The Recent Tightening of Mortgage Insurance Rules and Their Impact on Residential Sales in Québec

The government of Canada has tightened the rules for government-backed insured mortgages three times since October 2008. In the box below, you can see the chronology of changes that were adopted during this period.

Chronology: tightening of the rules for federal government-backed insured mortgages

① **October 15, 2008** (measures announced on July 9, 2008)

- The maximum amortization period for new loans is reduced from 40 to 35 years
- The minimum down payment increased from 0 to 5 per cent

② **April 19, 2010** (measures announced on February 16, 2010)

- Borrowers must met the standards for a five-year fixed-rate mortgage
- The maximum amount that can be borrowed during a mortgage refinancing is lowered from 95 to 90 per cent of the value of the property
- The minimum down payment increased from 5 to 20 per cent for loans associated with buildings with 1 to 4 dwellings, in which none of the dwellings are occupied by the owner

③ **March 18, 2011** (measures announced on January 17, 2011*)

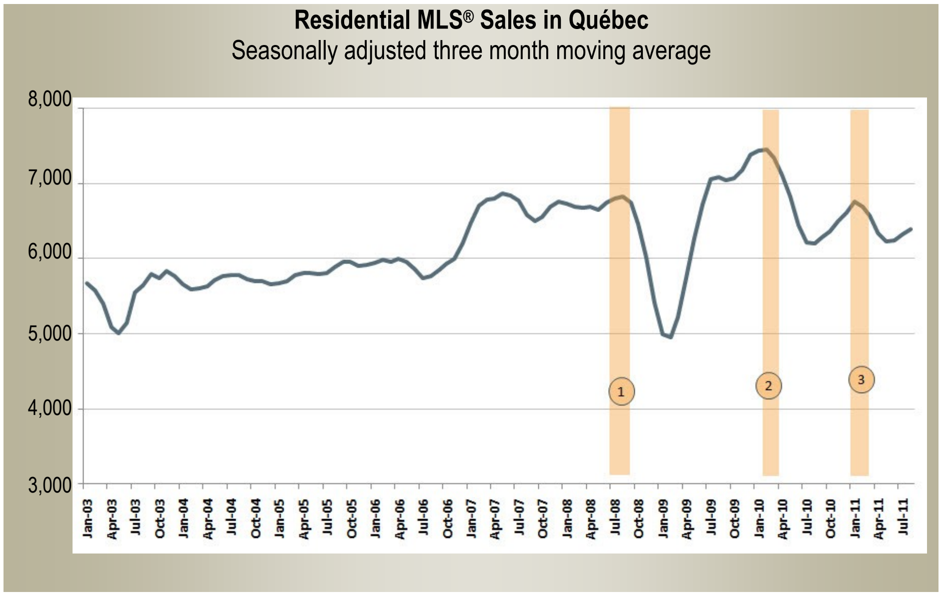
- The maximum amortization period for new loans is reduced from 35 to 30 years
- The maximum amount that can be borrowed during a mortgage refinancing is lowered from 90 to 85 per cent of the value of the property

* On this same date, the government also announced that, as of April 18, 2011, it would stop offering lenders insurance backing on lines of credit secured by homes, such as home equity lines of credit, with a loan-to-value ratio (LVR) of 80 per cent or less. This measure did not have a direct impact on consumers.

We were interested in exploring the effect that these tightenings would have on residential home sales in Québec. However, it is not the impact of the rule changes, per se, that we will be examining; rather, we will examine the short-term impact of their *announcement* in the months immediately preceding their implementation.

Some Households Advanced Their Purchase

Insofar as the changes to mortgage insurance rules have made the financing of a property a little more difficult, it is plausible that some households, particularly first-time buyers, may have advanced the purchase of their home by buying it before the new rules came into effect. We tested this hypothesis empirically. The chart below shows the evolution of the number of sales across the province on a monthly basis since January 2003, and identifies the periods that precede the implementation of the rule changes.



Source: QFREB by Cenris®

On the chart, we can see that sales levels did not change in the months preceding the first tightening in October 2008. However, in the months preceding the tightening in April 2010 and March 2011, we notice peaks in the number of sales. The magnitude of the first peak is much more pronounced than the second one, suggesting that the tightening of April 2010 had a greater impact than that of March 2011. Using statistical tests[1], we verified whether each tightening had a significant impact on sales in the period between the announcement of the new rules and their implementation.

The results we obtained suggest three things. First, the announcement of the tighter mortgage rules of October 2008 did not have a significant impact on the number of sales[2]. Thus, the lowering of the maximum amortization period from 40 to 35 years, combined with the requirement of a minimal down payment of 5 per cent, did not prompt a significant number of Québec consumers to advance their real estate purchase.

Second, the tightening of April 2010 did have a significant impact, upwards, on the number of sales that occurred in the months preceding its implementation. This corroborates the idea that, in this case, some households advanced the purchase of their home in order to make their purchase before the more severe rules took effect. Remember that the new rules announced at that time, which had a direct impact on buyers' financing conditions, stipulated that borrowers must meet the standards for a five-year fixed-rate mortgage and that the minimum down payment increased from 5 to 20 per cent for buildings in which none of the dwellings are occupied by the owner. The results suggest that, when faced with the prospect of having these new measures take effect, some buyers chose to take action right away. The tighter mortgage rules were not necessarily the only possible cause of the jump in sales between February and April 2010, but they certainly did play a role.

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1 We conducted a hypothesis test based on a regression analysis. Binary variables were used to identify the periods preceding the tightening (including the months of the announcement and implementation). We then tested the significance of the results for a confidence level of 2 per cent.

2 It must be said that the Canadian economy went into a recession a few months later and that consumer confidence had already started to deteriorate. The tightening is therefore probably not the most important factor involved in the evolution of sales during this period.

Third, we concluded that the tightening of March 2011 did not have a significant impact on the number of sales. The announcement that the maximum amortization period would be lowered from 35 to 30 years did not prompt a significant number of Québec households to advance their purchase.

A Phenomenon That is Most Noticeable in the Montréal Area

We examined in more detail the impact of the announcement of the tightening of April 2010. Initially, we wondered if the impact on sales was felt in all categories of residential properties. By individually testing sales for each property category, we concluded that sales had increased during the examined period for single-family homes, condominiums and plexes with 2 to 5 dwellings. The impact therefore affected all residential property categories.

Geographically, we concluded that the impact of the announcement of the tightening of April 2010 was significant in the Montréal Metropolitan Area (which accounts for approximately 53 per cent of the province's real estate activity). Conversely, we cannot conclude that it had a significant impact in the other metropolitan areas, meaning those of Québec City, Gatineau, Saguenay, Sherbrooke and Trois-Rivières. This does not mean that the phenomenon of advancing a home purchase was not present in these areas, but rather, that it wasn't large enough to cause a significant increase in sales[3].

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Impact on Prices

In the next "Word From the Economist" (October 2011), we will examine the impact that the announcement of new rules for insured mortgages may have on property prices. More specifically, we will show that, in some cases, they contributed to overbidding in the months that preceded the implementation of these tighter mortgage rules.

[3] In particular, in the Gatineau Metropolitan Area, we would have obtained a significant result if we had used a lower threshold (confidence level of 5 per cent). As for the Québec City area, it may be the lack of properties for sales in the first months of 2010 that may have limited sales growth.

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