A Housing Solution

The Question Of Equity

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Part 2: A challenging environment

Global banking rule changes since the Great Recession:

In most G20 countries right now, housing ownership participation rates are in the mid-60 percent range and along with the introduction of common banking rules following the 2008 credit crisis, these countries' national housing finance systems also look fairly similar at a high level. Strangely, at odds with what Singapore [link to Part 1] has achieved, the G20 countries are all missing large-scale, free-market, institutional sources for funding housing *equity*.

Many countries have publicly traded REITs (Real Estate Investment Trusts) for all kinds of income-producing real estate - from shopping centres to offices, to apartment communities, etc. but none of them have established universes of publicly traded housing equity funds to provide supplemental down payment capital for home purchasers.

A high-priced under-insured market?

As of January 2024, it required $114,600 in household income for a family to qualify for a mortgage on a 700 sq. ft one-bedroom condo in Victoria [costing $500,000] - whereas a family that is moving into that same home as part of a purpose-built rental apartment building needs only $70,000 to comfortably afford the rent.

The Canadian Mortgage and Housing Corporation (CMHC) provides the lion's share of the nation's mortgage insurance and securitized loan portfolio guarantees. As an organization, the CMHC is vital to the proper functioning of Canadian real estate markets and the ability for hundreds of thousands of Canadians to be able to purchase a home.

What is strange to see, is a government-guaranteed organization that is so profitable from what it charges for the insurance needed to cover claims. In 2022, the total premiums and application fees shown on CMHC statements amounted to $1.43 billion, and it only had $78 million of insurance claims. One of the highest dollar value of losses claimed in the last 15 years, in fact, was $334 million in 2016, a year in which the agency collected $1.5 billion in premiums.

It appears the conservative policies of the CMHC are effective as a business because the organization has made enough profit to consistently pay $400 million or more in taxes back to the Canadian government annually, which coincidentally has been more than the insurance claims each year. The CMHC could and maybe should take on more risk, especially if the result is that more Canadians are able to qualify for insured financing.

What is even more strange is that the total value of the mortgage market being insured by the CMHC has been shrinking for the last 7 years. The sum of guaranteed mortgages both directly insured by the CMHC and those CMHC guarantees through the Canada Housing Trust reached $964 billion in 2016. By 2022, that total had shrunk to $870 billion, but on an inflation-adjusted basis using CPI, it is now only 75% of the amount insured and guaranteed in 2016. If the CMHC is insuring 25% less on an inflation-adjusted basis, this means that the impact the CMHC is having on the market is even further reduced given the greater-than-inflation rise in home values since 2016.

Most home purchasers and mortgage brokers would agree that the bar everyone jumps over to be approved for a CMHC-insured mortgage has risen along with home prices since 2016. It’s heartbreaking for many families to be turned away and feel underserving of a home in a country they were born in.

While the housing industry in Canada depends on the CMHC, and the organization does a tremendous amount of good for Canadians overall, there are several signs that new and additional solutions are needed.

The WestJet example of success at lower price points:

An interesting Canadian example of a business success story that changed the game is that of WestJet’s early years. They followed in the footsteps of Southwest Airlines by changing a few key factors of the business model, dropping the entry price threshold, and financially succeeding with higher seat occupancy.

WestJet showed that by “tunnelling under the cost barrier”, an airline could be profitable while offering lower fare prices. The airline started with a single aircraft type, point-to-point routing, and an employee share ownership program instead of a defined benefit pension plan. WestJet then offered flights at lower prices which opened up air travel to a brand-new market segment.

Instead of struggling after cutting fare pricing, WestJet went on to become the most profitable airline in Canadian history. The lesson here is that new business models that make a handful of changes in the way a product or service is delivered to customers can offer that service to whole new segments of the population with more affordable pricing.

For the housing development and finance markets, a similar strategic combination of a few profit centers could open up the housing market to a whole new segment of home buyers.

A new approach could combine the economics of mortgage insurance (being defacto self-insured), housing finance revenue (rents and interest), and development profits (building and selling homes). Following in Singapore’s footsteps, we could see an all-new cost/risk model emerge for the housing markets that allows people to start with a smaller down payment without taking on dramatically higher monthly payments. Home buyers could access equity substitutes to offset taking on traditionally more risky levels of debt.

In part 3, a new category of solutions for housing finance will be described, along with a plan for its widespread adoption.

Read Part 3 Here: **https://ahouseshared.ca/part-3-onwards-and-upwards/**