

**Scott J. Gillis, AMP**  
Accredited Mortgage Professional  
The Gillis Group

3-2359 Queen Street East  
Toronto, Ontario M4E 1H2  
Tel/Fax: 416.440.0338  
Email: [scott@gillisgroup.ca](mailto:scott@gillisgroup.ca)

## Changes to Government Guaranteed Mortgages

There has been lots of discussion in the news about the recent changes to government guaranteed mortgages announced by the Minister of Finance.

However we believe the majority of Canadians do not understand what exactly it means to remove the “government guarantee” from some of these lending programs.

### We'll explain...

Many Canadians generally understand how mortgage insurance works. We're not talking about mortgage life and critical illness insurance, we're talking about mortgage default insurance. This is the premium that is applied to your mortgage amount and is paid to a mortgage insurer, who in turn agrees to insure your mortgage with your lender in the event *you* default. In other words, it is protection for the lender in case their customer cannot make their payments. This is a mandatory insurance for mortgages higher than 80% of the home value.

Well that's great, but what happens if a lot of people all of a sudden can't make their payments and the insurer who is supposed to protect the lender is unable to cover their insurance obligations?

### Enter the government guarantee.

The Canadian government will guarantee up to 90% of the mortgage amount against insurer default. So, this is security for the lender in the event the *insurer* defaults. This Government Guarantee is in place for CMHC (Crown Corporation) as well as the private insurers, such as Genworth Financial Canada.

The government guarantee is also a criterion for high ratio loans to be sold into the Canada Mortgage Bond program, which is a relatively new cost-effective funding source for banks and mortgage lending companies. These Bonds are bought up by investors all around the world due to their higher yield than Government of Canada Bonds combined with their “government guarantee”.

## So what has changed?

Well, the Finance Minister looked to our southerly neighbours as well as across the pond and noticed some pretty dire scenarios which begged the question: Are we guaranteeing mortgages that are a little too risky? After an analysis of the mortgages that fall within their guarantee, recent trends, and industry consultations, the Minister of Finance decided to cease guaranteeing high ratio mortgages with the following characteristics:

- LTV ratios in excess of 95%
- Amortizations in excess of 35 years
- Non-amortizing mortgages (Interest-Only Mortgages).
- Applications where the beacon score of both borrowers is less than 620.

## How does this affect me?

If you are a *current homeowner*, who is happy in your home and have no intentions of moving in the near future than this probably doesn't affect you. However if you are a *prospective homebuyer*, looking for 100% financing and a 40 year amortization then your financing options are becoming a little more limited. Most of the big chartered Banks and many lenders have already pulled the above products. Other lenders are offering these products until October 13, 2008 (please speak with your mortgage originator concerning rules around this deadline).

## Let's take a closer look at the 40 year amortization phenomenon:

Why is it appealing when borrowers know they are paying many thousands of dollars in interest over the life of their mortgage? Well there are a couple of predominant reasons:

1. New homeowners are increasingly concerned more with their payment amount than the house price or the interest cost over the life of the mortgage. It's a decision made largely on cash flow.
2. The vast majority of people who take 40 year amortizations actually qualify for 25 year amortizations but choose the former and accelerate their payments, which reduce their amortization to 32 years. Registering their mortgage with a 40-year amortization helps protect them in the future should they need to decrease their payment.

From a purely mathematical perspective, according to the Ministry of Finance: "Reducing amortization from 40 years to 35 years on a mortgage loan of \$200,000 with a 6 per cent interest rate results in a \$41 increase in a borrower's monthly payment, but the borrower will save \$49,000 in interest payments."

## Looking ahead...

If the decision to take 40 year amortizations is based on cash flow, then we'd suggest \$41 per month on its own will not cause any major disruptions in the housing market. The reality is that new mortgagors will have to spend a little more in their monthly mortgage obligations but the impact to the housing market will be isolated to those who needed the 40 year amortizations and 100% financing to qualify for their mortgage. As a replacement for 100% financing, we may see the increase in popularity of Cashback mortgages once again. The 100% financing programs have all but made CashBack offers obsolete, however they may be a decent option for some people once again - even if the interest rate is higher.

In the short term, we may see a small spike in home buying and refinance activity as people try to accelerate their timelines in order to take advantage of these fleeting offers. This may keep the market relatively strong through 2008. In the medium to long term, we don't expect these changes to have much of an impact to the housing market. 35 year amortizations are still available and for that matter 40 year amortizations will still be available by some lenders for those customers who have the minimum 20% down payment for conventional financing.