A Housing Solution

The Question Of Equity

A Housing Solution, The Question of Equity

Part 3: Onwards and Upwards

Shared Equity housing:

One fundamental problem of dealing with social challenges is "scale", as Harvard professor Michael Porter addresses in his TED Talk on why business can be effective at solving social problems.

In the case of finding a solution to the housing crisis, the "scale" of the down payment needed for home-buying is the most critical part of the problem. It's easy for people to become disheartened by the numbers.

Michael Porter believes that businesses are by far the best suited to create resources, rather than governments or charities. Business is built to create resources that meet societal needs at a profit, which leads to taxes, incomes, and charitable donations. “That profit is the magic,” Porter says.

Profit allows for the solution to be scaled by orders of magnitude, and for the business to access the capital markets, which in the case of housing, is the fundamental difference that provides a pathway to an ultimate solution. Porter closes by calling for business to change their self-perception and realize that social value and economic value can be created together.

The category of solutions that most excites me, and that I believe has the best chance of moving the most Canadian families towards the dream of home ownership, is a model of “shared equity” agreements. Shared equity agreements are contracts, that can be secured by a charge against the title to the home, which provide the family living in the home an economic share of the increase in the home’s value, even if they aren’t the registered owner of the home. These agreements have the potential to achieve a form of Nash Equilibrium between a landlord and tenant (referring to Nobel prize-winning economist John Nash depicted in the movie A Beautiful Mind). This would mean that both monthly savings and a share in the home equity growth are provided in exchange for looking after the home like an owner would. This alignment of interests and the pride of ownership saves a landlord on property management and maintenance, along with providing a financial benefit, in exchange for the "sweat equity” that a home buyer builds.

For more details on key terms and further understanding of “shared equity housing,” see my book titled, ~~A House Shared~~.

A fundamental principle of shared equity housing is that the equity funding provided doesn’t create an increase in the monthly payment or raise the effective interest rate used for financing the senior debt portion of the property. The purchaser’s growth in equity is realized from the eventual sale of the home.

The other differentiating factor with shared equity is that, unlike rent-to-own programs, the purchaser does not need to ultimately qualify for a conventional mortgage to gain a benefit (many rent-to-own programs require completion of the contract with a mortgage qualification, or the purchaser loses the benefit or even loses the money they put into the contract).

Our housing markets tested the limits of the benefit of increased access to debt in the form of home mortgage financing during 2006 and 2007, which led up to the credit crisis. In 2006, more than 100% of the purchase price for a home could be borrowed. Surprisingly, the rate of homeownership participation only went up by approximately 2%, from 65% to about 67%. That “test” was great proof that debt isn’t the entire solution, leaving us with the need to pursue equity-based solutions rather than trying to pursue Singapore’s level of homeownership through more elaborate debt funding innovations.

We need to have equity options available for would-be home purchasers to accelerate their ability to accumulate the needed down payment to the point where it is easier to qualify for mortgage financing. Until they do, they shouldn’t have to qualify for mortgage financing at all - just like tenants who are moving into an apartment. This solution takes into account the current average amount of savings that a family accumulates each year (see the table in the appendix).

Singapore has aligned its housing construction fund with a fund for assisting buyers with accumulating down payments. This model of alignment is desperately needed in Canada and the U.S.

We need “equity funds” that finance housing development and shared equity agreements for home purchasers. These new equity funds can start and function at a smaller scale with a handful of in-house development projects and evolve to fund third-party developments, bulk home inventory acquisition, and the acquisition of homes being re-sold through traditional MLS networks. The equity funds can take on a larger scale of home buying at tighter spreads as their cost of capital decreases with a greater asset base.

For example, a transition to becoming an institutional grade-rated bond issuer, or having their common equity added to more broadly traded stock indices, would give them a low enough cost of capital to pursue a broader funding program.

These new equity funds can and should achieve competitive market returns while going through this evolution, and attract the capital they need without relying on government subsidies. However, one way that the Government of Canada and the CMHC could support this process is by creating a mortgage insurance program for portfolios of single-unit residential properties that mirrors the programs they have for insured mortgage financing on apartment buildings. This would dramatically reduce the cost of senior mortgage financing for these new housing equity funds, even at lower loan-to-value maximums than what is currently available on multi-family apartment buildings.

As one or more funds start to reach a significant scale, other positive benefits can be realized from a publicly traded equity interest in the housing market. In his book Macro-Markets, Robert Shiller, the Nobel laureate who also co-created the “~~Case-Shiller Home Price Index~~,” describes inventing a hedging instrument on the value of homes which would allow banks, insurance providers, and most importantly, homeowners to protect themselves from any significant negative changes in the value of their home. By allowing more forms of investment into the housing market, there could be more equity capital that flows in to provide greater liquidity, supporting more housing development and, in turn, more families beginning shared equity agreements.

Matching deserving families hoping to become homeowners with homes that developers are building, in ways that make moving into the home rewarding and financially comfortable, allows developers to absorb the homes they develop faster and reduces their risk. The increased speed of absorption and reduction of risk would enable developers to venture out and acquire more land and start more home development projects therefore creating supply faster to catch up with unmet housing demand.

What follows is an ideal progression that would allow for a small housing equity fund organization to grow without suffering from a lack of "economies of scale".

"The Plan" - a progression to achieving widespread housing equity:

small

1. Seed/Launch one housing equity fund

2. Establish a greater track record and data set for the performance of shared equity agreements.

3. Evolve the variety of shared equity agreements to encompass a "full life-cycle" of home buying steps from a small amount of savings through to comfortably qualifying for current conventional financing options.

large

4. Scale a housing fund to maturity with an institutional bond rating and participation in relevant equity indices.

5. Develop an "Operating Model" policy set framework that can be shared with other would-be housing fund management teams to see several funds established so that as an industry, enough capital is deployed to transition a greater portion of households towards ownership.

multi-country

6. Translate the housing equity fund model into other developed countries' national housing finance systems.

Through scaling and implementing diverse forms of housing equity funds, the housing market can progress towards allowing millions more to enjoy the ability to grow their home equity.

As the funding sources for housing evolve from primarily focusing on debt programs to also including a full range of equity options, we can begin to envision a future where home ownership becomes an achievable choice and not an out-of-reach privilege for the average person.

P.S. - For greater housing supply…

“Shared equity provides a financial solution to level the playing field in housing, leaving home size and building permit approval speed as remaining challenges.”

With Houston’s “no zoning” restrictions, there’s always a home available:

Given our current situation, we need more funding for all kinds of housing development, along with much faster building permit approval timelines. A great example of no-zoning process with quick permitting can be found in Houston, Texas, where it takes only 90 days for building permits to be approved. Compare that to the minimum turnaround of 18 months for most Canadian cities and other American cities, and even longer for multi-storey buildings on land that is not already zoned for that use.

In Houston, apartment vacancy rates have historically stayed above 5%, keeping housing options readily available. This is because whenever demand increases, developers can meet it right away.

Adapting to rising construction costs, increased density with land constraints:

As the housing market adapts to inflation’s effect on construction prices, homes are becoming smaller to keep sale prices in line with purchasers’ buying power, given the current mortgage qualification requirements and interest rates. If the mortgage qualification process further reduces the price points for which purchasers can obtain financing, it will only force more families to move into smaller, high-density housing types.

In South-Western BC (Victoria, Vancouver, and Kelowna) and the Greater Toronto Area, with the huge area of green belt restriction zones and agricultural protection covenants means cities have now reached their horizontal expansion limits. With no more room for these cities to grow outwards, housing types are becoming denser, higher, and inevitably, smaller. With the worldwide population forecasted to reach its peak in the next 80 years, if enough capital is deployed and given enough time, eventually we will be able to construct comfortably sized homes for everyone along with enough variety of multistorey building sizes in each city.

Appendix

The below chart shows the time needed for millennial couples to save a down payment given the 4.4% national average household savings level:

Rank	City	Median Income/Millennial Couple	Average House price	Minimum. Down-payment amount	Years to save (20% of income)	Years to save (4.4% of income)
#1	West Vancouver	$72,390	$2,541,300	$508,260	35	160
#2	Vancouver	$72,390	$1,416,729	$283,346	20	89
#3	Oakville	$67,880	$1,074,230	$214,846	16	72
#4	Burnaby	$72,390	$1,137,924	$227,585	16	71
#5	North Vancouver	$72,390	$1,134,400	$226,880	16	71
#6	Richmond Hill, ON	$67,880	$1,033,754	$206,751	15	69
#7	Richmond, BC	$72,390	$1,031,900	$206,380	14	65