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INSTITUTE OF  
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*CHRA ACHRU*

## **BUILDING ASSETS THROUGH HOUSING**

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## TABLE OF CONTENTS

I. Introduction .....	1
II. Home prices and the financial impact of purchasing a home .....	4
III. When is a home a good financial investment?.....	8
Scenario 1 .....	9
Scenario 2 .....	11
Scenario 3 .....	13
Implications of the scenarios .....	16
IV. Options to assist low-income home ownership .....	18
1. A second mortgage with deferred repayment .....	18
2. Shared equity with deferred repayment .....	20
3. Shared equity with rental payments.....	23
4. Shared equity with ‘staircasing’ up to sole ownership .....	24
5. Sale with ‘right of first refusal’ at a pre-established price.....	25
6. Rent-to-own .....	26
7. Forgivable grant to purchaser .....	27
8. Forgivable grant to builder/renovator .....	28
9. Repayable interest free loan to purchaser .....	28
10. Assisted savings plans.....	30
11. Sweat equity and donated labour/materials .....	30
12. Land trusts.....	31
Assessing the program models .....	32
V. Conclusion .....	34
Appendix A: A partial inventory of Canadian initiatives to assist low-income households to own homes .....	37
Affordable New Home Development Foundation (Saskatoon).....	37
Calgary Community Land Trust Society (Calgary).....	37
Central Edmonton Community Land Trust (Edmonton).....	38
Centretown Affordable Housing Development Corporation (CAHDCO) .....	38
Colandco Co-operative Homes Inc. (Ontario).....	40
Communauté Milton Parc (Montréal).....	40
Community Housing Land Trust Foundation (Vancouver).....	40
Fair Gains & Owen Hart Homeowners Program (Calgary) .....	40
Habitat for Humanity Overview 2004 .....	41
Home Ownership Affordability Partnership, Hamilton (HOAP) .....	41
Independent Living Accounts Demonstration Project (ILA) .....	42
Manitoba Homebuyer Down Payment Assistance program.....	42
Options for Homes (Toronto) .....	42
Quint (Saskatoon) .....	44
Regent Park redevelopment (Toronto) .....	45
The Royce – Dupont project (Toronto) .....	46
Region of Waterloo.....	46
West Broadway Community Land Trust (Winnipeg).....	47
Winnipeg: Housing IDA Program .....	47
Bibliography .....	49

# I. Introduction

In dozens of cities across Canada, the last few years have seen middle class homeowners spellbound by the dizzying spectre of escalating prices for homes in their neighbourhoods. Today, some homeowners find themselves sitting on, or *in*, substantial wealth; seemingly far beyond the amount they could have accumulated by saving a few dollars every month. Anecdotal reports of ordinary families with assets worth a million dollars and more have fuelled the perception that the road to riches runs through owning a home – for example, a recent story in the *Globe and Mail* begins “Neighbours have been abuzz since an Annex semi recently sold for \$1.4 million.” [*Globe and Mail*, 15 April 2006, M1].

Is this gravy train real? And, if so, can lower income Canadians also hitch a ride? The purpose of this paper is to answer these questions by:

- 1) Assessing whether home ownership is a reasonable financial strategy for low income Canadians to increase their savings;
- 2) Describing current initiatives to assist low income Canadians to own a home; and
- 3) Assessing the extent to which these initiatives are effective in helping low income Canadians increase their savings.

Of course, increasing savings is not the only possible policy objective for encouraging home ownership. In addition to enabling low-income families to increase their net assets, other objectives [adapted from Maxwell 2005] could include:

- A better quality of housing for lower income families;
- Improving family functioning, pride and social participation for low-income Canadians;
- Increasing the overall supply of affordable housing; and
- Creating viable, healthy mixed-income and mixed-tenure communities.

It may well be that owning a home is a good or bad financial decision, but that the financial rational should be outweighed by other more important considerations, such as these. When discussing current initiatives to assist low income home ownership, these other objectives will also need to be noted; however, weighing alternative objectives is not the role of this paper. Here we are focused solely on home ownership as a financial strategy.

Why the focus on savings?

Net assets – that is, savings and wealth – have become a more frequent topic of social policy, especially in the United States since the 1991 publication of Michael Sherraden’s book: *Assets and the Poor: A New American Welfare Policy* [Sherraden 1991]. Previously, analysis had focused almost entirely on income in any given year, paying little attention to the accumulation of assets. Sherraden argued that a range of policies were in place to assist middle and upper income families to accumulate wealth, such as tax free savings through registered pension plans, and, in the US, the deductibility of home mortgage interest payments, but that

programs for the poor were designed only to provide annual income. Sherraden advocated creating savings programs for low income families to supplement income subsidy programs. These new savings programs would allow less well-off families to accumulate wealth which they could use for education or purchasing a home.

More broadly still, social policy evaluation and design in Canada has increasingly adopted what has been called a ‘life course’ perspective [see Policy Research Initiative 2004]. Rather than looking at the effect of social policy just at a moment in time, a life course analysis takes account of effects over the whole lifetime. In asking whether the acquisition of a home increases lifetime net assets, we are in step with a life course perspective. However, in adopting a life course analysis, we would want to know not only whether home ownership increases lifetime wealth, but whether home ownership increases well-being.

Of course, it does not follow axiomatically from a ‘life course perspective’ that anything which increases financial savings is better than alternatives which do not. It may be, for example, that sacrificing current consumption while children are young in order to build savings, which will only be realized when children are older, *does* increase savings, but foregoing needed expenses when children are young may also be the wrong thing to do and diminished lifetime well being may be the overall result. In short, more saving is not necessarily always better than more spending, and increased lifetime wealth is not synonymous with increased lifetime well-being.

When and whether to encourage increased savings among low-income Canadians is a substantive unanswered policy question. At least some partial answers will be provided to this question when the results of the current *learn\$ave* social experiment are available, but this will not be for some time. [See Kingwell et al. 2004 for a discussion of early results.] Consequently, we are not, in this paper, in a position to answer the larger and prior question of whether increased savings among low-income Canadians are a ‘good thing.’ Rather this paper confines itself to analysing whether home ownership does indeed offer a route to increased savings for low-income households, and whether programs to encourage and assist low-income home ownership are likely to increase savings over and above what might be accomplished through alternative expenditures of the same public or charitable funds – where such funds are spent.

The next section of this paper, following this introduction, is a review of historical and economic trends regarding home prices and the financial consequences of buying a home. In this section we look at the cost of housing in Canada and three regional markets, and compare the housing price increases to the Consumer Price Index. We also discuss existing research regarding housing as an investment.

The third section of the paper presents the results of a financial model developed to assess home buying as a financial investment in the Canadian context. It looks at the savings resulting from, on the one hand, home purchase or, on the other hand, from renting and investing an equivalent amount. The model allows us to see under what conditions purchasing a home does result in additional savings. We analyse the financial consequence of purchasing a home in Canada in three periods: 1986 through 2005; 1991 through 2005; and 1996 through 2005. The financial model is unavoidably complex, involving many inter-related calculations. We have

attempted to keep this work in the background and present the results as clearly and simply as possible, while at the same time making all the assumptions clear. Despite this, the explanations are sometimes complex and will call for some perseverance.

The fourth section of the paper describes and assesses current initiatives to assist low-income households to own a home. It turns out that there are a plethora of program models in Canada and internationally. In Canada, these programs are mainly small and limited to a few projects in a few locations. This dispersion perhaps reflects the nature of affordable housing development in Canada. While allowing for a healthy measure of innovation and local adaptation, the large number of small programs makes it difficult to learn from one another. In fact, as best as we have been able to determine, the present paper is the first systematic, comprehensive description of programs of assistance for low-income home ownership in Canada. [Connelly Consulting Services (2004) have a partial list and a useful classification that has been helpful to this paper, although their list does not attempt to be comprehensive.] A review of programs of this nature internationally did not uncover any models used in other countries (with one exception) not being used in some form in Canada. No doubt, this paper misses several models being used somewhere in Canada or elsewhere, for which we apologize in advance.

Given the lack of prior research this paper necessarily spends much effort just in setting down each model and explaining how each works. We have tried to use the same simplified numerical example that is used in the preceding analytic section; namely a \$100,000 home purchase. We assess each of the program models, where possible using some of the analytic techniques developed in the previous sections. The assessment is strictly from the perspective of increasing savings among low-income families. Quite apart from the other purposes of this paper, reviewing the program models could be of some practical and immediate utility to developers of affordable housing, including government planners, in assisting them to decide whether there is a way to construct an assistance plan for prospective low-income home purchasers and, if so, what model they wish to use.

Finally, the paper concludes with some general observations following from the previous sections.

## II. Home prices and the financial impact of purchasing a home

There has been surprisingly little research on the utility of housing as a *financial* vehicle for low-income households. Among the sparse selection of research, the most thorough analysis was done in 2002 in the US, when the Brookings Institution and Harvard University's Joint Center for Housing Studies wrote a series of research papers centred on the specific issue of low-income home ownership as a savings strategy. In *The Financial Returns to Low-Income Homeownership* Belsky et al undertake a rigorous economic analysis of low-income housing markets in Boston, Chicago, Denver and Washington from 1983 through 1994. They conclude that:

“...given the considerable number of years during the study period when renting was a better option than owning over a variety of shorter holding periods, the constant drum beat for expanded low-income homeownership should be carefully and discriminatingly evaluated.

Low-income homeownership has a lot of appeal especially for those who intend to remain in their homes for a long time, but it also entails substantial risks. Faced with a choice of investing small amounts of money in other ways such as Treasuries and indexed stock funds or investing the same amount in housing on a highly leveraged basis, investing in a home is undeniably attractive, though perhaps not the ideal risk diversification strategy. The payoffs can be huge and favor homeownership asymmetrically to the payoffs from renting, especially if the owner defaults rather than covers the full loss on the home. This is largely because few low-income people are able<sup>1</sup> to make other investments on such a leveraged basis.” [Belsky et al 2005 pp 17-18]

As Belsky et al note, a house is a highly leveraged investment: a down payment of 5 percent can leverage a loan of 95 percent of the value of the home. Like any highly leveraged loan, this works wonders when the rate of appreciation of the investment is greater than the interest rate on the loan – 10 percent appreciation on an investment with a 5 percent interest rate on the loan used to pay for the investment can double your money in a single year. For example, a \$100,000 home appreciating at 10 percent will gain \$10,000 in value. If the interest on the loan to buy the house (the mortgage) is 5 percent and the down payment was \$5,000, the homeowner's equity will have more than doubled in a single year, ignoring all the other complicating factors for a moment. This is the power of successful leveraged investment.

But if the house depreciates, the leverage works in reverse. For example, if the home depreciates 1 percent, with the other conditions the same as in the previous example, the homeowner's pays \$4,750 interest and loses \$1,000 in value of the home: effectively totally wiping out the value of the down payment and ending up with \$750 in the hole in one year. This is the danger of leveraging, and it is why banks will not make loans for leveraged investments to ordinary people (Enron and the like seem to be exceptions) unless there is solid security to back

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<sup>1</sup> In the original text, Belsky et al actually say “...few low income people are *unable* to make other investments...” (italics added here). We assume this is an error and have corrected it.

up the loan – indeed, that is why a mortgage is usually the only leveraged investment low-income or even middle-income households ever make, since it is backed up by the security of the house.

Leveraged loans are very sensitive to small changes in rates. If the prevailing interest rate is 3 percent and the rate of housing price appreciation is 5 percent, the homeowner with a 95 percent mortgage is doing very well. But a 2 point percentage rate increase in interest rates combined with a 2 percentage point decrease in the rate of housing appreciation translates into a 4 percentage point net change. Suddenly the homeowner is paying 5 percent on a huge loan and gaining only 3 percent on the capital asset that the loan has purchased.

Of course, this example is highly simplified: the mortgage holder is also getting a home to live in and other benefits, property tax has to be paid, otherwise there would be rent, and so on. These factors are built into the modelling in the next section; however, the critical point here is that buying a home may be a risky financial proposition for a low-income household, which would likely only be able to accumulate a single asset – the house – with no diversification, and have a very low down payment, so end up with a highly leveraged single asset. Unless the investment was a sure bet, this is not a financial strategy that would ordinarily be judged prudent.

So how do house prices actually perform over time? Is the investment a sure bet? In fact, we have all experienced the volatility of home prices and rapid changes in interest rates, particularly those of us who lived through the early 1980s with its 18 percent mortgages, and the precipitous crash in house prices in some cities in the 1990s. However, hard data on house prices needed to confirm this anecdotal information is not easy to obtain. Canada does not have an index that reflects ordinary house purchases, most of which are sales of older homes; rather most research on housing prices in Canada uses the New Housing Price Index<sup>2</sup> that reflects the selling price of *new* homes. The cost of homeownership is included in the Consumer Price Index, but this is a composite of several costs (e.g., property tax) and only partially reflects the price of purchasing a home. Despite the limitations of the New Housing Price Index, it is likely the best proxy available for a house price index.

Figure 1 shows the rate of change<sup>3</sup> in the New Housing Price Index compared to the Consumer Price Index (CPI) for Canada as a whole, and for three regional markets: the province of Newfoundland, and the cities of Winnipeg and Vancouver. These regions were selected to illustrate different types of markets in Canada. As we can see, over the long run, change in house prices more or less track the CPI, although house prices are subject to much greater

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<sup>2</sup> “The New Housing Price Index (NHPI) is a monthly series that measures changes over time in the contractors' selling prices of new residential houses, where detailed specifications pertaining to each house remain the same between two consecutive periods.” From Statistics Canada, New House Price Index: Definitions and Data Sources. <http://www.statcan.ca/> The alternative house price index is the owned accommodation or the replacement cost component of the Consumer Price Index. These series are both very close to the New Housing Price Index and do not make any material difference in the results presented here.

<sup>3</sup> Graphs showing the levels of indexes are sometime provided, but the absolute value of an index has no meaning in and of itself. It is the ‘rate of change’ that can be compared across indexes.



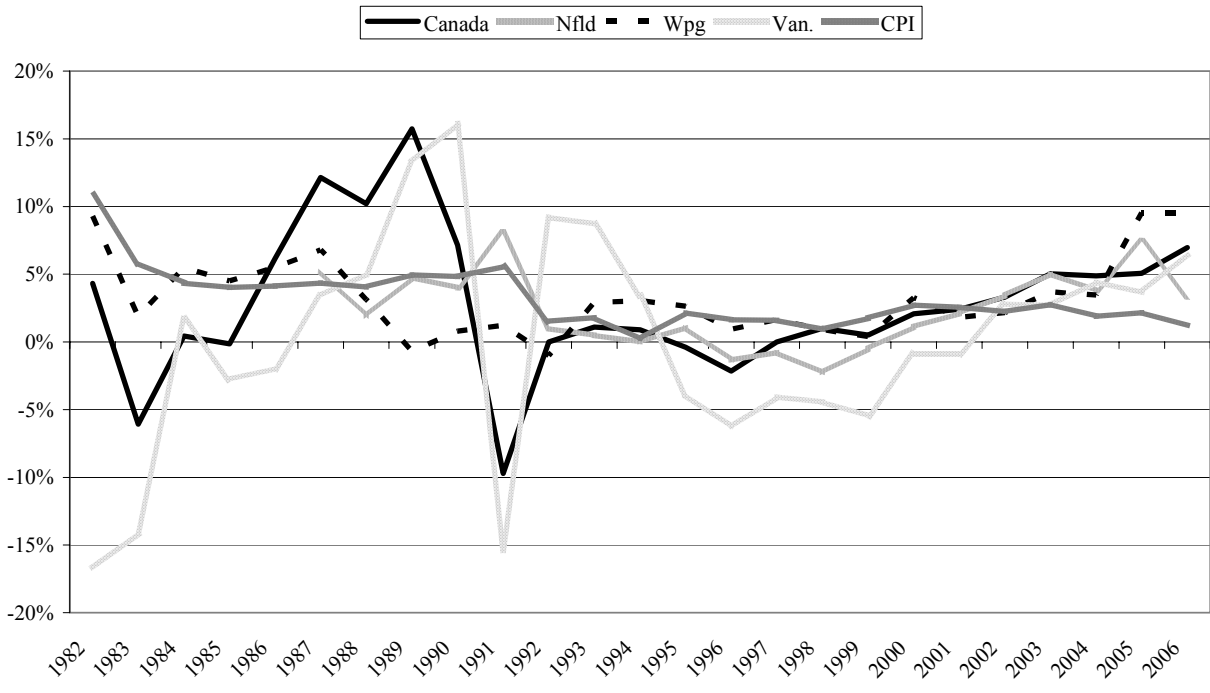
swings. Housing prices appreciated at a lower rate than the CPI in 15 out of the 25 years shown. Overall new house prices appreciated 95 percent over the 1981 through 2006 period, while the CPI appreciated 119 percent.

Figure 2 shows the value of \$100 indexed according to the New Housing Price Index in Canada and the three local markets, compared to \$100 indexed by the CPI, in 1981. The price of housing bought in 1981, just before the recession of that year started eating into the price of new housing, took a long time to catch up to the CPI and, in the case of Vancouver, never did. We would therefore anticipate that, as a financial investment, a house would be quite sensitive to market timing, as discussed further in the next section. Buying in the troughs leads to good returns: buying in the peaks can lead to losses. This is the problem in Vancouver where we see in Figure 1 extraordinary volatility in new house prices, and significant negative price movements in both the 1981 and the 1991 recessions. Of course, if someone bought in one of these down periods in Vancouver, they would now be doing extremely well.

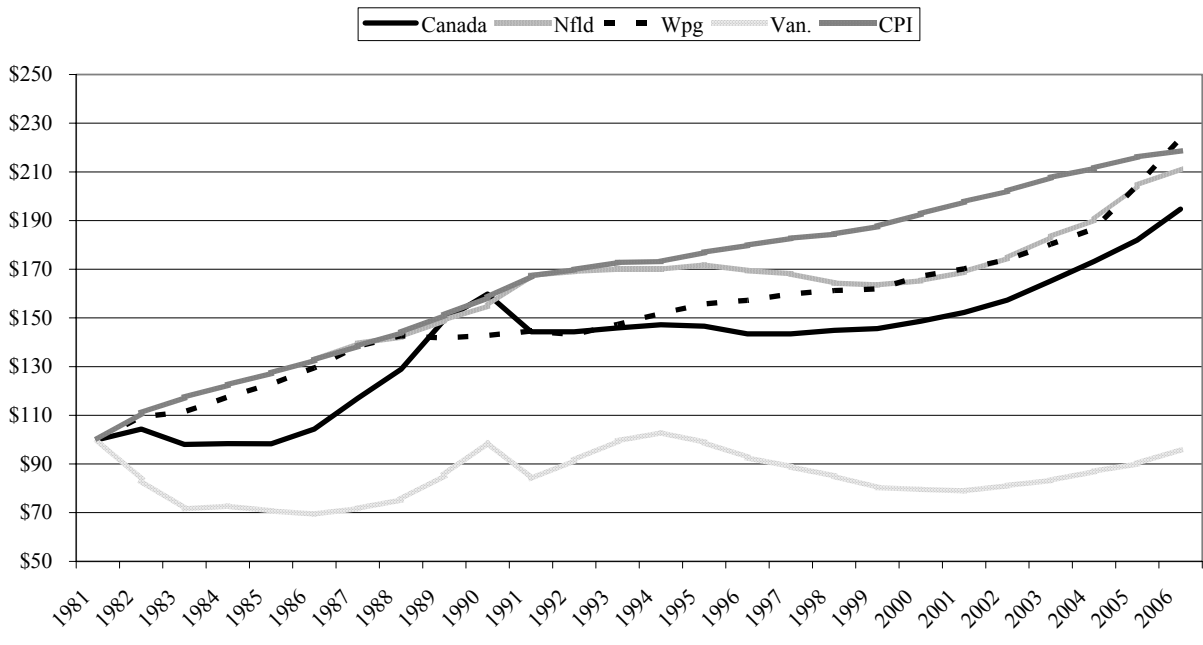
Case and Marynchenko (2001 p23) arrive at similar conclusions in their study *Home Price Appreciation in Low- and Moderate-Income Market*: “First of all, whether homeownership is a good or bad investment clearly depends on the time of purchase, conditions in the regional economy, and the dynamics of supply and demand at the local level. Second, since home purchase is almost always leveraged, particularly among low-income households, effects of price changes on equity accumulation over particular periods of time can be dramatic.”

In the next section, we look at a more detailed analysis of the factors determining whether a house is a ‘good investment’ or not. The message in this section is that we need to drop some of our biases: a house is not a certain investment.

**Figure 1**  
**Rate of change of New Housing Price Index and Consumer Price Index, 1982 - 2006**



**Figure 2**  
**Value of \$100 indexed to the New Housing Price Index versus the Consumer Price Index, 1981-2006**



### III. When is a home a good financial investment?

To answer this question, we need to assess the long-term financial consequences of the ‘rent or buy’ alternatives facing a low-income family. The alternatives to compare are, on the one hand, buying, using savings for a down payment and transaction costs, and, on the other hand, renting, using savings instead to invest. We want to know when and under what conditions the value of the owner’s equity in the home will be more or less than the value of the alternative investment. When the value of the owner’s equity is greater than the accumulated savings from investment, the purchase of the home contributes to the savings of the family. When the owner’s equity is less than it would be had the family instead used its savings for investment, purchasing a home instead reduces savings.

The calculations required to make this assessment are complex. There have been several ‘rent or buy’ models, but none of them adequately captures the issue under discussion here (see McCarthy et al 2001 for a summary of US studies)—namely, the issue of the financial implications of buying a home, and nothing else. Furthermore the US studies all assume long-term (e.g., thirty-year) fixed-rate mortgages, which are generally not available in Canada. The following section presents the results of a model reflecting historical Canadian rates, developed specifically to compare savings at the end of various time periods as a consequence of renting or buying. We assume a house purchase price of \$100,000, with three different levels of down payment: 5, 10 and 25 percent. We look at the effects of the ‘rent or buy’ decision for the twenty year period, 1985 through 2005; for the fifteen year period 1990 through 2005; and for the ten year period 1995 through 2005.

The findings are presented as a series of tables showing progressively more realistic— and therefore more complicated - scenarios for the ‘rent versus buy’ analysis. The first scenario is set up in such a way that monthly buying and renting costs just cancel each other out, so we look only at appreciation of housing and returns on investments and nothing else. This is unrealistic, but it is useful in providing a base upon which to build more realistic scenarios. The second scenario includes a monthly flow of rent and mortgages, as well as other costs, but does not include transaction costs (e.g. mortgage insurance, legal fees, etc.). The third and final scenario includes all the monthly expenses plus transaction costs and is therefore most realistic.

The alternatives compared in each scenario are:

Alternative A: The ‘home ownership scenario,’ a family uses a down payment to buy a \$100,000 home, usually with a mortgage amortized over 20 years. The family does not, of course, pay rent. In all cases, we assume that the value of the house increases by the Housing Price Index for Canada as a whole. We then assess the value of the family’s equity in the home for each of the three ownership periods noted above.

Alternative B: The rental scenario, the household does not buy a house. The household instead invests the money that would have gone for the down payment and transaction costs, holding the investment for a number of years. In each scenario we assume returns on investment equal to the yield on 10 year government of Canada bonds prevailing in January of the year under consideration. Here the household does pay rent, but does not

pay mortgage and other ownership costs. Any savings or losses the household experiences as a consequence of paying rent rather than monthly home ownership costs are added or subtracted from their investment in the year of the gain or loss. We can then assess the value of the investment in each of the time periods noted.

The question as to whether home ownership is a good means of encouraging savings among families with low incomes then boils down to this: under what conditions are the family's net assets worth more in Alternative A than Alternative B?

## **Scenario 1**

Let us first imagine the simplest conditions: the monthly maintenance, property tax and mortgage interest payments in Alternative A are exactly equal to the rent in Alternative B. Rather than the 20 year amortization schedule assumed in subsequent scenarios, here we assume that the mortgage is an 'interest only' loan, so that no equity is paid down on the home. These two assumptions imply that the rent and all on-going costs of home ownership cancel each other out, so we need only consider the initial investments and their appreciation. We also assume that the quality of the shelter is the same in B and A (in subsequent scenarios this rent-buy accommodation equivalence is dealt with more substantively). Further, we assume that the investment is in a non-taxed account such as an RRSP and we ignore the capital gains tax owed on the investment gains. A last simplifying assumption is that there are no transaction costs upon purchasing the house. Finally, we also assume here, and in all of these discussions, that utility and similar costs are the same for both renters and owners, so these just cancel out as well.

With all these simplifying assumptions, we may simply compare the value of the homeowner's equity in the home under Alternative A with the value of the renter's investment in Alternative B. This comparison is clear given the simplifying assumptions: the equity in Alternative A is determined by the appreciation of house prices; and the value of the investment in Alternative B is the amount of interest accumulated. Table 1 shows the results for various down payment levels and ownership or investment periods. Home buying results in a positive net gain to the household's wealth with both a 5 and 10 percent down payment, but with a 25 percent down payment the household basically breaks even whether renting or buying – even experiencing a slight loss in the fifteen year and twenty year periods.

To understand this result, imagine that the owner had just paid cash for the home, with no mortgage payments at all. The equity in the house would then simply be \$100,000 (the cost of the house) increased according to the Housing Price Index. The value of the savings would be the interest payable on Canada ten year bonds. But the Housing Price Index is less than the interest payable on Canada ten year bonds in most years, except in the years 1986 through 88 and 2003 through 06. As a result the value of the comparative \$100,000 investment grows more rapidly than the value of the house. In fact, \$100,000 indexed by the yield on 10 year bonds beginning in 1986 would be worth over \$400,000 by 2005, while the \$100,000 house purchased in 1986 would be worth only about \$182,000.

However, recall as noted in the previous discussion, that a house is usually a highly leveraged investment. It is most unusual to pay the whole cost of a house in cash. A 5 percent down payment is \$5,000 leveraging a \$100,000 asset. If the asset grows by just 1 percent, that is a gain of \$1,000, which is fully 20 percent of the initial investment of \$5,000. The result is that the less the down payment, the more the gain—just because the homeowner gets the equity on the appreciation of the value of the *whole* house. Table 1 merely demonstrates the effects of a well-performing leveraged investment. The problem with a highly leveraged investment is that the opposite effect works just as well: if there is a 1 percent decrease in the value of a \$100,000 asset, the result is a loss of 20 percent of the owner's down payment equity in one blow. This is why highly leveraged investments are dangerous, and especially if the investor may not be able to hold onto the asset through downturns: in housing terms, if there is a risk of a default.

In the period 1986-2005 there were three down turns in the housing price index, and 17 increases, with the only large downturn in 1991, so 'negative leveraging' largely did not occur except in 1991. There were very big increases in the Housing Price Index in the 1980s. However, with the large downturn in 1991, the fifteen year period covers a big downturn, with no compensating upturns, so this is the reason why it has the worst results for the homeowner – even negative where the high down payment results in less positive leveraging to recover losses.

Of course, the assumptions are highly artificial; nevertheless Table 1 does establish a useful base case from which to build more realistic scenarios.

<b>Table 1</b>			
<u>Scenario 1</u> : Net change in savings through purchase of a \$100,000 home with no transaction costs and rent equal to on-going ownership costs.			
Ownership or investment period	Value of homeowner's equity at end of time period	Value of investment at end of time period	Net change in savings through home ownership
5 percent down payment			
1996-2005 (10 years)	\$40,707	\$10,370	\$21,510
1991-2005 (15 years)	\$39,895	\$11,346	\$19,776
1986-2005 (20 years)	\$99,676	\$20,963	\$66,052
10 percent down payment			
1996-2005 (10 years)	\$36,881	\$20,741	\$16,140
1991-2005 (15 years)	\$36,122	\$22,691	\$13,430
1986-2005 (20 years)	\$84,483	\$41,925	\$42,588
25 percent down payment			
1996-2005 (10 years)	\$51,881	\$51,852	\$29
1991-2005 (15 years)	\$51,122	\$56,729	-\$5,607
1986-2005 (20 years)	\$99,483	\$104,813	-\$5,330
Sources: Home price indexed by New Housing Price Index for Canada Statistics Canada CANSIM - 2310 Table 327-0005; interest on investment equal to benchmark yield on 10 year Government of Canada bonds in each year from the Bank of Canada, Department of Monetary and Financial Analysis <a href="http://www.bankofcanada.ca/en/rates/index.html">http://www.bankofcanada.ca/en/rates/index.html</a> .			

## **Scenario 2**

In Scenario 2 we add on assumptions for monthly costs of home ownership and for rental of an equivalent accommodation.

We assume that the homeowner has a mortgage with a 20 year amortization period. The mortgage is a series of five year closed mortgages, set at the prevailing rate for five year closed mortgages in January of the year at the start of each five year period. Thus the rate for 1986 through 1990 is assumed to be the rate for a five year closed mortgage in January 1986; the rate for 1991 through 1995 is assumed to be the rate for a five year closed mortgage in January 1991; and so on.

One of the most challenging aspects of the 'rent-buy' comparison is to decide how to assume a realistic rent for more or less equivalent accommodation. Here we do this by assuming

that the market value of the rented accommodation is always the same as the market value of the home that the homeowner has purchased. In other words, we assume that the landlord could sell the rented accommodation for whatever the indexed value of the home is in any year. While this may be less than perfect, it is at least reasonable to assume that dwellings of equal market value would be roughly equivalent. We can then calculate a reasonable rent by assuming that the landlord achieves an after expenses rate of return on his capital that reflects current market rates for investments. The assumption here is that the landlord would sell the building if he could make more money just as safely by placing it in a secure investment, so this establishes a floor rent given that we know the value of the home.

Here we assume that the landlord gets a target rate of return equal to the rate for five year GICs, *after* expenses. However, to reflect the fact that landlords cannot change rental rates every year, we assume that the rent is set according to the five year GIC rate in each five year period, as we did for mortgage rates.

Of course, a landlord has to pay for up-keep and property taxes and other incidentals. But so does the homeowner. Given that the capital cost of the dwellings is the same, it is reasonable to assume that these additional costs are roughly equal in the rent or buy alternatives, so they cancel each other out; the same is true in the case of utilities.

In some years the mortgage costs might exceed the rent, and in some years it might be the other way around. We accommodate that by adding or subtracting the difference from the investment equity. In years where the mortgage costs (interest and capital) exceeds the rent, the difference is added on to the value of the investment in that year. If, on the other hand, the mortgage costs are less than the rent, the amount of the excess is subtracted from the value of the investment in that year. This reflects the implication of our assumptions, namely, that the homeowner would have ‘saved’ that much money had they been renting, or, in the reverse case, spent that much more money had they been renting, which would have reduced their savings. Finally, in this scenario we assume no transaction costs; these will be added in Scenario 3.

In Scenario 2 buying a home would have resulted in additional savings only if the home is owned for the full twenty year period. This is partially because the value of homes increased rapidly in 1987-89—about 45 percent—and only the twenty-year period encompasses this period of rapid growth. In other words, the period of rapid inflation in the second half of the 1980s was good for debtors (mortgage holders) and bad for investors.

The later time periods do not benefit from the price run-up of the late 1980s, but the fifteen year period is affected by the price run-down of 1991. In this Scenario the 1991 Housing Price Index downturn of 9.7 percent has a significant impact because mortgage costs do not go down significantly despite the decrease in the market value of the home (the mortgage *rate* does go down, but the mortgage is still based on amortization of the original loan required to buy the home, so the total monthly costs are not much changed), whereas in the previous Scenario mortgage costs were automatically fully offset by rent increases. The larger down payment options are more successful, because they reduce monthly mortgage costs, and thereby minimize the impact of the downturns.

<b>Table 2</b>			
<u>Scenario 2:</u> Net change in savings through purchase of a \$100,000 home with no transaction costs, mortgage amortized over 20 years at 5 year closed rates in each 5 year period; and rent equal to 5 year GIC rate each 5 year period, net of all expenses.			
Ownership or investment period	Value of homeowner's equity at end of time period	Value of investment at end of time period	Net change in savings through home ownership
5 percent down payment			
1996-2005 (10 years)	\$61,837	\$69,001	-\$7,165
1991-2005 (15 years)	\$85,324	\$119,183	-\$33,860
1986-2005 (20 years)	\$174,483	\$104,715	\$69,767
10 percent down payment			
1996-2005 (10 years)	\$65,259	\$70,920	-\$5,661
1991-2005 (15 years)	\$87,470	\$117,750	-\$30,279
1986-2005 (20 years)	\$174,483	\$99,246	\$75,237
25 percent down payment			
1996-2005 (10 years)	\$75,530	\$76,672	-\$1,142
1991-2005 (15 years)	\$93,913	\$113,442	-\$19,530
1986-2005 (20 years)	\$174,483	\$82,825	\$91,658
Sources: same as Table 1 plus 5 year GIC yields from the Bank of Canada, Department of Monetary and Financial Analysis <a href="http://www.bankofcanada.ca/en/rates/index.html">http://www.bankofcanada.ca/en/rates/index.html</a> .			

Overall Table 2 shows that the financial consequences of purchasing a home may depend on when the house is bought in the housing price cycle. Those lucky enough to buy in a price trough, especially right before a quick price run-up, will do well, while those buying in a price peak would likely be better off financially to rent and invest – at least until the next trough.

### **Scenario 3**

Scenario 3 adds transaction costs to the assumptions in Scenario 2. Transaction costs are surprisingly important because they occur at the beginning of the purchase period, so they have an effect throughout the purchase period. Moreover, unlike the down payment, transaction costs are essentially ‘dead money.’ The down payment increases the owner’s equity, but transaction costs are deadweight. In Scenario 3 we assume that the transaction costs are added on to the value of the initial investment in the ‘rent’ alternative. Thus, for example, if transaction costs are \$3,000 and the down payment is \$5,000, then the alternative investment would start at \$8,000.



The transaction assumptions, in 2006 dollars, are set out in Chart 1. These costs were then indexed by CPI to derive estimated transaction costs for the beginning of each of the three periods (1985, 1990 and 1995) in nominal dollars for that time period. We assume that the mortgage renewals every five years can be accomplished without additional fees. These are only rough estimated transaction costs, of course, and would differ in each province and over time, but they are likely in the right range of costs and provide a reasonable picture of the effects of adding in transaction costs to the ‘rent or buy’ decision.

<b>Chart 1: Estimated transaction costs for \$100,000 older home purchase in Ontario in 2006</b>				
<b>Item</b>		<b>Down Payment</b>		
		<b>\$5,000</b>	<b>\$10,000</b>	<b>\$25,000</b>
<b>Mortgage insurance</b>				
	<b>Application fee</b>	\$100	\$100	\$100
	<b>Insurance</b>	\$2,750	\$2,000	\$650
	<b>Sales tax</b>	\$193	\$140	\$46
	<b>Sub-total</b>	\$3,043	\$2,240	\$796
<b>Appraisal</b>		\$250	\$250	\$250
<b>Land Transfer Tax</b>		\$725	\$725	\$725
<b>Property Insurance</b>		\$300	\$300	\$300
<b>Legal fees</b>		\$1,500	\$1,500	\$1,500
<b>Total</b>		<b>\$5,818</b>	<b>\$5,015</b>	<b>\$3,571</b>
Source: Mortgage insurance, application and appraisal fees from CMHC <a href="http://www.cmhc-schl.gc.ca/en/co/">http://www.cmhc-schl.gc.ca/en/co/</a> ; property insurance quote from TD/Canada Trust; Land Transfer tax and legal fees estimate from <a href="http://www.heydary.com/">http://www.heydary.com/</a> (legal firm).				

Table 3 shows the result of including transaction costs along with monthly costs as set out in the previous table. Table 3 is likely the most realistic assessment of net savings through home ownership, as the transaction costs have an especially significant effect on the shorter term period of ten years. In all cases, the twenty year holding period reflects substantial net savings (wealth creation) as a consequence of buying a house. The worst outcomes from the perspective of the home buyer are for the fifteen year 1991-2005 period, because, as previously noted, this includes the 1991 downturn without the offsetting up-turn of the late 1980s.

<b>Table 3</b>			
<u>Scenario 3</u> : same as Scenario 2 with transaction costs added.			
Ownership or investment period	Value of homeowner's equity at end of time period	Value of investment at end of time period	Net change in savings through home ownership
5 percent down payment			
1996-2005 (10 years)	\$61,837	\$77,136	-\$15,300
1991-2005 (15 years)	\$85,324	\$130,086	-\$44,762
1986-2005 (20 years)	\$174,483	\$118,535	\$55,948
10 percent down payment			
1996-2005 (10 years)	\$65,259	\$77,933	-\$12,673
1991-2005 (15 years)	\$87,470	\$127,149	-\$39,678
1986-2005 (20 years)	\$174,483	\$111,159	\$63,324
25 percent down payment			
1996-2005 (10 years)	\$75,530	\$81,665	-\$6,135
1991-2005 (15 years)	\$93,913	\$120,134	-\$26,221
1986-2005 (20 years)	\$174,483	\$91,307	\$83,176
Sources: same as Table 2 plus transaction costs as in Chart 1.			

The model also permits us to test sensitivity to some key variables. Table 3A shows the results of higher rents, assuming that the landlord targets a net after expense return from the rental accommodation of five year GIC yields plus 1 percent. Since the model adds or subtracts the difference of the mortgage and rent from the accumulated investment, this increase in rent shows up as a decrease in the value of the investment on Table 3A. The results are still negative for the 1991-2005 period, but break-even or better for the 1996-2005 period. This latter period has been one of rough price stability, so it shows that without peaks and troughs, home buying is likely about neutral from a financial perspective – unless one can get a very good deal on rent, in which case renting will be better. Of course, the reverse is true as well, if one can get nothing but a high-cost bad deal on rent, and landlords are seeking very high returns, then buying is likely better from a financial perspective.

Finally, none of the tables take taxes into account, and these may be important. We can assume that the investments are in an RRSP and are not subject to tax, but the income from RRSPs is in any case taxable when withdrawn. In contrast, if the house is sold there are no capital gains and the income is never taxed. (In the US this situation is further complicated by mortgage interest deductibility, but not in Canada.) It is hard to know what tax rate to assume with respect to income from investments, but if taxes were about 20 percent, home purchase becomes a better or at least more or less neutral financial option in all cases except the 5 and 10 percent down payment with the fifteen year 1991-2006 time period.

<b>Table 3A</b>			
Scenario 3 with additional yields of 1 percent on rented property.			
Ownership or investment period	Value of homeowner's equity at end of time period	Value of investment at end of time period	Net change in savings through home ownership
5 percent down payment			
1996-2005 (10 years)	\$61,837	\$63,597	-\$1,760
1991-2005 (15 years)	\$85,324	\$105,580	-\$20,256
1986-2005 (20 years)	\$174,483	\$78,978	\$95,504
10 percent down payment			
1996-2005 (10 years)	\$65,259	\$64,393	\$866
1991-2005 (15 years)	\$87,470	\$102,642	-\$15,172
1986-2005 (20 years)	\$174,483	\$58,659	\$115,824
25 percent down payment			
1996-2005 (10 years)	\$75,530	\$68,125	\$7,405
1991-2005 (15 years)	\$93,913	\$95,627	-\$1,715
1986-2005 (20 years)	\$174,483	\$38,807	\$135,676
Sources: same as Table 2 plus transaction costs as in Chart 1.			

### ***Implications of the scenarios***

The scenarios confirm the findings from the previous review of home prices. A home is not a sure-fire investment. Home prices can and do fall. A small down payment, large transaction costs and a hot market are not a good financial recipe for home purchasing. Throw in a potential move in the near future, or other possible sale of the home within ten or so years, and the scene is set for potential financial losses.

In short, the scenarios confirm that if you buy in the peak and the price drops significantly, it is going to be a long time before you feel you made a good financial decision – if ever. Unlike normal investing, a house is ‘lumpy.’ Investors will usually make numerous small investments spread over many years, but a house is like putting all your eggs in one basket at one time. So market timing matters.

On the other hand, if the market is stable and prices are good, if the family can keep the house for a long time and transaction costs are not too high, buying a house can generate serious financial gains with very little outlay. A house is likely the only leveraged investment a low-income household can make and when a leveraged investment performs as one hopes, it can

result in superlative returns. It will provide wealth accumulation that would otherwise be unattainable for a low-income household.

The scenarios do not tell us whether it is good financial planning to rent or to buy. They tell us instead that the specific conditions of the market matter and the 'rent-buy' decision needs to be made in light of the actual local conditions at the time. But the scenarios do give us some quantitative parameters to assess the financial effects of purchasing a home and to assess programs that attempt to help low-income households to accumulate wealth. We turn to these programs and their assessment in the next section.

## IV. Options to assist low-income home ownership

How exactly does a program to assist low-income Canadians to become homeowners operate? Drawing from the examples of actual programs described in Appendix A, we describe and assess a number of ‘archetypical’ program models. In fact, there are a multitude of variations, so any classification is going to be somewhat arbitrary, and likely miss a few examples. Nevertheless, this is a more systematic and comprehensive description of home ownership assistance schemes than any other we have found. We have attempted to set out the progression of program models in a logical order, so that later programs sometimes are discussed as variations on previous models. This means that the fullest descriptions are necessarily of the program models discussed first.

In the first five program models, the core strategy may be summarized as follows: the vendor retains part of the equity and then is compensated post-purchase for the retained equity. The vendor may be repaid for its share of the equity either during the course of home ownership, or upon sale of the home, or a bit of both. By allowing the purchaser to buy a reduced share of the equity up-front, the initial purchase price is reduced and the unit is made more affordable. However the trade-off is that the purchaser does not enjoy the full potential appreciation of the value of the home because the vendor recaptures a share of the equity and along with it a share of the appreciation. Effectively, this reduces the homeowner’s leveraging.

For non-profit firms interested mainly in the supply of affordable housing, this is a way of ‘recapturing’ all or part of the difference between the affordable price and the market price of the home, so that the funding can be recycled again either for a new affordable unit or to offer the same unit again at an affordable price. The difference between the affordable price and the market price does not become a windfall gain to the purchaser, as it does, for example, if there is a simple grant for part of the purchase price that does not have to be repaid (which is one of the later models described). In theory, for-profit firms might also be able to use some forms of this technique to open new markets both for homes *and* for financial instruments – financial instruments since the equity retained by the vendor could possibly be resold as a type of second mortgage or housing-price indexed bond.

The sixth program model is ‘rent-to-own,’ where the basic approach is the reverse: it obtains, or at least attempts to obtain, up-front compensation for the difference between the affordable price and the market price of the home, rather than waiting for the home to be sold.

The remaining six program models all have in common the requirement for an explicit grant or subsidy, but are otherwise only loosely connected. They do have the virtue of being easier to understand.

### **1. A second mortgage with deferred repayment**

In this program model a second mortgage is offered, but all payments on the second mortgage are deferred until the property is sold. At the time of sale, the total amount of

deferred payments and compounded interest are paid out of the sale proceeds to discharge the second mortgage.

This mechanism would significantly reduce monthly payments by reducing the size of the first mortgage. For example, if a property sells for \$100,000 with a down payment of \$5,000 then the monthly mortgage and interest would be \$722 (assuming a twenty year amortization and today's 6.75 percent closed mortgage rate). With a deferred second mortgage of \$20,000 the outstanding first mortgage is \$75,000 and the monthly payment for the first mortgage falls to \$570.

If the price of the home had substantially appreciated the second mortgage could be discharged and the homeowner would recapture some of the equity in the home, although not much. Assuming that interest rates on second mortgages would be 20 percent more than first mortgage rates (e.g., if the first mortgage was 10 percent, the second would be 12 percent), then a twenty year deferred second mortgage of \$20,000 would require a repayment of \$149,000 at the end of the 1986-2005 period. The value of the house would only be \$174,483. Even if the owner owned the house free and clear by that time, the homeowner would walk away with only about \$25,000. But how does it compare with the 'rent and invest' alternative, given the same cash flow as would be required with the deferred payment second mortgage?

With a deferred payment second mortgage monthly mortgage costs are much lower, so there are very few years in which the rent for a comparative home would be less than the mortgage, and many years when it would be more, implying in our financial model that there are few additions and many subtractions from the comparable investment. Consequently, starting with a \$5,000 investment plus transaction costs and renting instead of buying with a deferred payment second mortgage, would result in an investment equal only to about \$16,000 in 2005. So, the homeowner would have increased savings slightly (\$9,000) through buying with a deferred second mortgage rather than renting.

With the same assumptions, but in the fifteen year 1991-2005 time period, the homeowner would have accumulated about \$85,000 equity in the home, but have had to pay-off \$44,000 for the second mortgage, leaving a net equity (saving) of \$41,000. The savings from the comparative 'rent and invest' would have been \$73,000 so there would have been a net loss of \$32,000 in savings through the home purchase.

The deferred second mortgage does allow the purchase of a home at a much lower monthly costs but it eats up a lot of the equity in doing so. It may be good for affordable housing, but it does not seem to work very well when assessed strictly from the perspective of maximizing savings. In fact, it is probably strictly speaking neutral with respect to the issue of 'rent or buy,' except that a second mortgage creates both added risk and opportunity because of increased leveraging.

If house prices decline, or even fail to rise quickly enough, the second mortgage eats into the equity in the home. The homeowner would likely have declining equity in

the home or even, at some point, negative equity, depending upon the nature of the first mortgage and the size of the deferred payment second mortgage. This appears to be what would have happened in the 1991-2005 period due to the decline in prices in 1991. The homeowner would be accumulating a growing debt on \$20,000 of equity that has evaporated. It could be that the amount of equity available once the first mortgage is discharged would not be sufficient to repay the full accrued value of the second mortgage and the buyer would have lost his or her down payment. This is a risky arrangement: it increases risk for the homeowner and the second mortgager. However, risk is the same or reduced for the first mortgage holder (reduced because the size of the first mortgage is likely to be less). The second mortgager can offset their risk with higher interest rates. Therefore, the buyer is left holding the added risk.

If the interest rate on the second mortgage were somehow kept low, the potential risks and rewards for the homeowner would be much improved, as would the whole financial equation. A government or a not-for-profit developer might be interested in an arrangement of this kind, as an alternative to a straightforward grant. Unlike a grant, it would permit the government or the developer eventually to recapture some or all of the initial ‘affordability premium’ rather than handing it as a windfall to the homeowner. The proceeds from the discharged second mortgage could then be used to help finance similar arrangements for new affordable housing.

The deferred second mortgage has some practical advantages; namely the legal structures for it are reasonably clear and it would be simple enough to construct arrangements to permit homeowners to pay-off large parts of the second mortgage from time to time. The lack of novelty of the second mortgage is likely an advantage as well. There is nothing especially mystifying or stigmatizing about the arrangement, and nothing in it that should diminish the owner’s sense of being fully vested in the ownership of their home.

Unfortunately, housing prices and interest rates tend to move in opposite directions so, if the environment is one of rising interest rates, an arrangement with deferred payments and accumulating debt will leave the homeowner with a loan increasing more rapidly than the value of the capital the loan has been used to purchase. This is also a problem for the shared equity model that we discuss next.

Despite this short coming, the second mortgage route may have practical appeal as an affordable housing measure, and it is also useful to have the second mortgage model as a kind of ‘base-case.’ Most of the other program models are actually some variation of the second mortgage, with risks and rewards shifted about in a variety of creative instruments.

## ***2. Shared equity with deferred repayment***

This program model is the same as the one described above – a second mortgage with deferred repayment – except that instead of the lender being repaid on a fixed interest

rate, the lender receives a commensurately enhanced portion of the appreciation of the property. In effect, the potential appreciation of the property provides the interest plus the risk premium for the lender.

One example of a shared equity approach was attempted in Scotland, where the Bank of Scotland offered a Shared Appreciation Mortgage (SAM) beginning in 1997. [Description from notes by Tom Carter: 'Scotland's Shared Equity Ownership Scheme'.] There were two versions of the SAM. In version 1, the SAM was offered as an indefinite, interest free loan, but the share of appreciation was set at three times the proportion of the loan as a share of the total value of the home. For example, if the value of the property was \$100,000 and the SAM was \$20,000 (20 percent of the value of the property) then the Bank would be entitled to 60 percent (3 times 20 percent) of any appreciation above \$100,000 upon sale of the property, plus the original \$20,000.

In the twenty year period 1986-2005 the homeowner with a \$20,000 SAM would have had to repay about \$65,000 upon sale of the home in 2005. This would have left the homeowner with \$110,000 net equity in the home, which is much better than the comparable \$16,000 value of investment. This is better than a second mortgage and would have made home ownership a wise investment. However, the result is the reverse for the fifteen year period. At the end of the fifteen year 1991-2005 period the home would have been worth \$126,000 so the owner would have had to pay the Bank of Scotland \$35,600. However the homeowner's equity would have been \$85,000 so the net saving would have been almost \$50,000. But the savings from the comparative 'rent and invest' alternative for the fifteen year period would have been \$73,000 so there would have been a net *loss* of \$23,000 in savings through the home purchase.

The Bank of Scotland also required all other mortgages to be repaid or to be subordinated to its SAM, which meant that the SAM would have been very difficult for first time or low-income buyers to use, unless they already had a substantial down payment and wanted to use the SAM to finance a more expensive purchase. However, the SAM had to take precedence to other loans because otherwise the risk of non-repayment would have been far too high (given that it would take the majority of the appreciation). This likely makes the mechanism inappropriate to assist low-income households to buy their first house.

To raise the capital to provide financing the Bank of Scotland resold the debt, to large funds such as pension funds that held, for example, long-term bonds at fixed rates or other financial vehicles. Essentially the debt offered a housing-price index linked financial instrument as a way of diversifying portfolios. However there was a major flaw in this instrument. If interest rates were more than three times higher than the rate of inflation in home prices, the lender would be losing money. For example, if home-prices were going up by 1 percent a year, but prime interest rates were 6 percent a year, the SAM would be earning 3 points less than prime – and the Bank of Scotland obviously could not resell its paper. Conversely, if home-prices were rising by 3 percent a year and prime was 4 percent, the homeowner would be paying an effective rate of 12 percent, or 8



percentage points above prime. Unfortunately, home prices and interest rates tend to move in opposite directions, making this proposition extra risky all around.

The second version of the SAM was essentially the same except that it had a slightly below market fixed interest rate and took a share of the appreciation in equal (rather than three times) proportion to the share of property value at the time of the loan. Because of the fixed interest rate base, version 2 limited the risks compared to version 1, but the direction and nature of the risks were still the same. When interest rates go up (so the fixed interest rate was even less attractive to the lender) the price of houses tends to go down (so the share of appreciation of the house was also less attractive to the lender) and the lender takes a loss. Conversely when the interest rate goes down the homeowner takes the loss and the Bank is a big winner. Essentially, the SAMs amplified the risks of interest rate movements. As well, the problems of potentially eating into homeowner equity remained, as in the deferred second mortgage model discussed above, so that the Bank had to insist on its SAM being a limited share of the equity and on all other debts being subordinated to it.

The SAM plans were withdrawn in 1998, because the Bank could no longer sell the debt on the market to raise the funds needed to finance its scheme. The SAM was likely not viable financially to start with, but it is an instructive example of the kinds of contortions that can readily evolve in attempting to develop a shared equity instrument.

We have much more modest examples of shared equity schemes in Canada. The not-for-profit Ontario-based developer of affordable homes, Options for Homes, uses a financing mechanism that is a form of shared equity loan with deferred payment for its projects. It requires an initial payment for its homes at the cost-recovery level, but defers taking profits. The profit, which represents the difference between the market price and the cost-recovery price, is instead deferred as a kind of shared equity second mortgage, with no repayment required until the property is sold or rented. For example, if the cost recovery price is \$80,000 and the market price is \$100,000 then the buyer may take the \$20,000 as a shared equity second mortgage. The \$20,000 is repaid as a proportional share of the total value of the property when it is sold or rented. Assuming a \$5,000 down payment, 20 year amortization and 6.75 percent interest rates, this will reduce mortgage payments from \$722 to \$570 per month. (Actually the difference between market price and cost recovery is likely to be much lower – closer to 10 percent – but the higher figure is used here as an example to keep consistent with prior examples).

This is a rather good deal for home buyers compared to the SAM, where the Bank charged three times appreciation, rather than taking just a proportional share. After the twenty year 1986-2005 period the homeowner would have to pay back about \$35,000 to Options for the use of the capital. The homeowner's net equity would be about \$140,000, which is far superior to the value of the alternative investment of \$16,000. This is great savings for the homeowner, but it is because of the sub-market loan from Options. Twenty-thousand dollars invested in Government of Canada ten year bonds over the same period would have resulted in about \$80,000 by 2005. The opportunity cost for Options is therefore about \$45,000. If we are asking the broader question of whether

buying a house is a good way to save, the question we need to ask is whether this \$45,000 directly invested could have resulted in even greater savings for a household. Since this is \$45,000 in 2005, the correct comparison might be \$16,000 plus \$45,000 equal to \$51,000 in 'investment' comparable to the \$140,000 in the home. This is still a good deal for home buyers.

In short, the Options shared equity loan is actually a form of subsidization; however this mechanism has enabled Options for Homes to develop several affordable housing projects, apparently without public subsidy so it could be considered 'self-financing.' However, Options for Homes is also using up the real value of its capital through its subsidization, so is cross subsidizing from its full market sale business. This mechanism might also be suitable for a for-profit firm that wanted to offer a few of its units on a below-market affordable basis, but reduce slightly the windfall profit for the purchasers (and they could undertake to recycle the funds when the shared equity loan is repaid).

### **3. Shared equity with rental payments**

In this model the lender is paid for its share of equity by a rental charge, in addition to obtaining a proportionate share of the sale price when the housing unit is sold. It is a model in use currently in the UK. This is similar to a shared equity loan, except that instead of deferring all repayments and the amount owing to the lender accumulating until the home is sold, the lender is paid monthly and upon sale the lender also receives repayment through a share of the sale price equal to the percent of the original loan. This model is the same as Options for Homes but with the addition of on-going payments for use of the capital until the loan is paid off.

For example, if a home is sold for \$100,000 and the loan is \$20,000 then the lender's share of equity is 20 percent. The mortgage, as in the above example, is \$75,000 with a \$5,000 down payment, and the monthly mortgage payments are \$570 with a 6.75 percent interest rate. In addition to the monthly mortgage payments, the lender also charges rent for the homeowner's use of the lender's share of the home, at some advantageous percentage of the loan. For the shared equity loans in the UK it is approximately 3 percent, but 5 percent is likely a more realistic yet still advantageous interest rate in Canada's present monetary environment. This would add on \$83 a month to the monthly costs, for a total monthly cost of \$653. This is a saving from the \$722 which would have to be paid on a full mortgage of \$95,000.

The monthly saving is entirely derived from the lower interest rate charged as rent, compared to the mortgage, and the lack of amortization of the loan (no capital is repaid). If the unit is sold after the twenty year 1986-2001 period the homeowner's net equity is \$140,000 and the comparative value of the 'rent plus invest' alternative would be \$57,000 (including an additional \$1,000 a year in investment to reflect the added monthly costs of paying rent for the portion of the home owned by the co-owner) so there is a net gain in savings of \$83,000 for the homeowner at the end of the period. This is a

little better than the outcome for the homeowner for the same period in the pure second mortgage example, because of the implicit subsidy in the reduced rental rate for use of the vendor's capital. At the same time the vendor gets back an approximate net present value of \$76,000 in 2005, including both the vendor's 20 percent share of the equity and the flow of \$1,000 a year for rent of the vendor's share of the home.

The rental rate needs to be subsidized – as is the case in the UK – or this model is just the same as a second mortgage model with no subsidy; however it is a low level of subsidy. This program model is actually a kind of compromise between a commercial type of second mortgage and an Options for Homes shared equity mortgage. It spreads the risk between lender and buyer. It allows the lender to recapture some of the possible appreciation of the property. Finally, from the lender's perspective this arrangement recaptures more of the original capital which can then be re-circulated. As a savings measure, it makes home ownership a better savings instrument by reducing (through an implicit subsidy) the cost of purchasing, although it is not, of course, as generous as Options for Homes. The trade-off is that there is more funds back to the developer to re-circulate for more affordable homes, but then there is less accumulation of wealth and higher monthly payment for the home buyer than in the Options for Home model.

#### **4. Shared equity with 'staircasing' up to sole ownership**

In this model there is a shared equity loan, but the homeowner is allowed to increase his or her share of the equity in the home after the initial purchase. This is readily adaptable to the 'shared equity with rental payments' model above, as the rent could more or less seamlessly be converted to mortgage payments. It can also be an ordinary part of any second mortgage. Actually it is not a separate model, but an added feature that can be adapted to many models.

In the UK, this kind of arrangement is called 'staircasing' and the usual allowance is for redemption of equity in 10 percent steps. This allows the owner to buy back 10 percent shares of the equity at prevailing market values at the time of the buy back. For example, if the initial value of the home was \$100,000 with a \$20,000 shared equity loan equal to 20 percent of the equity, and ten years later the home was worth \$140,000, redemption of 10 percent of the equity would require a payment of \$14,000 to the lender. This would leave the homeowner with 90 percent of the equity in the home, and the lender with the remaining 10 percent.

There are many advantages to the homeowner in having the option to staircase towards 100 percent equity, and no apparent disadvantages to the lender. Of course, where the homeowner is paying nothing or very little for the lender's share of equity (as in the Options for Homes variant), it usually does not make financial sense to the homeowner to pay off the equity. In this case the owner could choose not to use the option. Given a shared equity or second mortgage type of arrangement, the only obvious problem with staircasing is that it increases transaction costs. From a savings perspective, this option does not appear to make any material difference.

## **5. Sale with 'right of first refusal' at a pre-established price**

In this model the vendor sells the home below market price and in exchange obtains the option to purchase the home at an agreed upon price when the home is offered for sale, thereby recapturing the implicit subsidy. In Canada, the Centretown Affordable Housing Development Corporation's (CAHDCO) has used this approach for several affordable units in its Clarence Gate development, as does the Whistler Housing Authority for workers in the Whistler area.

Affordable units are sold to low-income purchasers at below market prices. CAHDCO is able to sell the homes at about 15 percent below market because it foregoes profit on these units, includes some cross subsidization from market sale homes in the same development and staff donate their labour. The purchaser holds the units under the Condominium Act, so the only difference between the 'affordable units' and other units is that CAHDCO has an option to buy back the units when they are offered for sale. At that time, CAHDCO has the right to repurchase the unit at the full purchase price plus change in the housing component of the Consumer Price Index, less 3 percent for administrative costs. This means that CAHDCO will be able to recapture the 15 percent below market rate, and the homeowner will be able to enjoy the average increase (or decrease) in housing prices without getting the full value of a windfall due to the initial discount price. No government subsidies are involved.

As an illustrative example of this program model we will use the same figures as for other models, although this is slightly more than CAHDCO's 15 percent. Say the market price of the home is \$100,000, but CAHDCO is able to sell it for \$80,000. Using the same retrospective twenty year 1986-2005 series, the house would have a market price of \$174,000 at the end of the period. If the house were put up for sale at that time, CAHDCO would have the option to buy it for approximately \$140,000 less 3 percent, which is approximately \$136,000 (rounding to simplify the example). CAHDCO can then re-offer the unit at below the new market price, or it could sell the unit at market price and use the \$38,000 less administrative costs to create a new affordable unit elsewhere.

Like Options for Homes, CAHDCO is foregoing the earnings on the capital it could have obtained had it sold the units at market price twenty years earlier. As noted \$20,000 in government bonds at the beginning of the period would have resulted in about

\$80,000 by 2005. CAHDCO's opportunity cost is therefore about \$42,000. Essentially, the CAHDCO model is the same as the Options for Homes model, except that the former is a pre-established price set through an index, while the latter is simply a percentage of the sale price.

Like Options for Homes, this is a good deal for home buyers and likely results in substantial potential savings. But, unlike Options for Homes, if the local market is different than the price index applied contractually, CAHDCO could do better or worse. If local prices fall more rapidly than in the price index used, then the market price for the home when it is put up for sale could be under CAHDCO's reserve price, in which case CAHDCO would, presumably, not use their option and the subsidy would be lost to the sector. On the other hand, if the local price rises substantially above the index price, CAHDCO will do much better than its original share of the equity and the home buyer will do much worse. The Options for Homes model does not permit either of these circumstances to occur. In some ways, the CAHDCO model is a little riskier and less predictable, because it is not tied to the real market price. Nevertheless, it obviously provides a good saving opportunity for the home buyer.

## **6. Rent-to-own**

Theoretically, a rent-to-own plan may also be used to capture the difference between the affordable price and the market price. The difference is that in the case of rent-to-own this is achieved by paying the difference in *advance* of the purchase, by accumulating rent, rather than upon sale of the home. This model is unlike the other self-financing models in that it would be used to pay the down payment, rather than to reduce the first mortgage or the selling price *per se*. Apparently, rent-to-own has been employed by for-profit home sellers in the US, where rent-to-own contracts have been abused to avoid landlord-tenant laws and to extract additional fees from low-income tenants. Interestingly, it was not possible to find any successful examples of real rent-to-own where financing was clearly set out and understandable. So-called 'rent-to-own' seems most often to just be an offer of an option to the tenant, without the rent actually having been a factor in the financial arrangement. Nevertheless, rent-to-own may be a legitimate option.

A highly simplified example of a rent-to-own plan might work as follows: imagine a home with a market value of \$100,000 with full cost recovery of \$80,000 (i.e., profit of \$20,000). The vendor borrows \$80,000 against the value of the home as an 'interest only' loan, which the vendor then uses to pay his building costs. At 6.75 percent the vendor pays monthly interest on the loan of \$450 per month. The vendor then rents the home for \$450 plus \$180 a month, plus expenses. This would be about \$90 a month less than a 20 year mortgage of the whole \$100,000, assuming the house could be purchased without a down payment. At the end of the fifth year the renter has paid \$10,000 to the vendor, over and above the on-going \$450 interest payments and expenses. The vendor 'counts' the \$10,000 as the down payment towards the purchase price of \$100,000. If the purchaser accepts, the vendor gets \$90,000, discharges his loan

and keeps the additional \$10,000. Mortgage payments on the \$90,000 would be \$684 a month: just a few dollars more than the amount paid prior to the purchase.

There are risks in this kind of arrangement. If the market price of the house goes down during the rental contract period, the rent-to-buy arrangement means that the renter may just lose the ‘additional’ rent that has been paid. If the price is not agreed upon before hand then the vendor may raise the price, either legitimately or other wise, rather than offering the home at the original price. On the other hand, if there is a prior agreement on a price (as it seems there would have to be in a fair arrangement), then the buyer may get a good deal indeed, if the market price has escalated in the five year period. In the former case, the model results in lost wealth for the home buyer: in the latter case, the home purchaser will have accumulated some wealth in the five-year rental period. Other than this initial allocation, which is risky and dependent upon market conditions, once the purchase has been made the chances of wealth accumulation from ‘rent-to-own’ are the same as from a non-assisted home purchase as outlined in the previous Scenario 3.

On a strictly commercial basis the rent-to-own formula may be used to carve out a few dollars a month saving for the home buyer (at the expense of a de facto longer amortization period). A not-for-profit might be able to use the rent-to-own formula with some built in subsidization for a more attractive package to the home buyer.

## **7. *Forgivable grant to purchaser***

This model is straightforward: it is always possible for the government to provide a grant to a qualified purchaser. For example, the Manitoba Homebuyer Down Payment Assistance program provides a forgivable grant to qualified purchasers towards their down payment. If a house costs between \$60,000 and \$90,000, the Manitoba Homebuyer Down Payment Assistance will pay up to 10 per cent of the purchase price. If the house costs less than \$60,000, down payment assistance is 15 per cent. The maximum amount provided by the program is \$9,000. The assistance is forgiven if the home buyer remains in the home for at least ten years but it has to be paid back proportionately if the home is sold before then.

The forgivable grant model has the advantage of being simple, easy to administer and easy to understand. It has the disadvantage of losing the subsidy forever from the affordable housing sector, rather than trying to recapture the funds upon resale as do the self-financing models.

Obviously any home buyer who gets a grant and can hold onto their home long enough to have the grant forgiven is going to accumulate an asset greater than they could have without any grant – assuming that the house keeps its value. However this is not the correct question. We are interested in whether home buying is a good way to accumulate an asset: the question, then, is whether a grant going straight into investment would result

in greater savings than the same grant going into purchasing a home. In other words, given an equal level of public expenditure, is this the best way to encourage savings?

To use the same figures as in previous examples, imagine a \$5,000 grant that can be used as all or part of the down payment on a \$100,000 home. The question is: would the household be better off to invest the \$5,000 and rent, or to buy and pay a mortgage? This is the same as the alternatives set out in Scenario 3 in the previous section, with exactly the same results, except that in all options, either home purchase or investment, the household would be better off at the end of it by \$5,000 commensurately adjusted for time.

In short, a grant makes a home more affordable, but it does not demonstrate that home buying is a good strategy for accumulating savings. Rather the policy questions need to be asked in reverse. *If we find that home buying is a good strategy for low-income families to accumulate wealth that they otherwise could not have, and if we assume that it is good public policy for low-income families to accumulate wealth (rather than, for example, spending on current needs), then it makes sense to develop a grant or similar program that provides encouragement for low-income families to buy a home.*

## **8. Forgivable grant to builder/renovator**

This model is the same as the grant to purchaser except that instead of being paid to the purchaser, who then pays it to the vendor – it is paid directly to the vendor. The vendor is constrained by such a grant to only offer the home to purchasers meeting specified criteria and may also be constrained as to price and other standards regarding the nature of the building. It appears that the Royce-Dupont project in Toronto had this type of forgivable loan.

This model is likely most builder-friendly, but it probably also requires more supervision than consumer directed grants. Like the forgivable grant to the purchaser, the grants are forever lost to the affordable housing sector. More importantly for this paper, like the forgivable grant to the purchaser, it is neutral in respect of the question as to whether home buying is a good way of saving.

## **9. Repayable interest free loan to purchaser**

In this model, qualified purchasers are able to obtain an interest free loan for down payment assistance, which is paid back at face value upon sale of the home. For example, if the home is \$100,000 and there is an interest free loan of \$20,000 than the mortgage is \$80,000 and the homeowner repays \$20,000 whenever the home is sold. If the consumer price index has increased 50 percent in the intervening period, the real value of the repayment will be \$10,000 in constant dollars. The interest free loan appears to be the mechanism that the federal and provincial governments in Ontario are piloting in three projects in Toronto, Pickering and Markham under the 2005 Canada-Ontario

Affordable Housing Program Agreement. Qualified home purchasers will be able to get an interest free loan of up to about \$27,000 to use towards their down payment.

An interest free loan will almost always shrink in real value over time, and will become a smaller proportion of the market price of the home. This drop in real value and as a share of the market price is in contrast with a shared equity loan, as for example offered by Options for Homes or the sale of a home with a pre-established and indexed price as with CAHDCO. These loans at least may maintain their real value over time by being indexed in some implicit or explicit manner.

The repayable interest free loan does return some funding when the home is eventually sold, and those funds can then be used to help create future affordable units, but the returned funds will always be a hugely diminished amount in real terms. In other words, only a part of the subsidy returns to the affordable housing sector and a windfall grant is provided to purchasers.

The one circumstance in which the repayable interest free loan is in fact *less* favourable to the purchaser is if there is a precipitous drop in housing prices. With a drop in housing prices the repayable loan may go up as a share of the market price, and be worse than an Options for Homes or CAHDCO model, at least from the homeowner's perspective. If there is deflation – a falling consumer price index – the homeowner will be required to repay an increased amount in real terms. This seems pretty unlikely, but it underscores the arbitrary nature of non-indexed long-term financial arrangements in an environment where inflation is not predictable. It makes the repayable interest free loan into a bit of a lottery scheme.

A variation on the interest free loan is Habitat for Humanities interest free mortgage. Habitat offers an interest free mortgage which is repayable as a monthly payment of 30 percent of income, rather than on a fixed payment schedule. This is similar in some ways to an interest free repayable loan, except that it is paid out of current income rather than out of the sale price of the home and, of course, the repayment will ordinarily be much more rapid – since Habitat begins to collect some funds as soon as the home is purchased. Nevertheless, this model does involve a large implicit subsidy as the value of the repayment decreases over time due to inflation. It also has the arbitrary character of other loans or grants where the interest portion is forgiven. Interest varies widely over time. Not charging interest in a 2 percent interest environment is very different than not charging interest in a 6 percent environment, so the real value of the Habitat interest free mortgage in turn varies widely over time.

Like most other models where there are subsidies, these program models are essentially neutral with respect to the question of whether a house is a good instrument to accumulate savings, once we take into account the alternative of investing the amount of the subsidy and compare the results with equal levels of public or charitable spending. Model 11, sweat equity and donated labour / materials, provides additional information about the Habitat approach.



## **10. Assisted savings plans**

This model is essentially a matching grant towards a down payment, but assists prospective home buyers over time through matching their savings and encouraging them to accumulate sufficient funds for a down payment. For example, a qualifying applicant might be able to save up to, say, \$50 a month which would be matched \$2 for every dollar saved. After 5 years the saver will have been able to accumulate up to \$9,000 plus earned interest, which must be used for a qualified purpose, such as a down payment. Participants might also be required to meet other conditions, such as attending a financial management course.

In Canada, the Owen Hart Homeowners program (Calgary) and the Winnipeg Housing IDA program both are assisted savings programs structured in this fashion. Social and Enterprise Development Innovations (SEDI) has proposed a major national demonstration project based on this model, which they have called *Home\$ave*.

Like a grant towards a down payment the public (or perhaps charitable) funding is lost to the affordable sector. This model has the advantage, however, of empowering and educating the purchaser, so that by the time they are prepared to buy a home they should be better prepared to take on the responsibilities of a homeowner. However, a broader question is being pursued in this paper: if savings are a worthy goal of public policy is encouraging home ownership a good way to achieve it? Assisted savings programs are neutral with respect to this question.

## **11. Sweat equity and donated labour/materials**

In this model the cost (and eventual purchase price) of the home is reduced by relying in part upon the labour of the purchaser and upon other donated labour and material. In rural areas it is quite common to build one's own house, often with help from neighbours, but very rare in urban areas. 'Sweat equity' brings the concept of using one's own labour in addition to purchased labour into the urban environment as a way of reducing the monetary cost of building a home. It also is intended to increase the commitment and the maintenance capacity of the home builder/purchaser.

As is well known, Habitat for Humanity uses this model for its home development, requiring qualified purchasers to provide at least 500 hours of their own labour either into building the home that they eventually purchase or into other Habitat works. Unlike the other program models discussed here, sweat equity cannot be converted into a financial investment. It is therefore not neutral with respect to the equation of 'rent or buy.' To the extent that providing free labour does reduce the cost of the home, and thereby reduces the purchase price, it translates directly into increased wealth in the hands of the home purchaser. It is not possible to quantify this contribution in respect of savings, but it likely more than compensates for all transaction costs, in a way that cannot be duplicated as a financial investment.

## 12. *Land trusts*

Community Land Trusts (CLTs) “focus on meeting the affordable housing and community development needs of low to moderate-income households – those households least served and often priced out of the prevailing housing market – and neighbourhoods. CLTs do so by acquiring land in the community either by purchasing land directly or by receiving as a donation land, land and buildings, or money to purchase land. The land is then held by the CLT permanently so that it can always be used for affordable housing. Access to that land is often limited to low- and moderate-income households and/or non-profit organizations that serve low- and moderate-income households.” [Housing Strategies Inc. 2005 p3]

CLTs attempt to expand the supply of affordable housing by the following:

- Reducing the purchasing price of the home through eliminating the purchase of the land component of the home (although there will usually be lease charges at a market or below market rate for the land). The purchasing price of the home is also reduced simply because it is built on land that can only be used for non-profit, low-income housing. Similarly, the market price of the land will be reduced or somewhat artificial, as the land will now have a caveat on it preventing it from being used for any purpose other than non-profit housing.
- Retaining land and any development on it in perpetuity in the non-profit sector. This includes the capacity to place restrictions on who is allowed to purchase a house on the land, such as upper limits on the incomes of potential purchasers.
- Retaining the difference between the affordable price and the market price within the organization (as do most of the self-financing strategies), rather than passing it through to the home buyer, where it will eventually be lost to the non-profit sector.

A CLT requires a means of financing or acquiring its land without paying a market price. This requires a donation or grant of some kind, since the CLT cannot acquire the land at market prices and then afford to finance the purchase through using or leasing the land at sub-market prices. In other words, a CLT is not a self-financing structure, although once it has acquired its land it can be operationally self-financing and even generate a surplus that can be reinvested.

The CLT model is especially well adapted where a private sector donor wants to make a substantial donation and ensure that the funds will be used in perpetuity for charitable purposes. By donating land, or funds to buy land, to a CLT the donor can ensure that their contribution will remain in the low-income sector for the foreseeable future. As well, tax law has to be adapted to the CLT structure so that a charitable gift does not trigger large tax liabilities on unrealized capital gains (which was done in the recent 2006 Budget but not for gifts of land to be used for housing – only for gifts to be used for conservation).

In the US, where there is a reluctance to trust government to deliver good quality services, and where significant donors have made charitable donations of land, the CLT model seems to work well. US law has been adapted to CLTs and an active national organization exists to facilitate the establishment of CLTs. In Canada, none of these conditions apply: the legal structure is difficult and not well established, the tradition of large private sector philanthropy is not as well established, the tax treatment is not advantageous or even neutral and there are existing, well-regarded vehicles for co-op and low-income housing, both within and outside of government. Consequently, despite several attempts, we are aware of only one example of a clearly successful well-established land trust in Canada – Communauté Milton Parc in Montreal. The Calgary based Community Land Trust Society also seems to be off to a good start, but it has only been around for a few years and so must yet prove that it is self-sustaining operationally over the longer term.

It is not clear that the CLT model is especially useful if home buying in a CLT is being promoted as a way of accumulating savings. The idea of a CLT is, to some extent, exactly the opposite: it is more like a co-operative where all members get to use the services as inexpensively as possible but do not get to walk away with equity. The CLT concept may be especially adaptable in certain circumstances, for example, on First Nations lands where the home itself might be sold but not the land on which the home is situated.

The resale value of homes in a CLT should be less than those outside of a CLT, and may or may not move with the general market. As an affordability and neighbourhood renewal mechanism, CLTs may be a great idea, but it is hard to see how they can add to the use of a home as a financial vehicle.

## ***Assessing the program models***

We have described twelve program models here. Many of these models could prove useful in expanding opportunities for home ownership among low-income Canadians. Some of the models are also capable of enhancing the possibility of using housing as a financial savings vehicle for low-income families. Chart 2 below summarizes some of the assessment of the models against these and other criteria. In understanding these models, however, the lessons on the previous section should always be kept in mind; namely, buying a house is a risky financial venture and housing is not a safe investment. It is highly subject to market conditions and timing may be critical. Therefore, in encouraging low-income households to buy a home, advocacy groups and governments need to exercise caution and care. Low-income families have lost money on housing and found their very hard won savings wiped out, rather than enhanced – at least in the US.

<b>Chart 2: Assessment of assisted home ownership program models</b>				
	<b>Increases savings potential of home ownership?</b>	<b>Keeps money in affordable housing sector?</b>	<b>Increases affordability for purchaser?</b>	<b>Requires government or charitable grant?</b>
<b>Second mortgage with deferred repayment</b>	Neutral to negative	Yes	Yes	No
<b>Shared equity with deferred repayment</b>	Positive where there is implicit subsidy	Yes, but reduced to the extent of subsidy	Yes	No
<b>Shared equity with rental payments</b>	Slightly positive to the extent there is implicit subsidy	Yes, half-way between 2 <sup>nd</sup> mortgage and subsidized deferred repay	May depends upon implicit subsidy	No
<b>Shared equity with 'staircasing'</b>	Neutral – not a separate model	Yes, depends on structure	N/A	No
<b>Sale with buy back at a pre-established price</b>	Positive where there is implicit subsidy	Yes, but reduced to the extent of subsidy	Yes	No
<b>Rent-to-own</b>	Very slightly positive	Yes	Marginally if without subsidy	No
<b>Forgivable grant to purchaser</b>	Attractive but really neutral when alt. use of funds considered	No	Yes	Yes
<b>Forgivable grant to builder</b>	As above	No	Yes	Yes
<b>Repayable interest free loan to purchaser</b>	As above	A little is kept, but much reduced	Yes	Yes
<b>Assisted savings plans</b>	As above	No, subsidy is lost to sector	Yes	Yes
<b>Sweat equity</b>	Positive	Neutral (no money out)	Yes	No
<b>Land trusts</b>	Negative	Yes	Yes	Yes

## V. Conclusion

The three objectives of this paper were stated in the introduction:

- 1) Assessing whether home ownership is a reasonable financial strategy for low income Canadians to increase their savings;
- 2) Describing current initiatives to assist low income Canadians to own a home; and
- 3) Assessing the extent to which these initiatives are effective in helping low income Canadians increase their savings.

We have shown here that, from a strictly financial perspective, buying a house is not likely the best way for low income households to acquire wealth, everything else being equal. Analyzed purely as an investment strategy, buying a house has many of the characteristics of a poor investment. A house is a single, huge expenditure made at a point in time, rather than smaller amounts being invested periodically over an extended period. Buying a house entails high transaction costs making it an illiquid investment from which it is expensive to extricate oneself. The housing market is not stable and predictable: rather it is volatile and subject to large price swings. Therefore market timing matters a lot. A house is almost always a highly leveraged investment, so it is wonderful when things go well, but it can result in huge losses when things go bad. All of these findings were confirmed by our analytic model of the ‘buy or rent’ alternatives, using retrospective Canadian data. In short, a house is not a diversified investment strategy with a low risk profile, which is likely the savings strategy that an objective financial analysis would recommend, especially for a low income family.

In the US it was found that a significant percent of low income households did indeed lose money. Looking at homes held over a 5½ to 8½ year period, losers ranged from a high of 52 percent in Philadelphia to a low of 13 percent in Denver [Belsky et al 2005]. There is no reason to think that Canadian markets are any different. At the very least, these results imply that advocating and promoting home ownership for low income families must be undertaken with caution and due care. If, rather than a social service, home ownership were a medical procedure, would it be acceptable to promote use of a medical procedure where ‘only’ 52 percent to 13 percent of the patients were made sicker instead of healthier? If this were a randomized controlled drug trial, it would have to be stopped immediately on ethical grounds. Too often, social policy is treated as an ideological battleground where true believers fight it out for their favourite faith: too rarely are social policies subject to rigorous and objective analysis to find the best evidence as to whether good or harm shall likely result.

However, these observations are with respect to a house *only* as a financial investment. Other factors are not considered here, such as pride, security of tenure, and control of one’s own environment. As well, the financial alternatives we developed are only theoretical. In reality, there may be no equivalent housing available on a rental basis, so that good housing must be acquired through buying a house, or not at all. In many markets, there are no ‘buy or rent’ equivalent alternatives. Nevertheless it is important to understand the financial aspects of buying a home and consider these carefully along with the other factors that may encourage home ownership. It is one thing to feel proud of owning one’s own home when the home is

appreciating every year and adding substantially to the family's net wealth: quite another to feel proud and lose one's life savings.

The second purpose of the paper is met in the Appendix in which nineteen existing Canadian assisted home ownership programs are described. The information for these descriptions was difficult to obtain. Often the financial details available for the arrangements were at best sketchy. If there is ever any kind of 'assisted home ownership association' one small step might be to establish some minimum standards of financial disclosure and require these to be posted on Web sites, or otherwise to be readily available. Despite this absence of detail, these Canadian and other international programs formed an adequate basis upon which to distil assisted home ownership into a number of models as set out and assessed in Section IV.

Which assistance models are preferable, from a financial perspective? Buying a house is a risky investment for anyone, especially low income households. Some assistance models increase risk and potential reward: some models decrease risk and potential reward. Models that decrease risk are clearly preferable for low income households, even at the expense of losing out on some possible gains.

The model that most increases risk, because it increases leveraging, is the second mortgage with deferred repayment. If house prices depreciate, or even fail to increase more rapidly than interest rates, the owner may quite quickly be in a negative equity situation. Of course, the option of walking away from the home exists in Canada (in the UK the loan goes with the individual, not the home), but this is a major step which will likely impede any possibility of future credit for many years to come. Moreover, it means leaving any past investment behind, so it is not much of an option.

The model that most decreases risk is that of shared equity with deferred repayment. This model decreases risk because it lowers leveraging, so that the holder of the shared equity also bears some of the risk of house depreciation. Of course, this model decreases potential wealth accumulation, and this loss would be significant if there were substantial inflation, so it cuts both ways, but this model appears to be the most reasonable strategy for a low income household. In all models, it is advantageous to both the owner to permit buying back the share of the equity that is not owned – 'staircasing' to use the UK expression.

On the face of it, it might seem self-evident that models that contain a subsidy, such as a government or charitable grant, permit even greater savings than those that do not require a subsidy. This is incorrect. The correct comparison is not that of a house with a grant to an investment with no grant: rather it is to the purchase of a house with a grant and an equal grant being added to the investment side. In other words, given this level of government or charitable expenditure, is buying a home the best way to accumulate net wealth? A subsidy or grant is neutral with respect to the 'buy or rent' alternative.

This does not imply that there is no rationale for subsidies. A completely self-financing assisted home ownership program can have only quite shallow subsidies, without the vendor having to dip into its own capital resources – perhaps 10 to 15 percent of the market price. As a deferred shared equity loan this can be a reasonable amount of assistance and shave monthly

costs, but perhaps not enough in the more expensive markets to make homes affordable among any other than the upper end of the low income spectrum. A deeper discount to market price cannot be self-financing and requires government or charitable contributions, at least to set up a pool of capital. The capital could then be reclaimed after the home is sold, although that likely would be many years into the future and implies substantial loss of potential income that the capital could have earned in the meantime.

To go even deeper towards affordability requires more than a self-sustaining capital pool to set up shared equity loans, even if the pool is formed initially through government subsidies. If the vendor's share of equity is too deep – say more than 30 percent or so – then the owner does not really own the home with a deferred payment shared equity loan and this may have perverse effects on maintenance and so on. As well, upon resale the owner would never be able to buy an equivalent accommodation in the same market. Thus to go further towards affordability does require some form of outright grant or forgivable loan.

Caution is needed in offering inducements for home ownership such as grants and forgivable loans. As we have seen these do not add to the inherent quality of a home as a way to acquire assets, so why should they be used? If there is a significant government grant it is presumably to meet some public goal beyond the private good of the home buyer, such as neighbourhood regeneration. But we need to be properly wary of behavioural inducements, especially where the state and its agents are using overwhelming financial power to get low income families to do something they would not have otherwise done. For example, is it good policy to use grants to induce low income families to buy a home in declining neighbourhoods in the hope that a few home owners scattered here and there can reverse the decline? If this strategy does not work then the homeowner and their children will be trapped in a bad neighbourhood, likely by a forgivable loan requiring a pre-determined length of ownership, while the price of the house deteriorates around them.

Home ownership is one of several forms of tenure possible for housing. It offers many benefits and some risks. Doubtless it is suitable for many low income families, but not for others. We have found here that it is not *necessarily* an assured road to riches, or even to a moderately improved level of wealth, for all low income families.

## **Appendix A: A partial inventory of Canadian initiatives to assist low-income households to own homes**

### ***Affordable New Home Development Foundation (Saskatoon)***

The Affordable New Home Development Foundation is a registered non-profit organization that was created in 1999 to assist qualifying families to become homeowners by providing education, support, financial assistance, and housing options to families and individuals that want to buy their first home.

Starting with the Borden Crescent Pilot Project in 1999, the Foundation helped five families become homeowners. Since then, over 200 families have been able to buy brand new homes in various neighborhoods throughout the city, including Parkridge, Confederation, Fairhaven, Forest Grove and Silverspring. And, with the ongoing education and support that the Foundation provides, there are many more on the road to home ownership.

All new homes are constructed by builder members of the Saskatoon & Region HBA and are backed by a New Home Warranty to offer the maximum in quality construction and consumer protection.

The Foundation targets individuals and families with annual household incomes of \$40,000 or less. Families and individuals in this income range are often paying rents approximately equivalent to monthly principal and interest payments; however, because of real or perceived barriers, they are not able to purchase a home through the normal channels. The foundation works with people to help overcome these barriers, leading to the purchase of a new home.

### ***Calgary Community Land Trust Society (Calgary)***

The Calgary Community Land Trust Society (CCLT) is a newly established organization whose focus rests strictly on the acquisition of land and cash donations for affordable housing. CCLT does not manage housing, but rather partners with local non-profit and charitable organizations with that experience and reputation. [Housing Strategies Inc. 2005] It appears that the Land Trust has one project now nearing completion: a 27 unit townhouse development being built by Habitat for Humanity (13 homes have been completed and 14 more should be completed in Spring 2006).



## ***Central Edmonton Community Land Trust (Edmonton)***

CECLT began in 1997 when a group of residents, members of local community groups, and social service agencies began meeting to discuss potential solutions to the lack of adequate and affordable housing in inner city Edmonton. CECLT was officially incorporated as a non-profit corporation in September 1998. For its first housing project, the CECLT Board of Directors looked at over 100 existing properties in the inner city (McCauley and Norwood neighbourhoods) and eventually purchased 14 single-family homes and 3 duplexes (six units). Each of these properties was in substandard condition and in need of renovation. Since then, CECLT has purchased an additional two single-family homes, bringing its total portfolio to 16 single family homes and three duplexes (22 units). Original funding was from a series of grants from a variety of governmental and non-governmental sources, as well as a loan.

Using a variety of CMHC and other grants to purchase existing homes in inner city Edmonton that are in substandard condition, renovates these homes and makes them available to CECLT member households CECLT uses a rent-to-own approach to promote affordable homeownership among low- and moderate-income households.

The organization currently (as of 2005) has rents in arrears, three properties are currently vacant (CECLT's business model can only support one vacancy at any given time and remain viable), and CECLT has not been actively recruiting new qualifying households. One household was even found to have rented its home out to another non-qualifying household!

[Housing Strategies Inc. 2005]

## ***Centretown Affordable Housing Development Corporation (CAHDCO)***

The objective was to ensure the housing was targeted at those not currently being served by the private market. In the absence of new rental housing programs, home ownership is more and more seen as the only way to extricate low-income families from the continuing cycle of dependence on an unstable and often inappropriate rental housing market. At Clarence Gate, CAHDCO's target group included households with annual incomes of \$31,500 to \$48,500, paying rents of \$780.00 to \$1,205.00 per month and possibly more in the private rental market. A market study, undertaken by CAHDCO, indicated the affordable tenure model was particularly attractive to and financially viable for working families.

The Not-for-Profit Condo is a new tenure arrangement that is designed to balance the need for the sponsor to retain control of resale and ensure long-term affordability, and the homeowner's need to protect his or her equity. Clarence Gate was registered as a condominium. The condominiums are managed according to the Condominium Act, and CAHDCO will only become involved when units are sold. CAHDCO will then exercise its option to buy back the unit. Owners will receive their full purchase price plus any

increase or decrease in the housing component of the Consumer Price Index during the time they have owned their home. CAHDCO will discount this sale by a 3 % charge for administration and resale.

New 30 unit stacked townhouse ownership project launched in 2001; fully occupied in 2003.

The following section is from Connelly Consulting Services and Tim Welch Consulting. 2004.

#### Eligible Households

- Priority given to CMHC core need income thresholds in City of Ottawa (2002):
  - Maximum one bedroom income \$31,500
  - Maximum two bedroom income \$39,500
  - Maximum three bedroom income \$48,500
- income increases after purchase do not affect right to own
- 19 units targeted towards households eligible to receive a housing subsidy in social housing including existing CCOC and other non-profit housing residents, 11 units sold on open market at full price

#### Type of Homes Eligible

- Price: one bedroom - \$105,000; two bedroom - \$124,000 - \$135,000, average \$124,200; three bedroom - \$130,000 - \$144,000, average \$135,900
- stacked townhouses
- New homes only, one development so far

#### Financial Assistance

- Land purchased from City of Ottawa at market price;
- no city development charges (as with all central city residential developments)
- in-kind staff contributions of CAHDC with no profit – house prices about 15% below market.
- Full price of 10 market units help cross subsidize 20 affordable homes
- CCOC short-term start up loan

#### Resale controls

- when home to be resold, CAHDCO has option to repurchase at original price plus change in Consumer Price Index. Home will then be resold to another low- or moderate-income household at below-market affordable price.

#### Counseling/training

- no formal education/training course for purchasers

### ***Colandco Co-operative Homes Inc. (Ontario)***

Colandco is now an essentially defunct land holding trust that worked within the co-op sector in Ontario to purchase and develop affordable and co-op housing. Its original funding was based on a \$2 million donation from Campeau Corporation. It developed and held in trust land for several co-ops in Ontario, but ran into financial trouble due to the difficult real estate market in Ontario in the early 1990s. As well, the co-op sector found the land trust model to be an expensive and cumbersome mechanism to keep land for non-profit use. Legally, Colandco still exists as it was too expensive to dissolve, but the co-ops have ensured that their lands will remain for non-profit use by registering a caveat on their Titles. [Housing Strategies Inc. 2005]

### ***Communauté Milton Parc (Montréal)***

“Communauté Milton Parc (CMP) is a “syndicat de copropriété”<sup>38</sup> in the ethnically diverse neighbourhood of Milton Parc in Montréal, Québec. CMP was created in 1987 to support the joint ownership of land by housing co-operatives and non-profit corporations. CMP is the largest co-operative neighbourhood in North America and it demonstrates the effective use of a syndicate of this type to ensure the perpetual affordability and non-profit status of the housing stock.” [Housing Strategies Inc. 2005 32]

### ***Community Housing Land Trust Foundation (Vancouver)***

A community land trust holding the land for six co-op housing developments in BC. Ensures a stable lease policy and that the lands will continue in the non-profit co-op sector. Land appears originally to have been a transfer purchased from the province, but with a variety of grants and donations to reduce costs. [Housing Strategies Inc. 2005 32]

### ***Fair Gains & Owen Hart Homeowners Program (Calgary)***

MCC Employment Development has operated this program since 1999. The first-stage one-year Fair Gains Program requires the participants to save a minimum of \$15 to a maximum of \$45 every month. These savings are further matched at a rate of 3:1. Participants are expected to attend regular workshops, peer group meetings, and one-on-one counselling. The authorized uses include savings for adult or child education, business start-up or expansion, and home purchase. The second stage Owen Hart Program is devoted to homeownership. Participants who continue into this second one-year program save only for home purchase. The minimum and maximum monthly savings of \$45 and \$90, respectively, are matched at 4:1. Participants are required to attend education courses specifically designed for homeowners. As of early 2002, five participants have purchased a home.

## ***Habitat for Humanity Overview 2004***

Habitat for Humanity is an independent, non-profit housing program dedicated to the elimination of poverty housing by building homes in partnership with families in need. The ministry of Habitat is to provide simple, decent, affordable housing to those who would not qualify or be able to afford a conventional mortgage. The Habitat program is about home ownership, a long-term solution designed to break the poverty cycle. The income of all Habitat homeowners is reviewed on an annual basis. If income increases, monthly mortgage payments are adjusted to remain at 30% of their monthly income. If income decreases, usually due to a temporary situation such as a job loss, similar adjustments may be made to maintain affordability during this period of decreased cash flow. Habitat for Humanity is committed to educating and supporting partner families toward successful homeownership. This commitment has resulted in a mortgage default rate of less than 1% in Canada.

### ***Home Ownership Affordability Partnership, Hamilton (HOAP)***

In Hamilton, Ontario, the recently launched Home Ownership Affordability Partnership (HOAP) is helping tenants get out of city-owned public housing and into home ownership. HOAP is a partnership between the City of Hamilton, the Realtors Association of Hamilton-Burlington, the Hamilton-Halton Home Builders' Association and the Threshold School of Building. Its goals are to promote affordable homeownership, enhance the quality of existing housing stock, and build technology skills for youth at risk.

Families are selected based on need and ability to secure a zero percent mortgage. With help from volunteers, families select and purchase a run-down or neglected home, which is inexpensive because it is in need of repair. The family contributes to the redesign and renovation plan. As homeowners, they are eligible for a Residential Rehabilitation Assistance Program (RRAP) grant from CMHC and the house is used to train youth in building trades. Costs are kept low, Keith Extance, Hamilton's program manager told Housing Again, by donations of cash and building materials. Older homes are to be renovated using donated labour (provided by a non-profit community group with renovation expertise), with additional financial assistance of up to \$18,000 provided under the federal government's Residential Rehabilitation Assistance Program. The City of Hamilton is also beginning to design an education program to assist social housing tenants make a successful transition to home ownership.

A similar program exists in Saskatoon, Saskatchewan. The Affordable New Home Development Foundation is a non-profit organization with a board of directors drawn from the community, the Saskatoon and Region Home Builders' Association and the municipality.

## ***Independent Living Accounts Demonstration Project (ILA)***

A Social and Enterprise Development Innovations (SEDI) incentive assisted saving demonstration project for persons living within transitional housing. Overall, this project, completed in March of 2006, indicates that the ILA project components are effective in increasing the human capacity of those living within transitional housing by providing them with practical tools and incentives that allow them to change their savings behaviour. In addition, the ILA project outcomes clearly identify that those living under very constrained financial circumstances CAN and DO save when given the right incentives and supports. In fact, the project's saving incentives, together with financial capability training and strong community-based case management, resulted in 78% of the enrolled participants opening bank accounts to commence savings and 57% of those participants cashing out and moving from the transitional housing facility into more appropriate and affordable housing. Overall, participants in this project collectively saved over \$33,000, leveraging over \$78,000 for approved goal attainment. In addition, many of the participants went on to save beyond what was required for the project commitment.

## ***Manitoba Homebuyer Down Payment Assistance program***

This Affordable Home Ownership Initiative (AHI) program will help first-time homebuyers access new or recently renovated affordable housing, developed under the AHI, by providing financial assistance for a down payment. The Homebuyer Down Payment Assistance Program will target low- to moderate-income applicants below the AHI maximum household income limit. To be eligible, homebuyers must be renters who can afford to operate and maintain a home. Home purchases must be valued at \$90,000 or less. The homebuyers must live in the house for at least 10 years. If they sell or move before then, they must repay a portion of their loan. Homebuyers will be encouraged to take a homeowner education course, such as those offered by a financial institution or the Canada Mortgage and Housing Corporation.

If a house costs between \$60,000 and \$90,000, the down payment assistance is 10 per cent of the purchase price of the house. If the house costs less than \$60,000, down payment assistance will be 15 per cent of the purchase price. The maximum amount provided by the program will be \$9,000. [From [http://www.gov.mb.ca/fs/housing/downpayment\\_assistance.html](http://www.gov.mb.ca/fs/housing/downpayment_assistance.html)]

Likely there are similar programs providing down payment assistance in other provinces as well.

## ***Options for Homes (Toronto)***

A Home at Last, November 27, 2004, Dee Gibney, Toronto Star

The provincial and federal governments are collaborating on an innovative housing program to help low- to moderate-income renters buy their first home. Joining forces with Options for Homes, a private non-profit developer of affordable condo and

townhouse projects in Ontario, the two levels of government will lend just over \$25,000 for down payments to people who qualify.

It's a life-changing program for people like Kartik Mehta, 55. Born in India, Mehta is a former chemist in the pharmaceutical industry who once held a number of lucrative contracts in the Middle East and Zimbabwe.

Now renting an apartment in Scarborough, Mehta pays \$850 a month — more than two-thirds of his income. "I saw that I could carry a small apartment for \$650 and I saw if I had a little down payment, they could help me," says Mehta. "I thought, 'I'm paying \$850 a month now. I can do this.'"

To qualify for the program individuals must be renting. The annual household income must be less than \$45,000 and the carrying costs for the Options for Homes condo they plan to buy must be more than 32 per cent of their income. The funds to cover the new initiative are part of a \$2.3 million commitment made by the two levels of government to Options for Homes to build 382 affordable condo units in Scarborough, Pickering and Markham.

The money is a combination of provincial sales tax and land transfer tax rebates, matched by federal government funds totalling up to \$750,000 per project. Each suite will receive \$2,000 in provincial sales tax construction cost rebates and a further \$1,500 in land transfer tax rebates, both matched by funds from the federal government, then pooled in each project to enable individuals who qualify to receive \$25,470. The government funds will appear as an interest-free mortgage, which owners must repay when they sell or if they decide to rent out their suite. If they die, their estate is responsible for the payback. Plus, they must repay the amount if their income improves by as little as \$6,000 to \$7,000 annually, explains Options for Homes founder and president, Mike Labbé.

"It's in their best interest for people to pay it back as soon as they can," Labbé points out. Options will monitor owners' incomes for signs of improvement by asking them to report back in a yearly letter. The funds can be paid back in increments over time. In addition to the mortgage repayment, sellers must pay a percentage of the profit accrued through the suite's appreciation. This money is then ploughed back into the building of further Options projects.

This government loan works in tandem with Options' payment-free second mortgage structured to enable modest income first-time buyers to purchase from "no frills" projects offered at below market rates. The pilot program, unveiled earlier this month, is designed to help people like Jane Clarke. At 42, saddled with loans taken to finance her postgraduate degree, the dream of owning her own home eluded her. "It was a wish, really something that I never thought would ever be realized," says Clark, who works four part-time jobs to scratch together \$34,000 a year.

Her rent was cheap — \$550 for a basement apartment in a house at Weston Rd. and Highway 401. But she lived with the constant worry that some day "someone would

come and say, 'okay, you have to move out because my aunt is moving in.'" With a \$6,000 down payment, an \$8,000 second mortgage from Options and \$25,470 from the new federal-provincial program, she was able to qualify for a \$116,000 mortgage on a one-bedroom condo selling for \$155,000 at the Village at Guildwood. "

In Mehta's case, he was able to come up with a \$4,000 down payment on the \$103,247 price for the 435-square-foot condo from his savings. Options contributed \$24,133 as a second mortgage augmented with the \$25,470 from the new government loan program, leaving Mehta with a \$49,644 first mortgage.

It works like this. If a condo unit costs Options \$100,000 to build, it would normally sell for \$110,000 at market prices, but Options sells it for \$100,000 - the cost price. The difference of \$10,000 becomes the second mortgage. The down payment is based on the market value. "People expect the down payment to be on the money they are contributing -but we are giving them \$10,000 toward their down payment to start with," Labbé explains." So a minimum 5 per cent down based on the market value of \$110,000 is \$5,500," The down payment is taken off the cost price (\$100,000) leaving the buyer with a mortgage of \$94,500, \$10,000 less than they would have had to pay at full market price. As the condos appreciate, so does the second mortgage, an amount buyers must repay only if they rent or resell. This money then goes into an equity pool that is used to develop other similar projects.

## **Quint (Saskatoon)**

Quint Development Corporation was formed in 1995 by residents of the five neighbourhoods that comprise the inner city of Saskatoon. This not-for-profit community organization was created to help local people work together to improve the social and economic well-being of their neighbourhoods. Quint is guided by the belief that local residents are the primary agents for rejuvenating their community. It adopted a community economic development perspective in which the community would direct its own multifaceted, long-term renewal process.

Beginning with an innovative affordable housing program that is rebuilding the community physically, socially and economically, Quint gradually has begun to expand its range of activities to address other important issues e.g., housing and education for young single mothers, self-employment training and a community-based industrial development strategy. It is an exemplary model of how communities can take action to address their own social and economic needs. [Usiskin, L., Szejvold, L et al., (2001) *Quint: CED and Affordable Housing in Saskatoon* Caledon Institute of Social Policy: Ottawa]

## ***Regent Park redevelopment (Toronto)***

Toronto Community Housing is looking at ways to create 300 – 500 homes at Regent Park that tenants could afford to buy. This spring, it hired consultants to study ways to reach this goal. Here is a summary of the consultants' findings.

The study found that new ownership homes at Regent Park would cost between \$83,000 and \$267,000 to build depending on the size of the condominium apartment or townhouse unit. Most Regent Park tenants cannot afford these prices. The “affordability gap” ranges from zero to over \$229,000, depending on the household's income and the size of unit the household wants to buy.

Is there a way to bridge this gap? Yes, but only if all three levels of government help out. Toronto Community Housing can't afford to bridge this gap by itself. The consultants' report suggests that Toronto Community Housing invite Regent Park tenants to help ask the Federal, Provincial and City governments for the money needed to make home ownership affordable.

What would make the homes affordable? To make the homes affordable for both the first and future owners, the report suggests that:

- Toronto Community Housing help cut the cost of the homes by not charging any money at first for the land the homes will be built on (but waiting to be repaid for the land when a home is re-sold); and using some income it is planning to get from selling Regent Park land for the market-price homes (as long as the entire Regent Park plan works)
- Toronto Community Housing partner with SEDI to help tenants save to buy a home. SEDI is a non-profit organization that already runs a successful “Learn/Save” program in Ontario. SEDI would like to develop a “Home/Save” program, where tenants could save money for a down payment, get matching funds for these savings from the federal government, learn how to improve their credit rating, and learn more about financial management and home ownership.
- The Federal Government be asked for: pilot funding for the “Home/Save” program; funds to match the savings each homeowner makes for a down payment mortgage insurance; some money from its new affordable housing program
- The Provincial Government be asked: To match the Federal contribution under the planned housing program; To help guarantee the mortgage; To change the rules that stop Ontario Works (Ontario's welfare program) and Ontario Disability Support Program recipients from owning a home
- The City of Toronto waive development charges and permit fees, and ideally, property taxes for the first owner
- That Toronto Community Housing “stack” its own contribution, and any government funds, into one package – a second mortgage. Homebuyers would repay this mortgage only when they sold the unit. Toronto Community Housing would get back the same percentage of funds it put in. If, for example, the stacked assistance was 60% of the original cost of the unit, Toronto Community Housing would keep 60% of the re-sale price and the household would keep the rest.



Toronto Community Housing could then use this money to bring down the purchase price for future owners. [From Connelly Consulting Services and Tim Welch Consulting. 2004]

### ***The Royce – Dupont project (Toronto)***

In 1994 the former City of Toronto initiated a different approach to affordable ownership at a City owned piece of land in the Royce - Dupont area. This land would be tendered to developers who were to produce low-end-of-market ownership housing. There was to be no capital subsidy, as the City intended to encourage modest-size, low-end-of-market housing.

The Royce – Dupont project targeted tenants of, or applicants to the (former) Cityhome who either required shallow subsidy or could afford market rents. The proposal call resulted in Arcadia Group being selected to build 24 townhouse units targeted to existing municipal non-profit (Cityhome) households earning approximately \$37,000 to \$43,600 per year. The homes were sold at the price range of \$116,000 to \$136,000.

The affordability of the homes was helped by first mortgages offered by the developer of 25 to 50 basis points below the market mortgage rates and by various Cityhome (now TCHC) contributions.

To enforce long-term affordability, a second mortgage of \$20,000 (representing the approximate difference between the purchase price and the market value) was to be held for 12 years by the developer. The interest rate for this second mortgage was set at 6% annually, with a portion of the principal and interest to be forgiven each year. Any sales in the first 12 years would see a portion of the increased value of the home to be paid to Cityhome for future reinvestment to help new purchasers buy affordable homes. [From Connelly Consulting Services and Tim Welch Consulting. 2004]

### ***Region of Waterloo***

A pilot initiative launched in 2003, partnering with non-profit builders including Habitat for Humanity and Options for Homes; no purchasers have yet moved into any homes.

#### Eligible Households

- Eligibility maximum household income \$44,000
- Targeted towards existing social housing residents or households of coordinated access waiting list
- Must obtain private mortgage financing

#### Type of Homes Eligible

- maximum price of \$135,000
- townhouses and condominium apartments
- New homes only

#### Financial Assistance

- Interest-free loan, registered as a second mortgage, repayable when home resold, plus share of equity appreciation
- loans funded by Region of Waterloo
- purchaser can contribute up to \$2,500, which will be matched on a 2:1 basis by Region, in addition cost of Region Development Charge (approx. \$3,400) is loaned interest free until house is sold, secured as a second mortgage.

#### Resale controls

- when loan repaid, funds will be recycled to another eligible ownership applicant.

#### Counseling/training

- exploring partnership with community based agency to provide 15 hours of home buying training at a cost of \$9,500 for up to 30 clients (\$320 per household), this education program funded by Region of Waterloo.
- also exploring ongoing savings program and counseling support
- currently no post occupancy counseling or support planned

[From Connelly Consulting Services and Tim Welch Consulting. 2004]

### ***West Broadway Community Land Trust (Winnipeg)***

The West Broadway Community Land Trust (WBCLT) was planned to use a rent-to-own approach to provide affordable homeownership opportunities for to low- and moderate-income households in inner city Winnipeg, Manitoba. WBCLT's experiences demonstrate some of the challenges Community Land Trusts in Canada face in the absence of both an established a tradition of CLTs in the country and a nationally-focused body (such as ICE in the U.S.) providing technical assistance, expertise and resources from the Canadian perspective. [From Housing Strategies Inc. 2005]]

It seems that the 22 units that have been rehabilitated by the Winnipeg Housing Rehabilitation Corporation will not in fact be handed over to the Land Trust. Five homes have been sold on the open market at market prices. It is not at this time clear whether any of the rent-to-own families will actually get to own their units.

### ***Winnipeg: Housing IDA Program***

Winnipeg's Housing IDA Program has been operated by the Alternative Financial Services Committee, North End Community Ministry, Assiniboine Credit Union, Mennonite Central Committee, SEED Winnipeg and United Church Conference

partnership since October 2000. Participants are required to save a minimum of \$15 to a maximum of \$250 every month. Savings are matched at a rate of 3:1. Attendance of money management course is required. To date, three of the forty program participants have purchased homes and a number of participants have cashed out partially or fully for home renovations. The average monthly saving is \$75.

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