



Millennials Bear Brunt of Fed Policy Changes

Many, if not most, first-time buyers will experience a steep decline in housing affordability on October 17. New rules introduced by the Federal Government will cause the sharpest drop in the purchasing power of low equity home buyers in years. At a time when housing affordability is a critical issue, deliberately chopping millennials' purchasing power by as much as 20 per cent will only exacerbate a well-known problem.

Under current rules, insured mortgages with variable rates and fixed terms under five years require home buyers to qualify at the five-year benchmark rate. However, if a borrower opts for a five-year or more fixed term, the borrower can qualify at his or her negotiated, discounted rate instead of the higher benchmark rate. This has long been a fixture of the Canadian mortgage market. As of October 17, 2016, **ALL** home buyers securing a high-ratio mortgage must qualify at the five-year benchmark rate, even if they have negotiated a lower five-year fixed term rate with their lender.

The low interest rate environment has benefited home buyers and sellers for many years, with all but the least credit-worthy borrowers negotiating a contract rate significantly lower than the benchmark rate. Now, even the most credit conscious households face a dramatic reduction in their purchasing power. For example:

- A family with an annual household income of \$80,000 and a 5 per cent down payment will see their purchasing power fall from \$505,000 to \$405,000 (-\$100,000).ⁱ
- An individual with an annual income of \$60,000 and a 5 per cent down payment will experience a reduction of purchasing power from \$380,000 to \$305,000 (-\$75,000).
- A household earning \$120,000 per year and a 10 per cent down payment will see a reduction in purchasing power from \$803,000 to \$651,000 (-\$152,000).

We expect this policy to have the following impacts:

1. Housing demand will slow as millennials, other first-time and early move-up buyers are squeezed out of the market.
2. This reduction in demand may cause imbalances and declining prices across some product types in some communities. In addition, new home construction activity will lag along with related employment and economic growth.
3. Pent-up demand will intensify, contributing to another cycle of rapidly rising prices in the future as financially retrenched millennials buy up an undersupplied housing stock.

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ⁱ Calculated from principal and interest only, not including property taxes, maintenance fees, mortgage insurance fees or heat. Calculations based on 25-year amortization, best five-year fixed discount rate and five-year fixed benchmark rate.