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March 19, 2019. For Immediate Release

Federal budget bravely resists calls to soften mortgage stress tests

More work required to restore housing affordability by 2030

Amid pressure from real estate boards that lament home sales aren't at record highs, the Liberal government bravely resisted calls to soften stress tests and amortization policy that would have encouraged younger people to borrow more than we should, inflating demand, and driving up home prices. These patterns ultimately force younger Canadians to pay more, and punt the hard work to recouple home prices with earnings to future generations.

The tough pill to swallow now is that housing becomes more affordable when home prices stall, or dip, by comparison with earnings. The federal government reconciled itself to this reality more in this budget than in the past.

This leaves space for Ottawa to welcome last year's slowdown, as Generation Squeeze has been encouraging. Average home prices fell from $522k in 2017t o $489k in 2018, adjusting for inflation. As a result, the number of years of full-time work required to save a 20% down payment fell from 14 years in 2017 to 13 years in 2018. In other words, the price drop saved first-time home buyers an entire year of work! (Alas, 13 is still way more than five years, which was the average work required when my mom started out in the housing market).

Instead of relaxing mortgage rules, Mr. Trudeau's team adjusted the Home Buyers' Plan (HBP). It now allows first time home buyers to withdraw up to $35,000 from their registered retirement savings plans (RRSPs) to purchase a home – up from the previous $25,000 limit. Being able to use another $10k in income that is sheltered from taxation can add up to thousands in a tax subsidy for purchasing a home, although the amount of savings depends on a person's income tax rates. This is the kind of "election candy" we predicted from this pre-election budget.

More interesting is the federal decision to try to scale up "shared equity" loans. The budget allocates the Canada Mortgage and Housing Corporation (CMHC) funds to help first-time home buyers lower their borrowing costs by sharing the cost of buying a home. For households with income below $120,000, CMHC will kick in 5%-10% of the purchase prices, which reduces the mortgage and borrowing costs required by first-time buyers. When the home is resold, CMHC will be repaid its 5%-10% share of the home equity.

The details of the plan have yet to be shared, and the budget indicates that CMHC will release more information shortly. The idea is certainly better than relaxing stress tests generally, and moves CMHC into a novel position of building "shared equity". But we must all be careful to monitor the degree to which these loans reignite the kind of home price inflation that compromises affordability now and for future generations.

Given the gap between home prices and earnings, the government also recognized the need to grow the supply of purpose-built rental homes in anticipation that more younger Canadians will rent for longer periods of their lives, if not indefinitely. This budget adds nearly a billion per year for the next decade to provide developers with favourable borrowing rates when they build rental. Since the industry had wanted Ottawa to eliminate GST on new purpose-built rental units, it remains uncertain whether developers will take up the new financing to build new rental homes.

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Several other brave housing decisions are still needed from Ottawa, starting with a bold goal.

Every federal political party should adopt the Canada Mortgage and Housing Corporation goal that all residents be able to afford a suitable home by 2030. This will require policymakers to restore the idea that housing is for homes, *not* top performers in investment portfolios. If we want to protect home prices for future generations, we can no longer want, or tolerate, home prices growing faster than local earnings.

This requires a Tax Shift (tax bads more; tax goods less) by raising taxes on unhealthy home values to slow down home prices, and pay for tax cuts on typical earnings. Income tax cuts could be targeted to renters and younger adults who have not benefitted from the escalation in home equity through ownership. The federal budget takes a baby step in this direction by increasing the capacity of the Canada Revenue Agency to monitor the sale of principal residences, flipping, and real estate fraud.

Ottawa should also incentivize cities to stop using residential land inefficiently by zoning for low-density. Mr. Trudeau's team should link access to the largest share of its housing, transit and other infrastructure investments to municipal density targets. While it wouldn't cost Ottawa anything, it would give mayors and councils some political cover to approve density in the face of NIMBY'ism, because doing so would be required for their community to receive the largest share of federal transfers.

Finally, Canada won't meet CMHC's affordability goal in 2030 unless home prices fall, and/or young people's incomes grow, at rates we haven't seen for decades.

Since neither trend is likely, we need federal parties to search for other policy options to reduce rent-sized costs in young people's lives. Child care and parental leave are prime options. If these weren't rent-sized payments, younger Canadians could better manage with modest, rather than dramatic, drops in home prices. This would protect home equity for those who bought into the market earlier, including our aging population.

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