by introducing a modest level of lender risk sharing for government-backed insured mortgages could enhance the current system.

Canada's system of 100% government-backed mortgage default insurance is unique compared to approaches in other countries. A lender risk sharing policy would aim to rebalance risk in the housing finance system so that lenders retain a meaningful, but manageable, level of exposure to mortgage default risk.

This proposal by CMHC has been floated for some time and, needless to say, the Canadian Bankers' Association, is against it. The measure would certainly increase the risk associated with funding mortgages and therefore likely increase the capital required to be set aside against this additional risk. Therefore, in essence, it increases the cost to the lenders to finance mortgages. **The lenders will undoubtedly attempt to pass off this increased cost to the borrower or reduce its supply of credit**. Right now, mortgage rate or the Bank of Canada’s conventional five-year fixed posted rate. The Bank of Canada’s posted rate is typically higher than the contract mortgage rate most buyers actually pay. As of September 28, 2016, the Bank of Canada posted rate was 4.64%, compared to roughly 2% or so on variable rate mortgages.

For borrowers to qualify for mortgage insurance, their debt-servicing ratios must be no higher than the maximum allowable levels when calculated using the greater of the contract rate and the Bank of Canada posted rate. Lenders and mortgage insurers assess two key debt-servicing ratios to determine if a homebuyer qualifies for an insured mortgage:

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

the cost of mortgage insurance is borne by the taxpayer.

Bottom Line: These are very meaningful initiatives to slow housing demand, making it more difficult for Canadians to borrow. Finance Minister Morneau has taken out the big guns. I have no doubt that the pace of mortgage lending will slow from what it would otherwise be as a result of these government actions. However, these actions do nothing to address the shortage of housing supply in Vancouver and Toronto.

Housing has been a very important pillar for the Canadian economy, especially at a time when oil price declines have decimated the oil sector and manufacturing continues to struggle. This is a case of being very careful what we wish for-- I'm concerned that we might see more of a slowdown in housing than the government was counting on, which will certainly affect jobs and growth and reduce tax revenues at a time when budget deficits are mounting and fiscal stimulus has yet to do its job.

Does Breaking Your Mortgage Make Sense?

With mortgage rates settling at historic lows, chances are you’ve considered breaking your current mortgage and renewing or refinancing now before rates begin to rise.

Perhaps you want to free up cash for such things as renovations, travel or putting towards your children’s education? Or

interest rate on your mortgage contract and today’s rate, which is the rate at which the lender can relend the money. And with rates so low these days, the IRD tends to be greater than three months’ interest. Because this is a way for banks to recuperate any losses, for some people, breaking and renegotiating at a lower rate without careful planning can mean they come out no further ahead.

Keep in mind, however, that penalties vary from lender to lender and there are maybe you want to pay down debt or simply pay your mortgage off faster?

If you've thought about breaking your mortgage and taking advantage of these historically low rates, feel free to give me a call or send me an email to discuss your options.

In some cases, the penalty can be quite substantial if you aren't very far into your mortgage term, but we can determine if breaking your mortgage now will benefit you long term.

People often assume the penalty for breaking a mortgage amounts to three months' interest payments so, when they crunch the numbers, it doesn't seem so bad. In most cases, however, the penalty is the greater of three months' interest or the interest rate differential (IRD).

The IRD is the difference between the different penalties for different types of mortgages. In addition, the size of your down payment and whether you opted for a "cash back" mortgage can influence penalties.

While breaking a mortgage and paying penalties based on the IRD can result in a break-even proposition in the short term, it may still make strategic sense once all factors are considered. Your current goal may be to secure a long-term low rate commitment before things change, and herein lies potential significant future savings.

As always, if you have questions about breaking your mortgage to secure a lower rate, or general mortgage questions, I'm here to help!

About ROYAL LEPAGE

Royal LePage is Canada's oldest and largest Canadian owned real estate company. Founded in 1913 by Albert LePage when he was just 26 years old, Royal LePage is now Canada's largest real estate company with more than 14,000 agents in more than 600 locations across the country. And we firmly believe that you can only become the oldest and largest company by being the best.

Over the years, we've learned a lot about real estate – and how to provide the best possible service for our clients. Since the mid-1990s, Royal LePage has more than tripled the size of its sales force and almost doubled its market share.

Throughout our successes, we remain dedicated to helping you through the real estate process. Our commitment to innovation and customer service is as strong as ever.

We offer all of our REALTORS® – from those serving tiny communities to those in major urban centres – strong support from our national pool of knowledge, skill and technical expertise. We regularly invest time, money and resources to develop and provide the knowledge and tools they need to best market your home, including:

- Up-to-date information about local market conditions
- Quarterly housing reports
- Creative brochures and newspaper ads to showcase your home
- Ongoing negotiation, marketing and technical training