

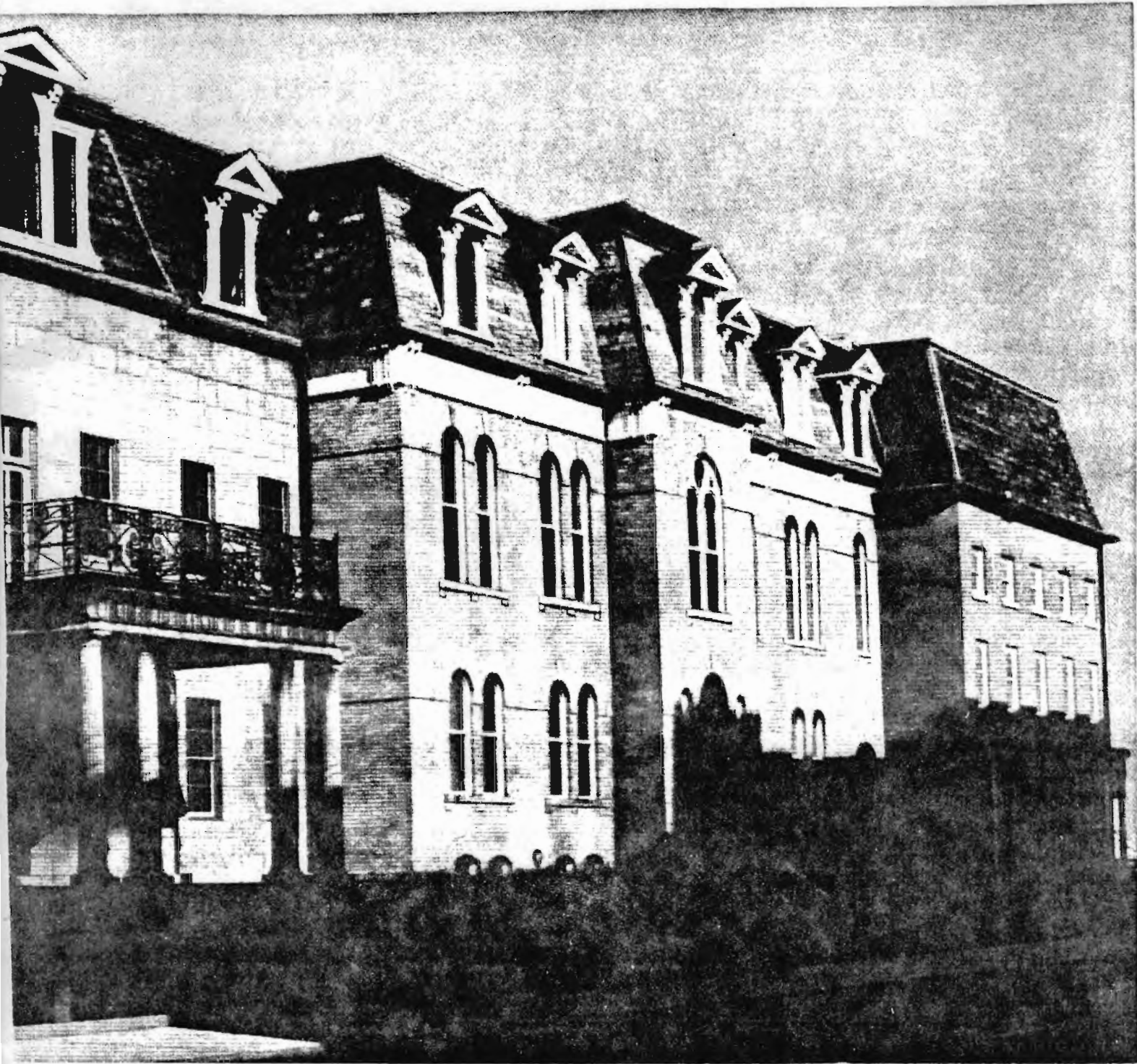
HOMEOWNERSHIP

THE REVIVAL OF THE CANADIAN DREAM



Frank Oberle, MP

Prince George—Peace River



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*Angus Laidlaw, BA
Frank Oberle, MP*

CONTENTS

INTRODUCTION	1
CHAPTER 1	
The "Housing Problem"	2
Social Right and Social Utility	8
The Utility of Ownership	13
CHAPTER II	
Mortgages and Affordability	18
An Overview of the Mortgage Instrument	20
Government Response to the 1981 Affordability Crisis	24
The Inflation-Capital Availability Problem	29
CHAPTER III	
A Recapitulation	30
Approaches in Other Countries	31
A Proposal for Savings-Mortgage Agreements and Homeowner's Bonds	37

HOMEOWNERSHIP: DREAM OR REALITY?

INTRODUCTION

Few issues of an economic and social nature engender as much concern as the availability and quality of housing. At certain times in Canadian history, housing problems have ranked very high on the political agenda. The problems have at various times involved a shortage in housing stock (such as occurred following the end of the Second World War) and housing affordability, a preoccupation of many Canadians and their parliamentary representatives in the 1980s.

This paper addresses primarily the latter problem: housing affordability as it is inevitably affected by economic conditions and countercyclical policies of government. The paper examines the most recent manifestations of the problem - the acquisition and support of mortgages during the period of painfully high interest rates in 1981. In the context of affirming that a broad consensus exists among Canadians that institutional arrangements should be broadly conducive to homeownership, an innovation in these arrangements is proposed. The objective of this innovation would be to give Canadians who aspire to their own home, the opportunity to obtain it, with built-in protection against the effects of sudden, marked increases in mortgage interest rates over which they have no control.

The innovation envisioned is a savings-mortgage agreement under which aspiring homeowners could place savings dedicated to the homeownership objective with financial institutions. In time, they would assume a mortgage at a guaranteed, affordable rate of interest.

A related proposal to ensure the availability of funds for construction of housing stock is advanced.

CHAPTER I

THE "HOUSING PROBLEM"

As the "third basic need", shelter is a matter of on-going, personal involvement for all adults. Yet, unlike food and clothing, shelter is a matter whose many dimensions contribute toward confusion. Housing is a commodity and, at the same time, an asset.

As a commodity, its price, and the factors which help determine price, are influenced by the economic and social characteristics of the several elements that make it up; land, structure, privacy, amenities, services and location. For the consumer, each of these elements plays some part in the consumption decision, so that the "resource bulk" of the commodity -- the material inputs which comprise a shelter -- is often of less than primary importance.

Housing economics then:

"Involves an investigation of many physical, social and psychological dimensions which the housing commodity assumes in the eyes of the public. It is deceptive to attempt to reduce the problems of housing economics to a single scale of input costs because the real efficiency of the housing sector depends on a complex balancing of personal requirements, community institutions and spacial linkages, in addition to considerations of resource cost."(1)

It follows that the identification of a "housing problem" is no less complex. In simplest terms, the perception of a housing problem by an individual depends greatly on his reaction to his own shelter circumstances. Housing markets are by nature local, and the perception of problems in a metropolitan area may differ greatly from that in smaller cities and rural areas.(2)

Even within a local market, individual householders will perceive their own housing problem as the disparity between their circumstances and their own housing standards. Thus,

"Each individual will have standards for himself, standards for other special groups and some thoughts regarding the average standard for society . . . it should be obvious that there is no simple way to generalize about housing standards."(3)

Nevertheless, few would argue with housing policy expert, Albert Rose, that Canadians are among the best housed people in the world.(4) TABLE I shows changing housing conditions in Canada between 1951 and 1974. The changes in figures in TABLE I would perhaps be less than impressive to many in a nation that has come to take for granted a progressively improving standard of living. But supply figures -- housing starts for example -- in the years since the end of the Second World War are evidence of a remarkable increase in both housing demand and government involvement in the direct and indirect provision of accommodation.

An acute shortage of dwellings after World War II moved the King government to develop a national housing program with a goal of 80,000 new units per annum, in sharp contrast to the average of 43,000 units per annum which had been obtained during the previous 20 years.(5) This target of 80,000 units was met in 1952, and, apart from some periods of critical shortage following recessions in the mid 1950's and early 1960's, housing starts continued to increase until a rapid decline began after 1976 (TABLE II). While demographic factors had a role in this decline (progressive attenuation of the baby boom, decline in immigration), the chief influences were economic: growing uncertainty on the part of investors and homebuyers in the face of increasing and fluctuating interest rates.(6)

The figures are instructive when taken in the context of housing requirement projections. The Canada Mortgage and Housing Corporation in 1978 estimated that in 1985, Canada would need 237,000 new housing units. While this is less than the 266,000 peak requirement in 1980, it well exceeds the projected annual starts (which in 1982 did not rise above 180,000). This difference in levels between construction and estimated requirement suggests to one analyst:

"A significant backlog of unmet housing requirements is building up in Canada. Over the past five years, the accumulative increase in dwelling requirements -- to keep up with net household formation, to provide for replacement of old houses, and to allow for vacancies -- has exceeded actual starts by 200,000 units".(7)

T A B L E I

CANADA'S HOUSING CONDITIONS (PER CENT)

	1951	1961	1971	1974
CROWDING:				
More Than One Person/Room	18.8	16.5	9.4	6.0
Families Not Maintaining Own Household	9.4	5.2	2.9	N.A.
PHYSICAL ATTRIBUTES				
No Central Or Electrical Heating	52.0	32.5	18.9	10.9
No Piped Hot and Cold Water	43.1	19.9	7.3	4.2
No Exclusive use of Flush Toilet	35.9	21.0	6.9	3.0

SOURCE: 1951, 1961, and 1971 Census of Canada and 1974, Survey of Household Income and Family Expenditure, reprinted in CMHC The Relationship Between Social Policy and Housing Policy: A Federal Perspective. (Background Paper, Ottawa, 1979).

T A B L E I I
DWELLING STARTS IN CANADA -- SELECTED YEARS

YEAR	STARTS
1932	24,900
1935	33,900
1938	43,900
1941	51,200
1944	41,500
1947	74,300
1950	92,531
1953	102,409
1956	127,311
1959	141,345
1962	130,095
1965	166,565
1968	196,878
1971	233,653
1973	268,529
1975	231,456
1977	245,724
1979	197,049
1981	177,973

SOURCE: CMHC, CANADIAN HOUSING STATISTICS, 1981
(Ottawa, 1982) p. 1.

Insufficiency in the increases in housing stock may contribute to rising prices in some centres at least, although it would be spurious to predict an impending housing shortage attributable to a disequilibrium between supply and demand for new housing.(8)

We return to the question, "What is the housing problem?" Clearly it is not generally one of housing quality (as statistics on amenities and crowding demonstrate) except perhaps in two respects. First, housing quality is an obvious concern among those groups in society -- low income, the disadvantaged and the elderly -- which have not enjoyed the benefits of the general improvement in the quality and quantity of housing.(9) Second, rising costs have undoubtedly had an effect on expectations of quality, particularly among middle income earners, as developers have tended toward building dwellings of smaller size.

The housing problem in Canada, as perceived over the last three years, is clearly one of affordability in respect of continued and prospective homeownership and the availability of rental accommodation at reasonable cost. The causes of the affordability problem, if complex on close examination, are generally well known: a volatile real estate market in the late 1970's in metropolitan centres resulting in occasional periods of rapidly escalating housing prices; mortgage interest rates boosted substantially over the rate of inflation by monetary policy; and a high rate of general inflation which precipitated in most provinces politically expedient rent controls on older apartment dwellings, thus lowering the level of investment in new rental buildings.

Statistics on the unfortunate manifestations of the housing problem are abundant. Mortgage rates in 1981 topped 21%. While fifteen years ago, every other Canadian could afford to buy a house and to carry a mortgage for 30% or less of the family income, only three in ten people could manage the purchase in 1977. According to the Housing and Urban Development Association of Canada, the proportion of renters able to afford a home was 40% in 1971, and 6% in 1981, while the annual income required for a family to buy an average house now approached \$44,500, considerably above the average family income of \$27,000.(10)

The Canadian Press examined increasing prices over the eight years from 1974 to 1981 of a three bedroom bungalow, with brick and wood, aluminum or stucco siding, five to eight years old, one and one-half baths, one car garage, basement but no recreation room. The figures are instructive, at least for showing the wide disparity among various local housing markets (TABLE III).(11)

The cumulative effects of recession and high interest rates have been severe. There has been considerable dislocation among lower income earners whose mortgages have come up for renewal. Between June 1 and October 31 of 1982, just under 500,000 Canadian families renewed. In October of 1981, a leaked cabinet document suggested that 45,000 Canadians facing mortgage renewal in 1983 could lose their homes, and another 55,000 would have to remit more than one-third of their incomes after renewal.

Housing starts are dramatically off, and more seriously, the aforementioned deficiency in housing plans will continue to escalate long before housing requirements begin to drop off in the late 1980's.(12)

Of singular importance at the social (and by extension political) level, is the effect on the Canadian psyche as the dream of owning one's home -- so recently a mere matter of waiting and saving -- has vanished.

"SOCIAL RIGHT AND SOCIAL UTILITY"

In the course of the 1974 election campaign, Prime Minister Trudeau stated, "Every Canadian family is entitled to be housed in a healthy and satisfying environment. The national government has a responsibility to make this expectation a reality".

The statement, an important plank in a successful election campaign promoting the Just Society, followed by six years, a conference held by the Canadian Council on Social Development that concluded that decent housing at affordable cost is a social right. Although many now blame at least one of the symptoms of the recent housing malaise -- the loss of homes purchased by low income owners with assistance by the government during those halcyon days -- on elevated expectations created by such statements, government commitment to increasing homeownership is by no means new in Canada.

The first piece of federal legislation dedicated to improving housing was the Dominion Housing Act of 1935, aimed at reducing the need for second mortgage funds, then in short supply. The legislation was directed in no small way to the creation of new employment.

TABLE III

Prices of a three bedroom detached dwelling in thirteen cities from 1974 to 1981. Source: Canadian Press in London Free Press, September 19, 1981.

	DEC.74	DEC.75	DEC.76	OCT.77	OCT.78	OCT.79	FEB.80	OCT.80	FEB.81	JUNE.81
Vancouver	53,000	68,800	70,500	72,100	95,200	95,200	97,800	130,700	175,500	172,700
Victoria	52,000	62,000	64,000	64,000	63,500	74,000	79,500	105,000	120,000	140,000
Calgary	44,000	61,000	65,000	76,300	83,700	97,800	102,600	113,900	114,600	128,200
Edmonton	44,000	61,500	68,500	71,500	79,800	89,500	90,600	94,700	100,400	104,000
Regina	43,000	49,000	58,000	54,500	57,000	60,000	62,000	63,500	65,200	76,200
Winnipeg	41,000	46,500	51,000	56,000	59,800	62,200	62,300	63,250	66,400	71,200
Toronto	63,600	66,400	68,600	72,600	75,600	80,000	83,500	89,500	94,600	126,000
Ottawa	47,000	57,000	60,300	62,400	61,725	62,500	62,000	63,000	63,900	73,100
Montreal	35,900	38,300	39,700	41,800	41,400	48,300	50,900	58,100	63,100	69,900
Saint John	38,000	41,500	41,000	40,000	42,500	46,000	47,000	49,500	50,500	51,500
Charlottetown	34,000	38,000	40,000	43,500	44,500	51,000	51,000	55,000	55,000	58,000
Halifax	45,000	49,000	50,000	53,900	56,000	61,000	61,000	68,000	71,500	79,000
St. John's	44,000	45,500	43,800	45,800	49,400	55,250	55,250	65,500	68,250	73,000

A treatise on post-war housing policy in Canada would enumerate the various pieces of legislation, including provincial housing acts, perhaps starting with the creation of Central Mortgage and Housing Corporation in 1946. Such enumeration is beyond the scope and requirements of this paper, and would in any event be unrewarded by discovery of a clearly enunciated, long-term federal policy. According to Rose,

" . . . none of the various (federal, provincial or municipal) governments in Canada ever really came forward with a clear statement of their goals and objectives, courses of action and programs designed to attain these. There was no clear statement of what might be termed "federal housing policy", but a series of statements and pronouncements each year on the overall housing situation and, in particular, on the total number of dwelling units likely to be constructed, under construction and completed that year. Under the circumstances, the analyst can do no better than infer the most important elements of national housing policy from the enactment of legislation, the amendment of legislation and the encouragement or discouragement of various aspects of the total national housing program."(13)

Rose's inference:

"The best conclusion concerning National Housing Policy from 1945 through 1964 is that the Government of Canada was very strongly in favour of the attainment of homeownership by every family. This goal was enunciated from time to time in Parliament and in the speeches of federal ministers, particularly those responsible for the operation of a Central Mortgage and Housing Corporation."(14)

Rose adds that every encouragement was given the private sector -- the home building industry -- to mobilize its resources for efficient and expansive production; mortgage money was made available through the National Housing Act at lower than prevailing rates, down payment requirements were progressively slackened and amortization periods increased (from 15 years in 1946 to 30 years in 1969) "to enable lower income families to acquire a home of their own. In the implementation of this course of action, Canada was transformed from a nation of tenants to a nation of homeowners."(15)

Rose laments what he regards as the singular preoccupation on an administrative level with single family detached houses on vacant land, noting that, until the late 1950's, this was the only type eligible for NHA financing, to the exclusion of rental accommodation for lower income earners. It is with this in mind that he argues that housing must be looked upon as a "social utility" -- a commodity upon which all depend and for the provision of which society must take some responsibility. Such a view, as far as it goes, arguably holds claim to universal acceptance. Its chief implication -- that government should intervene to the extent necessary to meet housing needs -- has invited debate in terms of both levels of assistance, and the form (programs) and focus (tenure).

If there is consensus at all, it is that Canada has enjoyed considerable post-war progress in housing production, largely at the hands of the private sector whose efficiency was assisted -- and not replaced -- by government intervention through programs aimed at stimulating demand and increasing the availability of credit.(16)

Much of the assistance was, it is true, directed toward housing intended for owner/occupiers. Unquestionably, the momentum for production of owner/occupied dwellings has been sustained by a general disposition toward homeownership in Canada. Steele found from 1971 census data that 24% of household heads in their late 20's were owner/occupiers in large urban areas, and that the proportion rises to a peak in the 45 to 54 age group. The corresponding figure for the younger age group was considerably smaller in 1941, leading to the observation that "the implied great shift down in the age at first purchase is probably largely a consequence of the great liberalization in mortgage terms in recent decades."(17) (TABLE IV gives a ratio of rented to owned dwellings for different sizes of dwellings. Quebec has always had higher proportions of rental dwellings than the Canadian average.)

TABLE IV

**SELECTED CHARACTERISTICS OF URBAN-OCCUPIED
DWELLINGS IN CANADA AND QUEBEC -- 1971**

	CANADA	QUEBEC
Ratio of Rented to Owner-Occupied Dwellings	0.84	1.43
Ratio of Rented to Owner-Occupied Dwellings By Number of Rooms		
1 - 3	12.74	19.42
4	2.51	5.50
5	0.72	1.16
6	0.51	0.56
7	0.19	0.30
8+	0.16	0.16
Rental Dwellings Which Are Single-Detached, Single Attached or Duplex	44.3%	51.3%

Table Adopted from Marion Steele,
The Demand For Housing In Canada,
(Ottawa, Statistics Canada, 1979) p. 38
SOURCE OF DATA: 1971 Census of Canada

Here again, the phenomenon is quite consistent with demographic characteristics and economic responsiveness of demand to income. Income elasticity of demand for separate dwelling units is substantial for individuals under 30, and declines with age (and by extension declines with increasing income).(18) It is thus suggested that, other things being equal, household splitting, most predominant in the under 30 age group, will lessen in the 1980's vis-a-vis the 1970's.

THE UTILITY OF OWNERSHIP

Statistics aside, the disposition toward homeownership has seldom if ever been a cause of surprise among policy-makers and observers of the housing scene. In noting the lack of an organized system whereby lower income families could aspire to homeownership, the Hellyer Task Force on Housing stated:

"That they do aspire to it -- as indeed do most Canadians -- was one of the more unanimous impressions the Task Force evolved from its cross-country tour. It was enlightening, if not humorous, for the members to hear a continuous flow of "expert" testimony that future housing policies must be directed to the provision of multiple unit accommodation, largely on a rental basis, while group after group of ordinary citizens voiced a deep yearning to own a single family dwelling of their own. It became the practice of the Task Force at its public meetings with various groups, to seek a show of hands on this question. Invariably, the response indicated that at least 80% of those present wanted to own their own home, the same figure incidentally . . . obtained (in Toronto) in a more scientific sampling."(19)

There are several factors of a historical and current nature which seem to underlie the disposition toward homeownership. Perhaps most obvious is one that is rooted in the Canadian, indeed North American, psyche. Land has always been in abundance, and immigrants from countries of high population densities, where private ownership is not common, have looked upon North America as almost uniquely able to offer the opportunity for acquisition of useful land and the private home.

A closely related factor is summed up well by the Hellyer Task Force.

" . . . there continues to be widespread, if not universal, support for the time worn concept that a homeowner is a better citizen of his community and his country than a tenant and that to have one's roots in the soil of homeownership is to be stabilized against the vagaries and pressures of modern society."(20)

On balance, it seems likely that such a perception continues to be widespread. In citing this factor to justify the continued promotion of homeownership, one should take care to avoid spurious extension of the argument to a conclusion that places renters in a pejorative light (i.e. that renters are merely transients who have no particular stake in the community while homeowners, by virtue of their commitment to a large investment, are the backbone of the community). Some see this element of the issue as becoming even more prominent in the "housing dynamic" as the traditional homeownership preference is offset somewhat by increasing mobility, changes in tastes and lifestyles, as well, of course, as rising costs of homeownership (vis-a-vis rental costs, especially under regimes of rent controls).(21)

In more tangible terms, the homeownership decision has powerful attractions, as Steele has pointed out.(22) Ownership is in itself a "housing commodity" and thus confers utility. Ownership provides security and precludes eviction. The certainty of enjoying accommodation on a secure and inexpensive basis after a home is fully paid for is a powerful incentive. In addition, the quality single detached home with its attendant unique features is in the main only available through purchase, seldom through rental.(23)

Ownership confers absolute choice in maintenance cost decisions -- the tenant has little choice. Too, the tenant must pay the average operating and maintenance costs ("wear and tear"), and not precise user costs, as does the owner.(24) Homeownership, at least the single unit detached or semi-detached variety, provides a more amenable environment for raising children. While this factor might more logically follow upon the earlier discussion of widespread perceptions, it has an economic dimension; namely, there is a bias against renting to households with children, households that may impose higher costs to landlords than childless households.

Most significantly, Canadians have looked upon housing as an investment in three senses. Firstly, some tax advantage is received by investing in an owner/occupied dwelling in that the accommodation it provides is a tax-free return, as opposed to investing an equal sum in other types of investment, dividends from and sale of which are taxable. Secondly, homes represent a major and, in many cases, the only retirement asset among middle income purchasers. Thirdly, there has been a widespread understanding that acquisition of real property is one of the safest hedges against inflation.

The near universality of the perception is attributed to a predominant inflation psychology in Canada, but its validity is open to question. The real estate market is highly volatile and short-term boom bust cycles are common. TABLE V shows house price movements from 1970 to 1979 in comparison with the changes in the consumer price index for that period. It should be noted that the aggregate figures fail to reflect the important fact that while real growth in prices continued to occur in some metropolitan areas in the West after 1975, they were unchanging or declining in many other cities in that period. (Contrast this with the 1960's when housing prices rose more rapidly than the general price level, but less rapidly than disposable income.)

As in the early 70's, 1980/81 saw substantial leaps in prices in some centres. Nation-wide, the price of a typical new single detached house in the metropolitan areas rose by 12% in 1981 relative to 1980, with the highest local increase in Vancouver, mostly in the first quarter of the year (26%). By the last quarter of 1981, housing prices in Vancouver had dropped 16% below the first quarter level.(25) Housing prices in most metropolitan areas have continued to stabilize through 1983.

From another perspective, the dollar's purchasing power has been cut in half since late 1974. To offset this, in terms of inflationary benefit, the price of a house would have had to double, and most, even in the most volatile markets, have not. In point of fact, "real money can generally only be made by selling with adroit short run timing, and with flexibility enough to avoid the immediate necessity of purchasing new accommodation at equally inflated prices".(26)

T A B L E V

HOUSING PRICE MOVEMENTS FROM 1970 to 1979

YEAR	% CHANGE IN HOUSING PRICES	% CHANGE IN CPI	REAL GROWTH/DECLINE IN HOUSING PRICES
1970-72	17	8	+9
1972-74	21	19	+2
1974-76	21	23	-2
1976-78	26	16	+10
1978-79	8	9	-1

SOURCE: CMHC -- The Long Term Outlook for Housing in Canada, And Its Implications for the Residential Construction Industry (Discussion Paper, Ottawa, CMHC, 1980), p. 4.

It is fair to say that while the perception of homeowning as an inflation hedge may be on the wane, the other elements which make up the homeownership decision continue to exert powerful influences. The downside of inflation -- its effect on the costs of financing and the resulting impact on Canadians who aspire to homeownership -- will be further discussed below.

In conclusion, it is affirmed that decent housing is a social right; that government has a responsibility to foster the freedom among Canadians to choose the type of accommodation in which they wish to live; and that in response to the demonstrated aspiration of most Canadians to homeownership and to the difficulties that many Canadians have experienced in purchasing homes and in maintaining ownership, government must develop mechanisms to expedite production of housing stock and to ease the affordability problem.

CHAPTER II

MORTGAGES & AFFORDABILITY

The foregoing sections have given some indication of the several dimensions of the housing problem. The singular importance of housing costs (including maintenance and operating costs) to the household budget, and the negative effect that rapid escalation of costs has on the tenure and expenditure decisions are by now obvious. It is the purpose of this section to examine in some detail the problems of homeownership affordability and credit availability, in advance of proposing solutions.

It is clear that the heterogeneity of the housing commodity and ubiquity of consumption are the two characteristics that amplify the importance of the housing problem in recessionary periods. The housing industry is at all times an activity critical to the national economy. About 5% of the labour force is directly or indirectly dependent on housing construction. Through gross fixed capital formation, and its effect on demand for durable consumer goods, the housing industry accounts for upwards of 5% of the GNP. Residential construction expenditures nation-wide amounted to \$12.3 billion in 1981 (exceeding non-residential construction by \$700 million).(27)

The housing industry has been used as a tool in demand management policies for some obvious reasons which foregoing statistics reflect; the "product" is universally consumed; the industry is fairly labour intensive; it involves many different commodities so that spin-off effects are marked. Most significantly, the industry -- construction, sales and purchase -- is wholly susceptible to counter-cyclical monetary policy which, combined with inflation against which that policy is directed, has at various times had a severe impact on demand for mortgage funds by both purchasers and builders.

In this respect, 1981 was a signal year. In the effort to maintain the integrity of the dollar, the Bank of Canada followed U.S. interest rates closely, with the result that the prime rate charged by charter banks peaked at a record 22.75% in August, declining to 17.25% in December. The mortgage interest rates roughly paralleled these movements, with September's rate peaking at 21.46%, declining to 17.79%. The high levels and, as important, the uncertainty engendered by dramatic fluctuations were responsible for the substantial drop in mortgage commitments in 1981 (\$10.6 billion) vis-a-vis 1980 (\$14.5 billion), although lending rebounded in 1982 to \$12.2 billion.(28)

Several other features of the 1981 year are noteworthy. The mortgage commitment figure of \$10.6 billion represented 206,000 units. Trust companies, banks and loan companies and life insurance companies accounted for respectively 35%, 29%, 17% and 13% of lending. Commitments for non-residential construction declined by 12% to 77,000 units in 1981, but all of the decline was in conventional lending, while NHA lending for housing starts increased.

On the other hand, the share of NHA starts decreased as a proportion of total starts, due to the substantial increase in mortgage lending by non-institutional lenders: credit unions, pension funds and individuals. Fifty-seven per cent of total starts in 1981 were financed by the non-institutional sector versus 40% by institutions, with the balance of starts financed through public funding. Credit unions enjoyed a secular increase in their share of mortgage lending, owing to the attraction of relatively higher deposit rates and lower lending rates in this inflationary time.

It is interesting to note the increase in the banks' share (from 6.8% in 1971), a result of overcoming the regulation limiting mortgage loans to 10% of assets by creating subsidiary mortgage loan and investment companies. Both credit unions and banks have "filled the vacuum" created by the gradual withdrawal of the federal government from the mortgage market.(29) In 1982, banks superseded trust companies, becoming the biggest single group of lenders at \$3.9 billion for 85,000 units. See C.M.H.C. Canadian Housing Statistics 1982, p. XII.

Predictably, mortgage commitments for existing residences dropped by 60% in 1981 over 1980, as more purchasers assumed existing mortgages rather than negotiate new ones at current interest rates.(30)

In tandem with this purchase postponement effect, and abetted by a 10% drop in completions of multiple units, the vacancy rate for rental dwellings tightened to a level of 1.2% in October of 1981, the lowest since April of 1976.

The homebuilding industry was in that year, as it continues to be, quite heavily affected by high interest rates. Despite some mitigating effects of programs such as assisted homeownership plan, assisted rental plan, and MURB (now Canada Rental Supply Plan)(31), drops in housing starts translate into man-years lost in construction, construction dependent manufacturing and trade, and elsewhere in the economy due to the multiplier effect.(32) Housing starts continued to decline in 1982, to the lowest level since 1961.

One other supply side effect is noteworthy. Suppliers and labour desert the industry during the hard times, leaving a serious deficiency in capacity when the economy returns to any degree of prosperity. Consequently, lower cost of money will encourage new demand and restimulate pent-up demand, and with the shortage of supply, there may be serious inflation in housing prices, thereby benefiting homeowners contemplating sale and the reduced number of builders who have survived into the lean times. (This is one of two obvious manifestations of a tendency, prevalent in housing, to transform increased demand into elevated prices rather than greater supply. Another, and far more intractable effect, is land cost inflation, the inevitable consequence of the fact that increased demand for houses in preferred locations doesn't increase the number of locations available as new house sites; it inflates the prices of existing houses.)(33)

AN OVERVIEW OF THE MORTGAGE INSTRUMENT

An examination of housing in the 1950's, such as that undertaken by the Economic Council of Canada in 1973, shows five periods in that decade when housing starts declined substantially.(34) The study concluded that instability in housing starts was directly related to instability in the economy, as supply of mortgage funds seems to be related to the business cycle.

During economic expansion, funds are bid away from housing construction and, at the cycle's peak, starts begin to decline. As growth slows, funds become freedup for new residential construction. At times when the Bank of Canada has been contractionary, having observed strong demand pressures in the economy (as in 1957) or when combatting inflation, the tightening mortgage markets have been eased somewhat by government lending activity. Institutional and legislative changes through the 1950's and 60's (changes to the NHA, increased activity by CMHC, increased participation of banks) have at various times expedited mortgage origination.

In a comparatively few years, the mortgage instrument has undergone changes made inevitable by inflation and the disposition toward homeownership. Inflation in the 1960's and 70's favoured homeownership. While the prices of existing homes increased, mortgages at fixed rates kept the cost of money low. Until 1969, the term of NHA insured loans always equalled the amortization period; for single family homes, the period was between 25 and 40 years, for rental residences, the maximum term was 40 years. In the words of one American commentary:

"Appreciation in housing values combined with the subsidies granted to homeowners and cheap credit made homeownership a particularly attractive hedge against inflation. But while inflation magnified the benefits of investing in housing, it also raised the cost of credit by diminishing mortgage lenders' purchasing power on returns from fixed mortgages. When the competition from high yielding money market funds forced Savings and Loans to pay higher interest rates to savers . . . lenders simply raised their interest rates on long-term mortgages and other types of loans.(35)

This argument applies equally well to Canada, despite substantial differences in tax treatment of home purchasers; the exemption in 1972 of principal residences from capital gains taxes positively affected the shift to owner/occupier dwellings. At the same time, rental investment was partly discouraged by application of capital gains taxes, cost of capital, and imposition of provincial rent controls encouraging the shift on the supply side to owner/occupied dwellings.(36)

While one risks belabouring the point, it is important to understand the distinction between the relationship of inflation to the "pre 1970 mortgage instrument" vis-a-vis inflation/recession and its current effects on homeowners. The Economic Council of Canada in 1976 analyzed the 1969 to 1975 inflationary period and its effect on assets, of which homes are the most common.

The ECC cited then current statistics; three of four middle-aged families, 70% of retired people, and less than one-third of families under 35 years of age owned homes. Eighty per cent of higher income families and 50% of the lowest income families owned homes. The vast majority of these families acquired their homes through conventional mortgages. During this period, their debt load was substantially affected by inflation, in that the real values of fixed debt repayments declined. Thus, young families in mortgage debt were favoured over older people "whose savings are being used through financial intermediaries to finance their debts".(37) (For an evaluation of the "tilt effect" in conventional mortgages, see Box Page 27).

The rapidity with which five year term mortgages gained favour after regulations of the NHA were changed in 1969 is noteworthy. At the time, trust companies and banks were especially receptive to the idea, in that many liabilities had five year terms. But the shortening of the mortgage term -- the advent of the roll-over mortgage -- was a product of risk aversion and the demand for shorter term deposits. In effect, it was an attempt to shift some of the burden of inflation-induced risk from lender to borrower.

The culmination of the process has been the introduction of the variable rate mortgage. In use for some time in Britain and parts of the United States, V.R.M.'s were introduced to Canada in November of 1981 by the Canadian Imperial Bank of Commerce. Fixed monthly payments over a term of as long as five years are negotiated by the homeowners with 30% equity or more. As the prime mortgage rate varies over a term, the interest differential is added to or subtracted from the principal. Features include a lower penalty for prepayment, and a graduated payment option to allow mortgagors in later years to accelerate payment via 10% increases in monthly payments. (The effect resembles that of the graduated payment mortgage which, by reducing mortgage payments in early years of homeownership and increasing them in later years, brings total costs into sync with income stream over a homeowner's lifetime.)

The V.R.M., only one of several new mortgage instrument proposals, is seen as the most appropriate to the structure of capital markets and to the realities of volatile interest rates. Stated Robert Keller, Vice-President of Victoria-Grey Trust;

"If more borrowers opt for V.R.M.'s, that would free up a significant amount of three and five year money which is extremely difficult for lenders to attract these days because depositors want much shorter terms."(38)

There are problems with the V.R.M. of course. Interest is calculated on a monthly basis, unlike V.R.M.'s in the United States where the period is every six months. This poses problems for prospective homeowners when comparing the V.R.M. with conventional mortgage loans.(39) There is little uniformity of detail among any plans offered by trust companies and banks. There is also no agreement upon the preferred interest rate, since preferences will vary among the various lenders with different asset and liability structures.

Most significantly, however, is the aspect of risk sharing, as lenders can sustain a profitable spread between borrowing and lending rates under the V.R.M. regime.

As well as having a positive effect on institutions like trust companies, variable rate mortgages may foster the growth of a secondary mortgage market. The investment characteristics of V.R.M.'s, versus fixed rate mortgages, particularly in terms of the protection of the real value of the stream of income accruing to V.R.M.'s, favour such a development. One source suggests that the inflation hedge that V.R.M.'s provide may attract investors such as life insurance companies and pension funds, which have heretofore found higher yields on loans in other sectors.(40)

Other noteworthy innovations have been proposed in both the United States and Canada (See Box on Page 25).

What is clear in this evolution of the mortgage instrument is that the effort to attract funds to meet continued and assured high demand has been unceasing. This, it is suggested, is quite in accordance with the realities of the market, an increasing propensity for expenditures on shelter, and a high propensity for savings in Canada. As CMHC states;

"There is little basis for believing that there will be higher mortgage rates in Canada for reasons internal to the mortgage market itself. Canadians have one of the highest rates of personal savings in the world . . . over 10%, yielding some \$17 billion annually. Mortgages have become a preferred investment for security at competitively high rates of return and constitute about 45% of the capital market in Canada. In the past five years, there has been little trouble in raising upwards of \$14 billion for first mortgage loans on between 400,000 and 500,000 new and existing dwellings each year.(41)

Innovations have not been without costs. The five year roll-over mortgage, developed to stabilize supply of funds, has had significant and occasionally punishing effects on individuals from the cost and cash flow point of view.(42) Variable rate mortgages softened the blow somewhat for purchasers, but if the result is a reduction in term to periods less than that required to construct a house, builders who prefer to pre-sell houses may be unable to offer financing at a guaranteed rate.

GOVERNMENT RESPONSE TO THE 1981 AFFORDABILITY CRISIS

In the face of the affordability crisis for homeowners in 1981, the federal government responded with budgetary measures of a "stop-gap" nature. Provisions in the November, 1981, and June, 1982, Budgets were designed to lend assistance to homeowners in the celebrated "dire straits" of renewing mortgages at 20 plus percent rates of interest. The June Budget announced new initiatives aimed at further assisting homeowners, ensuring the availability of rental accommodation and boosting a depressed construction industry through incentives to first-time homebuyers. Resulting programs included the Canada Mortgage Renewal Plan, a Home Renovation Plan, the Canada Rental Supply Plan and increased allocation for non-profit and corporate housing.

Offsetting somewhat the positive political impact these budgetary measures had was the addition to the November Budget of a White Paper, which made reference to massive federal tax expenditures, including several billions of dollars lost to the Treasury through non-taxation of imputed rent. The concept -- that homeowners receive an advantage in the tax treatment of the housing service which their investment provides -- is arguably logical in the context of Canadian (and other nations') tax structures. But, as evidenced by the outcry it provoked, the concept is inimical to society for which homeownership is an admired aspiration as well as a struggle.

NEW APPROACHES TO MORTGAGE LENDING IN THE U.S.

ADJUSTABLE MORTGAGE LOANS (AMLS) AND ADJUSTABLE RATE MORTGAGES (ARMs) are offered by savings and loans associations and banks, respectively, and have monthly payments with variable interest rates tied to prevailing market rates.

VARIABLE RATE MORTGAGES (VRMs), the first kind of flexible rate mortgage offered in this country, had relatively tight restrictions. They were superseded by AMLs and ARMs.

RENEGOTIABLE RATE MORTGAGES (RRMs), the second type of flexible mortgage developed, also were superseded by AMLs and ARMs.

BALLOON. A fixed-rate loan where the balance is due in a lump sum at maturity, usually in three to five years.

ROLLOVER. Renewal of a loan to extend the term. It is often used to put off payment of a balloon note.

GRADUATED PAYMENT MORTGAGE. Monthly payments start low and gradually increase to a fixed level according to a specified schedule.

GRADUATED PAYMENT ADJUSTABLE MORTGAGE. This is the same as the graduated payment mortgage, except after the graduation period interest rates vary with prevailing rates.

BUY-DOWN. The builder of a home pays the lender in advance to reduce the interest the borrower has to pay on the mortgage, usually for the first one to five years.

SHARED APPRECIATION MORTGAGE (SAM). The lender offers a mortgage at below-market interest rates in return for a portion of the property's appreciation.

EQUITY PARTICIPATION AGREEMENT. A home buyer and third-party investor share in the property's appreciation in return for the investor's help in paying the down payment, monthly payments or both.

ASSUMPTIONS. A buyer "assumes" or takes over from the seller the existing debt on a property. These mortgages usually have extremely low, fixed interest rates.

SECOND MORTGAGE. A loan, usually provided by the seller, to cover the difference between the selling price of a home and the balance on an existing assumable mortgage. Most second mortgages have terms of three to five years requiring a balloon payment upon maturity and have interest rates below the market rates for new first mortgage loans.

WRAPAROUND MORTGAGES combine an existing mortgage with a new loan, to cover a home's selling price minus the down payment. This is an alternative to a second mortgage.

At the same time, considerable press was given to allegations that bank profits have recently been excessive, the unhappy and unacceptable consequence of counter-cyclical monetary policy and a great number of homeowners who faced mortgage renewals at very high interest rates.

In addressing all of the related questions in the report which the issue brought about, the Standing Committee on Finance, Trade and Economic Affairs took note of the frequent suggestions that banks be required to reduce mortgage rates to the level of inflation, on the theory that some of the substantial bank profits could be used to finance such a reduction. The obvious question as to whether mortgagors should be thus subsidized by borrowers, depositors and shareholders of the banks, or by the government was raised but not addressed.(43)

But it was suggested that such an action in the highly competitive money market would drive trust companies out of business, as they would need to similarly reduce mortgage rates, but would be unable to finance the reduction from premium interest - varying savings and term deposits. The realities of the admittedly imperfect, but still competitive marketplace, preclude this or similar proposals, the Committee asserted.

Of most recent interest to the mortgage market and the aspiring homeowner has been the White Paper accompanying the June, 1982, Federal Budget, entitled, "Inflation and the Taxation of Personal Investment Income". The subject of a special study by a Committee headed by Bernard Lortie, the report addressed inter alia, the impact of inflation on access to finance in the housing industry, the tilt effect -- so painful in inflationary periods -- as well as dampened effective demand due to uncertainty. Passing reference was made to the effect of restrictive monetary policy on mortgage rates.

One proposal for a solution involved the development of new interest-bearing debt instruments. The principals of long-term deposits could be periodically adjusted to reflect decline in purchasing power. Real interest would accrue by market competition. Only the real interest would be taxable. Corresponding funds would be made available as loans to, among others, home-buyers and small businesses under similar conditions: periodic adjustments to the nominal outstanding principal with real interest accruing thereon at a rate set by contract.

Although well set out on a theoretical level in the White Paper, shortcomings in the design were recognized, both implicitly in the White Paper and by the Committee following it up. Still, the Committee reported favourably on the possibilities for shielding investment income from the ravages of inflation through some form of indexation. On the potential for similar treatment of mortgages, it was not so sanguine.

In the final analysis, the Committee was not enthusiastic about the prospect of such a transformation of the mortgage money market, distortions which could result, and the problems of adaptation that would be forced upon financial intermediaries, borrowers and lenders.

A NOTE ON THE TILT EFFECT

The "tilt" effect of traditional five-year rollover mortgages is seriously enhanced in an inflationary environment. Conventional level premium mortgages involve a sizeable burden of carrying costs in terms of payments to income ratio in the early, i.e. younger years of the homebuyer vis-a-vis the later years, when income has increased. As Table VI shows, the tilt problem exists without inflation, but is greatly magnified in its presence.

It should be noted that it is the real and not the nominal rate of interest that best reflects carrying costs of ownership with fixed rate five-year term mortgages. The homebuyer gains if the expected inflation rate which has been factored into the contract, falls short of the actual rate at which prices of houses, other commodities and cost of capital rises. While this remains as true today as in 1977, the rapid rise in both inflation and money cost have focussed attention in the years since on the burden of mortgage renewal at high nominal rates of inflation.

These increases were also instrumental in shortening mortgage terms with the effect that the inflationary risk to lenders was lowered. Risk was correspondingly raised for the borrower and, in return, shorter term mortgages bore lower rates of interest. The tilt problem, so pronounced in the last few years, has been addressed by innovations such as the VRM and GPM described in the paper.

T A B L E VI

PATH OF CARVING COSTS OF MORTGAGE FINANCE IN
NON-INFLATIONARY & INFLATIONARY CLIMATES

	Year	Annual Payment(\$)	Income(\$)	Payment/Income(%)
(A) NO INFLATION	1	2,602	20,000	13.01
	5	2,602	22,081	11.78
	15	2,602	26,917	9.87
	25	2,602	32,812	7.93
	30	2,602	36,227	7.18
(B) INFLATION AT 6% (Nominal Interest=11%)	1	4,601	20,000	23.01
	5	4,601	29,336	15.66
	15	4,601	63,443	7.25
	25	4,601	136,970	3.36
	30	4,601	201,253	2.29
Basic Income = \$20,000/Annum Income Rises - at 2%/Annum Reflecting Real Productivity Increases in the Economy Mortgage = \$40,000 Real Interest Rate = 5% Amortization Period = 30 Years				

FROM: James E. Pasendo, The Impact of Inflation on Financial Markets In Canada
(Canadian Economic Policy Committee, C.D. Howe Research Institute, 1977)

THE INFLATION-CAPITAL AVAILABILITY PROBLEM

The argument for setting up structures which will enhance affordability of homeownership and protect the mortgagor from the punishing effects of countercyclical monetary policy is made with the conviction that homeownership is a desirable social goal. That said, it is of some vital importance to appreciate the characteristics of housing, of housing demand, and the effects of inflation and anticipated inflation before proceeding with any policy that involves homeownership promotion and wholesale fiscal changes directed thereto.

The point has been made that a house is the single largest investment that most Canadians acquire. It is the preferred method of saving and is perceived as a good investment in the short or long terms. Even in the absence of policies such as mortgage interest and property tax deductibility -- an inviolate tax expenditure in the United States -- the capital gains tax-free nature of home sale has considerable attraction for those who may roll equity into new, better and more spacious housing, and more important, for older citizens who may sell their houses for alternate more suitable accommodation without tax penalty.

It has also been suggested that inflation in recent years has had a powerful effect on the home purchase decision. The high leverage inherent in the conventional mortgage instrument meant that the home buyer, having made a relatively small down payment, may realize rapid real returns to equity during inflationary periods. As Downs has pointed out, anticipation of inflation in the late 70's caused millions of householders in the United States to rush to buy homes, thus inflating housing prices at greater than overall price increases.(44) But ironically, he notes, increased prices did not dampen demand as economic theory predicts; rather they increased demand by people who expected continued inflation.

Taken to an extreme, the widespread perception that homeownership is a useful hedge against inflation or will speed accumulation of capital, can lead to results which are undesirable in the context of the accepted social goal of affording people the opportunity to own their own homes for ownership's sake. The most obvious undesirable effect is over-investment; the acquisition of more space than is actually required for the household.

One other cautionary note from CMHC; a lessening rise in house values and rising home maintenance and operating costs, particularly energy costs, could damage investor confidence in the mortgage instrument as funds are directed to safer investments.

CHAPTER III

A RECAPITULATION

By way of summary, and before proposing a long term, two-stage solution to the affordability problem, we may re-iterate some observations and draw tentative conclusions.

Homeownership, a trend that has been growing since World War II albeit with the encouragement of federal and provincial governments, continues to hold a great attraction for Canadians for several important reasons; attainment of stability within a community; provision of an environment suitable for raising a family; peace of mind afforded by the protection from eviction; a source of savings; a preferred investment free from capital gains tax; an inflation hedge; and enjoyment of the housing service over whose maintenance and operating costs the owner has full control.

Residential construction, both owner-occupied and rental, is a major sector in the Canadian economy employing substantial labour and capital and involving significant linkages to other sectors. At present, it is institutionally integrated with Canadian capital markets and is affected by counter-cyclical monetary policies.

The tilting problem -- an early high ratio of carrying costs to income -- is abetted by high rates of inflation and has been a considerable burden on mortgagors under five year term conventional mortgages. Government action has addressed the problem through subsidies to low and middle income home buyers, allowing them to purchase without spending excessive portions of their income. The AHOP is an example, but the recent rise and fluctuation in interest rates had devastating impacts on beneficiaries whose mortgages came due.

Financial intermediaries have on the whole adapted well to changes in market conditions. Most institutions such as trust companies have managed to match maturity of deposit liabilities with mortgage assets. Nevertheless, mortgage instruments, notwithstanding recent innovations and government subsidy, continue to be subject to daunting carrying costs increasingly associated with inflation and monetary policy.

Some of the public and private policy approaches to immediate problems of affordability have been described. Clearly, however, there is a need to develop new arrangements, or refine existing ones, to effect the desired stabilization of residential construction and home acquisition over the long term.

The policy proposed in the 1979 election campaign by the Progressive Conservative Party was a first step in changing the institutional arrangements, i.e. tax structure, to this end. Mortgage interest deductibility and property tax credit were questioned by critics both as to the cost in tax expenditures and the equity of promoting home acquisition for middle income earners while allegedly neglecting lower income groups and renters.

APPROACHES IN OTHER COUNTRIES

It is instructive to examine the experience of tax subsidies in other countries where housing has been subject to significant government intervention. The United Kingdom is an especially interesting case. Before 1963, an individual taking out a loan for home purchase -- often from co-operative credit institutions called "building societies" -- could offset interest and repair costs against tax payable on imputed income associated with living in the house (i.e. housing services or imputed rent), which imputed rent had been taxable since 1925 according to a set schedule. One source has described this (more clearly than most Canadian sources at the time of the controversy over imputed rent in 1981) as:

A notional market rent the owner received from himself as a tenant and . . . was thus treated for tax purposes as both landlord and tenant.(45)

While imputed rent was thus taxable, interest costs of all personal borrowings for purposes of purchasing shares and stocks could be set against income received as dividends. The co-existence of tax relief for "investors" in both houses and stocks, along with the taxation of imputed rent, apparently obviated any controversy regarding housing subsidies.

However, in 1963, Schedule A, prescribing taxation of imputed income, was abolished for reasons of its imperfect -- i.e. aged -- base. This action seemed to undercut the basis for deducting interest payments on mortgages as expenses incurred in earning imputed income. Furthermore, in 1974, tax relief on personal borrowings for investment was eliminated except for housing.

These developments -- exemption from imputed rent and preferential tax relief -- led to allegations that homeowners were receiving subsidies vis-a-vis both renters and individuals investing in other sources of income. It should be noted, however, that in 1967 Britain introduced an option mortgage scheme which was intended to provide a benefit in the form of a straight interest subsidy to those mortgagors who paid little or no income tax against which they could set interest costs of a standard mortgage. Thus, the basic rate taxpayer was put on equal footing with the mortgagor whose income was at a level that allowed him to enjoy the standard tax relief.

While it may be true, as Stafford claims (46), that there is an economic logic to taxation of imputed income representing housing services, (and that the benefit to British homeowners of foregoing the tax far outweighed the cost in tax expenditures to the Exchequer, eg. £190 million versus £48 million in 1963) it would seem obvious that political considerations are of great importance in this regard, since homeowners in Britain and indeed, Canada, are less than receptive to the idea that, having purchased a house, they should be taxed on the services the house supplies. In addition, in the case of Britain's Schedule A, the admittedly undervalued level of taxation on imputed rent was, in 1963, more than offset by household expenditures on repairs and maintenance; most homeowners were in fact exempt from Schedule A.

Political considerations aside, one must ask the question of how effective are such financial aids as tax subsidies on production of housing. Lansley notes that:

There is little doubt that the level of investment in housing (in Britain) has been greater than it would have been in the absence of these financial aids (and that) the population is therefore better housed than would otherwise have been the case.(47)

Further, the British Government has continually taken the view, as put forward in the 1977 Green Paper on Housing that "continuance of mortgage tax relief and option mortgage subsidy is vital to the growth of homeownership", especially in the face of continuing rent controls which have discouraged investment in dwellings for rental.(48)

There are some key issues of progressiveness and effectiveness in tax aids. The tax relief of which we are speaking is a demand subsidy which can, but need not have a positive effect on supply. In Britain between 1968 and 1974, mortgage tax relief doubled but the value of new housing supplies fell by 14%.(49) Real increases in housing prices, increases in interest costs, and, as important, use of tax relief by other than first time buyers account for much of this disparity. In other words, a wide application of demand incentives for owner/occupied may promote faster transfers of existing housing stock, disproportionate increases in housing prices, and over-investment by homeowners (purchasing accommodation in excess of need) and, at the same time, may have a near negligible effect on new supply.

In addition, stock of private rental accommodation can decline (as in Britain) with declining demand for rental dwellings as owner/occupied demand is encouraged. Clearly, a government not politically locked into large scale institutionalized subsidies (as are the governments of Britain and the United States, where two of three voters benefit from homeowner subsidies) would want to draft tax incentives to maximize the positive effects -- increased supply and restrained inflation of housing prices -- and minimize negative effects such as under-occupation (over investment).

Of equal importance (and of relevance to recent Canadian election campaigns) tax relief for homeownership, which takes the form of a tax deduction, can have questionable equity effects. The absolute value of relief will rise with income level, even as relief falls as a proportion of average income. A uniform tax credit on the other hand would conspicuously aid lower and middle income earners while discouraging, to a degree at least, those of more substantial means.

It is worth noting that, despite the obvious attention successive British Governments have paid to housing and finance for housing, post-war national housing policy is judged by some as less effective than in other European countries.(50)

Both Labour and Conservative Governments emphasized production of high volume, but through different means; the former initiating public enterprise via local authorities and sustaining publicly subsidized rental housing; the latter promoting private investment in single family owner/occupied dwellings, with continued subsidization for publicly-owned housing in certain areas. The significant shifts in policy as one party succeeded another in power, and the sizeable long term burdens that each in its own way placed on the Exchequer are among the reasons that post war housing policy with respect to production has been relatively unimpressive.(51)

West Germany's post war housing policy was from the beginning fully consistent with national economic objectives of encouragement of private sector investment through tax incentives and "fiscal control of inflationary tendencies".(52) High volume annual production was consistently pursued through the 1950's as succeeding legislation was passed to allocate low interest public loans for social housing and to develop tax subsidies that could lure funds into the mortgage market. Sweeping tax measures allowed for deduction of loans for mortgages from taxable income by corporations and individuals in the year in which the (interest-free) loans were granted.

The First Capital Development Law of 1952 exempted from taxation interest income earned by corporations and individuals on loans paying between 5% and 5.5% for social housing. Tax subsidies, says Wendt,

Proved a powerful instrument for channelling private funds into the second mortgage market at relatively low interest rates. The encouragement offered to savers through income tax subsidies contributed to the overall national objective of controlling inflation and provided an indirect form of capital rationing.(53)

The program was not, of course, without cost. In a significant period of housing growth -- 1948 to 1957 -- it is estimated that the Federal and Lander Governments sacrificed DM5.2 billions in tax revenues (income and property/real estate). But the successful attainment of the objective is reflected in money channelled into the mortgage market; it amounted to DM18.2 billions, or over half of the private savings devoted to the market in the period 1950 to 1956. To those who look askance upon the magnitude of the tax expenditures, Wendt states,

It is difficult to defend the view . . . that the total amount of income tax credits allowed represented a net loss to federal and state governments since the subsidized housing investment undoubtedly contributed to the total taxable income in the nation.(54)

The fact that Germans are now slowly decreasing investment in housing is testimony to the long term success of the national program. But what is more important is the past and present mechanisms affording Germans the ~~opportunity to save for future mortgage commitments, which savings can be used for the initiation of productive investments elsewhere in the economy.~~ In an article that suggests Americans, who unlike Germans and Canadians are not particularly noted as a nation of savers, should be shifting money away from mortgages and into other investment sectors, the Christian Science Monitor described the West German Bausparkasse savings institutions.

Bausparkassen lend money to prospective home buyers through savings contracts. Depositors agree to put aside a specified amount at a low interest rate, in return for a future mortgage commitment at a guaranteed rate of interest, which in the late '70s was 4.5 to 5%. In addition, various government incentives -- premiums over and above the interest rate -- mean a total return on a saver's funds of up to 28% per year, tax-free, providing a high inducement for people to save toward the purchase of a house.(55)

It is safe to say that the saving habit, and tax policies and institutions affecting it one way or another, are of primary importance in maintaining stable, desirable levels of investment in housing and other sectors.

The Monitor article points out that two out of every three American voters benefit from homeowner (demand-based) subsidies, making it "politically impossible to eliminate (the subsidies) totally." While it is not suggested that total elimination would be desirable from a purely economic point of view, the article describes an example of the anomalies that can result.

The after tax interest on a 1979 mortgage of 10% was 6%. Since inflation meant the money the homeowner paid out monthly was declining in value by at least 10% a year, the real interest rate was -4%. Moreover, Americans do not pay taxes on the profits they make as investors by renting their homes to themselves. Under these circumstances, it is little wonder that housing demand was stimulated far in excess of any potential to increase supply, driving up prices for new and existing homes.(56)

Where does Canada fit into a three-way comparison with Germany and the United States? As savers, we are, like Germany, on the high side. In 1982, the personal savings rate, as a percentage of personal disposable income, was 12% versus 6% ten years ago, and 3% twenty years ago.(57) The U.S. saving rate has hardly changed for twenty years, ranging in various years from 4% to 7%. This contrast is partly attributable to the difference in orientation of the respective tax systems (deduction of interest from taxable income in the U.S., versus various and sundry saving instruments such as R.H.O.S.P. and R.R.S.P. in Canada) and partly due to putative pessimistic views on future economic growth.

Canada as a nation is arguably much closer to the United States in terms of our propensity to over-invest in homes, although rising energy and maintenance costs have tempered the demand for, and supply of new stock of large houses.

At the same time, the country will undoubtedly require considerable pools of capital to pursue industrialization and particularly energy projects in the 1980's. The development of opportunities for individuals to purchase homes, and the provision of funds via mortgages to the residential home building industry, must take account of these factors.

A PROPOSAL FOR SAVINGS-MORTGAGE AGREEMENTS AND HOMEOWNERS' BONDS

One mechanism that might prove useful in marshalling into the mortgage market savings of individual Canadians aspiring to homeownership is a two-phase savings and mortgage agreement. These "packages" would be sold through financial intermediaries -- both banks and thrifts. Here is how it might be made to work. An individual who plans to buy a first time home some time in the future would agree to deposit specified, but not necessarily equivalent amounts each year over a term period, perhaps five years. The institution would pay interest on the amount at a rate substantially less than that paid on premium savings accounts. An appropriate yearly contribution maximum, not tied to earned income, would be set by tax authorities, since, as with the R.H.O.S.P., the contribution would be deductible from taxable income. Interest accruing to the cumulative deposit would not be taxable, provided the funds were eventually used to purchase a home.

The institution would, in return, arrange a mortgage at a guaranteed rate of interest as a function of the return realized on the accumulating deposit in the interim. The elements of the subsequent mortgage agreement -- term and limits of interest increases -- would be a function of the size and term of the deposit.

The fundamental difference between this scheme and the current R.H.O.S.P. would be the savings/mortgage agreement which would trade off a measure of interest income earned by the deposit for reduced risk of higher mortgage rates at and after the time of purchase. Depending on how attractive the term deposit appeared to the saver, considerable amounts of money could be drawn into the mortgage market. Nevertheless in times of high or increasing interest rates, housing supply could be seriously constrained. A supply subsidy could, at such a time, be useful in relieving pressure on the housing industry.

Such a subsidy could take the form of a reduced rate on income earned by institutions as interest, at a lower than prevailing rate, on loans to builders of houses intended for owner occupancy and rental. This mechanism would be a slight variation of the small business development bond, and might also be considered useful in affording a measure of protection in a high interest environment to institutions locked into savings/mortgage agreements with homeowners at the predetermined (i.e. agreed upon) mortgage interest rates.

The recent experience with the Small Business Development Bond has not been a particularly edifying one. As a budget measure intended to protect small businesses in the threatening period of 1980 to 1982, the mechanism proved only as effective as the banks administering it were co-operative, and many complaints reached Members of Parliament that the banks were reluctant to become involved with it.

As an alternative to, or precursor stimulant for, the savings/mortgage agreement outlined above, a system similar to the SBDB, could be the object of a reincarnated Mortgage Exchange Corporation. Legislation for such a corporation was passed by Parliament in 1976, (but never proclaimed), in an effort to stimulate the growth of a secondary mortgage market.

It is suggested that the time is ripe for the creation of the corporation, which could issue "homeowner's bonds" under roughly the same terms and conditions as outlined for the savings/mortgage agreement. These bonds could be purchased by individuals proposing to acquire downpayments and mortgages for homes in the future. At the same time, this instrument would draw savings into the corporation which would stimulate the secondary mortgage market and provide the incentive required for banks and trusts to engage in savings mortgage agreements.

These parallel mechanisms, involving primarily private sector capital with government participation restricted to an incentive or "seeding" role, could be made as versatile as deemed necessary to meet the objectives while keeping the capital markets relatively free of distortion. A particularly interesting possibility is that savings/mortgage agreements and homeowner bonds could be purchased by say, parents, for the express purpose of passing them along to children at a predetermined age. In such a case, the tax advantage enjoyed by the purchaser would be at a level appropriate to the fact that the funds were deposited for a specified minimum term and would be available to the recipient solely for the purpose of purchasing or building a principal residence.

There are obvious pitfalls of an administrative and fiscal nature to any scheme which seeks to guarantee affordability over long periods. Financial intermediaries would have to adapt to what initially would be a short-term distortion in capital markets. However, if the experiences of other countries, where similar innovations have been quite successful in providing housing, such distortions should not prove unmanageable.

It is suggested that, with careful planning, such mechanisms could be integrated into the existing mortgage market without it suffering from undue flight of capital. Indeed, with such structures as the M.E.C., the fear that mega projects in the '80s would bleed away mortgage money, creating a housing investment shortfall, should be lessened.

Tax expenditures are of particular concern to governments with high and increasing deficits. There is no attempt here to estimate the revenues that governments would forego through these mechanisms. There is no reason to suppose, however, that these foregone revenues would not be substantially offset by revenues arising from increased and stabilized housing investment as happened in West Germany in the 1950's. Too, the funds drawn into the secondary mortgage market need not be restricted to private housing. Where required, they could prove a source of financing for social housing as well.

In the final analysis, systems such as the ones outlined here could be put in place which mobilize the savings of Canadians toward a market in which most, now or in the future, wish to participate.

More important, such systems could by definition ameliorate the effects of relatively sudden and dramatic reverses in interest rates on owned shelters, unarguably one of the primary concerns of all Canadians.

NATIONAL HOUSING ACT (1951): - government assumes responsibility for setting interest rates on N.H.A. mortgages

NATIONAL HOUSING ACT (1954): - joint mortgage lending: government guarantee of loans made by approved lenders so that C.M.H.C. assumed role of mortgage insurer rather than lender

- banks permitted to make and trade C.M.H.C. insured loans

[In 1959, N.H.A. maximum interest rate is raised above 6% for the first time, causing banks, which have been statutorily forbidden to charge more than 6% on loans, to withdraw from the mortgage market.]

BANK ACT (1967): - 6% ceiling on bank loans removed

- banks permitted to make conventional loans, but amounts restricted on any individual mortgage to 75% of value of property

[Subsequently, the 75% restriction was lifted so that "high ratio loans" could be made, provided excess was insured by a registered mortgage insurance company.]

NATIONAL HOUSING ACT (1973): - loans to individuals and municipalities for rehabilitation or upgrading of old houses and neighbourhoods respectively

- increased assistance to cooperatives and incentives for promotion of sale and rental housing

NATIONAL HOUSING ACT (1978): - permitted N.H.A. insurance on graduated payment mortgages

F O O T N O T E S

- (1) Wallace F. Smith, Housing: The Social and Economic Elements, (Berkeley: University of California, 1970), p. 10.
- (2) F.G. Dennance, S.W. Hamilton, David Baxter, It's Your Move, (Vancouver: University of British Columbia, 1976), p. 2.
- (3) Ibid.
- (4) Albert Rose, Canadian Housing Policies, 1935 - 1980, (Scarborough: Butterworth & Co., (Canada) Ltd., 1980), p. 186.
- (5) Ibid.
- (6) We may note the recovery in 1981 which reversed a four year contraction in housing starts. CMHC explains that "the miniboom in the first half of 1981 was brought about primarily by the erosion of consumer resistance to mortgage rates in the 15 to 16 per cent range and speculative buying in several large markets. However, in the second half, sagging consumer confidence resulting in large inventories and flat or falling housing prices were very much in evidence." CMHC, Canada Housing Statistics, 1981, (Ottawa: CMHC, 1982), p. 1.
- (7) Ronald Anderson, "Canadians Well-Housed But Standard is Falling," Globe & Mail, (February 18, 1982).

Put another way, only 0.63 of a house was added to national stock for each new household in 1981, compared to 0.98 in 1976, approximately 1 in 1961 and 1.52 in 1921. Financial Times, (May 31, 1982).

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- (8) Influences on supply of and demand for housing are discussed in some detail in the paper. Suffice it to say at this point that, on the supply side, it has been shown that the construction industry is quite responsive to demands placed on it for new housing, although a six to nine month lag exists between additional demand and corresponding starts. Availability and cost of mortgage funds are also important factors. Housing shortages in the physical sense have been known in Canada in the past, but the aforementioned demographic characteristics, as well as an increasing tendency among households to inner city residential ownership will restrain demand. Parenthetically, we may note Wallace Smith's denunciation of the justification for deep subsidies for middle-income purchasers of new homes in the United States:

Housing commentators in the United States are fond of producing data which show that new housing is priced beyond the income of most of the middle-income population as well as the lower-income group. It is nonsense to conclude that middle income households require housing subsidies, because this group finds its housing primarily in the existing stock of dwellings. Indeed, the ordinary homebuilder's reason for not trying to build homes for the lower-middle income group is that he cannot compete with the used housing market where such families get substantially more for their housing dollar.

(In Irving Welfeld "That Housing Problem: The American vs. The European Experience." in George Sternlies (ed), Housing, 1971 & 1972: An AMS Anthology, (New York: AMS, (1974), p. 62.

Needless to say, in this, as in all references to the American scene, comparisons to Canada must take account of the respective tax structures which heavily influence acquisition and sale of houses.

- (9) See F.G. Dennance et al, p. 2.
- (10) "New Home Market Worst in 20 Years," Ottawa Citizen, (May 20, 1982).

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- (11) London Free Press, September 26, 1981.
- (12) Some experts regard as the central problem our preoccupation with current problems seen as interest rates, mortgage foreclosures and inflated building problems to the exclusion of the medium term problem of a steadily mounting backlog of housing requirements, especially in rental accommodation. See Halifax Chronicle Herald, (March 20, 1982).
- (13) Albert Rose, "Housing Policy in Canada, 1940 - 1968," in Michael Wheelander (ed) The Right To Housing, (Proceedings of the Canada Conference of Housing, 1962), p. 82 - 83.
- (14) Ibid., p. 85.
- (15) Ibid. Quebec is the exception, where there has always been a pronounced preference for rental tenure in large urban areas.
- (16) Randall White, (in "The Political Theory of the Shelter Allowance Concept" unpublished paper prepared for CMHC, Ottawa, 1981), gives the following corporate statistics for the proportion of housing starts undertaken by private builders in the early 1970's: United States, 98%; Canada, 87%; West Germany, 67%, United Kingdom, 54%; Sweden, 39%; France, 35%. White's paper is recommended for its concise and thoughtful treatment of the shelter allowance issue and, in particular, the "supporting political theory which can be developed on the basis of recent strains in both right-wing and left-wing thinking."
- (17) Marian Steele, The Demand for Housing in Canada, (Ottawa: Statistics Canada, 1979), p. 20.
- (18) Ibid., pp. 21, 88.

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- (19) Report of the Federal Task Force on Housing and Urban Development. (Ottawa: Queen's Printer, 1968), pp. 15 - 16.
- (20) Ibid., p. 17.
- (21) "Pride of ownership" and the resulting sense of social responsibility appears to be a central concern in promoting assisted home ownership policies. It has been suggested that a rigorous adherence to the argument presupposes that a suburban home and garden is the aspiration of the average Canadian. In acknowledging the increasing trend to inner city habitation among middle income earners, and the recent popularity of condominium ownership, one might agree with the notion that pride and sense of community may and does exist in the rehabilitated homes of large Canadian cities among both renters and owners.
- (22) Marian Steele, p. 36; c. 6, passim.
- (23) Single unit dwellings are apt to be rented on a short term basis by absent owner-occupiers.
- (24) Marian Steele, p. 37.
- (25) Canadian Housing Statistics, 1981.
- (26) Jack McArthur, "Some Hard Lessons in Money Management," Toronto Star, July 1982.
- (27) Canadian Housing Statistics, 1981, p. 18.
- (28) Ibid., p. X, and Canadian Housing Statistics, 1982, p. XII.
- (29) House of Commons, Standing Committee on Finance, Trade & External Affairs, Bank Profits, (Ottawa: Queen's Printer, 1982), Chapter 5.
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- (30) Canadian Housing Statistics, 1981, p. 10.
- (31) HUDAC reported in May of 1982 that the deficiency in rental starts was considerably less than the disparity between ownership starts and requirements. See HUDAC, "Housing Fact Sheet," (submission to the Government of Canada), May 1982.
- (32) Ibid.
- (33) Roger Montgomery, Dale Rogers Marshall, (eds.) Housing Policy for the 1980's, (Toronto: D.C. Heath, 1980), p. 10.
- (34) Cited in James E. Hatch, The Canadian Mortgage Market, (Toronto: Queen's Printer for Ontario, 1975), p. 14.
- (35) Jean Rosenblatt, "Creative Home Financing," Editorial Research Report, (October 1981), p. 795.
- (36) Economic Council of Canada, Two Cheers for the Eighties, (EEC Annual Review, Ottawa, Supply and Services Canada, 1979), p. 19. An interesting manifestation of this effect was the rush to sell multiples as condominiums, "a new form of tenure particularly suitable to the inflationary seventies, as it brought homeownership within the financial reach of many Canadians."
- (37) Economic Council of Canada, The Inflation Dilemma, (Ottawa: Supply and Services Canada, 1976), p. 20.
- (38) "Variable Rates on Mortgages Held Necessary," Globe & Mail.
- (39) The VRM is quite similar in effect to the Variable Term Mortgage which would reflect the interest rate differential in the extension of the amortization, a mechanism quite agreeable to the homeowner who is much more concerned with the size of monthly payments than with the number to be made over the long-term.

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- (40) See Richard G. Mareis, "Variable Rate Mortgages: Their Use and Impact in the Mortgage and Capital Markets," George Steinlies, (ed) Housing, 1973 - 74: An AMS Antology, (New York: AMS, 1976), pp. 56.
- (41) CMHC The Long Term Outlook for Housing in Canada, and its Implications for the Residential Construction Industry (Ottawa: CMHC, May 1980), pp. 2 - 3.
- (42) The "tilt" effect -- the skewed pattern of mortgage amortization -- is discussed in the paper, and in considerable detail in Jonathon R. Kesselman, "Mortgage Policies for Financial Relief in Inflationary Periods", Canadian Public Policy (Winter 1981), p. 82 - 93.
- (43) Standing Committee on Finance, Trade and Economic Affairs, Bank Profits, p. 130.
- (44) M. Downs, "Too Much Capital for Housing?" The Brooking Bulletin: (17:1, Summer 1980), p. 2.
- (45) D.C. Stafford, The Economics of Housing Policy (London: Croom-Helm, 1978), p. 81.
- (46) Ibid., p. 82.
- (47) Steward Lansley, Housing and Public Policy, (London: Croom-Helm, 1979), p. 133.
- (48) Ibid.
- (49) Ibid., p. 134.
- (50) Paul F. Wendt, Housing Policy: The Search For Solutions (Berkely: University of California, 1963), p. 241.
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(51) Ibid., p. 240.

(52) Ibid., p. 231.

(53) Ibid., p. 232.

(54) Ibid., p. 237.

(55) Bruce Stakes, "To Finance Housing in the '80s: Invest Less," Christian Science Monitor, (January 14, 1982).

(56) Ibid.

(57) "We Suffer From Too Much Thrift," Financial Post, (October 23, 1982).