Tighter mortgage rules may yet save us from ourselves

By Ray Turchansky, For Postmedia News

People who remember the days when there was only one type of mortgage - with interest fixed at five per cent annually for the entire 25 years - will also remember the cartoon character Pogo saying: "I have met the enemy, and he is us."

Indeed, there are times when we need to be saved from ourselves.

Two years ago, when Trevor Hamon was branch manager with Dundee Private Investors, he warned of serious peril by banks offering home-equity lines of credit and by people taking debt into retirement. I've since seen people go $100,000 into their HELOC, lose it investing on penny stocks and essentially wind up paying for their home twice.

In fact, Canadians currently owe $1.48 for every dollar of their disposable income, which is more household debt per capita than in the United States. And the argument that household debt is immaterial as long as the value of the house increases is no longer comforting. TD Economics expects existing home sales in Canada to drop about eight per cent in 2011 and prices to slip one per cent.

So the government faced two options - raise Bank of Canada interest rates, which would soon increase mortgage rates, or tighten mortgage lending rules, which was wisely done for the third time since 2008.

Effective March 18, the maximum amortization period is reduced from 35 to 30 years for government-backed mortgages with loan-to-value ratios greater than 80 per cent; and the maximum Canadians can borrow to refinance their mortgage falls from 90 to 85 per cent of the value of their homes.

In addition, effective April 18, the government will no longer insure lines of credit with homes as collateral, such as home-equity lines of credit.

The Canadian Association of Accredited Mortgage Professionals said in a news release that it "supports measures that strengthen owners' equity in their homes and encourages the reduction of their mortgages. CAAMP is also pleased that there was no change made to the down-payment requirement as it recommended. "

Less enthusiastic was Randall McCauley, vice-president of government relations at the Canadian Real Estate Association, who said in a release: "We're not sure the government needed to take this step now."

Much has been made about how reducing amortization periods from 35 to 30 years on a $300,000 mortgage at four-per-cent interest will cause monthly payments to go up $105. Instead, people should be thankful that the change will save them $42,288 in interest.

Adrian Mastracci, portfolio manager with KCM Wealth Management in Vancouver, has shown that paying off a $240,000 mortgage at 5.75 per cent costs you $65, 165 in interest if paid off in 10 years, but $313,410 in interest if paid off over 35 years.

Said Mastracci after the latest mortgage changes were announced: "The repayment of debt is a best investment for many, particularly in jittery times, and it's risk free."

Two rules of thumb are not to go into debt for consumer purchases using either home equity because the value of the home could drop, or retirement savings because you might not be able to fund living expenses once employment income ends. The exception is when you combine the two by taking out the $25, 000 allowed from your registered retirement savings account under the Home Buyers Plan, which makes sense because you have to pay it back or be taxed on the withdrawal, and because you're not paying interest on the loan.

The concept of home ownership is often founded on three beliefs: that interest rates won't spike, making payments unbearable to maintain; that the homebuyer will remain employed; and that property value will continue to rise and build up equity.

But in the U.S., after prolonged near-zero interest rates lured people to buy houses, interest rates rose, the financial crisis boosted unemployment and people used their homes as automatic-teller machines, refinancing them to buy depreciating assets like gas-guzzling cars and flat-screen TVs. The result was a deluge of houses for sale, which lowered prices and in many cases wiped out home equity completely.

The Canadian government saw housing become a sinkhole in the U.S. and has decided to Sherpa us around that crevasse.

In 2006, mortgage insurers, including Canada Mortgage and Housing Corp., began extending amortization periods from 25 to 30 years, then 35 and even 40. There was even talk of 50-year mortgages. At the same time they began insuring interest-only loans that essentially required no down payment.

When more than half the mortgages taken out during the first six months of 2008 had 40-year amortization periods, the federal government started putting speed bumps on the road to ruin. It reduced mortgage maximums to 35 years and eliminated interest-only loans by requiring a minimum five-per-cent down payment.

Last year came a second round of changes, making borrowers meet the standards for five-year interest rates, lowering maximum mortgage refinancing from 95 to 90 per cent of home value and requiring a 20-percent down payment for government-backed mortgage insurance on rental or investment properties not lived in by the owner.

And now, a third wave of changes, to save us from ourselves.