The Fourth Round of Mortgage Tightening, One Year Later

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In this document, we examine the effects of the latest tightening of mortgage insurance rules on the performance of Québec's real estate market. Since July 2012, these rules limit the maximum amortization period for new insured mortgages to 25 years, down from 30 years.

In July 2012, Canada's Finance Minister Jim Flaherty tightened mortgage rules for the fourth time since 2008 (consult the annex for the chronology) in order to slow the Canadian housing market[1] and household debt. At the time, the impact on mortgage payments by reducing the maximum amortization period from 30 to 25 years was equivalent to increasing the interest rate by 0.9 percentage points for the borrower[2]. These new measures should have logically dampened the real estate market, especially for first-time buyers since they are the ones who primarily make use of mortgage loan insurance[3].

To see if the new rules have had a significant impact on the performance of the real estate market, we will use two periods: the 12 month period prior to the tightening of the mortgage rules (August 2011 to July 2012) and the 12 month period following this tightening (August 2012 to July 2013). We will then compare the results of the two periods[4]. To isolate the effect of the mortgage tightening, all other factors that may have influenced real estate market performance would theoretically have to be eliminated. All factors are evidently not constant in the situation we are discussing, but since there were no major variations to the main determinants of real estate activity[5], it is reasonable to say that the tightening of the mortgage rules is the primary factor.

Sharp Drop in Sales

Figure 1 shows the evolution of residential sales across the province before and after the tightening of the mortgage rules. Prior to the tightening, sales showed a clear upward trend, registering eleven monthly increases in twelve months. In total, sales increased by 6 per cent during the period from August 2011 to July 2012.

After the mortgage tightening, provincial sales registered twelve consecutive monthly declines, with an overall decrease of 11 per cent. This is the largest decrease of its kind since the 2008-2009 recession[6].

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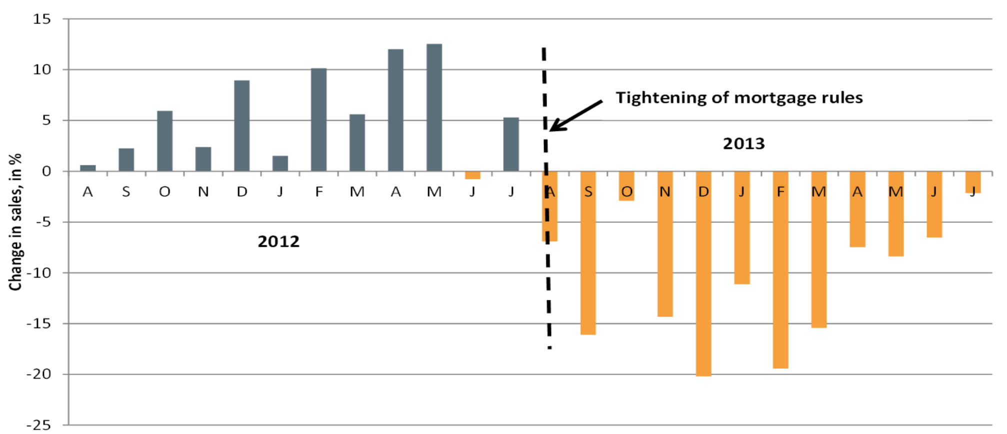
1. Mr. Flaherty was of the opinion that the Canadian real estate market was overheating although his concerns appeared mainly related to the Vancouver and Toronto markets.
2. Based on a negotiated interest rate of 3.5 per cent for a five-year term.
3. Mortgage loan insurance is mandatory for borrowers who do not have the minimum 20 per cent down payment on the purchase price of the property.
4. The short time between the announcement of the new rules (June 21, 2012) and their implementation (July 9, 2012) precludes the possibility that a large number of consumers advanced the purchase of a property before the rules came into force.
5. One of these factors is, of course, interest rate levels. However, mortgage rates have remained very stable and at a historic low during the comparative periods. Other factors to consider are consumer confidence, employment and demographics. Still, there was no change in trend or sudden movement of these variables.
6. Sales fell by 7 per cent during the period from August 2008 to July 2009.

Figure 1: Evolution of residential sales, Province of Québec



Source: QFREB by the Centris® system

Sales clearly slowed after the mortgage tightening in all regions without exception.

Table 1 below shows the evolution of sales before and after the tightening of mortgage rules in the six census metropolitan areas (CMA) of the province. Based on column (A), we note that sales clearly slowed after the mortgage tightening in all regions without exception. The Trois-Rivières CMA recorded the most pronounced turnaround, followed by the Québec City CMA where sales went from an increase of 9 per cent during the period from August 2011 to July 2012 to a decrease of 15 per cent during the period from August 2012 to July 2013.

Table 1: Evolution of specific real estate market indicators by area before and after the tightening of mortgage rules in July 2012

Region	(A) Sales		(B) Price		(C) Selling Time		(D) Market Conditions	
	Before*	After**	Before*	After**	Before*	After**	Before*	After**
Province	**6%**	**-11%**	**4.1%**	**2.5%**	**92**	**102**	**-**	**-**
Gatineau CMA	6%	-12%	4.2%	2.0%	66	76	Seller	Balanced
Montréal CMA	6%	-13%	4.4%	2.1%	81	88	Seller	Balanced
Québec City CMA	9%	-15%	4.0%	4.4%	86	99	Seller	Balanced
Saguenay CMA	6%	-13%	6.7%	2.5%	85	93	Seller	Balanced
Sherbrooke CMA	4%	-11%	-0.3%	4.7%	95	119	Balanced	Buyer
Trois-Rivières CMA	16%	-14%	0.0%	-0.3%	96	92	Balanced	Balanced
Outside of the CMAs	5%	-4%	3.3%	2.7%	124	124	-	-

* *August 2011 to July 2012* ***August 2012 to July 2013*

Source: QFREB by the Centris® system

Slowdown in Price Growth

Column (B) of Table 1 shows the rate of price increases (all property categories combined)[7] for the province and its six CMAs before and after the tightening of the mortgage rules. Across the province, prices rose at an annual rate of 2.5 per cent after the tightening which represents a clear decrease compared to the 4.1 per cent rate observed prior to the tightening. The slowdown in price growth affected four out of six CMAs. The two exceptions are the Québec City CMA where the rate of price increases showed no change while remaining strong, and the Sherbrooke CMA where it accelerated[8].

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7. A weighted average price was used. For more details, consult "A Weighted Average Price to Better Measure Price Variation", QFREB, September 2013.

8. This acceleration mainly manifested itself in the periphery of Sherbrooke as well as in the Magog condominium market.

Sellers No Longer Have the Upper Hand

Prior to the implementation of the new mortgage rules, the number of active listings in the Centris® system had already been trending upward for several months and has continued to do so since then. The decrease in sales which began in August 2012 in conjunction with this increase in supply has, of course, led to an easing of market conditions (see column (D) of Table 1). While real estate markets in the Montréal, Québec City, Gatineau and Saguenay CMAs formerly favoured sellers, they are now balanced. In the Trois-Rivières CMA, market conditions have essentially remained the same (balanced). Finally, the Sherbrooke CMA market has shifted in favour of buyers since the mortgage tightening. Accordingly, none of the province's CMAs have market conditions that give sellers the upper hand.

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Along with more relaxed market conditions, the average selling time is now longer (see column (C) of Table 1). For the province as a whole, the average selling time, all property categories combined, has jumped from 92 days before the tightening to 102 days afterwards. Five of the six CMAs recorded an increase in average selling time (Gatineau +10 days, Montréal +7 days, Quebec City +13 days, Saguenay +8 days and Sherbrooke +24 days). Once again, the Trois-Rivières CMA is the exception (-4 days).

Condominiums Most Affected

Let's now examine real estate market performance by property type since the last mortgage tightening. Table 2 shows the evolution of specific real estate market indicators by property category for the province before and after the reduction of the maximum amortization period.

Table 2: Evolution of specific real estate market indicators by property category before and after the July 2012 reduction of the maximum amortization period — Province of Québec

Category	(A) Sales		(B) Price		(C) Average selling price	
	Before*	After**	Before*	After**	Before*	After**
Single-family home	6%	-9%	3.3%	1.4%	92	101
Condominium	7%	-15%	3.4%	1.4%	96	111
Plex	2%	-12%	4.6%	0.0%	86	89

* *August 2011 to July 2012*   ***August 2012 to July 2013*

Source: QFREB by the Centris® system

Sales of condominiums (Column (A)) which had the wind in its sails before the mortgage tightening (7 per cent growth during the period from August 2011 to July 2012) decreased by 15 per cent after the tightening. The other two property categories registered slightly lower decreases in sales, ranging from 9 per cent for single-family homes to 12 per cent for plexes. Condominiums also saw average selling times (column (C)) increase slightly more than the other two property categories (+15 days vs. +9 days for single-family homes and +3 days for plexes). Table 2 also shows that the pace of price increases (column (B)) slowed down for all three property categories during the period that immediately followed the introduction of the new rules.

In the three major condominium markets of the province, the Montréal, Québec City and Gatineau CMAs, sales for this property category fell by 16 per cent, 20 per cent and 18 per cent respectively since the implementation of the more restrictive mortgage rules.

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Thus, although all property categories have been affected by the tightening, the condominium market seems to have suffered the largest setback, which is consistent with the fact that condominiums are more popular with first-time buyers than single-family homes or plexes.

Lower Price Ranges are Most Affected

Since first-time buyers are the ones most affected by the new measures that reduced the maximum amortization period, it is plausible to believe that sales decreased primarily in the lower price ranges. In contrast, it is not certain that the tightening has had an impact in the higher price ranges where fewer buyers require the use of mortgage loan insurance. These are the two assumptions that we want to confirm.

Due to the significant difference in price levels between certain metropolitan areas, it is best to use price ranges that are specific to each CMA in order to properly diagnosis these assumptions. Table 3 shows the variation in sales in the lower and upper price ranges for each CMA.

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Table 3: Variation in sales by price range after the tightening of mortgage rules*

Gatineau CMA	
Less than $250,000	**$250,000 or more**
-16%	-5%
Montréal CMA	
Less than $400,000	**$400,000 or more**
-15%	-7%
Québec City CMA	
Less than $250,000	**$250,000 or more**
-22%	-5%
Saguenay CMA	
Less than $250,000	**$250,000 or more**
-16%	8%
Sherbrooke CMA	
Less than $250,000	**$250,000 or more**
-13%	-2%
Trois-Rivières CMA	
Less than $200,000	**$200,000 or more**
-13%	-19%

*August 2012 to July 2013 vs August 2011 to July 2012

Source: QFREB by the Centris® system

According to Table 3, the largest decreases in sales occurred in the lower price ranges of the Gatineau, Montréal, Québec City, Saguenay and Sherbrooke CMAs, which supports our hypothesis. However, there is nothing conclusive in this regard for Trois-Rivières which is by far the most affordable market among the six CMAs. Note also that in the Sherbrooke CMA, if we chose the price range of $300,000 and more, sales actually increased by 10 per cent which, in turn, explains the acceleration in the rate of price increases in this CMA (see column (B) of Table 1), which was contrary to the results of other regions.

In summary, variations in sales by price range seem to demonstrate that sales decreased more in price ranges that are most affordable for first-time buyers.

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Conclusion

Following the reduction of the maximum amortization period from 30 to 25 years in July 2012, the real estate market slowed down, resulting in a significant decrease in sales, a moderation in price growth, longer selling times and an easing of market conditions. Although the deterioration of these real estate market indicators cannot be fully attributed to the mortgage tightening, it is probably the main reason. In this sense, it was an important turning point for the real estate market in Québec.

If you have any questions or comments about the content of this article, please contact us by email at: stats@fciq.ca.

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ANNEX

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 mut 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 wellings, in which none of the dwellings are occupied by the owner

③ **March 18, 2011** (measures announced on January 17, 2011[9])

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

④ **July 9, 2012** (measures announced on June 21, 2012)

Maximum amortization period for new loans is reduced from 30 to 25 years

Maximum amount that can be borrowed during refinancing is lowered from 85 to 80 per cent

Maximum gross debt service ratio was set at 39 per cent of household income

Maximum total debt service ratio was set at 44 per cent of household income

Government-backed insured mortgages are now limited to homes that have a purchase price of less than $1 million.

9. 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.