ECONOMIC VIEWPOINT

Desjardins Affordability Index:

New Mortgage Policies Will Have Mixed Effects on Housing Affordability

By Kari Norman, Economist

Highlights

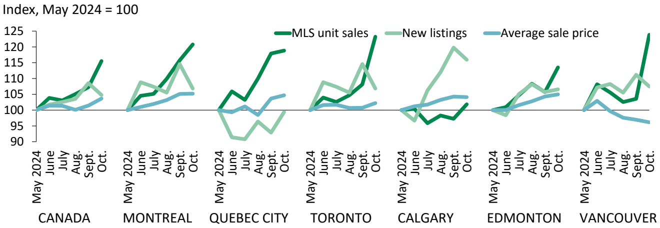
- Canadian homebuyers have several reasons to be cautiously optimistic at the close of 2024. Fixed and variable mortgage rates have fallen this year, and average home prices in many cities have come down from their peaks. Meanwhile the federal government has announced new policies, including 30-year amortization of insured mortgages for all first-time homebuyers and all buyers of newly built homes, as well as an increase in the cap on insured mortgages to $1.5M, both effective December 15, 2024.
- Looking forward, while we do anticipate a modest rise in average home prices in each province over the next two years, higher incomes and lower mortgage rates should prevent any further deterioration in affordability.
- The new 30-year amortization for first-time homebuyers and all buyers of newly built homes will help lower monthly mortgage payments, thereby improving affordability—so long as there's no offsetting increase in home prices.
- On the other hand, increasing the price cap for insured mortgages from $1M to $1.5M isn't intended to help homebuyers by lowering their monthly payments. Instead, it targets the difficulty of amassing a 20% down payment on a home when many properties, especially in large cities, are now selling for over $1M. This policy will be particularly impactful in cities like Toronto, where 1 in 3 houses are priced between $1M and $1.5M, allowing buyers to get a house in this range for as little as $75k down instead of over $200k. That said, it could still take the average household over 7 years to save enough for a down payment, even if they're socking away 10% of their after-tax income each month.
- Our work shows that mortgage payments on an average-priced home in Canada could decrease by about $600 per month from the combination of longer amortizations and preferred borrowing rates for insured mortgages, assuming home prices don't rise more quickly in response. But this would be more than offset by having a minimum down payment as low as 5% instead of 20%, plus the cost of mortgage insurance if buyers roll it into their mortgage. As a result, we've concluded that the federal government's new mortgage measures are likely to have little overall impact on affordability in Canada.
- The key to meaningfully improving affordability over the long term will be increasing the supply of housing. But the construction industry continues to face persistent headwinds from labour shortages, an aging workforce and high building material costs. And while borrowing costs are coming down, they remain high and homebuilder sentiment is poor.

Canadian homebuyers have several reasons to be cautiously optimistic at the close of 2024. Both fixed and variable mortgage rates have fallen this year, albeit to a still-higher level than they were several years ago. Average home prices in many cities have come down from their peaks. And there have been many policy announcements advertised as making it easier for homebuyers in the short term. These include expanding 30-year amortizations for insured mortgages to all first-time homebuyers and all buyers of newly built homes, as well as increasing the cap on insured mortgages to $1.5M, both effective December 15, 2024. All of these shifting dynamics in the housing market beg the question: what will be the impact on housing affordability?

Affordability Is Expected to Improve in Most Provinces

The Bank of Canada (BoC) began lowering interest rates in June with a 25-basis-point (bps) cut. It followed that up with identical cuts in July and September, then jumbo 50bps cuts in both October and December. But the response by the existing home market to lower borrowing costs has been fairly tepid nationally and mixed across local markets. In Toronto and Vancouver, new listings have well outpaced sales, with sales just picking up recently (graph 1). But with plenty of inventory remaining for some segments of the market, average prices haven't yet followed suit and are now lower in Vancouver than they were in the spring. In contrast, Quebec City has seen rising sales and falling listings, with average prices starting to pick up.

Graph 1
The Housing Market Response to Lower Rates Has Been Mixed So Far

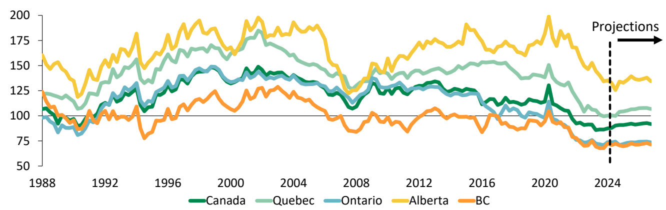


* The Bank of Canada started cutting policy rates in June 2024
Canadian Real Estate Association and Desjardins Economic Studies

In every market, the balance of supply and demand affects the inventory of homes listed for sale and ultimately selling prices. But affordability is also impacted by interest rates, with monthly mortgage payments falling as rates come down. Rising disposable income also improves affordability, as households are better positioned to comfortably make their mortgage payments.

Looking forward, while we do anticipate a rise in selling prices in each province, higher incomes and lower mortgage rates should prevent any further deterioration in affordability in the Desjardins Affordability Index (DAI) (graph 2). Moreover, federal policies intended to slow population growth by limiting the number of newcomers will ease housing demand. Our baseline outlook is for affordability to improve modestly in the Atlantic provinces, Quebec and the Prairies through the end of 2026. Ontario and BC are expected to experience the highest increases in average home prices over the outlook period, meaning that even lower interest rates and higher incomes will be just enough to roughly offset home price increases in our baseline outlook. Overall, affordability in all provinces remains well below pre-COVID levels. (See Box 1 for details on the DAI.)

Graph 2
Affordability Is Expected to Hold Steady



* Assumes a 20% down payment
Canadian Real Estate Association and Desjardins Economic Studies

Box 1: What Is the Desjardins Affordability Index?

The Desjardins Affordability Index (DAI) compares the average household after-tax disposable income with the income needed to qualify for a mortgage on an average-priced existing home. Our baseline scenario uses the 5-year fixed mortgage rate and a 20% down payment with no mortgage insurance.

An index value of more than 100 indicates greater affordability, as the average household income is more than enough to qualify for a mortgage on an average-priced home. A rising index means homeownership is getting more affordable.

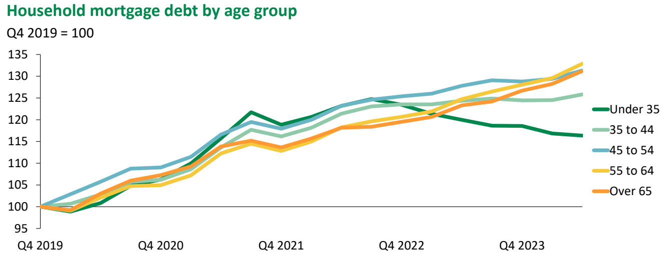
Conversely, a value under 100 means that the average household doesn't earn enough after tax to qualify for a mortgage on an average-priced home. A falling index implies homeownership is getting less affordable.

Declining Affordability Has Disproportionately Affected Young and First-Time Homebuyers

Deteriorating homebuying affordability has hit Canadian youth especially hard, keeping them largely on the sidelines of the housing market. In recent quarters, mortgage balances have fallen considerably for households under age 35 (graph 3 on page 3). In contrast, mortgage holders ages 45 and older seem little affected by changes in affordability.

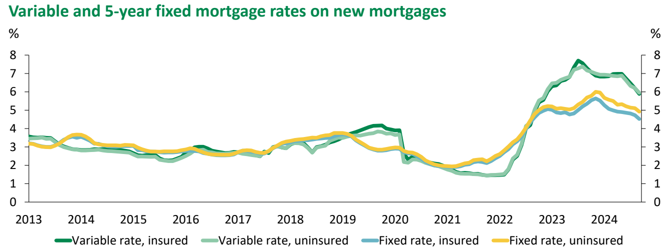
The share of mortgaged homes purchased by first-time buyers fell sharply at the start of the pandemic. While it has picked up of late, the share remains below pre-COVID levels and on a downward trend. By contrast, the share of investors in the market has grown (graph 4 on page 3).

Graph 3
Younger Households' Mortgage Debt Is Declining



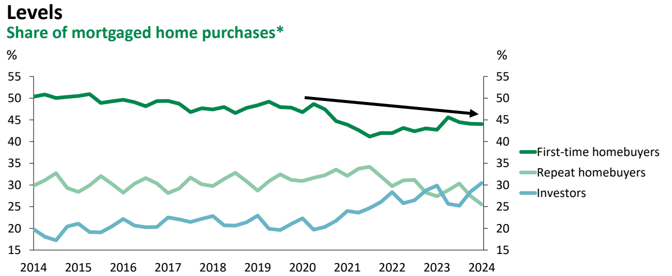
Statistics Canada and Desjardins Economic Studies

Graph 5
Insured Mortgages Can Currently Get a Lower Fixed Mortgage Rate



Bank of Canada and Desjardins Economic Studies

Graph 4
The Share of First-Time Homebuyers Remains Well Below Pre-COVID Levels



* Excludes homebuyers without a mortgage
Statistics Canada and Desjardins Economic Studies

New Federal Housing Measures Will Have a Mixed Impact on Affordability

In recognition of these challenges, the federal government has announced two important policy changes to help would-be homebuyers.

30-Year Insured Mortgages Will Bring Down Monthly Mortgage Payments

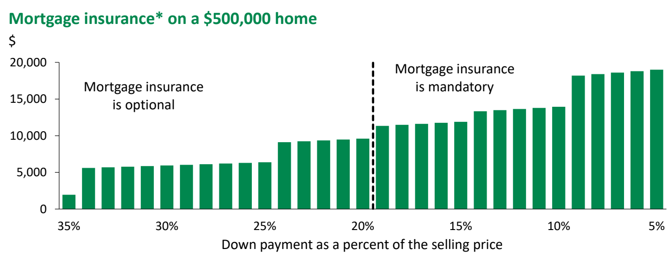
In Budget 2024, the federal government announced it would amend the mortgage rules to allow insured mortgages of up to 30 years for first-time homebuyers purchasing newly built homes beginning August 1, 2024. In mid-September, they announced an expansion of this program to all first-time homebuyers and to all buyers of newly built homes effective December 15, 2024.

Amortizing a mortgage over an additional 5 years reduces the monthly payment for homebuyers. This in turn reduces the income needed to qualify for a mortgage, potentially allowing more people to get their foot in the door of homeownership.

Moreover, insured mortgages are currently eligible for preferred lending rates (graph 5). While traditionally this hasn't been the case, at the time of writing, 5-year fixed-rate mortgages were about 40bps lower for insured mortgages than for uninsured mortgages. For variable rates, there has historically been little difference between insured and uninsured mortgages.

However, 30-year mortgages must be insured. The insurance premium can tack as much as 4% onto the loan amount depending on the loan-to-value ratio. For example, on a home selling for $500k—such as a condo or even a house in a more affordable city—insurance will add as much as $19,000 (graph 6). While buyers can pay this up front in a lump sum, many add it to the mortgage principal, where it is then amortized over the life of the mortgage, therefore increasing the amount of interest they will owe. So while the government has touted the amortization extension as an affordability relief measure, it does add to the overall cost, which many homebuyers may not realize.

Graph 6
The Smaller the Down Payment, the Higher the Mortgage Insurance

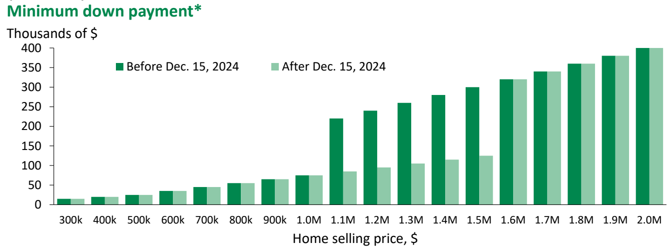


* Mortgage insurance is optional for mortgages with a down payment of 20% or more
Canada Mortgage and Housing Corporation and Desjardins Economic Studies

Increasing the Price Cap for Insured Mortgages Will Help Homebuyers Get Their Foot in the Door

The other major housing announcement by the federal government was that it's increasing the price cap for insured mortgages from $1M to $1.5M effective December 15, 2024. This means Canadians will be able to purchase homes of up to $1.5M with less than a 20% down payment, making it easier for prospective homebuyers to enter the market. According to the Canada Mortgage and Housing Corporation (CMHC), if a home costs $500k or less, a minimum 5% down payment is required. For homes over that threshold, buyers need a down payment of 5% on the first $500k and 10% on the remainder up to $1M. The CMHC has confirmed that the 10% down payment will be extended to $1.5M (graph 7). Homes over $1.5M require a minimum 20% down payment. The original cap was set in 2012, when the $1M limit covered the vast majority of home sales. As home prices have risen over the years, fewer and fewer purchasers were eligible for insured mortgages. Looking at current freehold and condo/strata homes for sale on MLS, 74% are listed for under $1M. Another 12% of listings will be included under the higher $1.5M price cap. This policy will be more impactful in cities like Toronto, where 1 in 3 houses are priced between $1M and $1.5M, allowing buyers to get a house in this range with a down payment as low as $75k instead of over $200k. That said, it could still take the average household over 7 years to save up for a down payment, even if they're socking away 10% of their after-tax income each month. For prospective homebuyers who have seen their rent and other living costs soar over the last two years, that saving objective might be daunting.

Graph 7
Homebuyers Can Now Get Their Foot in the Door of Homes Priced at $1M to $1.5M
Minimum down payment*



* The CMHC requires a 5% down payment on the first $500k and 10% on the portion between $500k and $1.5M. Homes over $1.5M are not eligible for mortgage insurance and must have a minimum 20% down payment.
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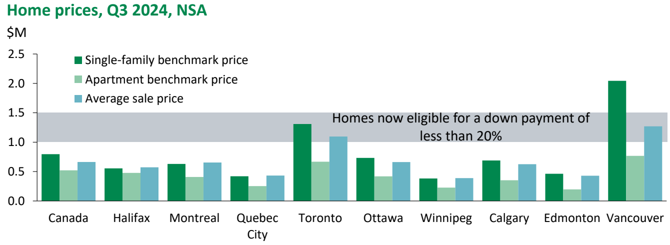
To calculate housing affordability, we use the average home sale price, which has remained below $1M in every province. But in Toronto and Vancouver, the average sale price has surpassed that threshold, and other major cities aren't far behind (graph 8).

Graph 8
The Average Home in Toronto and Vancouver Costs More than $1M
Home prices, Q3 2024, NSA



NSA: Not seasonally adjusted
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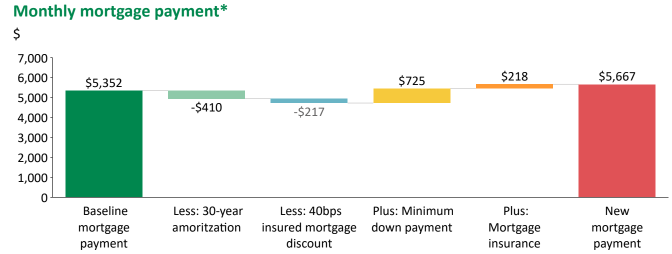
The benchmark price for single-family homes is above $2M in Vancouver, putting them well above the eligibility threshold for insured mortgages. In Toronto, the single-family benchmark price remains within the new eligibility range for down payments of less than 20%.

The Impact of Recent Policy Announcements on Homeownership Affordability Will Be Mixed

For a home purchased for $1.1M with a 5.4% mortgage rate and 20% down payment, moving to a 30-year amortization would lower the mortgage payment by $410 per month (graph 9). Insured mortgages may also get a preferred borrowing rate. Assuming the current 40bps discount on 5-year fixed-rate mortgages continues, it would give homeowners additional payment relief of $217 per month. Our scenario also pairs the longer mortgage amortization with a minimum down payment. Since homebuyers would be financing a larger share of the home's cost in this scenario, the loan itself would be significantly larger. Monthly payments would increase by $725. For homes purchased with a minimum down payment, mortgage insurance would be 4% of the loan amount. This would add another $218 per month if the insurance is rolled into the mortgage rather than paid up front. For buyers with both a 30-year amortization and a minimum down payment, their monthly mortgage payment would increase by over $300. In other words, the government's so-called affordability relief measures would do the opposite.

Graph 9
The New Policies Don't Make Homeownership More Affordable
Monthly mortgage payment*



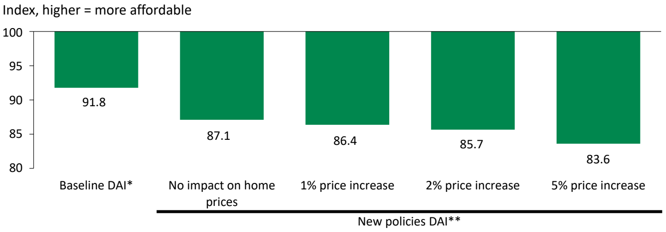
* Purchase price of $1.1M; baseline: 25-year amortization, mortgage rate of 5.4%, 20% down payment, no mortgage insurance
bps: basis points
Desjardins Economic Studies

What Will Be the Impact on Housing Supply and Demand?

Any policy that makes it easier for prospective buyers to enter the market will add to demand. Longer mortgage amortizations make monthly payments lower than they otherwise would be, allowing homebuyers to bid up prices a bit more than before. Similarly, where disappointed homebuyers might have previously dropped out of bidding wars at the $1M threshold, they can now purchase homes above that price point with just a little extra down payment.

Thus far, we've assumed there will be no change in home prices as a result of increased demand from improved affordability. But if the new policies drive up demand to the point that average prices start to rise, homebuyer affordability will deteriorate (graph 10).

Graph 10
Higher Demand from New Policies Could Erode Affordability If Home Prices Rise



* The baseline DAI assumes a 25-year amortization, a 20% down payment and no mortgage insurance
** The new policies DAI assumes a 30-year amortization, a 40bps mortgage rate discount, a minimum down payment and mortgage insurance
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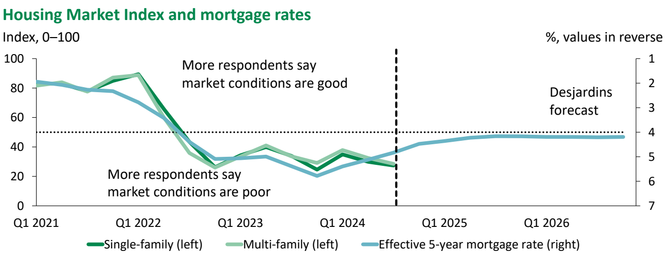
The key to improving affordability over the long term will be increasing housing supply. Indeed, we've published an extensive list of successful global housing supply policies that could help boost construction here at home. We've also evaluated recently announced housing supply measures. However, the industry continues to face persistent headwinds from construction labour shortages, an aging workforce and high building material costs.

Borrowing costs are coming down but remain high. The latest survey by the Canadian Home Builders' Association found that homebuilder sentiment was poor and declining in both the single-family sector (27.4 on a scale of 0 to 100) and the multi-residential slated for ownership sector (28.5). Builders surveyed said that falling interest rates alone won't be sufficient to restore affordability enough to materially improve their sales. Indeed, if homebuilder sentiment continues to follow the forecast path of effective 5-year mortgage rates, there will at best be an even split between those viewing market conditions as good and those viewing them as poor over the next two years (graph 11).

Graph 11
Homebuilder Sentiment Is Weak



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Moreover, nearly 40% of builders surveyed reported considering pivoting to rental construction, suggesting that some of the new rental supply supported by recent government incentives may come at the expense of new ownership units.

Conclusion

The newest policies aiding homebuyers target two distinct challenges. The 30-year mortgage amortization for new homebuyers and buyers of newly built homes will lower the monthly costs associated with purchasing these homes, modestly improving affordability. In contrast, increasing the price cap on insurable mortgages from $1M to $1.5M means that those living in more expensive regions of the country will be able to get their foot in the door of homeownership with a smaller down payment. But since their loan amount will be larger, their monthly mortgage payment will also be higher. Affordability will diminish rather than improve. As we've said many times before, the key to meaningfully improving affordability over the long term will be increasing the supply of housing. Given the sense of urgency to address housing affordability on the rental side, the supply-constrained construction industry is now more active in this space at the expense of the ownership market. Enabling more people to access the homeownership market without increasing supply will therefore push prices higher and make the affordability improvement—if there is any at all—very short lived.