Economics

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Mortgage changes only half the battle

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Ottawa's recent announcement to increase the limit for mortgage insurance and expand eligibility for longer amortization periods is a significant move — but one that needs to be accompanied by more action on driving the supply of housing.

We should keep in mind that there are a few lessons to be learned from recent developments in the housing market, the first of which is that markets are capable of responding swiftly to abnormal conditions. Higher interest rates of late have brought the mighty housing market to its knees in a relatively short period of time.

Second, housing policy can notably have an impact on the trajectory of the real estate market. We have seen it numerous times in the past two decades in buyers' rapid response to demand boosting polices such longer amortization periods and lower down-payment requirements. The swift response of first-time homebuyers in 2007 to the decision to increase amortization periods to 40 years ended up pushing the government to retreat from that idea.

And third, if those policies are not directed at the core issues facing the market, their impact will be temporary at best. Since 2010, and until recently, most of the changes in mortgage regulations were aimed at tightening market conditions in response to ever-rising home prices. Unfortunately, none of them worked to change the fundamentals of the market in any significant and lasting way.

The latest announcement by the Liberal government increased the $1-million price cap for insured mortgages to $1.5-million, and expanded eligibility for 30-year mortgage amortizations to all first-time homebuyers and to all buyers of new builds, both effective Dec. 15, 2024.

Amortizing a mortgage over a longer period as compared with the current limit of 25 years would allow buyers to make lower monthly payments. Meanwhile, raising the price cap on houses eligible for insured mortgages was inevitable at some point, given that price increases since it was originally imposed threatened to drop Canada's largest cities from the program.

Mortgage insurance protects the lender in the case of a default by a homebuyer. It is mandatory for those who buy a home with less than 20-per-cent down payment. Currently, homes costing more than $1-million cannot get such insurance. And in places such as Vancouver and Toronto and many areas of southern Ontario, the typical home may sell for greater than $1-million.

From the past, we know that home buyers are very responsive to such policy changes. And this time will not be different, particularly in conjunction with easing mortgage rates.

The housing market in general, and in large cities in particular, is a tale of two markets. The detached (low-rise) segment of the market is operating at a reasonable level of activity despite high interest rates. However, the condo market is basically frozen largely owing to the fact that investors are basically out of the market.

Therefore, there is little doubt the current change to regulations will speed up the recovery process of the housing market that was ignited by lower and falling interest rates. To prevent that from becoming too much of a good thing, we need to match the additional demand with supply.

For many years, we used demand tools to deal with what is essentially a supply issue. The core issue is the lack of supply available to respond to rapidly increasing population. In recent years, there has been a dramatic change in attitude at all levels of government, with supply becoming the focal point. The additions to demand from these mortgage changes will make it even more imperative to deliver on policies aimed at inducing more homebuilding.

For now, at least in the condo market, there is new supply waiting to tapped. But given the fact that new condo construction activity is basically non-existent, the increase demand will eventually clear the market and reduced inventories to past level. At that point, the supply that is supposed to be built now will not be available a couple of years from now.

We are in the midst of an important transition period in the trajectory of the Canadian housing market, especially in Vancouver and Toronto. The level of activity is likely to continue to soften in the near term.

But when the fog clears, it will become evident that the long-term trajectory of the market will show even tighter conditions. We'll need all levels of government to pull in the same direction to allow supply to catch up to where demand is headed.

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