BoC rate hike coming on heels of new mortgage rules, hits home buyers

By Janet McFarland
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First-time home buyers are facing a double blow after the Bank of Canada boosted interest rates on Wednesday just weeks after tougher new mortgage-qualification rules took effect in Canada.

The central bank's move to raise its key overnight lending rate by a quarter percentage point to 1.25 per cent marks the third interest-rate increase since July, immediately pushing up interest costs for borrowers with variable-rate mortgages or lines of credit, which are automatically linked to lenders' prime-lending rate.

Canada's six largest banks announced later on Wednesday that their prime lending rates will rise a quarter percentage point to 3.45 per cent from 3.2 per cent previously.

On a $400,000 mortgage, the quarter-point rate increase will add about $52 in additional monthly payments, said James Laird, president of mortgage brokerage CanWise Financial. Coupled with two prior interest-rate increases in July and September, borrowers are facing $156 in higher monthly mortgage payments.

"Household budgets are tight," Mr. Laird said. "That can be your car insurance payment, for example. Most people don't have an extra $150 lying around at the end of the month."

Bank of Canada senior deputy Governor Carolyn Wilkins said the central bank is aware of the risks of doing further interest-rate increases this year given recent changes to mortgage-lending policies and high household debt in Canada. She said the bank "will therefore remain cautious" when considering future rate increases.

"Household debt is keeping me up at night," Ms. Wilkins told reporters. "It's just a vulnerability that we would face if we had a shock."

However, she said the recent changes in lending policies will improve mortgage-underwriting standards in Canada and improve the "quality" of outstanding debt, while prior interest-rate increases appear to have already slowed the pace of borrowing growth.

The latest rate increase will not only affect people with outstanding mortgages, but is also expected to influence future home buyers, adding another hurdle to buying a home in expensive markets such as Toronto and Vancouver. Canada's banking regulator imposed tougher new stress-testing rules on Jan. 1, making it harder for borrowers to qualify for a mortgage.

The effect is greatest on first-time buyers who typically have to borrow more because they have smaller down payments than move-up buyers with equity in their current homes, especially in cities such as Vancouver and Toronto, Mr. Laird said.

"If they had 20 per cent to put down, their affordability has decreased by about 20 per cent with the introduction of the stress test, and then rising interest rates also decrease how much they can qualify for," he said.

Robert McLister, a mortgage planner at intelliMortgage and founder of RateSpy.com, said he hasn't seen the banks' prime-lending rate as high as 3.45 per cent in nine years, while the discounted five-year fixed-mortgage rate offered by many of the major banks is at a four-year high of about 3.5 per cent.

However, the unknown variable is how much people can adjust, he added. He is already seeing more borrowers turning to credit unions because they are not covered by the stress-test rules imposed on banks, for example.

“There’s certainly a bigger share of our business as mortgage brokers going to credit unions now,” he said. “I’ve said that roughly about one in six uninsured mortgagors are going to be affected in some way by this, but it doesn’t mean one in six can’t buy a home.”

Tom Storey, a Royal LePage real estate agent in central Toronto, said he does not expect the rate increase to have a significant impact on slowing the pace of home sales in Toronto and Vancouver because there is so much more demand relative to available supply, even if some first-time buyers cannot get into the market.

“The gap is too large – it’s not going to slow down the overall market,” he said. “These regulations will have an effect, but I don’t know if it’s an effect we’ll be able to see based on the gap that’s there between supply and demand.”

Mr. Storey said the effect will be greatest on the more expensive detached-home sector, where there is more inventory sitting on the market in both cities, but is particularly unlikely to affect sales in the hot condominium market, where bidding wars are common, especially in central Toronto.

“Even if you pull a few people out of the market, it’s not going to make a difference. Maybe there were 14 offers last week, maybe there will only be 12 this week, but that’s how I see what’s going to happen with condos,” he said.