Federal Ministry of Finance Announces Preventative Measures to Stabilize Housing Market

The Federal Ministry of Finance recently imposed preventative measures to stabilize the housing market and to improve tax fairness. These changes were prompted by concerns that low interest rates and rising home prices have resulted in borrowers assuming high levels of debt that may not be sustainable in the event that interest rates rise.

Major changes to the eligibility rules for government-backed insured mortgages have been made. A mortgage rate stress test will be used to determine if borrowers qualify for an insured mortgage. To get an insured mortgage, borrowers need to qualify for a mortgage at the Bank of Canada's 5-year conventional fixed mortgage rate, even if borrowers have negotiated a lower mortgage rate with their bank. The carrying costs of the home (including mortgage payments at the fixed Bank of Canada rate, realty taxes and heating costs) in relation to the borrower's income cannot exceed 39% and the total borrower's debt in relation to income cannot exceed 44%. The stress test will apply both to high-ratio insured mortgages (i.e. mortgages with a down payment of 20% or less) and low-ratio insured mortgages that are backed by the government.

As well as the stress test, low-ratio insured mortgages that are backed by the government will need to meet new additional criteria:

- a maximum amortization length of 25 years
- a property value below $1,000,000
- a minimum credit score of 600
- the property must be owner-occupied.

The effect of these changes is that some potential borrowers will now not qualify for a mortgage, while others will only qualify for a loan in a lesser amount. This will make home ownership more difficult for those trying to get into the market. Many prospective purchasers will find that a free-standing home is out of reach financially and that a condominium unit is the only affordable choice.

In addition to the mortgage eligibility changes, the current principal residence capital gains exemption has been amended so that only Canadian-resident individuals and trusts will be exempted from having to pay capital gains tax upon the sale of a principal residence. Non-residents will no longer qualify for this exemption. Taxpayers who dispose of a principal residence and are claiming the principal residence exemption must now report the disposition to the Canada Revenue Agency.

Time will tell what effect these measures will have on the housing market, particularly in the greater Vancouver and Toronto areas where the markets have been hot and house prices have been escalating.