Intelligence MEMOS

From: Jeremy M. Kronick

To: Toronto and Vancouver Millennials

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Re: Are shared mortgages the fix?

On June 6, 2017, in a much remarked speech in the House of Commons, you rightly extolled the virtues of a global order based on rules, including rules promoting, as you put it, "free and friendly trade."

As you noted, it is clear that the order carefully built by earlier generations is under great stress. Recent actions and pronouncements by the US administration threaten to shrink global trade and its attendant prosperity. Meanwhile, China, while moving toward greater trade openness in some respects, is in other respects acting in ways that many perceive as damaging to fair competition and even to global security.

After nearly a decade of policies geared at cooling an overheated housing market and trying to slow growth in household debt, Ottawa made affordability the name of the game in Budget 2019. The Department of Finance introduced the First-Time Home Buyer Incentive (FTHBI), whereby eligible first-time homebuyers can apply to enter into a shared equity mortgage with the CMHC. Like others, I have previously pointed out the tension between restraining household debt and helping people borrow. That tension likely helps explain the provisions in the incentive that seem likely to limit severely the number of people who will ever use it.

First, more detail on the plan itself. In Canada, the minimum downpayment requirement is 5 percent of the purchase price of a home. So, if the house price is $1,000,000, you would need $50,000, leaving you with a $950,000 mortgage. Under the FTHBI, qualified borrowers need the minimum required downpayment. While the budget is not explicit on this point, it seems likely a prospective buyer would need to pass OSFI's mortgage stress test, proving they can afford the mortgage at the higher of the Bank of Canada's five-year posted rate or 200 basis points above the mortgage rate they were offered.

If a household meets these criteria, and they have a household income below $120,000, they can apply to receive a shared equity mortgage where CMHC contributes 5 percent on an existing home, or 10 percent on a new build. This additional contribution means smaller monthly debt servicing costs during the entirety of the mortgage, but it also means CMHC will have to be repaid.

The big question is whether those currently priced out of expensive housing markets will benefit from this program. While housing affordability is an issue everywhere, most of the attention has to do with the 18-35 year olds trying to buy in Toronto and Vancouver. How many people in that situation will be willing and able to use the FTHBI?

To begin with, an applicant who can come up with a 5 percent downpayment and pass OSFI's mortgage stress test might not be priced out of the housing market to begin with. Some households who might have bought anyway and use the FTHBI will be able to bid more. If they do, others who might have qualified will find the higher price of houses knocks them out of the running.

As for the plight of young would-be homeowners in Toronto and Vancouver, if the maximum annual household income cannot exceed $120,000, and the insured mortgage plus the incentive amount cannot exceed four times $120,000, the property price presumably cannot exceed $480,000. Average condo and detached house prices (two ends of the housing price extreme) in Toronto in 2018 were $516,500 and $907,200 respectively. In Vancouver they were $660,300 and $1,443,100 respectively.

As I stated before the budget, the better solutions lie on the supply side, and, indeed, the budget did discuss such measures. However, the FTHBI has been one of the budget provisions that has attracted favourable comments, and its political appeal may, unfortunately, be its most salient success. More details are to come, but millennials in Toronto and Vancouver are unlikely to be able to declare victory any time soon.

Jeremy M. Kronick is Associate Director of Research at the C.D. Howe Institute

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