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When Lower Equity Meets Higher Debt Burdens

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Abstract

Declining house prices and higher interest rates have reduced housing equity and raised debt-service burdens for many mortgage holders. With a large share of pandemic-era mortgages set to renew during the remainder of 2026 and in 2027, this note examines how these two developments interact and identifies the borrowers most exposed to both lower housing equity and elevated debt-service ratios at renewal.

While lower equity or higher debt-service burdens alone may be manageable, their combination can reduce financial flexibility and leave them more vulnerable to future adverse shocks. Although the group of borrowers facing both lower housing equity and elevated debt-service burdens remains relatively small, the risks are concentrated in certain markets, particularly Toronto and Vancouver, and warrant close monitoring.

Topics: Debt management; Financial institutions; Financial stability; Housing

JEL codes: G21, G51, R31

Résumé

La baisse des prix des logements et la hausse des taux d'intérêt ont réduit la valeur nette immobilière (équité) et accru le fardeau du service de la dette de nombreux détenteurs de prêts hypothécaires. Alors qu'une part importante des prêts hypothécaires contractés durant la pandémie arrive à échéance en seconde moitié de 2026 et en 2027, cette note examine l'interaction entre ces deux développements et identifie les emprunteurs les plus exposés à la fois une baisse de leur valeur nette immobilière et un fardeau accru du service de leur dette.

Alors qu'une réduction de l'équité ou un fardeau élevé du service de la dette pris isolément peut demeurer gérable, la combinaison des deux peut réduire la flexibilité financière des ménages et les rendre plus vulnérables à de futurs chocs défavorables.

Bien que le nombre d'emprunteurs confrontés simultanément à une faible valeur nette immobilière et à un ratio élevé du service de la dette au renouvellement demeure relativement limité, ces vulnérabilités sont concentrées à Toronto et à Vancouver et méritent d'être suivies de près.

Context and key messages

By the end of 2027, about 40% of the stock of outstanding mortgages as of June 2026 (or about 2.3 million loans) will come up for renewal. Although mortgage rates have declined from their peak, many borrowers renewing by 2027 will still face higher payments and higher debt-service burdens than when they originated their mortgage.

At the same time, house prices have fallen significantly from their 2022 peak in some cities, reducing homeowners' housing equity.

While either factor alone may be manageable, borrowers facing both higher debt-service burdens and lower housing equity might face more financial stress.

Key takeaways

- We estimate that about one fifth of borrowers renewing in the second half of 2026 and a quarter of those renewing in 2027 have less housing equity than at origination. Reduced equity is particularly concentrated in Toronto and Vancouver and their surrounding CMAs.
- Higher payments and lower housing equity can create a refinancing constraint for some borrowers. The impact is most important for the 2027 renewal cohort which accounts for a quarter of the outstanding mortgages.
- We estimate that about 5% of mortgages renewing in 2027 (or 9% of mortgage balances renewing in 2027)—and 10% of 2027 renewals in Toronto (15% of mortgage balances renewing in Toronto in 2027)—could have both a loan-to-value ratio above 80% and a debt-service ratio above insured mortgage limits. This situation could limit their ability to refinance, switch lenders or extend amortization.
- Borrowers facing refinancing constraints can generally still renew with their existing lender, provided they remain current on their mortgage payments. This constraint should therefore not be interpreted as renewal constraint, but rather as limiting flexibility.

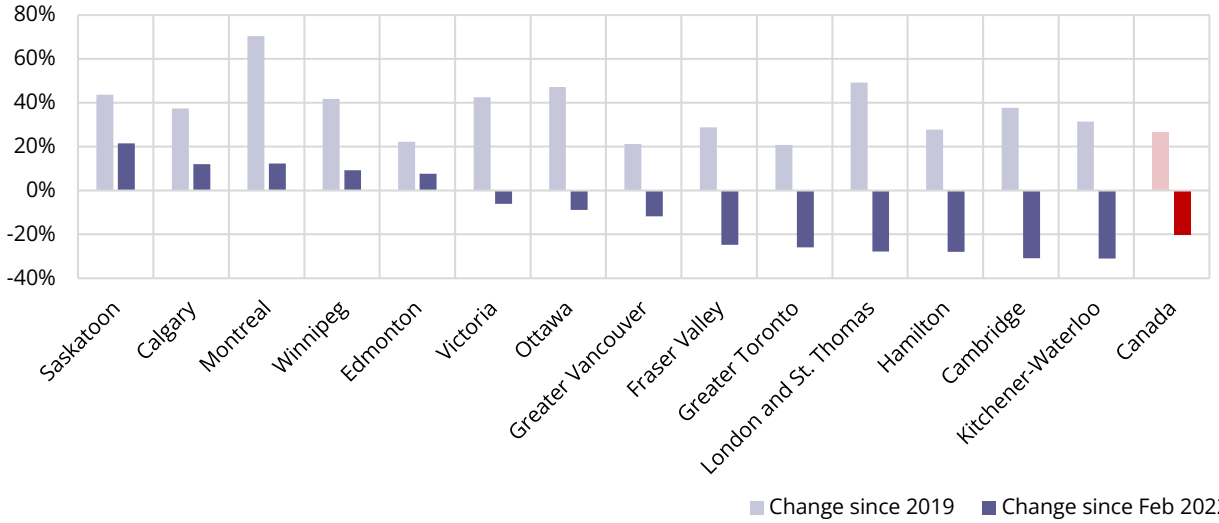
Late 2021 and 2022 origination cohorts have lost significant housing equity since origination

Over recent decades, mortgage holders have typically accumulated additional housing equity between origination and renewal. This is because mortgage balance declines as principal is repaid, while nominal house prices have generally risen over time.

The current renewal cycle will be different. House prices have declined by 20% nationally since their early-2022 peak, and as much as 30% in some cities near Toronto (**Chart 1**). As a result, about a quarter of the borrowers renewing their mortgages in 2027 will have less equity in their house than at the time of origination, despite several years of mortgage repayment (**Chart 2**).[1] This share rises to about 50% in Toronto and 30% in Vancouver, where house price corrections have been largest. Borrowers renewing in 2027 have experienced the largest equity loss, as a large share of them originated at the peak of the housing price cycle in 2022.

Chart 1: Canadian house prices have fallen since their peak in February 2022, with the sharpest decline around Toronto and Vancouver and their surrounding cities

Changes in house price levels (current compared to February 2022 and January 2019)



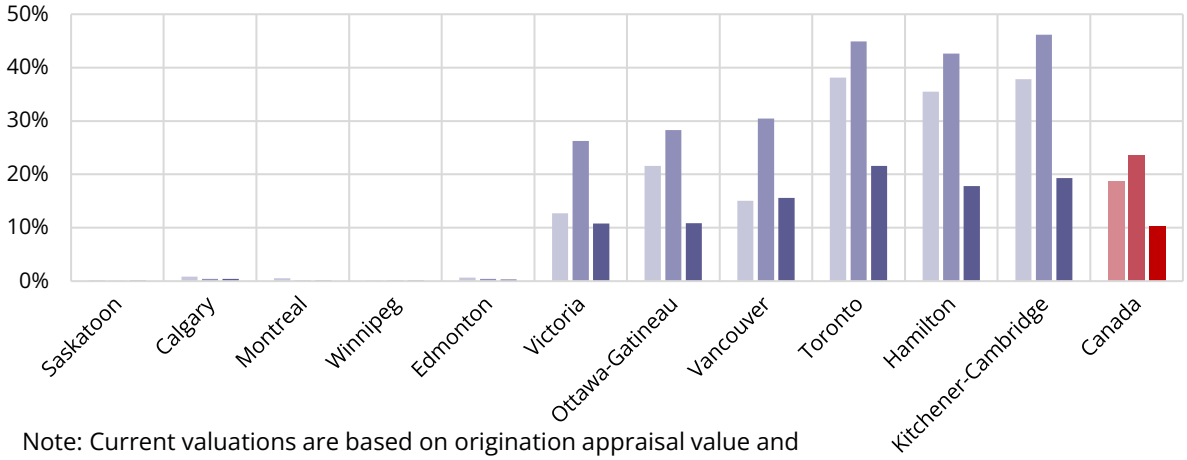
Sources: CREA and Bank of Canada calculations

Last observation: July 2026

[1] We update the current house price value based on appraisal at origination using the CREA house price index. From the last observable data point, we assume the level of house prices remains constant.

Chart 2: Cities around Toronto and Vancouver are most exposed to housing equity losses

Share of mortgages that have lost equity compared to origination by renewal cohorts



Note: Current valuations are based on origination appraisal value and CREA HPI changes. House price is assumed to stay constant from the last available data date onwards

Sources: CREA, Finance Canada, Regulatory filings of Canadian banks, and Bank of Canada calculations

Last observation: July 2026

Lower housing equity does not necessarily imply borrowers will go into delinquency or default on their mortgage. In particular, many of the borrowers flagged in **Chart 2** still have positive equity because they purchased their homes with a 20% down payment. A large body of US literature on mortgage-default (e.g. Foote et al., 2008) also finds that borrowers often continue servicing their mortgages even when equity is very low or negative. Instead, mortgage distress typically arises when lower equity interacts with other adverse shocks, such as income losses, unemployment, or higher debt-service burdens (Bhutta et al., 2010 and Gerardi et al., 2018).

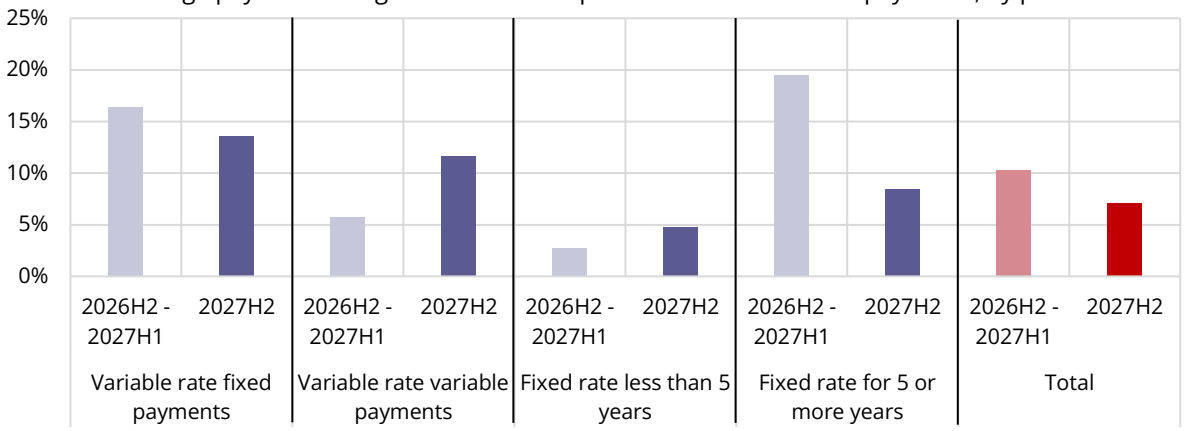
Fixed-payment mortgages renewing for the first time since the pandemic will face a significant payment shock

In the current context, the same borrowers are also likely to face higher mortgage rates at renewal, which will materially increase their monthly payments. This shock will be particularly large for borrowers renewing five-year fixed-payment mortgages before the

middle of 2027, as they have yet to fully experience the impact of higher interest rates since the pandemic lows (**Chart 3**).[2]

Chart 3: Renewing borrowers over the next 18 months face higher payments, with the sharpest increases for those holding fixed-rate mortgages of 5 years or more

Average payment change at renewal compared to December 2025 payments, by product



Note: The mortgage interest rates used in calculations are based on market expectations for interest rates as of Sept 29th 2026
Sources: Finance Canada, regulatory filings of Canadian banks, and Bank of Canada calculations

Last observation: July 2026

While the payment shock at renewal is expected to be smaller for borrowers with variable-payment and short-term fixed payments as they already faced the shock at the time of the rate hikes, most of these borrowers continue to have elevated payments and elevated debt service ratio.

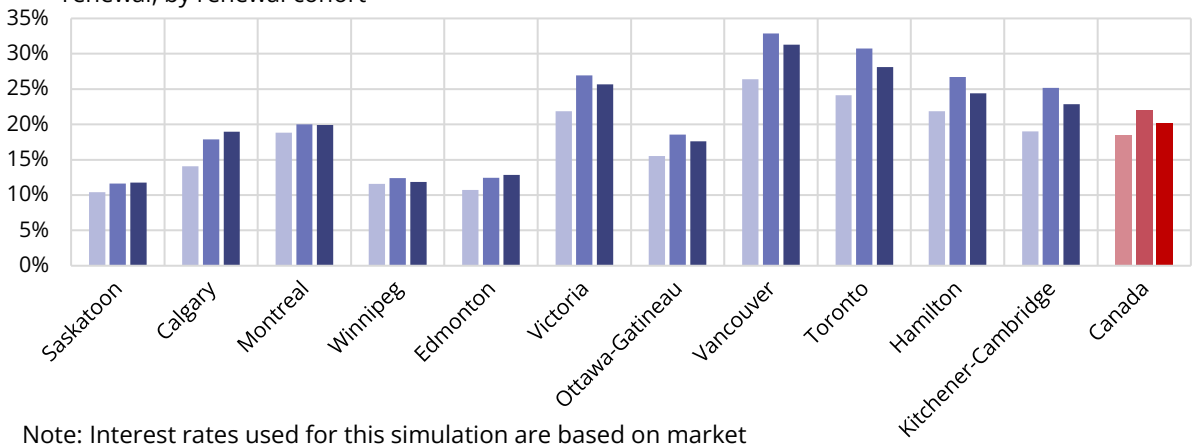
Given the current market interest-rate expectations and assuming household income grew at the historical average rate, we estimate that about 20% of all borrowers renewing their mortgage in 2027 will have a qualifying total debt-service (TDS) ratio above 44% or a gross debt-service (GDS) ratio above 39%. This would bring them above the regulatory limits from insured mortgage guidelines (**Chart 4**).[3]

[2] These projected payment increases are consistent with previous Bank of Canada work showing that many borrowers renewing pandemic-era mortgages are expected to face higher mortgage payments and debt-service burdens at renewal under market-implied interest rate paths (Godbout, Su and Xu, 2025).

[3] Uninsured mortgages are not subject to strict debt servicing limits but rather a broader set of borrower qualification criteria related to repayment capacity, credit score and overall wealth, with lenders retaining flexibility to establish their own underwriting standards within regulatory expectations. Therefore, a portion of uninsured mortgages already has debt-service ratios above the insured regulatory limits at origination.

Chart 4: Toronto and Vancouver and surrounding cities show the highest debt-service ratios after renewal

Share of borrowers with qualifying GDS and TDS ratios above insured mortgage thresholds at renewal, by renewal cohort



Note: Interest rates used for this simulation are based on market expectations as of September 29th, 2026

Sources: Finance Canada, Regulatory filings of Canadian banks, and Bank of Canada calculations

Last observation: July 2026

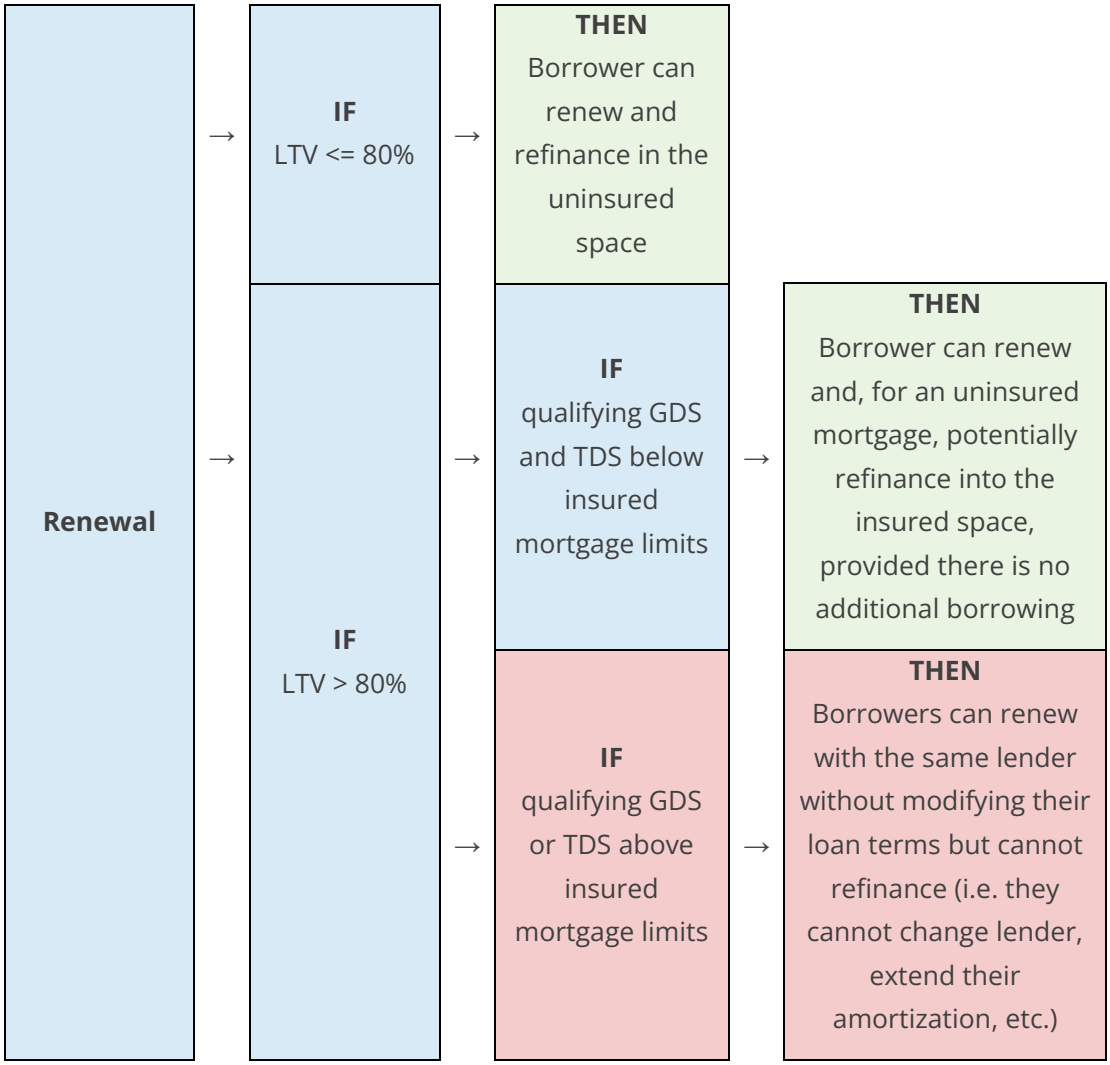
A high debt-service ratio alone is unlikely to create refinancing challenges, but it can become more consequential when combined with lower housing equity.

Uninsured borrowers who renew with a loan-to-value (LTV) ratio above 80% may need to switch into the insured mortgage market if they want to extend their amortization. If these borrowers have a gross debt-service (GDS) or total debt-service (TDS) ratio above insured mortgage guidelines, they would not be able to extend the amortization. The next section examines the prevalence of this dual exposure.

The combination of high debt-service ratio and reduced housing equity at renewal

Borrowers with both a loan-to-value (LTV) ratio above 80% and debt-service ratios above insured-mortgage guidelines at renewal, even after increasing the amortization to 25 years, may not be able to refinance their mortgage (that is, replacing their existing mortgage with a new loan that has a different amount, longer amortization, different lender, etc.) (**Chart 5**). As a result, if they experience a stressful event, such as a job loss or divorce, they may be more likely to fall into arrears than the average borrower. However, we estimate that about 40% of these borrowers have a combined loan product with unused credit limit, which borrowers can draw on to smooth financial shocks.

Chart 5: Describing the refinancing constraint at renewal



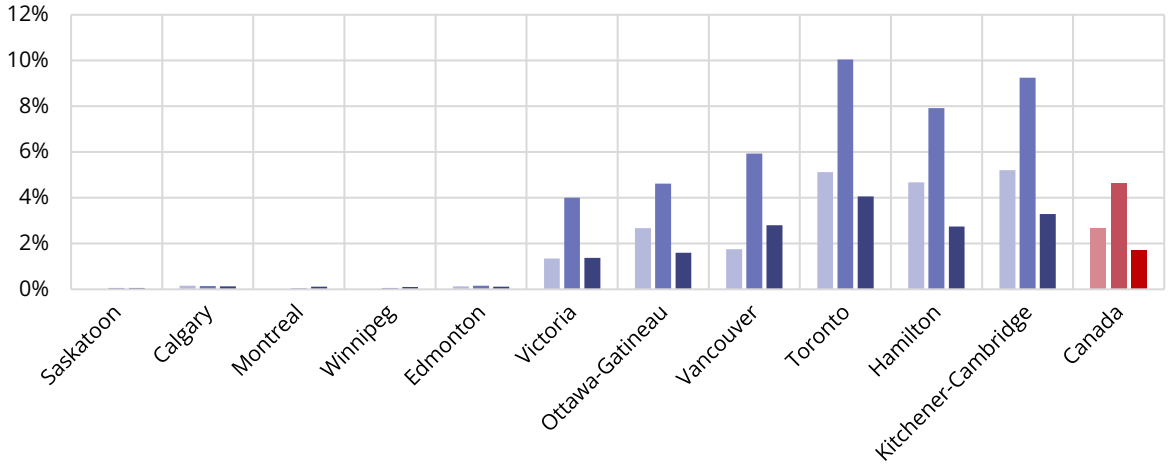
Borrowers who have renewed with both high LTV ratios (above 80%) and high debt-service ratios (above insured mortgage guidelines) since 2022 have experienced higher 60-day arrears rates. This finding is consistent with previous evidence showing that leverage and debt-service burdens are important predictors of future mortgage stress (Bilyk, Chow and Xu, 2021).

At current home prices and under prevailing market rate expectations, we estimate that about 2.5% of all mortgages renewing in the second half of 2026 and about 5% of all mortgages renewing in 2027 will have both a loan-to-value ratio above 80% and a debt-service ratio above insured mortgage guidelines, even under the assumption that amortization is extending to 25 years. This share increases to 10% for those renewing in

2027 in Toronto, reflecting the larger house price correction in that region (**Chart 6**). The share is even higher in dollar value terms, reaching 9% for Canada and 15% for Toronto among the 2027 renewals.

Chart 6: Toronto borrowers more at risk of facing low housing equity and high debt burden at renewal

Share of renewing borrowers with LTV>80% and qualifying DSR above insured limits



Note: Conditional on rate path from September 29th, 2026 and flat house prices

Sources: CREA, Finance Canada, Regulatory filings of Canadian banks, and Bank of Canada calculations

2026H2 2027 2028

Last observation: July 2026

The size of the at-risk group is sensitive to assumptions about the house price and interest rate change (**Table 1**). A further 10% decline in home prices would increase the share of vulnerable 2027 renewals to about 7% nationally and 13.5% in the Toronto area. Meanwhile, a 50-basis-point increase in the interest rate path has a smaller impact on this share, raising it to about 5.5% nationally and 12% in the Toronto area.

Table 1: The count share of all borrowers renewing in 2027 with low housing equity (LTV>80%) and debt service ratios above insured mortgage guidelines is sensitive to assumptions for interest rates and house prices

		House price change compared to current level		
		baseline	**-10%**	**-20%**
Rates scenario	**Market expectations (as of Sep 29th)**	4.7%	7.4%	10.2%
	+50 basis points	5.6%	8.8%	12.0%
	+100 basis points	6.6%	10.2%	13.9%

Conclusion

House price declines since 2022 have reduced the equity buffer of many mortgage holders, while many borrowers who bought near the pandemic peak are also approaching renewal and will soon face materially higher rates. While lower housing equity alone does not necessarily imply borrower distress, it can become consequential when combined with other adverse shocks or elevated debt-service burdens.

For a subset of borrowers, this combination of thinner equity and higher debt-service burdens could make it harder to refinance, switch lenders or adjust terms to lower monthly payments. These pressures appear most concentrated among recent cohorts in markets where house prices rose the most during the pandemic and have since fallen abruptly, particularly in and around Toronto and Vancouver. This group warrants close monitoring as it becomes more vulnerable to future shocks: impacted households may have higher arrears, reduced financial flexibility, weaker consumption and lower housing mobility as some borrowers may need to remain with their current lender or stay in their homes longer than planned.

Even so, the exposed group identified in this note should be taken as an upper bound as some of these borrowers might have additional financial resources they could use to lower their loan-to-value ratio and debt servicing costs. In addition, recent guidance from the Financial Consumer Agency of Canada (FCAC) may help mitigate some of these pressures. The guideline expects federally regulated financial institutions to offer tailored support for consumers at risk.[4] While such measures would not eliminate the underlying vulnerabilities identified in this note, they could provide additional flexibility for some households facing payment stress.

Taken together, we do not expect the combination of thinner equity and higher debt-service burdens to pose a broader financial stability concern. These borrowers are a relatively small group overall, most continue to hold meaningful equity, and borrowers can still renew with their existing lender.

[4] Guideline on Existing Consumer Mortgage Loans in Exceptional Circumstances - Canada.ca

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