New mortgage rules introduced to lessen mortgage crunch risks: sources say

By Julian Beltrame (CP)

OTTAWA — The federal government is expected to announce new rules Tuesday that would make it more difficult for first-time buyers to enter Canada's hot housing market.

Sources have told The Canadian Press that Finance Minister Jim Flaherty is ready to move on the issue because of concern Canadians may be taking on too much debt.

Economists have advised the minister the best way to protect Canadians is to institute a debt affordability test in order to qualify for a Canadian Mortgage and Housing Corp. insured mortgage.

Currently, prospective home owners can qualify for a CMHC insured mortgage if they put at least five per cent down on the cost of a home.

But bank officials say they usually apply a cushion to ensure home buyers have sufficient income to meet payment requirements if floating rates rise, in some cases by more than two percentage points.

Flaherty is expected to make such an income test a condition for acquiring an CMHC insured mortgage.

Another possibility is for the minister to reduce the amortization period from 35 years to 30, which would have the effect of raising monthly payments.

It is believed Flaherty rejected more radical measures to cool the housing market, which has reached record levels in sales and near record levels in average home prices despite the weak economy.

Economists have cautioned the minister against putting on the brakes too strongly. They say raising the minimum downpayment requirement to 10 per cent, one of the suggestions given the minister, could cause a crash in a key mainstay of the fragile economic recovery.

The Bank of Canada has been warning for months that homeowners should ensure they can absorb an increase in their floating rate mortgages once rates start rising, likely as early as this summer.

By the central bank's own stress test calculation, almost one in 10 households would have a debt-service ratio that makes them vulnerable to economic shocks by the middle of 2012 if current trend continue.

In an address written for deputy governor Timothy Lane last month, the bank suggested the government has all the tools it needs to address the problem.

"An array of supervisory and regulatory instruments can be used by the government to restrain a buildup of systemic risks," said notes the address.

"These include capital requirements for institutions, leverage ratios, loan-to-value ratios, terms and conditions for mortgage insurance, and a variety of other measures. These instruments can be targeted to risks to the entire financial system that stem from particular markets or institutions."