Home equity lines of credit no longer covered by government insurance

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Homeowners looking for mortgage financing or re-financing may face more stringent requirements from their lending institutions following implementation of the latest federal government changes on April 18, 2011.

In the fall of 2008, the spring of 2010, and again in January of 2011, the federal government announced changes to the rules which govern mortgage financing and refinancing in Canada. In March of this year, the changes which shortened the maximum amortization period from 35 to 30 years and limited re-financing to 85% of a home's value (down from 90%) took effect.

Implementation of a further change was deferred until April 18, 2011. As of that date, the federal government no longer provides government-backed insurance for most home equity lines of credit (HELOCs). Typically, a HELOC is a lending arrangement under which funds are made available to a homeowner, to a maximum of 80% of the value of the home. Unlike conventional mortgages, HELOCs are non-amortizing; while monthly payments are required, those payments can usually be as little as the interest accrued during the previous month and the homeowner therefore is not required to make any payments against principal.

It is that interest-only payment feature of HELOCs which has resulted in the decision to withdraw government-backed insurance. The federal government announcement (available on the Department of Finance Web site at http://www.fin.gc.ca/n11/data/11-003_1-eng.asp) summarized the change as follows: "[I]f a loan or a segment of a multi-segment loan is in the form of a revolving line of credit that does not amortize over time, it will no longer be eligible for government-backed insurance. However, with established scheduled principal and interest payments, a loan will continue to be eligible for government-backed insurance, provided it meets the underwriting standards set by the mortgage insurer."

In effect, the change removes the "safety net" for financial institutions which provide non-amortizing HELOC financing to homeowners, in that the financial institution will no longer be able to recover any losses incurred on such financing through government-backed insurance. Given that, the likely response by lenders will be to impose more stringent income and solvency requirements on would-be borrowers.