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New mortgage rules likely "significantly depress" economic growth, report finds

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Ottawa's proposed mortgage rule changes risk slowing the pace of lending and acting as a drag on the Canadian economy in coming years, a new research report says.

An analysis by ***Veritas Investment Research*** estimates tougher new stress-testing rules for mortgages could cause the growth rate in the value of new mortgage loans in Canada to slide to 4 per cent annually from 5.7 per cent currently.

The drop in lending "is likely to significantly depress GDP growth," ***Veritas*** said, because it will curtail how much Canadians can spend on new home purchases.

"Given our look at the linkage between mortgage credit and the overall economy, we think it would be foolish for regulators to believe that the changes … will not have an immediate and dampening effect on Canada's real estate market and its economy," ***Veritas*** concluded.

Canada's banking regulator, the Office of the Superintendent of Financial Institutions, is aiming to rein in risky borrowing practices by requiring buyers who make down payments of more than 20 per cent of a home's value – who do not need mortgage insurance – to prove they could still afford their mortgages if interest rates were 2 percentage points higher than the rate they negotiated.

OSFI superintendent Jeremy Rudin said recently that a final guideline on the rule proposal will be released later this month. Mr. Rudin said OSFI does not want to wait until high debt and risky borrowing "crystallize" into rising mortgage defaults.

Veritas chief executive officer ***Anthony Scilipoti*** said the rule change will be a "game changer" because it will reduce everyone's borrowing capacity to some extent. "It doesn't matter what your income is, your buying power will get affected," he said.

According to the ***Veritas*** report, spending on home purchases and related costs could fall by between 10 per cent and 20 per cent annually because of the rule change.

With residential home buying and related transactions accounting for more than 7.5 per cent of Canada's gross domestic product, ***Veritas*** predicts the estimated decline in spending could shave between 0.8 per cent and 1.6 per cent from GDP annually.

Veritas based its conclusions on an analysis of how much the rules would reduce the buying power of borrowers close to their maximum limits, and estimating the proportion of borrowers who would be significantly affected by the tougher standards.

The report estimates borrowers with a household income of $80,000 seeking a maximum mortgage with a bare 20-per-cent down payment would see the maximum house price they could afford fall by 19 per cent under the new rules.

Veritas examines different predictions about the proportion of buyers who would be most affected, saying if only 10 per cent of potential borrowers faced the 19-per-cent drop in buying power, it would represent a "small headwind" to new mortgage lending in Canada. But the drop in lending would be dramatic if the rules severely affected 20 per cent of buyers, the report concludes.

Several of Canada's large banks have said they don't anticipate a major impact to their lending business from the OSFI changes.

An official from Canadian Imperial Bank of Commerce, for example, told analysts in August that 90 per cent of current loan applications would still qualify under the new OSFI rule, while a Royal Bank of Canada executive said up to 90 per cent of its loan applications are already being assessed at the higher rate.

Veritas, however, says banks may face a greater impact than they believe.

The report said data published by the Bank of Canada on the six largest banks in Canada show 27 per cent of borrowers seeking uninsured mortgages had financial profiles that could fail the new stress-test standards because of the high ratios of loan levels compared to incomes. ***Veritas*** said the data suggest there's a possibility that the banks' estimates of the impact may be too low.

Veritas also said banks face a risk because uninsured mortgages make up a larger – and quickly growing – proportion of their loans. The research firm said similar changes introduced last year for insured mortgages had a bigger impact than many predicted, and the uninsured market changes now proposed could show a similar trend.