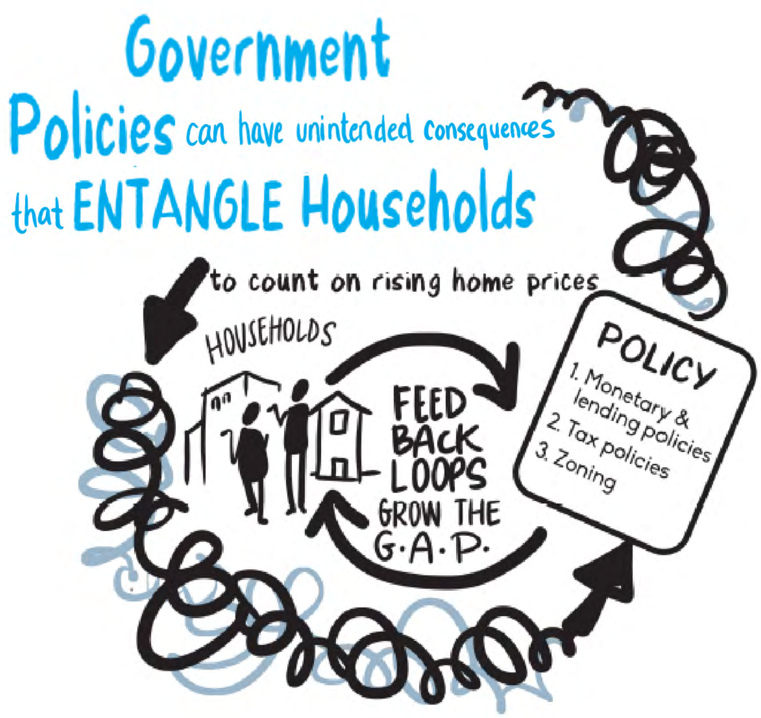
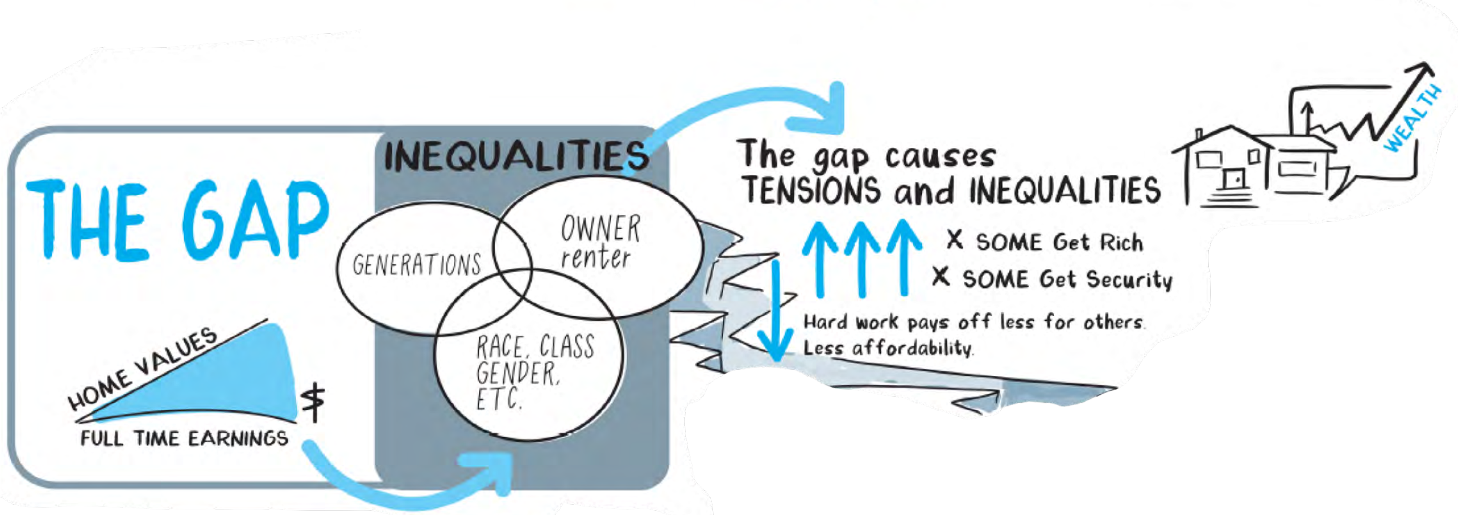
Wealth and the Problem of Housing Inequity across Generations:

A Solutions Lab





GENERATION squeeze

This project received funding under the National Housing Strategy's Solutions Labs Program.
For more information visit: www.cmhc.ca/SolutionsLabs.

CMHC SCHL

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A number of CMHC employees took part in the lab as independent participants providing technical expertise and advice. The views expressed are those of lab participants and should not be attributed to CMHC or to the Government of Canada.

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What is a Solutions Lab

This Solutions Lab was established as a collaboration between Generation Squeeze and the Canada Mortgage and Housing Corporation. Solutions Labs are a program under the National Housing Strategy.

Solutions Labs are also referred to as social innovation labs, change labs, or design labs. Such labs aim to tackle complex societal challenges that require systems change, and which have not been solved using conventional methods. The labs are therefore not intended to be academic exercises typical of research at universities.

Rather, labs fuel bottom-up collaborative innovation by bringing diverse groups of people together in search of new ways to solve complex housing problems. They provide a safe space for diverse perspectives to come together, for assumptions to be questioned and to experiment with housing solution.

The challenges that Solutions labs tackle are not black and white—they are layered in complexity, often messy and at times daunting or even controversial. Part of the role a Solutions lab is to deepen stakeholder understanding of the specific challenge by exposing them to perspectives of other stakeholders. It is presumed that no one group has the answer – but by enabling groups to work together, the lab can develop collective, relevant and responsive solutions, as well as identify "potential champions" who are best positioned to scale-up those solutions.

The solutions are developed by stakeholders for consideration by governments, rather than the other way around. It is anticipated that lab findings have potential to support decision-making at all levels of government. However, there is no direct link between the lab activities and any specific government branch or department of government.

Source: CMHC Solutions Lab Fact Sheet

The style and tone of the following report reflects the Lab's commitment to bottom-up collaboration among diverse stakeholders in search of common ground to spur innovation. This final report is not written as an academic paper or technical report with an extensive literature review or bibliography. Instead, it is a summary of the creative ideas that emerged from a diversity of actors exploring common ground.

Many academics and other technical experts participated in this Solutions Lab. All would encourage that the creative exploration of new solutions spaces resulting from the identification of common ground in this Lab should continue to be fleshed out in light of further economic modeling and the existing academic literature. Readers will find that discussion of the Lab's recommendations specifically includes reference to priorities for further inquiry to refine and strengthen the ideas co-created by Lab participants.

Acknowledgments

As an exercise in bottom-up collaborative innovation, the ideas generated by this Solutions Lab reflect insight shared by many bright minds and generous hearts, including over 70 industry, community and academic thought leaders. We thank all of them for their time, their talent and their openness to searching for common ground.

Lab leadership drew from three organizations: the Canada Mortgage and Housing Corporation, Watershed Partners, and Generation Squeeze. Tackling housing challenges that are layered in complexity, and viewed by many to be controversial, can be messy, even daunting, work. This is especially so when the work is done amid a pandemic that required Lab plans to shift entirely online, in a context where Lab leaders have still not all met together in person. As a result, the road to completing this Lab was not always smooth. We appreciate the goodwill and charity of spirit that various leaders within all three organizations brought to the Lab to see it through to a successful completion.

Graphics featured throughout this report were created in collaboration with the graphic artist Laura Hanek of Swoop Media and Sam Bradd of Drawing Change.

The many strengths of this Lab report reflect the collective wisdom of all who contributed. Responsibility for any weakness falls to the report author, Dr. Paul Kershaw, University of BC professor in the School of Population & Public Health, and Founder of Generation Squeeze.

Executive Summary

Problem statement

Canada is experiencing dramatic housing affordability challenges caused by the growing gap between local earnings and average home prices, especially for younger generations of renters and aspiring owners, newcomers of any age, and seniors who are renters. This gap is a major impediment to achieving the Canada Mortgage and Housing Corporation (CMHC) goal that all Canadians can afford a home that meets their needs by 2030. It also drives wealth inequalities, and elevates risks that some Canadians become highly leveraged when borrowing to make a home.

Lab premise

The Solutions Lab began from the premise that many everyday Canadians are entangled in perpetuating an unsustainable, unaffordable housing system – because public policies incline us to organize our wealth strategies in ways that count on home prices rising faster than earnings.

The focus on everyday Canadians was deliberate and provocative. Dialogue on housing unaffordability in Canada tends to focus on what others have done to create and perpetuate the problem – foreign investors, money launderers, speculators, etc. While all of these actors do play a part, government initiatives to address their contribution have proven insufficient to restore affordability.

A missing ingredient with which Canadians have not yet grappled is the role that rising home prices play in creating wealth windfalls for everyday home owners. While high and rising home values have a negative impact on affordability for renters and aspiring owners, the same high and rising home values benefit others by increasing their financial security and growing their wealth. When everyday Canadians normalize such benefits, count on them, or pursue them, we reinforce feedback loops in the housing system which further fuel unaffordability and wealth inequalities.

The Lab surfaced tensions between these 'good' and 'bad' aspects of high home prices – as well as the policy levers that influence them. Participants sought – and found – considerable common ground on how policies can be adapted to move Canada towards the goal of affordable housing for all.

Actions and recommendations

The Lab identified three areas for policy innovation, and three working groups proposed specific recommendations in each one. This Executive Summary includes one-page briefing notes for each policy recommendation (see below), and more information is available in the full report.

1. Monetary and lending policy: Participants recommend aligning the mandates of the Canada Infrastructure Bank and CMHC to incentivize lending to scale up green co-op and affordable purpose-built rental supply.

Participants also recommend that Statistics Canada review the "owned accommodation" component of its Consumer Price Index (CPI) Calculation, and report annually about the influence of monetary policy on the growing gap between home prices and earnings.

2. Tax policy: Participants recommend implementing an annual (deferrable) progressive surtax on the 9% of homes in Canada valued at over $1 million, to reduce the tax shelter on principal residences that incentivizes Canadians to see rising home prices as a source of wealth accumulation.

3. Protective policy: Participants recommend creating a permanent housing affordability 'off-ramp' program and savings plan, to transition low-density housing into a pool of permanently affordable rental units, financed by a diverse pool of capital through a Perpetual Affordable Housing Bond.

Conclusions and next steps

The Lab was successful in helping to shape and refine opinion among leaders of the housing system by exposing participants to different viewpoints. It has refined people's beliefs about policy problems, and more importantly, the adaptations to policy that can contribute solutions.

The Lab succeeded in identifying considerable common ground among diverse housing and policy experts – leading to concrete proposals for action. However, the dialogue also reinforced that there is no 'silver bullet' to restore housing affordability. Rather, we need a 'silver buckshot' approach that addresses the full range of policy tools that shape Canada's housing system.

Implementation of a strong knowledge mobilization strategy for the policy recommendations generated by the Lab is the key next step. Generation Squeeze intends to mobilize resources to move the agenda into action. This will take building coalitions of supporters around each idea in order to grow the political cover for elected officials to disrupt the status quo that is failing to deliver affordability, and to set our country along a path that can restore affordability forever.

Stewardship teams have emerged from all of the working groups to nurture efforts to move Lab recommendations from ideas to action. However, new fund development efforts are required to sustain this important work.

Recommendation: Align the mandates of the Canada Infrastructure Bank and the CMHC to Incentivize Lending to Scale Up Green Co-op and Affordable Purpose Built Rental

The working group recommends aligning the mandate of the Canada Infrastructure Bank (CIB) with that of the CMHC to incentivize lending to green co-op and purpose-built rental construction projects that simultaneously promote national goals for housing affordability and net-zero carbon emissions.

Better aligning the work of these two Crown Corporations could leverage funds to supplement the Rental Construction Financing Initiative and the National Housing Co-Investment Fund, which CMHC currently implements. Sector leaders indicate these two programs are currently insufficient to scale up green co-op and affordable purpose-built rental. There remains an overall gap between the total funds available to the National Housing Strategy (approximately $70 billion) and the level of investment required to scale up affordable housing to sufficient levels. While there is no firm estimate of the additional investment required to fill Canada's housing gap, anecdotal estimates from some in the sector have suggested the figure is $200 billion or more.

Public funds allocated to the CIB or CMHC would need to be used for both granting and lending purposes. Grants are necessary to subsidize the 'affordable' and 'green energy-efficient' aspects of new developments, and to attract other investors to provide loans, because these elements of projects are often neglected due to market failures and cost constraints. In other words, more lending is necessary, but not sufficient, to get the job done.

As an Impact Investor on behalf of Canada, the CIB is a particularly important investor/lender to engage. Not only can it make low-cost financing available to commercial and non-profit developers, it offers a longer-term horizon for financing by comparison with most other lenders, without taking collateral. For example, energy retrofits/upgrades pay for themselves over time, and the CIB welcomes repayments made from the share of energy savings that accrue over time.

The Parliamentary Budget Officer reports that the Canada Infrastructure Bank is expected to fall $19 billion short of its lending expectations between now and 2027-28. Minimally, some of this shortfall could be used to target the following goals identified by the Co-operative Housing Federation of Canada.

The Co-operative Housing Federation (CHF) of Canada identifies a need for 90,000 new units of co-op and not-for-profit housing over the next 7 years, along with another 60,000 units of low-cost private rental housing that could be converted to non-market housing over the remaining seven years of the National Housing Strategy. The CHF estimates that $18.5 billion is required as grants to subsidize the lending required to build or convert these 150,000 units.

Recommendation: Task Statistics Canada to review the "owned accommodation" component of its Consumer Price Index (CPI) calculation, and report annually on the influence of monetary policy on the growing gap between home prices and earnings Source: Working group calculations based on Statistics Canada Survey of Financial Security (2016) data, adjusted for home price inflation to 2020

The review will require developing a supplementary measure of housing affordability to capture changes to "average home values relative to typical earnings." This adaptation is necessary so that official measures of "owned accommodation" and "housing affordability" go beyond:

- The current focus on monthly interest payments to also examine payments required on principal;
- The current reliance on the New House Price Index in order to monitor trends in prices for established housing.

This review by Statistics Canada is important, because CPI measurement has wide-ranging economic and policy implications. The Bank of Canada relies on CPI to set its interest rates. Governments use the CPI as a target for monetary policy, and to adjust tax brackets, transfer payments and pensions. Canadian businesses use measures of inflation when making decisions about wages and investments.

The Working Group recommended this review to respond to concerns articulated by groups like the **Business Council of BC**, which observes:

"It can seem hard to reconcile the stellar growth in house prices in recent years in Vancouver and some other Canadian urban centres with the modest growth in the consumer price index (CPI). Established house prices in Greater Vancouver and Victoria rose 81% and 56%, respectively, over the past 5 years, whereas the CPI for BC rose only 7.5%. The disconnect is partly due to the way Statistics Canada tracks the cost of "owned accommodation." In particular, estimates of mortgage interest and other costs facing homeowners are based on the New House Price Index rather than a broader measure of established house prices. The result is that CPI likely understates trends in living costs facing many households in BC and Canada."

Recommendation: Implement an annual (deferrable) progressive surtax on home values starting at $1 million

The working group recommends that federal and/or provincial governments implement an annual (deferrable) progressive surtax on homes valued over $1 million. This threshold ensures that the vast majority of Canadians would NOT pay the tax, as 91% of Canadian households do not own a property valued over $1 million. The tax will apply only to the 9% of households living in the most valuable principal residences in the country – including 13% of Ontario households, and 21% of BC households.

Deferrable means that the tax would not need to be paid until the home is sold, or the property inherited. This design detail would respond to the principle that policy adaptations should avoid imposing risks on individuals with limited income or wealth beyond the home in which they live. A competitive interest rate would be charged on any deferred tax payment. This deferral practice is already common across provinces when it comes to collecting annual property taxes from seniors.

The proposed annual surtax will reduce the tax shelter that incentivizes Canadians to rely more on rising home prices as a strategy for savings and wealth accumulation than they otherwise would. Reducing the tax shelter will disrupt feedback loops that fuel rising home prices. This would slow the escalation of home prices and improve affordability; reduce inequalities, including between renters/owners and younger/older Canadians; and attract savings and credit towards economic activity outside of the housing sector, which may produce more jobs and innovation than is often found in real estate.

Government could use revenue collected from the surtax to provide benefits to renters, such as portable housing benefits. Revenue could also advance other Lab recommendations, including investments in new green co-op and purpose-built rental, and/or initiating the 'Off-Ramp Program and Bond'.

Table 1: Possible Surtax Rates and Revenue

Home Value	% of households Canada	# of households Canada	Average Value	Surtax Rate	Avg Annual (deferrable) Surtax payment	Annual Revenue (Billion $)
$1 to $1.5 million	5.5	845,108	1,204,184	0.2%	$408	$0.35
$1.5 to $2 million	1.8	271,618	1,723,587	0.5%	$2,118	$0.58
$2 million +	1.6	246,063	3,121,013	1.0%	$14,710	$3.62
Total	**8.9**	**1,362,789**				**$4.54**

Home Value	% of households Canada	# of households Canada	Average Value	Surtax Rate	Avg Annual (deferrable) Surtax payment	Annual Revenue (Billion $)
$1 to $1.5 million	5.5	845,108	1,204,184	0.5%	$1,021	$0.86
$1.5 to $2 million	1.8	271,618	1,723,587	0.5%	$3,618	$0.98
$2 million +	1.6	246,063	3,121,013	1.0%	$16,210	$3.99
Total	**8.9**	**1,362,789**				**$5.83**

Source: Working group calculations based on Statistics Canada Survey of Financial Security (2016) data, adjusted for home price inflation to 2020

Recommendation: Create a Permanent Housing Affordability Off-Ramp Program and Savings Plan

The working group recommends creating two new mutually supporting initiatives: a federally-guaranteed off-ramp program to transition low-density housing into a pool of permanently affordable rental units, and an off-ramp savings vehicle delivered through a Perpetual Affordable Housing Bond (PAHB).

Off-Ramp Program:
This arms-length program will purchase existing low-density housing from individual owners across Canada, and redevelop lots into 4-6 units. New units will be pooled into a large, diverse and distributed stock of higher-density, permanently affordable rental homes. Rent will be charged at 30% of the tenants' gross household income. Converting existing single-family homes is a focus, but other low-density housing forms also play a role in scaling the program. The Off-Ramp program would be universally available, and would address the problem of "missing middle housing."

The program would start with a minimum $1 billion federal investment to make funds available to purchase properties. For home owners, the sale of their property under the program would be executed at appraised market value; pay in cash all net equity owned by the seller, and any outstanding mortgage balance to the lender; give the seller the right to continue to live on-site in a home that meets their needs. Ownership of off-ramp homes would shift from private to collective, and sit in a legal vehicle governed by a number of stakeholders, including residents, community groups, private foundations, developers and government.

While home prices are still rising, the Off-Ramp may attract homeowners via a variety of motivations, including a values-aligned desire to support a shift to permanently affordable housing, access to accessibility or other improvements via conversion, and financial benefits from the sale of their home and from lower monthly costs, etc. Should home prices stall or fall, the program has potential to attract and protect those most at risk of being 'under water' by providing 100% debt relief for those who join. This offer of 'protection' is used as an incentive to achieve the program's primary objective – to scale up missing middle permanently affordable rental housing. The Off-Ramp program does NOT propose that governments directly subsidize homeowners with under water mortgages.

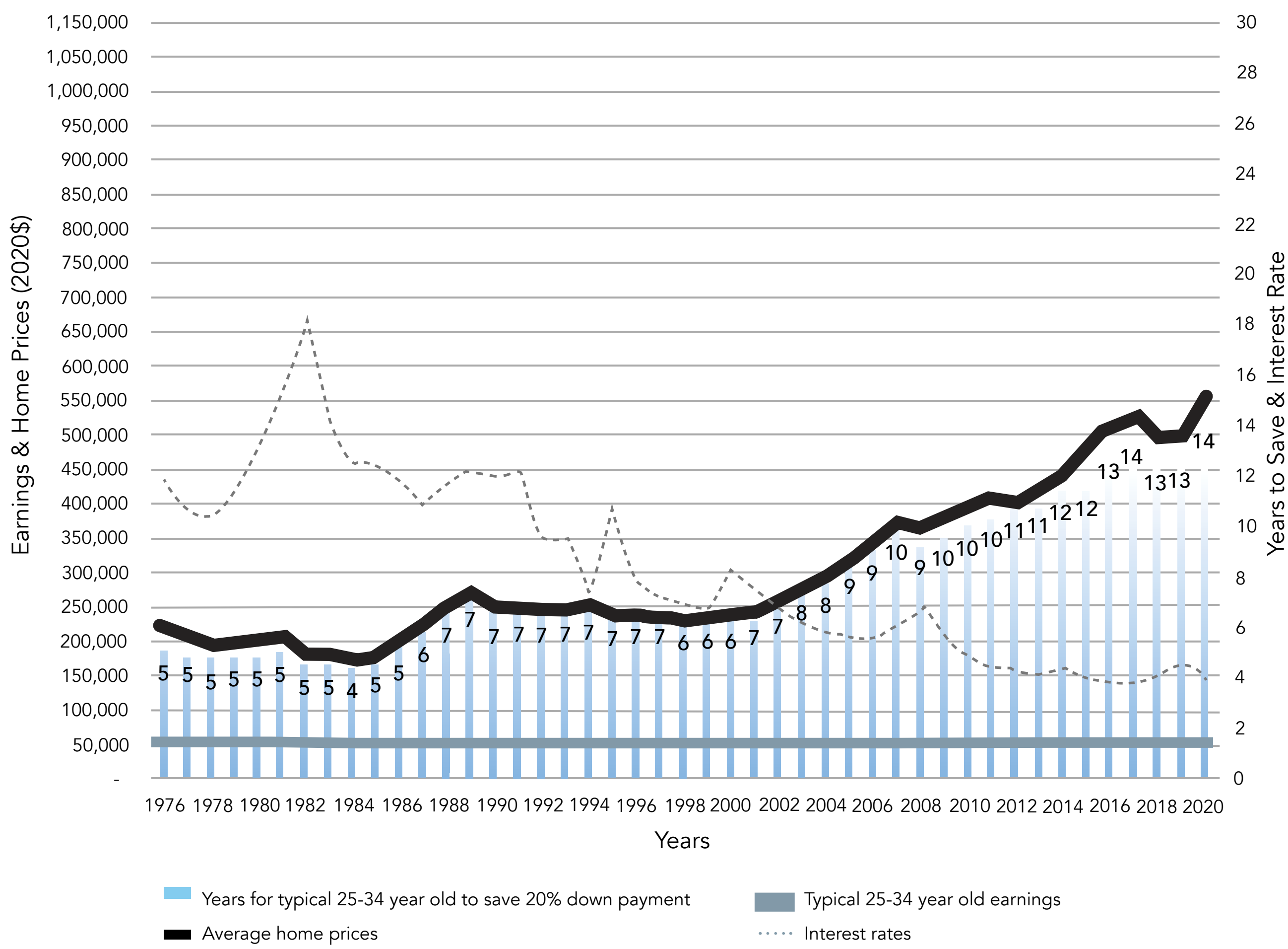
Off-Ramp Savings Vehicle:
To achieve scale in the Off-Ramp program, additional financing can be raised through a new Perpetual Affordable Housing Bond (PAHB) that delivers a stable and attractive return to investors, guaranteed by the federal government for 10 years. PAHB returns are anchored by the pooled rental income generated by the homes converted through the Off-Ramp program, along with a portfolio of supplementary community wealth assets built over time (e.g. car share, energy generation, etc.). This means that new permanently affordable 'missing middle' housing created under the Off-Ramp program will be paid for by a wide range of capital sources – versus just relying on public funds.

The PAHB would be available to everyone, and could serve as a stable retirement savings vehicle – reducing the number of Canadians counting on high and rising home values for their financial security. As such, the PAHB will contribute to the cultural shift needed to disentangle Canadians from current policy incentives that sustain the large gap between home prices and local earnings.

Section 1- Problem Brief & Lab Motivation: ‘Everyday’ Canadians are entangled or incentivized by public policies to count on high and rising home prices, which erode affordability for those who follow

This Solutions Lab searches for solutions to Canada’s housing affordability challenges that are caused by the growing gap between local earnings and average home prices.

Figure 1: The Gap. Home Prices Relative to Young People’s Full-Time Earnings



Sources: Average home price data provided by the Canada Real Estate Association

Earnings data from Statistics Canada, Custom table C1010886a

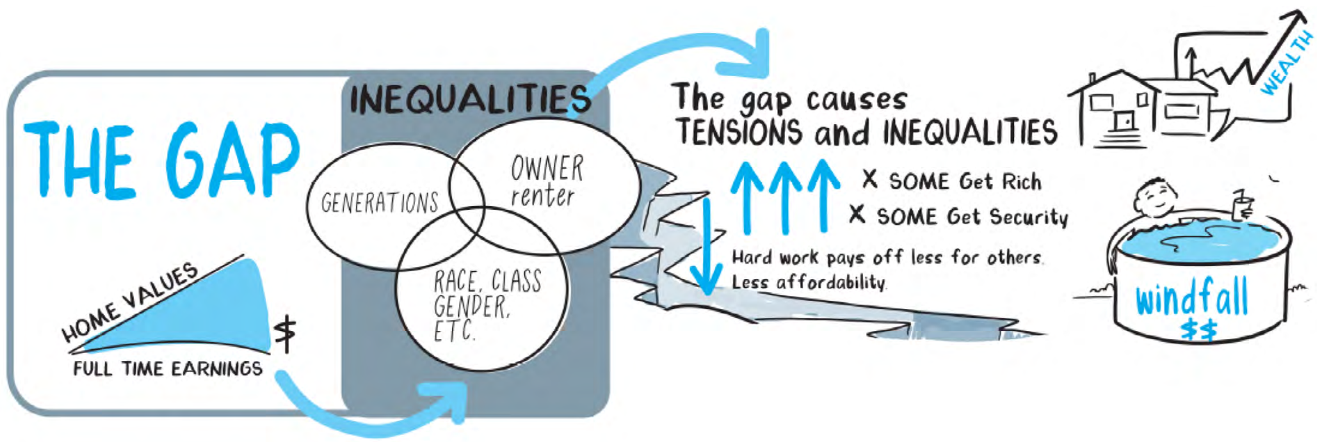
Interest rate data from Statistics Canada, Table: 34-10-0145-01 (formerly CANSIM 027-0015)

The gap reflects the interaction of two systems: one that shapes housing outcomes; another that shapes outcomes for earnings and wages. Our Lab focused exclusively on the former, while acknowledging that efforts to reduce the gap may be served by efforts to improve productivity in the labour market to accelerate wages, and address the increased levels of precarity found in Canada’s growing “gig economy.”

The wide gap between home prices and earnings creates wealth inequalities, especially between owners and renters; and between generations that bought homes decades ago compared to those starting out in the housing market today (see Kershaw 2018).

A wider gap creates risks that some Canadians become highly leveraged when borrowing to make a home.

The wide gap also imposes dramatic unaffordability barriers – barriers especially for younger generations of renters and aspiring owners, newcomers of any age, and seniors who are renters. Within these groups, the barriers are often particularly great for Indigenous residents and Canadians of colour, as signaled by the movements for Truth and Reconciliation and anti-Black racism.



Given all of this, the growing gap between home prices and earnings is a major impediment to the Canada Mortgage and Housing Corporation's (CMHC's) ambitious goal that all Canadians can afford a home that meets their needs by 2030.

At Generation Squeeze, we think this goal is so important, we have embraced it as our own, and encourage all in Canada to do the same.

In pursuit of that goal, Generation Squeeze aims to **disrupt a root cause** of the growing gap between home prices and earnings (without presuming to imply it is the only root cause).

We start with the recognition that the gap was growing rapidly for years well before the onset of COVID-19, and that it continued to grow rapidly during the pandemic. Given this observation, we judge that if even a pandemic-induced recession is insufficient to deflate home prices, then we can no longer ignore the probability that our housing system is actually structured, even if unintentionally, to grow housing values out of reach for local earnings.

Indeed, our Lab hypothesizes that many "everyday" Canadians are entangled or incentivized by public policies to bank on profits from homeownership to secure our financial future and gain wealth. And by being thus entangled, and by responding to such policy incentives, we reinforce feedback loops in the housing system which further fuel home prices to leave earnings behind, and generate wealth inequalities. This is the **overarching problem that motivates all of the Lab's work.**

Early Lab deliberations resulted in participants identifying three policy areas of primary interest because of their role in incentivizing, or entangling, many "everyday" households:

1. ***Access to cheap credit:*** The historically-low interest rates that have existed since the recession of 2008 provide Canadians with access to cheap credit. Low interest rates enable buyers to bid up the price of housing because they keep monthly carrying costs low for those who can pay for growing down payments.

2. ***Wealth gains from principal residences sheltered from taxation:*** Since 1972, Canadian tax policy has sheltered principal residences from taxation in order to help Canadians build wealth. This original objective might have been a good idea. But the way it is currently implemented creates a number of significant, unintended problems. The tax shelter on principal residences produces a basic incentive that draws households' and other actors' available savings and credit towards the ownership of housing. It also draws households' away from other economic activity that may produce more jobs and innovation, while inflating demand and average housing costs, thereby contributing to inequalities and unaffordability.

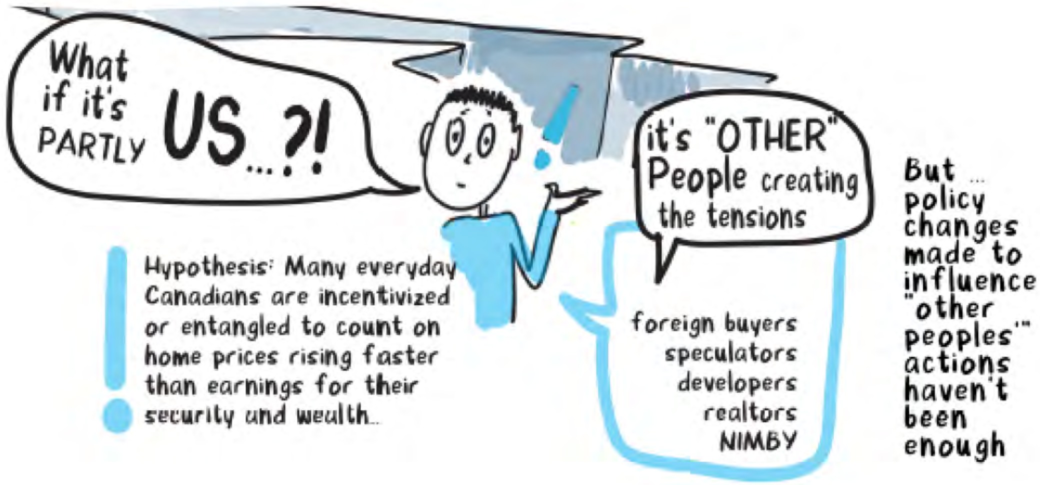
3. ***Limited protection for those who bought recently if prices fall:*** Lower average prices may create more affordability for renters and those who haven't yet entered the ownership market. But falling home values could mean that some Canadian homeowners, especially those who entered the market recently, end up owing more than their home is worth, which increases the risk of default and bankruptcy, while compromising retirement savings. As a result, many new entrants to the housing system have reason to want home prices to continue to rise, even if they know first-hand how difficult it is to straddle the growing gap between home prices and local earnings.

As Founder of Generation Squeeze, and the initiator of this Lab, my personal story is emblematic of the Lab's hypothesis that many 'everyday' households are incentivized by public policies to bank on profits from homeownership to secure our financial future.

In the year before the Lab started, BC Assessment reported that my home increased by $300,000. That single-year increase is way more than I earn as a professor. Were I to cash in by selling the home, the gain would be tax free, whereas I pay tens and tens of thousands of dollars in taxes on my income. While I chose not to cash out, I still had lots of opportunity to leverage the additional housing equity for home improvements, and other investments in the stock market. I have taken advantage of both of these opportunities with the support of remarkably low interest rates available amid the pandemic. My home now has several improvements I had wanted to make, and my investments have returned ten times the cost of low-interest charged me for increasing my mortgage to free up additional home equity to invest.

So, I clearly benefit from rising home prices.

But that rising home price is a double-edged sword. What's been great for my personal finances is hurting some of my other family members, who as renters struggle to afford an apartment with enough bedrooms for their kids. It's hurting my younger colleagues, who are just as smart as me, and just as hard-working as me, who now cannot afford to live where I do. It's hurting my community and country, because evidence shows that wealth inequalities and pervasive unaffordability barriers make our economy less efficient, while compromising our population's health.

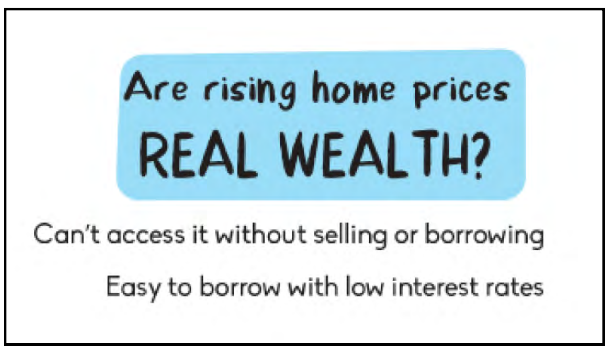


By putting everyday Canadians at the centre of our Lab, **our focus is provocative**, and potentially uncomfortable. Too often I have participated in housing dialogues where we hear Canadians say that unaffordability is simply the result of others – somebody over there: a foreign investor, a money launderer, a speculator, a NIMBY, a developer, a landlord, a realtor. And yes, all of these actors do play a part in Canada's housing unaffordability saga.

But our policy makers have increasingly focused on these "other" actors as "low-hanging fruit," often encouraged by Gen Squeeze to do so. There now exist foreign-buyers taxes, speculation taxes, empty homes taxes, new measures to address money laundering, new efforts to resist NIMBY'ism, new rent control policies, new expectations for developers, new regulations for realtors, and lots of efforts aimed at building more supply of housing. **So far, such measures have proven to have limited influence to dampen down home prices, or close the frightening gap between home values and what local residents earn in our cities.**

Which is why our Lab is determined to dig deeper. To move beyond the low-hanging policy fruit to focus on a more disturbing root cause of the problem – the reality that many everyday Canadians, myself included, are entangled in perpetuating our unsustainable, unaffordable housing system – because public policies incline us to organize our wealth strategies in ways that count on home prices rising faster than earnings.

It has been important to organize the Lab with this focus because we observe that the current National Housing Strategy – as important as it is – suffers a major omission.



Never once does this strategy mention the word "wealth."

One might judge that is because the National Housing Strategy aims primarily to address the housing challenges faced by those with modest incomes who generally have little, if any, housing wealth. This is true.

But it still begs the question: why do many Canadians and our decision-makers tolerate rising home prices? Routinely rising prices make it harder for those starting out in the housing market, along with residents of any age who have limited incomes and limited housing equity, to straddle the gap between local earnings and rapidly rising home prices for renters and aspiring owners.

Put bluntly: By failing to acknowledge wealth, the National Housing Strategy risks overlooking that a primary reason why our country is struggling to restore affordability is because few Canadians think rising home prices are uniformly bad. Quite the opposite, many people, many regular folks, benefit. Many gain wealth and financial security, as my story illustrates.

The "good" and the "bad" of rising home prices – that has been our focus in this Lab – along with the competing interests created by tensions implicit in the "good" and "bad" elements of rising prices. Our Lab has aimed to surface these tensions, **and surface the policy drivers that give rise to them.**

Because those policy drivers hold unique potential to redesign the Canadian housing system in search of "win-wins" wherever possible, or a better balance of competing interests when win-wins are not in reach.

We planned for disagreement at the beginning of the lab. As we searched for policy innovations, our invitation list for Lab participants was designed to engage a diversity of perspectives. 70+ leaders representing all parts of the housing system have participated at some point along the Lab's journey.

We planned for disagreement because there is disagreement in the broader Canadian context. Recent **polling by Angus Reid**, shows that 40% of Canadians want home prices to continue to rise; 60% want home prices to stall or fall.

Our Lab participants mirrored this split in public opinion.

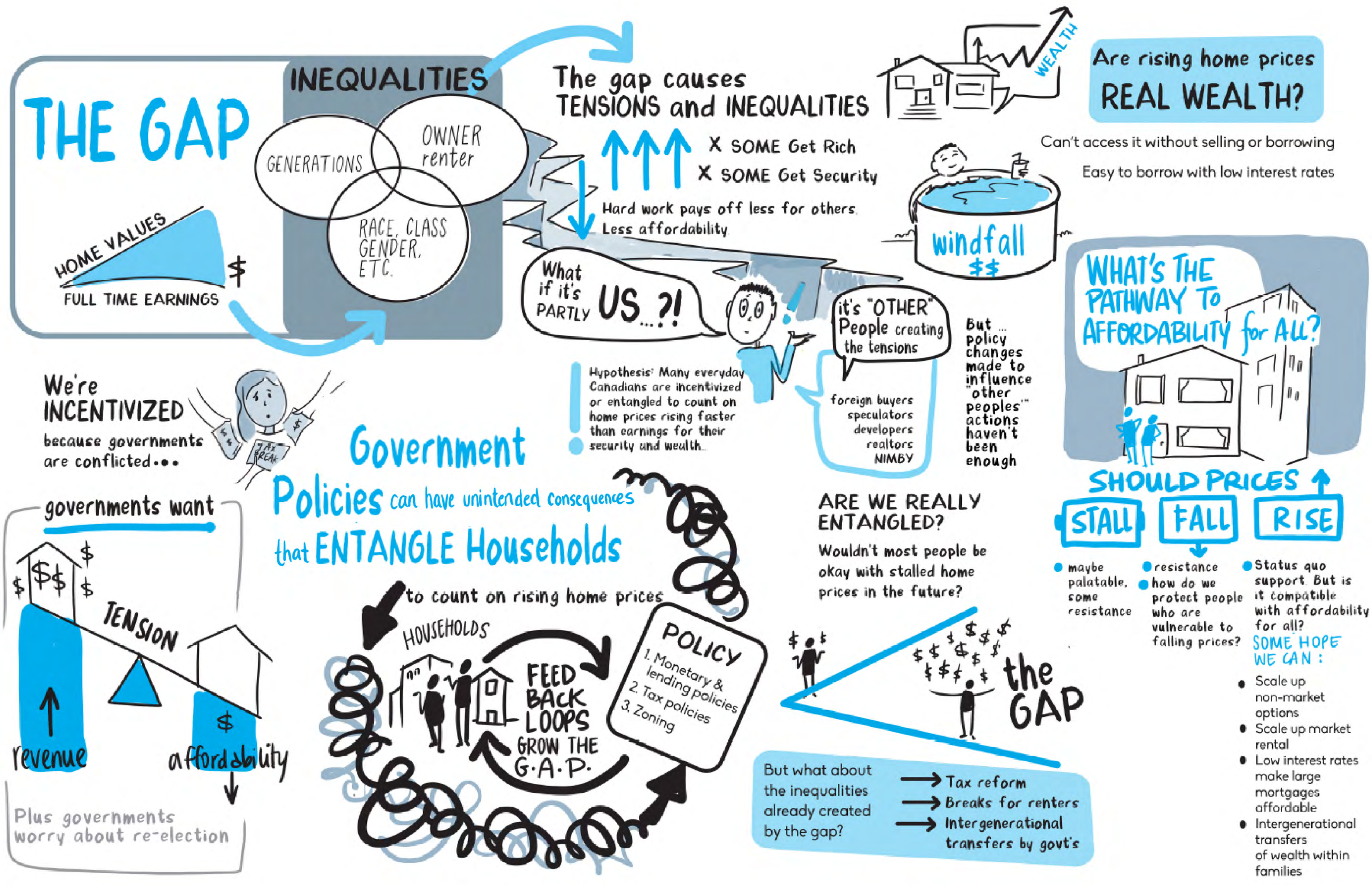
Which highlighted our challenge: the search for common ground amid the diverging opinions. Could we find and grow common ground to a degree where there may be a shared agenda for adapting a policy driver or two, or three, to narrow the gap between home prices and earnings?

That's been our Lab's quest. To surface tensions. Identify their policy drivers. Propose adaptations to those policies. Seek common ground. Use it to make positive change to reduce wealth inequalities and advance the goal that all Canadians can afford a home that meets their needs by 2030.

Happily, we found a lot of common ground, which is described in more detail in the remainder of this report.

But it would be an overstatement to imply consensus. And a misrepresentation to ignore that some of the 70+ participants didn't continue throughout the Lab's entire journey. Some likely dropped out because they didn't personally or organizationally align with the common ground that was emerging among others.

The following graphic summarizes the rich range of thematic ideas generated by the 70+ participants, along with key questions to which participants sometimes gave diverging answers.



Section 2: Lab Process

The engagement process by which our Lab searched for common ground to spur innovation followed the journey described in the following schematic.

The schematic shows that the Lab occurred online via Zoom during the pandemic, starting in September 2020, and wrapping up a year later. The Lab invited participants in the following six steps to complete our Lab journey:

1. Step 1 invited two groups of 30+ stakeholders to dialogue about the Lab's hypothesis: Many "everyday" Canadians are entangled or incentivized by public policies to bank on profits from homeownership to secure our financial future and gain wealth. When we respond to these policy incentives, we reinforce feedback loops in the housing system which further fuel home prices and wealth inequalities.

2. Step 2 engaged 34 participants from the opening session who volunteered for some homework offline to provide insight about the policy areas that may be entangling Canadians in this way, along with policy responses available to reduce those entanglements.

3. Our third step in the Lab's journey was another online session with dozens of the participants from session 1, at which participants identified the policy areas to focus priority attention for the remainder of the Lab. Participants selected three areas: monetary & lending policy; tax policy; and what became labeled as "protective" policy to explore the risks to highly-leveraged households should home prices fall substantially from current values.

   Our efforts to prioritize policy areas also resulted in substantial dialogue and disagreement about what Canada should hope for from home prices in the future: should they rise, stall or fall… if we want to restore affordability forever? Exploring this disagreement grew in importance for the Lab process, because the initiation of the Lab presumed that a slow-down in home prices is necessary to restore affordability.

4. Given the lack of common ground about the future of home prices, our fourth step featured a specific dialogue series to develop a rich understanding of participants' views about the underlying premise of the Lab: "Average home values must stall or fall if we are to achieve the goal of ensuring everyone living in Canada can afford a home that meets their needs, as renters or owners, by 2030" (the goal of the CMHC). This series featured three dialogues with small groups of 8-9 participants – all of whom had participated in one or both of the earlier large group online sessions. The input from these dialogues is summarized later in the report.

5. While the dialogue series was under way, the Lab launched three working groups of 8-12 participants – our fifth step. The groups were tasked with the goal of generating concrete policy recommendations to address incentives generated by monetary/lending policy, tax policy and (the lack of) protective policy, which entangle many 'everyday' Canadians to count on high and rising home prices for their financial security, and compromise affordability for those who follow.

Each group recruited additional academic and/or technical expertise to inform working group deliberations, the search for common ground, and opportunities for innovation. Each working group met roughly three times over approximately three months, with homework in between each online session conducted by individuals or sub-groups. These working group activities generated concrete policy recommendations, or "prototypes," which we describe later in this report.

6. The Lab's final step invited participants from the dialogue series who explored whether restoring housing affordability requires average prices to rise, stall or fall to comment on the policy recommendations produced by each of the working groups. Participants completed surveys reporting what they liked, tolerated, couldn't support, and/or needed more information about. This feedback was used to refine the final presentation of the policy recommendations produced by the working groups, as shared below in this report.

PHASES

1. Definition

2. Discovery

3. Discovery and Co-development

This phase of work – aimed at producing a "Landscape Map" – was cancelled due to a decision to not use a Landscape Map in the design of the virtual sessions.

4. Prototyping

PROBLEM OF FOCUS

Problem space:
Housing system characterized by unaffordability, generational and other inequalities

Honed in on a root cause:
⬆Those characteristics are partially by design, because of a broad desire for home values to rise

Problem statement/core question:
The "catch-22"/ how can we treat housing as just a place to call home, rather than an investment vehicle?

A mixture of both "problem space" language present in the Charter and refined "problem statement" language present in the invite is used to clarify the purpose and scope of the Lab

Coverage surfaces/highlights confusion about the meaning of "profitable" and "investment" in the problem statement/core question. Also: focus on policy drivers and household-level interactions not totally clear to some. Forces iteration.

Problem statement/core question:
Started working with alternative language describing the problem and core question in terms of an "entanglement" of Canadian households in a system of high and rising home values.

Key insight:
Participant opinion is split on a foundational premise that underlies the core question of the Lab: that to achieve housing affordability for all (e.g. the CMHC 2030 goal), average home values must stall or fall relative to earnings.

Problem statement/core question:
Updated the language to create a clearer, more concise core question: "what policies can we use to disentangle households from expectations or dependencies on high and rising home values (relative to earnings)?"

ACTIVITIES

Initial sponsor meetings

Pre-COVID design

Onset of COVID-19

COVID design

Lab invite

Media statements and interviews given in response to inaccurate coverage portraying the Lab's sole/primary focus being a "home equity tax."

Session 1

Session 1 was designed to begin exploring mental models associated with the problem space (Deliverable 3.2), and to begin identifying priority areas for eventual solution development (Deliverable 3.3).

6 Working groups struck

One for each of the participant-prioritized tension areas

Sprint Cycle 1: potential policy

Sprint 1 was designed to crowdsource ideas for policy responses to the prioritized tensions (via the working groups)

Session 2

Session 2 was designed to confirm the top 3 tension areas (from the original 6), and to discuss specific policy options. While there were challenges in this session, key insights emerged.

Switch-Up to Facilitation Team and Strategy

[Re]Orientation Guide

We split the remainder of the Lab into two follow-up streams: (1) a Dialogue Series to further explore the Lab's core premise, and (2) Prototype Working Groups to develop three concrete policy solutions (one for each of the prioritized policy areas). We wrote and circulated a [Re]Orientation Guide containing the final problem statement/core question of the Lab, a description of the two follow-up streams and an invitation to participate.

SOLUTIONS OF FOCUS

Identifying priority areas for further development

Participants were asked to begin identifying priority areas for the Lab in the form of specific tensions (entanglements) that arise when home values rise faster than earnings.

Session 1a

Participants identified 13 discrete tensions and then voted to prioritize the following top 3 for further work:

- Between "the interests of individual and institutional actors in the market"
- Between "a majority of households who benefit from high and rising home prices, and a sizable minority of households (particularly marginalized groups) who are negatively impacted."
- Between a "government that is economically dependent on housing prices" and e.g. affordability goals.

Session 1b

Participants identified 15 tensions, consolidated these into 10 groupings, and then voted to prioritize their top 4 (later collapsed to 3):

- Between homes as an investment vehicle and homes as a place to live.
- Between gains in housing wealth that on one hand help some homeowners, and on the other hand lead to intergenerational inequalities, and class inequalities within generations.
- Between preferred housing conditions of existing residents (e.g. green space, low density, minimal change, etc.) and the need for new supply.

34 participants volunteered for one or more of 6 working groups to explore each tension

Identifying potential policy responses to the priority tensions

13 participants provided possible policy responses, which can be categorized as follows:

Immigration Policy
- 1 idea sourced from 1 person

Supply Policy
- 3 ideas from 4 people (1 idea overlaps with tax policy)

Intergenerational Transfers
- 2 ideas sourced from 2 people

Tax Policy
- 5 ideas sourced from 9 people

Lending Policy
- 7 ideas sourced from 5 people

Protective Policy

Comments from both Sessions 1 and 2 suggest a need for accompanying protective policy to shield households from stalling or falling home values

DIALOGUE SERIES

Purpose: obtain rich understanding of participant reaction to the Lab's core premise

Participants were split into three groups and asked – during 90-minute sessions – for their gut reaction to the Lab's premise, and "under what circumstances might the premise be true or false?"

Group 3
- 8 participants

Group 2
- 9 participants

Group 1
- 9 participants

Commentary across all 3 groups revealed a variety of opinions about whether home values needed to rise, stall or fall to achieve affordability for all. Much of the commentary pertained to participants' perceived pathways to affordability. Afterward, every comment was categorized into whether it related to:

- A perceived pathway to affordability – 100 comments across 9 perceived pathways.
- A supplemental theme (e.g. inequality) – 83 comments across 9 supplement themes.

Dialogue series participants review policy recommendations: What do the like? tolerate? can't support? What do they need more info about?

ACTIVITIES

Mental models map

Previous input from participants was used to draft a 'map of mental models' related to the Lab's subject: housing, wealth and intergenerational equity.

Dialogue Series

Given that earlier Lab sessions raised questions about the Lab's premise -- restoring affordability requires home prices to stall or fall -- this three-part series gave Participants a chance to inform a mental models map about this premise.

Designed prototyping process

We designed and approved a basic plan for the prototyping stream.

3 Working groups struck

We wrote and approved backgrounders for 3 working groups (including specific "how might we" questions for each), to design policies within each of the previously prioritized categories.

Working group meetings and asynchronous work

Final Report and Roadmap

POLICY PROTOTYPING

Purpose: setting any disagreements on the Lab's premise aside, work with willing participants to prototype three solutions to the Lab's core question (1 for each of the prioritized policy areas)

Tax Policy
- 8 participants
- 7 starter ideas proposed

Monetary & Lending Policy
- 12 participants
- 8 starter ideas proposed

Protective Policy
- 10 participants
- 3 starter ideas proposed

Tax Policy Recommendations

Monetary/Lending Recommendations

Protective Policy Recommendations

Section 3: Canada needs to decide: does the goal to restore affordability for all require average home prices to rise, stall or fall?

In service of the National Housing Strategy (NHS), the CMHC aims for all residents to be able to afford a home that meets their needs by 2030, either as owners, renters, in co-ops or some other suitable form of tenure. This is the right goal, and an aggressive timeline, given that the NHS observes that over 1.5 million Canadians are currently in core housing need, and many more are squeezed by the high cost of housing relative to local earnings.

However, in pursuit of this 2030 goal, the National Housing Strategy is relatively silent about what needs to happen to housing prices in the market over the next decade. Can this goal be achieved if average home prices continue to rise well beyond local earnings?

Lab Premise

As we designed our Lab, we presumed the answer to this question is 'No, average home prices need to stall or fall by comparison with local earnings if we are going to restore affordability for all.' We started with this premise for two reasons.

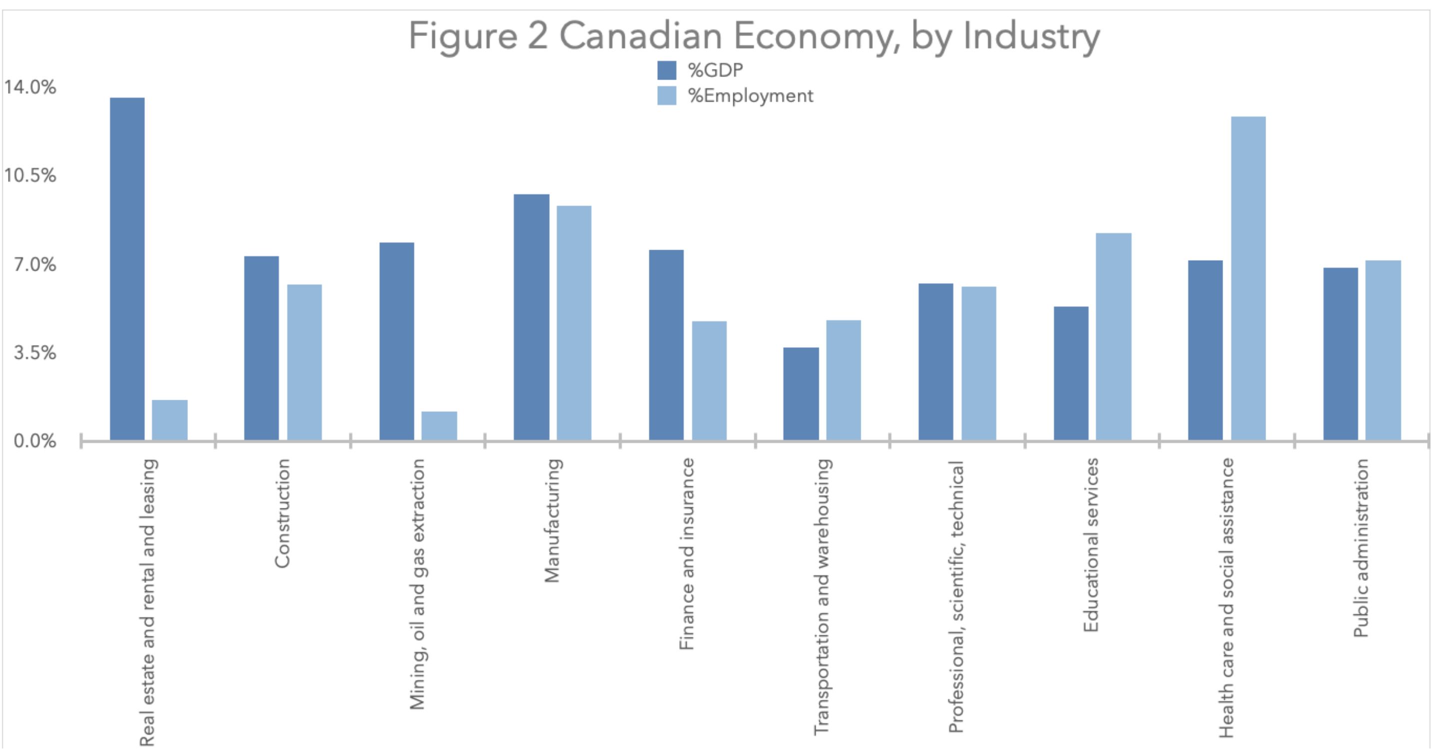
1. The first reason is motivated by Figure 1 above. It reveals that average home prices have skyrocketed out of reach from local earnings. When Baby Boomers came of age as young adults around 1976, it took the typical young person five years of full-time work to save a 20% down payment on an average home in Canada. Now, it takes 14 years. In Ontario, it's 18 years; 20 in BC; 24 years in the Greater Toronto Area and 28 in Metro Vancouver. These data reveal that when home prices rise faster than earnings, it imposes much more work on those trying to get a start in the housing market – especially for those aspiring for ownership, which has been the norm in Canada for decades.

   Yes, interest rates have fallen substantially over the last 45 years. Lower interest rates mean that the dramatic increase to the sticker-price of homes did not impose as dramatic an increase to monthly mortgage payments. Nevertheless, today's monthly payments required on a mortgage equal to 80% of average home prices are higher – even with record low interest rates – than they were decades ago when interest rates were much higher, but home prices much lower. This is the case even for 1982 when interest rates peaked above 18% and home prices averaged around

$180,000 in 2020 dollars. Recall, the higher monthly payments today come on top of years of more work required to save a 20% down payment (and thereby avoid additional mortgage loan insurance costs).

As home ownership grows out of reach for more people starting in the Canadian housing market (either as young people or newcomers), making a home through rental or co-op housing is another, important option. The influence of ownership costs on rents is complex, and not necessarily linear. But the ability to scale up rental and co-op housing is directly influenced by the cost of land, which is the primary driver of rising home costs in the ownership market. So as land values rise, the ability to develop rental and co-op housing at scale becomes much more challenging.

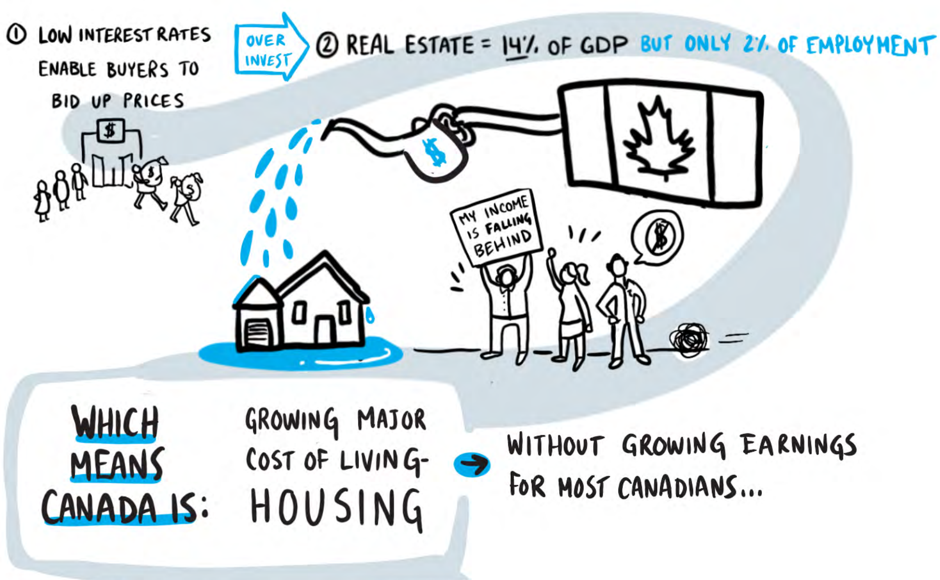
2. The second reason we presume homes prices should stall or fall relative to earnings in order to promote affordability is because we encourage Canadians, and our decision-makers, to revisit the role of real estate in our country's economic growth strategies. Real estate, rental and leasing represents the largest contributor to Canada's Gross Domestic Product (GDP). At 14% of our national GDP in 2021, this industrial sector is bigger than manufacturing; bigger than mining, oil and gas; bigger than construction; bigger than health care; bigger than financial services; bigger than professional, scientific and technical services; and so on (See Figure 2 below). Real estate has also grown as a share of gross domestic product in all provinces over the last two decades, and often has been the fastest growing part of provincial economies.



Sources:
GDP data from Statistics Canada Table: 36-10-0434-02 (formerly CANSIM 379-0031) Employment data from Statistics Canada Table: 14-10-0202-01 (formerly CANSIM 281-0024)

Anchoring our economic growth on real estate, rental and leasing would be a fine economic development strategy – if this industrial sector also was generating a large portion of jobs for Canadians. But it doesn't. Fewer than 2% of Canadians find employment in the real estate sector. No other industrial sector has such a big gap between its share of GDP and share of employment (See Figure 2).

This highlights a problem. It signals that Canadians have been growing our economy by increasing the major cost of living, without generating jobs in that industrial sector in numbers that ensure local earnings keep pace, especially in urban centres. The 2% of people who find employment in the



industry generally attract very large incomes. Existing property owners gain home equity increases, which will propel their spending and consumption to drive up GDP. It's one way to grow an economy. But it is not obviously a good way if our country prioritizes hard work paying off so that younger people and newcomers to Canada can earn enough to cover their primary cost of living – housing.

As we aim to #BuildBackBetter after the pandemic, it is timely to revisit the place of the real estate sector in our strategies for economic growth. Instead of an economic stimulus strategy that relies on driving up the primary cost of living, it is time to imagine an economy that is stimulated by a housing system which reconnects the cost of living to local earnings in order to support employment and growth in other industries. Reasonable concerns that stalling home prices may in turn stall GDP must be balanced against this alternative vision of how to stimulate the economy. The commitment to "measuring what matters" that grounds the new Quality of Life Framework in the **2021 federal budget (p. 410)** signals that the Government of Canada is more open than ever to achieving this balancing act. This section of the budget explains that: "The Government of Canada is working to better incorporate quality of life measurements into decision-making and budgeting based on international best practice, expert engagement, evidence on what shapes well-being, and public opinion research on what matters to Canadians." The framework explicitly identifies housing affordability as a key consideration when evaluating whether the economic strategy is promoting a high quality of life.

Disagreement about the Lab premise

During our Lab activities, half of our participants signaled that they align with the premise that housing prices need to stall or fall to restore affordability for all. But the other half did not.

Public polling suggests reflects a similar split. **Angus Reid data** shows that 40% of Canadians want home prices to continue to rise; 60% want home prices to stall or fall.

This lack of common ground about what our country wants from housing prices going forward is a societal barrier to restoring housing affordability. In the absence of clear signals from the public, we create political barriers to achieving the CMHC 2030 goal, because the public is not providing sufficient political cover for politicians to be courageous enough to diverge from the status quo that tolerates a large, and growing, gap between average home prices and local earnings.

Our Lab activities reveal that skeptics about the premise fall into two broad categories (see also the following graphic for a summary):

1. Some accept the premise, but reject the consequences of stalling or falling housing prices as being too harmful for some individual households, or the economy more generally.

2. Others suggest that pathways to affordability for all may be possible even as the gap between home prices and local earnings grows larger.

The intuitions of these two groups provide guidance about key areas of dialogue we need to foster with Canadians about future home prices as we pursue the goal of restoring housing affordability.

1. Trade-offs between objectives

The first group of skeptics signal the need to discuss possible tradeoffs between competing objectives. This is the case, because they agree that restoring affordability for all will require a change of course from the growing gap between home prices and earnings, but reject the idea that the goal of narrowing that gap should be prioritized over some other objectives.

Tradeoff: home owners

Some of these skeptics implied that concern about impacts for existing home owners may need to trump affordability for all, because certain owners could be harmed by stalling or falling home prices. When triaging trade-offs, it is unclear the level at which home-owner vulnerability arising from stalling home prices may surpass the vulnerability of those currently unable to afford rent or escape homelessness.

Yes, many Canadians count on equity in their homes as part of their strategy to achieve retirement security, and there are entire industries designed to help Canadians unlock growing equity in their home to use for other spending purposes (i.e. see the **CHIP Home Income Plan**). If we judge that stalling home prices is good for affordability for all, Canadian legislators would need to focus on retirement income policy that encourages Canadians to save outside of strategies that presume large returns to investments in principal residences.

While the risks for homeowners from stalling home prices are less obvious, the vulnerabilities from falling home prices are clearer, especially for those who have entered the market more recently. While lower average prices may create more affordability for renters and those who haven't yet entered the ownership market, it could mean that some homeowners end up owing more than their home is worth. These "underwater" situations trap households who can't clear their debt via sale, increase their risk of default and bankruptcy, and compromise retirement savings. People may reasonably disagree about whether such vulnerabilities are more or less important than vulnerabilities suffered by those who are already homeless, or in precarious housing as financially squeezed renters. However, this risk from falling home prices creates vulnerability that merits attention.

Tradeoff: slower GDP growth

Other skeptics in the "accept the premise, but reject the consequences" group focus more on macroeconomic concerns. The 2008 recession was shaped in part by many homeowners in the US defaulting on mortgages. This reveals the harm that can be imposed on economies when "underwater" households occur at scale. Such concerns motivate the kind of exploration with which we tasked the "Protective" policy group in our Lab.

But the macroeconomic skeptics also point to a broader concern – that stalling home prices would disrupt the contribution of real estate to Canada's economic growth. These skeptics emphasize the 14% of GDP represented by real estate, rental and leasing; but give less attention to the fact that Canadians find less than 2% of employment in the real estate sector. As discussed above, there is reason to reconsider whether growing the Canadian economy by increasing the major cost of living, without generating jobs in that industrial sector in numbers that ensure local earnings keep pace, is the optimal growth strategy for Canada to pursue at this time.

2. Presumptions that affordability for all can be achieved amid rising home prices?

The second group of skeptics about the Lab's premise that affordability for all will require prices to stall or fall proposes there may be pathways to achieve the goal in a context where prices continue to rise faster than earnings. This group points to at least three possible affordability pathways that could coincide with average home prices increasing in the market.

Market Ownership and Definition of Affordability

The first speaks to market ownership and the "definition of affordability." Some participants observed that home prices may not need to stall or fall if the goal is <u>monthly affordability</u> via continued low interest rates; and/or <u>down payment affordability</u> via looser mortgage rules, targeted down payment support, or fractional ownership models.

This proposed pathway must address several follow-up considerations. First, to the extent Canadian governments wish to advance homeownership affordability, should the goal be monthly affordability, down payment affordability, or total purchase price affordability? What is the relative importance of each measure? Given that much of the market presently focuses on monthly and down payment affordability, what existing or new measures should be considered to add attention to total purchase price, which is harmed when average prices rise in the market?

Second, this pathway is fragile. It breaks down if/when interest rates rise from current historic lows.

Third, the pathway doesn't look sustainable. Since interest rates are pretty much at their floor, if average prices in the market continue to rise there is no room to dampen this harm to affordability by reducing interest rates still further.

Fourth, as discussed above, the current gap between home prices and earnings has created substantial inequalities in wealth between owners and renters, and older and younger Canadians. If we pursue a path to affordability that banks on rising average prices, what do we do about the persisting and growing inequalities?

Market Rental

Some participants judged that home prices may not need to stall or fall if market rental costs are, or could be, decoupled from average home values.

Supporters of this proposed pathway must address a number of important follow up considerations. First, what evidence exists to show it is possible to sufficiently decouple average rents from average home values? Put differently, what evidence shows it is possible to increase rental supply and decrease average market rents to the point where everyone can afford to rent a home that meets their needs – even as average home values stay high and rise.

Second, the ability to scale up market rental depends partially on average land costs, which are the major driver of average prices in the market. If land costs keep rising, how can we scale up market rental at levels that will keep rents in reach for local earnings?

Third, wouldn't scaling up affordable market rental, and growing the share of Canadians who make homes as renters, decrease demand in the ownership market, and thereby dampen down average home values? This consideration circles back to the original 'stall or fall' premise of the Lab.

Non-Market Housing

Some participants suggested that average home prices may not need to stall or fall (i.e. reject the premise) if non-market housing could be sufficiently scaled and priced to meet the full need.

Supporters of this pathway face the following considerations. First, the most recent Census data* show that fewer than 5% of Canadians live in subsidized housing or receive rental subsidies. Imagine that we doubled it to 10% of Canadians. Or tripled to 15%. Or quadrupled to 20%. These would be massive accomplishments in the Canadian housing system – but 8 in 10 Canadians would still rely on the regular market to make a home. Can the 80% of Canadians relying on the regular housing market can afford a home that meets their needs if home prices continue to leave local earnings behind, beyond the large gap we already have? That seems highly unlikely.

Perhaps, some anticipate that Canada should be able to grow the scale of subsidized housing to well beyond 20% of our housing supply. For this option to be considered, champions need to make clear how the ability to scale up below-market housing at such high rates is decoupled from average land costs; and how the needed scale could be achieved if average prices continue to rise.

More generally, if we grow the percentage of residents who make their home in non-profit housing, it would reduce demand in the ownership market, which would be expected to dampen average values. Once again, this consideration circles back to the original 'stall or fall' premise of the Lab.

In sum, as a society, we need to gain clarity

Our Lab was not designed to provide the "final word" on ruling out whether there are any realistic pathways to achieving affordability for all without having home prices stall or fall. But our dialogues have surfaced a number of key considerations that proponents of this possibility must address. It should be a top priority for our citizenry, housing system leaders, and legislators to gain clarity on these options and considerations very quickly. The **Office of the Parliamentary Budget Officer reports** that even with all the noble investments under the National Housing Strategy (NHS), Canada is on a trajectory to see the number of households in core housing need rise from 1.5 million when the NHS was initiated to 1.8 million by the middle of this decade.

All things considered, this should not come as much of a surprise, because the gap between local earnings and average home prices has grown steadily since the NHS was announced. By the end of 2016, just before the NHS was initiated, the Canadian Real Estate Association reported that average home prices in Canada were approximately $523,000. As 2020 concluded, average prices were $568,000; and they surpassed $600,000 as of the summer of 2021.

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*Statistics Canada, 2016 Census Catalogue number 98-400-X2016229, Shelter-cost-to-income Ratio (5A), Tenure Including Presence of Mortgage Payments and Subsidized Housing (7) and Household Type Including Census Family Structure (9) for Owner and Tenant Households in Non-farm, Non-reserve Private Dwellings

SOLUTIONS LAB PREMISE: MENTAL MODELS MAP

This Lab's underlying premise is that average home values must stall or fall to achieve housing affordability for all (e.g. CMHC's 2030 goal). This diagram charts [direct and indirect] responses to the Lab's premise during Sessions 1 and 2 (fall 2020), and the Dialogue Series (winter 2021). The BLUE boxes represent questions asked, and future lines of inquiry that may become relevant as the Roadmap is implemented. GREY boxes contain the different response we heard, categorized by their relation to the premise being ACCEPTED or REJECTED. The grey boxes thus represent a map of 'mental models' or ideas about how the housing system works (in relation to the premise).

QUESTIONS | ANSWERS

Should the underlying premise be accepted or rejected? Why?

ACCEPT

And we SHOULD pursue stalling/falling/the goal

- Do we think the goal requires just stalling, or falling?
  - Stalling
    - Is the idea that earnings will catch up?
  - Falling
    - What/who is made vulnerable by this?

But we SHOULDN'T pursue stalling/falling/the goal

- Why?
- Should we do something about persisting inequalities? What?

REJECT

Technicalities

- Definition
  - e.g. average home values, affordability for all
- Can't target a specific price drop

Accept the premise, but reject the consequences:

- Household impacts
  - What categories of households would be made vulnerable?
- Macroeconomic impacts
  - What impacts?
- Sector impacts
  - What sectors? E.g. development?

Alternate pathways to reach the goal:

- Monthly affordability via low interest rates
  - What about if/when interest rates go up?
  - How long can this work? Rates can't go lower
  - Should we do something about persisting inequalities? What?
- Scale up rental
  - Aren't costs in the ownership and rental markets linked?
  - Isn't ability to scale partially dependent on average land costs?
- Scale up non-market options
  - Isn't ability to scale partially dependent on average land costs?
- Wouldn't addt'l supply also decrease avg. home values in regular market?
- Intergenerational transfer of wealth
  - What about those who don't benefit?
- Earnings will increase
  - What about trend over past 40 years, COVID?
- What else?

Section 4: Specific Examples of Policy Areas that Entangle Canadians to Count on High and Rising Home Prices

As discussed from the outset, our Lab hypothesizes that many "everyday" Canadians are entangled or incentivized by public policies to bank on profits from homeownership to secure our financial future and gain wealth. Rational responses to the incentives inherent in these public policies reinforce feedback loops in the housing system which further fuel home prices to leave behind local earnings, and grow wealth inequalities.

While the previous section reveals that some people anticipate pathways to restoring housing affordability for all can co-occur with rising average home prices, it's unlikely that rising home prices make it easier to achieve affordability. And either way, rising home prices risk exacerbating serious wealth inequalities caused already by the large gap between home prices and earnings.

In response, Lab participants identified four areas of policy which contribute in worrisome ways to feedback loops. These four areas are: monetary & lending policy; tax policy; policies that limit supply; and the absence of "protective" policy in case home prices stall or fall.

Since the CMHC already has underway an extensive **Housing Supply Challenge**, this Lab focused attention on the other three examples. In doing so, participants integrated a commitment to grow the supply of affordable housing into our treatment of the other three issues.

Feedback Loop 1: Monetary & Lending Policy

There is a lot of academic research about the influence of monetary policy on housing prices. **Ryan-Collins (2019)** provides one of many useful reviews of the literature.

Focusing on this area of policy, Lab participants identified two layers of problems that they believe flow from current approaches to monetary and lending policy in Canada: the first is an outcome of the second.

First, Lab participants observe that a wide variety of factors well beyond housing shape monetary policy, and monetary policy decisions must be made in light of objectives that exist well beyond the housing system. Nevertheless, participants also signaled that access to cheap credit over the past decade has been an important contributor to rising home values (in addition to tax policy and supply constraints). Low interest rates enable buyers to bid up the price of housing because they keep monthly carrying costs low for those who can pay for growing down payments.

As prices and debt loads rise, many Canadian homeowners become more financially dependent on continued high home values and low interest rates, which reinforces feedback loops that sustain high and rising home prices that are increasingly out of reach for what most residents earn. This pattern is set to continue, with the pandemic leading many to predict several more years of ultra-low interest rates.

These feedback loops reflect a second, deeper, problem discussed in the previous section. The largest part of the Canadian economy is driven by real estate, rental and leasing (14% of GDP). By contrast, Canadians find less than 2% of employment in the real estate sector. No other industrial sector has such a big gap between its share of GDP and share of employment **(See Chart).** This is a problem, because it reveals that we have been growing the Canadian economy by increasing the major cost of living, without generating jobs in that industrial sector at a rate that ensures local earnings keep pace, especially in urban centres. Instead, small numbers of employees gain very large returns for their work, while equity increases for home owners in ways that drive worrisome wealth inequalities between owners and renters, and between older and younger residents.

This problem with monetary and lending policy implies an opportunity: We can adapt policy to disrupt feedback loops that sustain high and rising home prices via a strategy that pursues the following three goals:

1. Incentivize a shift in lending & borrowing from mortgage to business loans in order to spur economic activity in other areas of the economy that will yield larger gains to earnings for a wider share of the population.

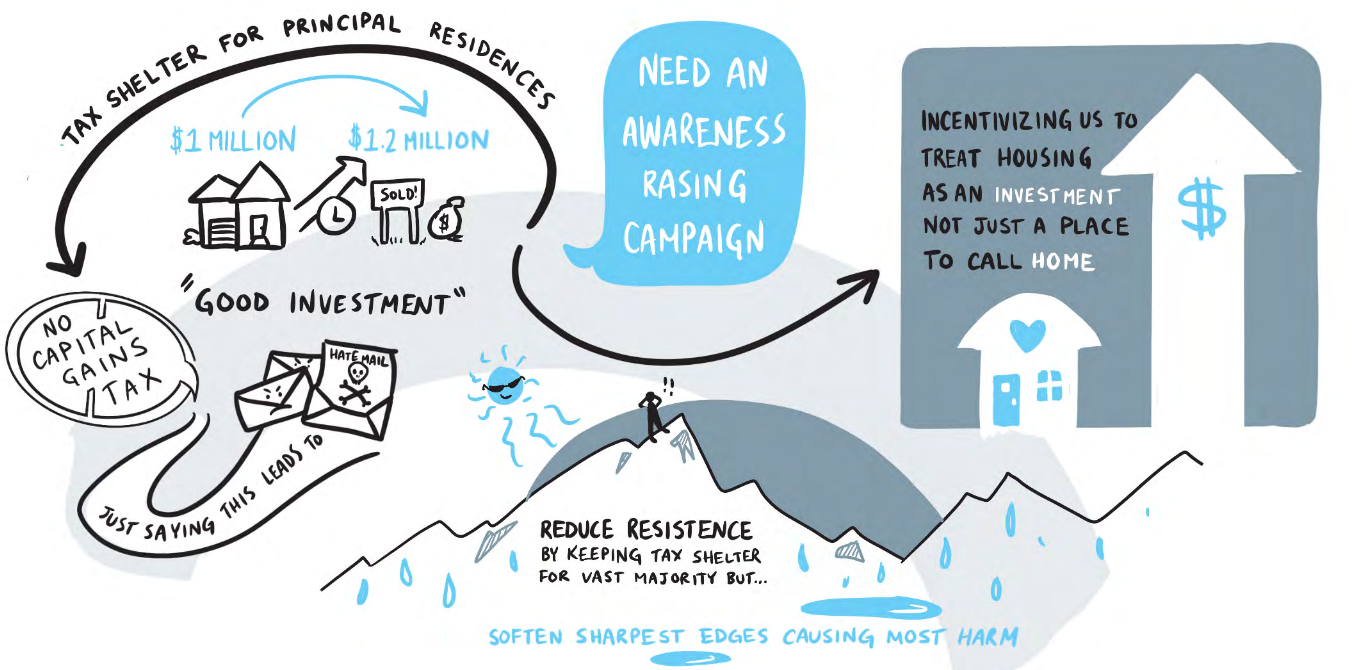
2. Improve the measurement of housing prices in Statistics Canada's measurement of inflation, and report annually on the influence of monetary policy on home prices in order to help monetary policy decisions maximize benefits for the economy in general, while minimizing collateral damage to housing affordability specifically.

3. Incentivize a shift in lending within real estate toward a healthy mix of affordable green, energy-efficient co-op homes, and purpose-built market and non-profit rental housing.

Feedback Loop 2: Tax Policy

Since 1972, Canadian tax policy has sheltered principal residences from taxation in order to help Canadians build wealth. This original objective might have been a good idea. But the way it is currently implemented creates a number of significant, unintended problems. The tax shelter on principal residences produces a basic incentive that:

- draws households' and other actors' available savings and credit towards the ownership of housing and away from other economic activity that may produce more jobs and innovation,
- inflates demand and average housing costs,
- contributes to inequalities and unaffordability, and
- makes homeowners problematically dependent on homeownership-related returns on investment.



This problem implies an opportunity. We can adapt policy to disrupt this incentive to advance the following goals and principles. The policy adaptation should:

- Stall home values to allow more opportunity for Canadian earnings to reconnect with home prices

- Reduce income and wealth inequality.

- Be efficient: it is better when the policy imposes the least cost to the economy: i.e. it should distort as little as possible individual economic decisions, including allocation of savings between industrial sectors. In other words, it should reduce tax shelters on wealth/consumption of residential land that distort the market by incentivizing investments in real estate.

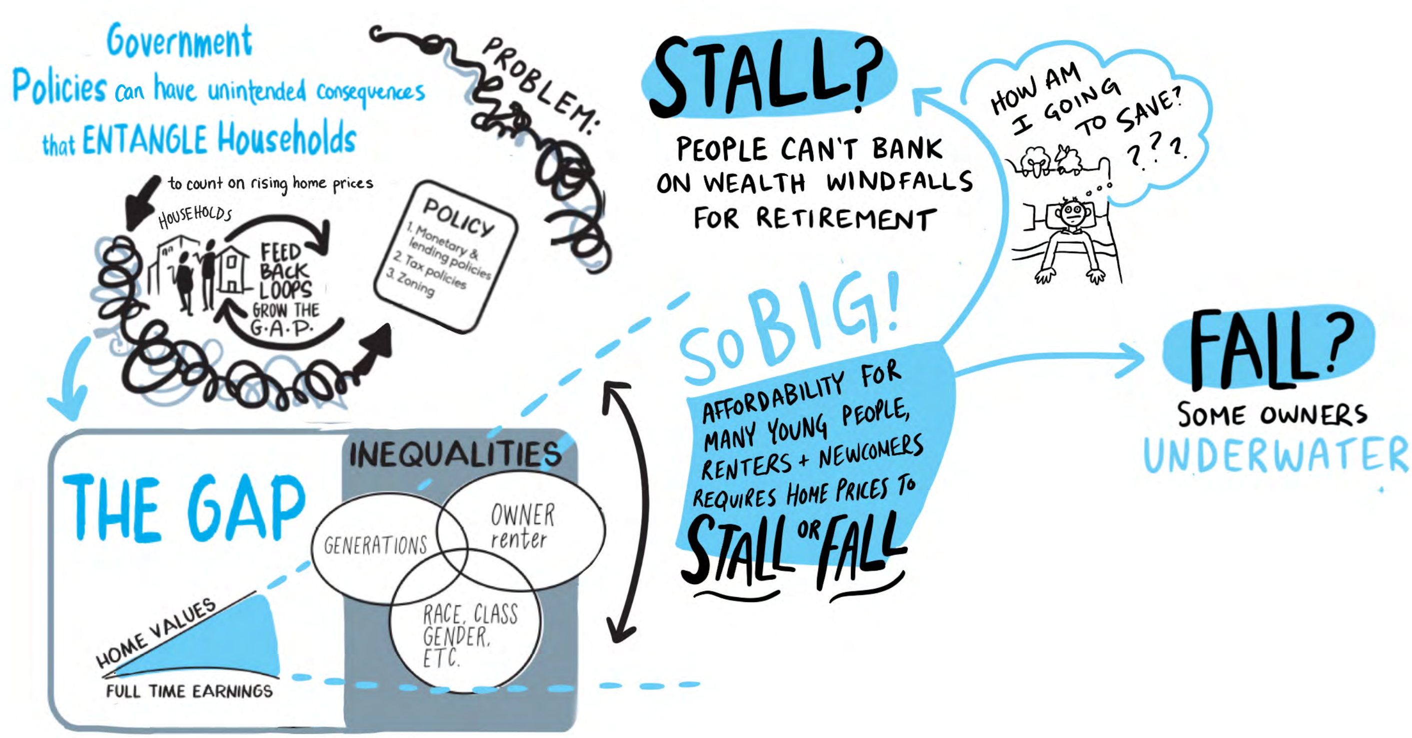
- Raise revenue: in support of an expansion of affordable housing supply.

- Certainty: it is better when tax payments can be assured: i.e. the tax change cannot be avoided or evaded through stealth or sophisticated accounting, which are widely seen to be unfair

- Mitigate risks: Any changes should anticipate, and reduce, risks for Canadians who have limited income and wealth outside of their home.
- Improve equity (vertical): People with more wealth or consumption should contribute more.
- Improve equity (horizontal): People with similar amounts of wealth or consumption should be treated the same.
- Incentivize more of the right supply: the development of higher-density housing in complete (livable) communities.
- Have simplicity: it is better when the policy is simple to implement; it is also better when the policy is simple to understand so that it is relatable to all and can contribute to solidarity.

Feedback Loop 3: No Protective Policy

Canada's skyrocketing housing market creates serious risks, instabilities and inequalities across the housing system and larger economy. The previous two problems focus on what happens if home values keep rising in ways that grow the gap with local earnings. The growing gap is associated with worsening purchase and rental affordability, inequality, and even greater structural dependence on high values as cohorts of new homeowners take on more debt and risk.



But, as discussed above, problems also rise if home prices fall, since some Canadian homeowners could end up owing more than their home is worth. These “underwater” situations trap households who can’t clear their debt via sale, increase the risk of default and bankruptcy, compromise retirement savings, and create macroeconomic and other impacts as these circumstances manifest at scale.

Between these two undesirable scenarios, many hope for a "soft landing" – home values flatline long enough for incomes to have a chance to recouple with incomes. However, this kind of scenario is extremely difficult to manufacture.

Again, this problem implies an opportunity. Policy can be changed to create a scalable off-ramp for those wanting to disentangle themselves from the market forces that give rise to the growing gap between home prices and earnings. While the off-ramp would be available for anyone, it could offer protection to those most likely to be harmed by a “soft landing” or steeper fall for home prices. This protection could incentivize owners of single (or other low-density) homes to convert their land into 4-6 permanently affordable rental homes. Such conversions could be pooled together to grow the supply of affordable non-market housing. The rental income generated from this new pool of permanently affordable homes could fund yields for a new stable retirement savings vehicle. This savings vehicle could attract private investment at levels required to build and maintain the off-ramp at a scale that could help to disentangle many Canadians from current policy incentives that incline them to count on high and rising home prices.

Policy Solutions to Disrupt Each of the Harmful Feedback Loops

Guided by these three examples of policy incentives that entangle ‘everyday’ Canadian households to count on high and rising home prices, Lab participants recommended that we form three working groups to co-create concrete policy solutions to disrupt each of the problematic feedback loops.

The next three sections provide three **briefing notes** that summarize the recommendations produced by each of the three Working Groups, along with **road maps** to implement the recommendations. The first road map provides a plan to implement the monetary and lending policy recommendations, followed by the recommendations of the tax policy and protective policy Working Groups.

These recommendations can be implemented individually. However, they have also been designed for implementation together, because they reinforce one another’s contributions to breaking the feedback loops that entangle many households to bank on home prices rising well above local earnings. In addition, the tax policy recommendation would provide funding needed by the other two Working Group recommendations.

Each Working Group recommendation is followed by a one-page **infographic policy brief.**

Section 5: Monetary & Lending Policy Working Group Recommendations

Members*

- Adnan Haider, IBM's Financial Services Practice
- Angela Redish, University of BC
- Christopher Ragan, McGill University
- Ed Steel, Mortgage & Title Insurance Industry Association of Canada
- Josef Filipowicz, Canada Mortgage and Housing Corporation
- Lu Han, University of Toronto
- Lynnette Purda, Queen's University
- Paul Taylor, Mortgage Professionals Canada
- Pedro Antunes, Conference Board of Canada
- Preet Banerjee, MoneyGaps

**Note: The recommendations presented below were co-developed by the members of the working group. The recommendations on which we landed have the support of the large majority of group members as individuals; but do not necessarily represent the positions of the organizations with which they are affiliated.*

Policy Recommendation

The Monetary & Lending Policy Working Group prioritized two policy recommendations.

1. The first aims to refocus lending within the housing system to simulate growth in green, affordable co-op and purpose-built rental (PBR) supply.

2. The second recommends that Statistics Canada revisit how it measures housing in calculations of inflation, and to conduct and publicize additional research about the relationship between monetary policy on the growing gap between home prices and earnings. This recommendation is offered as an incremental step to inform discussion among the public and decision-makers about the influence of monetary policy on housing prices, which could in turn guide future opportunities to incentivize a shift in lending away from real estate and more toward other businesses as part of Canada's plan to #BuildBackBetter. This recommendation is a clear example of how Working Group participants encourage additional economic modeling and research to build on this Solution Lab's deliberations. It is <u>not</u> proposing changes to monetary policy at this time.

Road maps for implementing each recommendation are presented below.

Road map: Align the mandates of the Canada Infrastructure Bank/ CMHC to Incentivize Lending to Scale Up Green Co-op and Affordable PBR

Policy Summary

The working group recommends aligning the mandate of the **Canada Infrastructure Bank (CIB)** with that of the CMHC to incentivize lending to "green" co-op and purpose-built rental construction projects that simultaneously promote national goals for housing affordability and net-zero carbon emissions.

Better aligning the work of these two Crown Corporations could leverage funds to supplement the **Rental Construction Financing Initiative** (RCFI) and the **National Housing Co-Investment Fund** (NHCIF), which the CMHC currently implements. Sector leaders indicate these two programs are currently insufficient to scale up green co-op and affordable PBR. There remains an overall gap between the total funds available to the National Housing Strategy (approximately $70 billion at present) by comparison with the level of investment required to scale up affordable housing at sufficient levels. While there is no firm estimate of the additional investment required to fill Canada's housing gap, anecdotal estimates from some in the sector have suggested the figure is $200 billion or more.

Public funds allocated to the CIB or CMHC would need to be used for both grants and lending purposes. Grants are necessary to subsidize the "affordable" and "green energy-efficient" aspects of new developments, and attract other investors to provide loans, because these elements of projects are often neglected due to market failures and cost constraints. In other words, more lending is necessary, but not sufficient, to get the job done.

As an "Impact Investor" on behalf of Canada, the CIB is a particularly important investor/lender to engage. Not only can it make low-cost financing available to commercial and non-profit developers, it offers a longer-term horizon for financing by comparison with most other lenders, without taking collateral. For example, energy retrofits/upgrades pay for themselves over time, and the CIB welcomes repayments made from the share of energy savings that accrue over time.

The **Parliamentary Budget Officer** reports that the Canada Infrastructure Bank is expected to fall $19 billion short of its lending expectations between now and 2027-28. Minimally, some of this shortfall could be used to target the following goals identified by the Co-operative Housing

Federation of Canada.

The **Co-operative Housing Federation of Canada** (CHF) (guided by estimates from the Federation of Canadian Municipalities) identifies a need for 90,000 new units of co-op and not-for-profit housing over the next 7 years; and identifies another 60,000 units of low-cost private rental housing that could be converted to non-market housing over the remaining seven years of the National Housing Strategy. The CHF estimates that $18.5 billion is required as grants to subsidize the lending required to build or convert these 150,000 units.

Implementation

Which level(s) of government, and which ministries/departments, would need to be involved in implementation? What are key details that need to be worked out?

While affordable, green housing falls within the definition of "infrastructure" for which the CIB has responsibility, its current mandate is perceived to focus primarily on infrastructure beyond housing so as not to duplicate work performed by CMHC. Initial meetings of senior leaders at both the CIB and CMHC, convened by our Solutions Lab, signal mutual interest in exploring opportunities for the two institutions to better collaborate to scale up affordable, green co-op and PBR units. An early implementation step could invite the responsible Ministers to collaborate to revise the mandate of the CIB so that it is encouraged to bring its lending power to serve National Housing Strategy goals.

In the absence of the Infrastructure Minister broadening the operational mandate of the CIB, there is scope within its current operational parameters to contribute to scaling up green, affordable housing. Specifically, through work streams that support (a) energy retrofits, (b) public transit infrastructure, as well as (c) the CIB's general mandate to accelerate growth in the social, economic and environmental prosperity of Canada (i.e. GDP indicators plus indicators identified in the Government of Canada's emerging quality of life framework). But restricting action to the current operational mandate limits the potential for the CIB to incubate investment at a sufficient level to serve as a "game changer" to restore affordability.

There will be challenges in determining which communities to target for investment, and an appropriate purchase price for land, etc. Addressing these challenges would benefit from collaboration between all three levels of government, with coordination provided by CMHC. Emphasis should be placed on building supply that meets a minimum standard for livability, and the right mix of units (privileging enough bedrooms for families with children) in order to counter recent market trends that privilege building micro and 1-bedroom units (which may be more suitable for investors than residents).

It will be important to determine whether new co-op units will require (some) residents to invest equity, with the option of withdrawing equity upon transfer.

Rollout Strategy

How will the policy be rolled out?

Use the estimated $19 billion shortfall in CIB lending to attract the additional private investment required to build the 90,000 new green, affordable co-op and PBR units identified by the CHF, and to convert the other 60,000 low-rent units into permanently affordable stock.

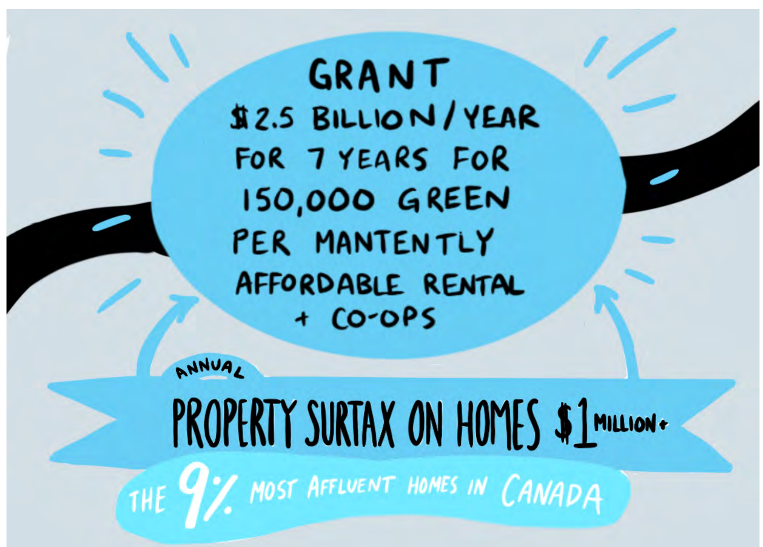
Use funds from the proposed new annual deferrable surtax on properties over $1 million (see tax policy recommendation below) to fund grants totaling $2.5 billion/year over seven years to cover the non-lending costs associated with scaling up the 150,000 units.

Costs and resources required

What are the direct and indirect costs associated with policy implementation?

1. Lending for land acquisition, including subsidy. **The Cooperative Housing Federation (CHF) of Canada** estimates that:

- $15 billion is required to build 90,000 new units. $15B is the total contribution (non-lending) cost of projects which use, on average, a capital grant worth 70% of total project cost, and assume an average cost of $225,000/unit across Canada. This amount also assumes a set-aside for first-stage support, given that many non-profits and co-ops don't have the funds available to assess the viability of a redevelopment or new development. First-stage support would allow for this, and would likely be able to identify both low-hanging fruit (intensification of a co-op that owns land and is clear of old operating agreement obligations) and larger, more ambitious projects (development adjacent to planned transit extension).
  It is worth noting this figure assumes a dedicated program for non-market housing (co-ops and non-profits), which would make it different from the National Co-Investment Fund. However, the Co-Investment Fund could be formulated to integrate this dedicated program with additional funds at the scale proposed above.



- $3.5 billion in grants (plus access to loans) is required to convert the 60,000 low-rent units into permanently affordable housing stock. This assumes a lower grant to loan ratio than new development, since the properties are already operating as tenanted, low cost rental housing
- $50 million is required under the Federal Lands Initiative specifically for the co-operative housing sector. This is the cost of making whatever federal body owns the surplus land "whole", and assumes a transfer to a co-op provided at no to very little cost.

2. Personnel are required for administration at each level of government to collaborate with CIB, CMHC and community/industry partners.

Revenue and/or other benefits

What are the financial and other gains (or cost recovery), other than the main impact above?

By adapting lending policy to scale up affordable, green co-op and PBR units, this policy change should reduce the risk of emigration by highly skilled Gens Y and Z Canadians because it will reduce the affordability challenges they are facing as a result of the large and growing gap between average home prices, the associated impact on rising rents, and local earnings. Reducing the risk of this brain drain yields numerous financial benefits, including tax revenues, access to talent for businesses, etc.).

The intention to scale new affordable housing units with an explicit commitment to "green" design is necessary if Canada is to meet its commitments to achieve net-Zero carbon emissions by 2050, given that **households represent about one-quarter of Canada's GHG emissions.**

There are downstream benefits that result from better affordability, increased sustainability in the housing system, and less inequality. These include better quality of life, sense of community, health, etc.

Risks: Political and Other

What are the risks associated with implementing this policy? Unintended consequences? How might these be mitigated?

The rationing mechanism for allocation of scarce co-op and PBR housing opportunities needs to be defensible if it is to sustain public support.

The success of this approach will require additional density to be added into metropolitan neighbourhoods that currently have low levels of density. Such changes can invoke "Not In My Back Yard" (NIMBY) responses. Presently, freehold-tenure is widely seen as 'ideal' in our cultural context, so successful take up of the increased supply of rental and co-op units may require a shift in "mindset".

Co-op members and renters of PBR lose the opportunity to build up housing equity, which may deter those hoping to find a stepping stone into home ownership.

Evaluation (system scale)

How will success be defined and measured? What are the anticipated key system-level results of the policy, both positive and negative?

If the planned increase in the supply of good, green, affordable co-op and PBR options attracts demand away from conventional home ownership, it is anticipated that the shift in demand would provide a counterforce to the persistent escalation in home prices. This would help to give local earnings a chance to catch up over time.

The increase in supply will be directly related to the amount of grant funding made available by the federal government to help the CIB and CMHC attract additional investors. This observation aims to correct for a weakness in the RCFI and Co-Investment Fund that, so far, have had insufficient funds to achieve the scale of new co-op and non-profit rental supply that is required.

Indicators

- # of new co-op and PBR units added relative to demand (along with estimates of the amount of supply required to slow down home price escalations in the market).
- Amount of funding allocated publicly to the CIB/CMHC for building this supply
- Amount of private capital attracted to the CIB/CMHC for building this supply
- % return on loans
- Relationship between average home prices, average rents and local earnings (with a smaller gap evaluated favourably)

Evaluation (individual scale)

How will success at the individual level be defined and measured?

The alignment of mandates between the CIB & CMHC will increase access to co-op and PBR units in cities across Canada, thereby adding supply to meet the growing demand for rent (and co-ops) in areas of the housing system that provide more security of tenure (by comparison with rental units offered by landlords who operate non-purpose-built rental units). It is anticipated this will dampen down the average rent costs overall. Consideration could be given to increasing access to these co-op and PBR units for people "entering" the housing system (younger Canadians and newcomers), as well as for BIPOC communities.

For those who are new to, or entering, the housing system, as well as long-term renters, there will be less fear that their paid labour force participation is insufficient to pay for good housing that meets their needs, including security of tenure.

For those who are established in the housing system as owners, there will be less opportunity to rely on windfall gains from substantial home price increases for their retirement savings and wealth accumulation strategies. The targeted lending/investment in green co-op and PBR units will attract demand away from conventional home ownership, and thereby dampen down the escalation in home prices.

There are downstream benefits that result from better affordability and less inequality, including better quality of life, sense of community, health, etc.

Indicators:

- Change in proportion of Canadians residing in green co-op and PBR units relative to the size of the population.
- Returns on investment for private individuals/organizations that partner with CIB to grow the

supply of green co-op and PBR units.
- Lower % of Canadians in housing stress (measured as 30+% of income paid to housing).
- Trends in home equity, and Canadian household debt levels
- Change in value to pay for a 20% down payment required for an average home (with stalling or falling down payments viewed favourably)

Road Map: Task Statistics Canada to review the treatment of housing in its calculation of inflation

Policy Summary

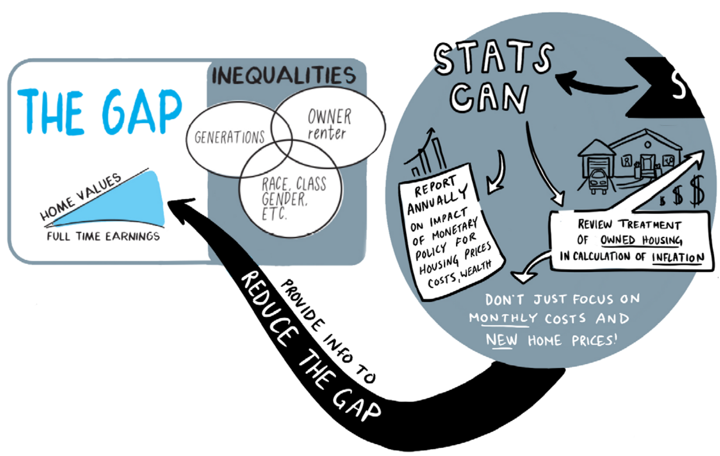
The Working Group recommends that the Government of Canada task Statistics Canada to review the "owned accommodation" component of its Consumer Price Index (CPI) Calculation, and report annually on the influence of monetary policy on established home prices.

The review will require developing a supplementary measure of housing affordability to capture changes to "average home values relative to typical earnings." This adaptation is necessary so that official measures of "owned accommodation" and "housing affordability" go beyond:

- The current focus on monthly interest payments to also examine payments required on principal;
- The current reliance on the New House Price Index in order to monitor trends in prices for established housing.

This review by Statistics Canada is important, because CPI measurement has wide-ranging economic and policy implications. The Bank of Canada relies on CPI to set its interest rates. Governments use the CPI as a target for monetary policy, and to adjust tax brackets, transfer payments and pensions. Canadian businesses use measures of inflation when making decisions about wages and investments (capital expenditures).

The Working Group recommended this review to respond to concerns articulated by groups like the [Business Council of BC,](#) which observes:



"It can seem hard to reconcile the stellar growth in house prices in recent years in Vancouver and some other Canadian urban centres with the modest growth in the consumer price index (CPI). Established house prices in Greater Vancouver and Victoria rose 81% and 56%, respectively, over the past 5 years, whereas the CPI for BC rose only 7.5%. The disconnect is partly due to the way Statistics Canada tracks the cost of "owned accommodation." In particular, estimates of mortgage interest and other costs facing homeowners are based on the [New House Price Index](#) rather than a broader measure of established house prices. The result is that CPI likely understates trends in living costs facing many households in BC and Canada."

Implementation

This recommendation would be implemented by the branch of Statistics Canada responsible for the production of (a) CPI calculations; and (b) housing affordability metrics.

Rollout Strategy

Statistics Canada would:

- Publish an annual study reporting on the latest evidence about the relationship between monetary policy and the growing gap between home prices and earnings. The goal of this additional reporting is to inform the public about the degree to which the deployment of monetary policy to stimulate the economy generally may be unintentionally inflicting collateral damage on housing affordability.

- Review the merit of counting repayment of mortgage principal in its estimate of "owned accommodation" costs, in addition to the current focus on payment of mortgage interest.

- Build on recent improvements made by Statistics Canada to its measurement of mortgage interest costs in the CPI. As reported by the Business Council of BC, prior to February 2021, Statistics Canada relied exclusively on the New House Price Index for its calculation of mortgage interest and replacement expenses. This index monitors "contractors' selling prices for new dwellings (including land) collected from builders in more than twenty cities" (Statistics Canada 2015, 8). By contrast, Canadian Real Estate Association MLS House Price Index and Teranet-National Bank House Price Index provide data about price trends for established house prices. These measures show that the rate of appreciation in established house prices substantially outpaces the growth in new house prices. Commenting on these indices, the Business Council of BC observes that new house prices in Canada are up 47% since 2005, compared to established house price growth of 136%.

  As of February 2021, Statistics Canada has adapted its measurement of mortgage interest expenses by integrating data about established home prices for the country's six major census metropolitan areas (CMAs): Montreal, Ottawa, Toronto, Calgary, Vancouver and Victoria. This is an important improvement. However, since Statistics Canada lacks data about resale home prices in the other 21 CMAs, it will continue to rely on the New House Price Index (NHPI) for these communities. This is an ongoing weakness, which needs to be addressed, because data show clearly that exclusive reliance on the NHPI risks underestimating housing price inflation in the stock of existing homes. By extension, Statistic Canada's overall calculation of the CPI risks underestimating the actual level of inflation in the country. Such underestimates fuel feedback loops that incline the Bank of Canada to resist increasing interest rates. Low interest rates in turn enable buyers to bid up the price of housing because they keep monthly carrying costs low for those who can pay for growing down payments.

Costs and resources required

What are the direct and indirect costs associated with policy implementation?

There are minor costs associated with the research required to review the treatment of owned accommodation, and to produce an annual report. Generally, it will require the re-allocation of staff time, and/or purchasing time from external expert consultants.

Revenue and/or other benefits

What are the financial and other gains (or cost recovery), other than the main impact above?

There are no direct revenue gains from the recommendation that Statistics Canada review its treatment of "owned accommodation" in its calculation of inflation.

There are significant "other benefits." The proposed annual review of the relationship between monetary policy and home prices, and improvements to how Statistics Canada calculates "owned accommodation" in the CPI, are anticipated to result in greater information for governments and the Bank of Canada to design monetary policy to stimulate the economy, manage inflation, and limit collateral damage to housing affordability.

Risks: Political and Other

What are the risks associated with implementing this policy? Unintended consequences? How might these be mitigated?

Were the escalation in average home prices captured more accurately in CPI calculations, it is more likely that the adjusted-CPI would motivate an increase in interest rates. The increase in interest rates would contribute to 'affordability' by imposing dampening pressure on home prices, thereby lowering down payments. But the increase in interest rates would reduce 'affordability' because debt service costs would increase. Higher interest rates might also reduce investment, consumer expenditures on durables, and consequently, employment. Therefore, additional econometric modelling is required to capture the multiple effects of rate increases on housing affordability, and the economy more generally.

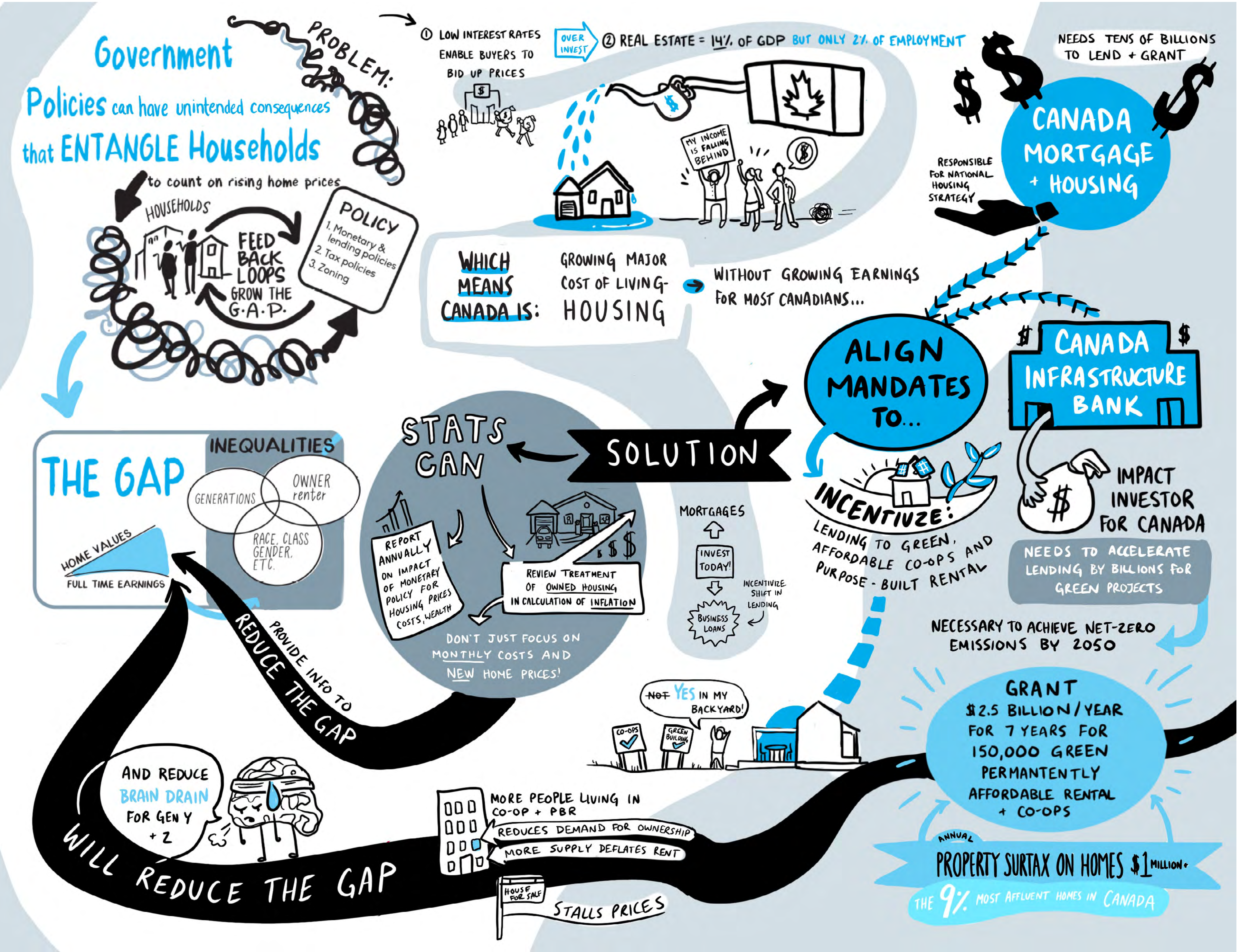
That is why our recommendation encourages Statistics Canada to review its treatment of "owned accommodation" in the CPI calculations, and to monitor and report annually about the influence of monetary policy on the gap between home prices and earnings – rather than proposing a change to how the CPI is calculated at this time.

Evaluation

How will success be defined and measured?

Indicators:

- Statistics Canada makes ongoing improvements to the calculation of "owned accommodation" in the CPI. The revised calculation is evaluated favourably by external sources.
- Statistics Canada publishes an annual report about the relationship between monetary policy and the growing gap between home prices and earnings. The report is evaluated favourably by external experts.
- Relationship between average home prices, average rents and local earnings (with a smaller gap evaluated favourably).



Government
Policies can have unintended consequences
that ENTANGLE Households
to count on rising home prices
PROBLEM:
HOUSEHOLDS
FEED BACK LOOPS GROW THE G.A.P.
POLICY
1. Monetary & lending policies
2. Tax policies
3. Zoning
① LOW INTEREST RATES ENABLE BUYERS TO BID UP PRICES
OVER INVEST
② REAL ESTATE = 14% OF GDP BUT ONLY 2% OF EMPLOYMENT
MY INCOME IS FALLING BEHIND
WHICH MEANS CANADA IS:
GROWING MAJOR COST OF LIVING - HOUSING
WITHOUT GROWING EARNINGS FOR MOST CANADIANS...
NEEDS TENS OF BILLIONS TO LEND + GRANT
CANADA MORTGAGE + HOUSING
RESPONSIBLE FOR NATIONAL HOUSING STRATEGY
ALIGN MANDATES TO...
CANADA INFRASTRUCTURE BANK
IMPACT INVESTOR FOR CANADA
NEEDS TO ACCELERATE LENDING BY BILLIONS FOR GREEN PROJECTS
THE GAP
INEQUALITIES
GENERATIONS
OWNER renter
RACE, CLASS GENDER, ETC.
HOME VALUES
FULL TIME EARNINGS
STATS CAN
SOLUTION
REPORT ANNUALLY ON IMPACT OF MONETARY POLICY FOR HOUSING PRICES COSTS, WEALTH
REVIEW TREATMENT OF OWNED HOUSING IN CALCULATION OF INFLATION
DON'T JUST FOCUS ON MONTHLY COSTS AND NEW HOME PRICES!
MORTGAGES
INVEST TODAY!
BUSINESS LOANS
INCENTIVIZE SHIFT IN LENDING
INCENTIVIZE:
LENDING TO GREEN, AFFORDABLE CO-OPS AND PURPOSE-BUILT RENTAL
NECESSARY TO ACHIEVE NET-ZERO EMISSIONS BY 2050
~~NOT~~ YES IN MY BACKYARD!
CO-OPS
GREEN BUILDING
GRANT $2.5 BILLION/YEAR FOR 7 YEARS FOR 150,000 GREEN PERMANENTLY AFFORDABLE RENTAL + CO-OPS
ANNUAL PROPERTY SURTAX ON HOMES $1 MILLION+
THE 9% MOST AFFLUENT HOMES IN CANADA
PROVIDE INFO TO REDUCE THE GAP
AND REDUCE BRAIN DRAIN FOR GEN Y + Z
WILL REDUCE THE GAP
MORE PEOPLE LIVING IN CO-OP + PBR
REDUCES DEMAND FOR OWNERSHIP
MORE SUPPLY DEFLATES RENT
HOUSE FOR SALE
STALLS PRICES

Section 6: Tax Policy Working Group Recommendations

Members*

- Elisabeth Gugl, University of Victoria
- Gillian Petit, University of Calgary
- John Dickie, Canadian Federation of Apartment Associations
- Lindsay McLaren, University of Calgary
- Marc Lee, Canadian Centre for Policy Alternatives, BC Office
- Paul Kershaw, University of BC & Generation Squeeze
- Shahar Rotberg, Canada Mortgage and Housing Corporation
- Steve Pomeroy, Focus Consulting Inc.
- Tom Davidoff, University of BC

**Note: While the recommendation on which we landed has the support of the majority of group members as individuals, it does not necessarily represent the positions of the organizations with which they are affiliated.*

All group members agreed that it is valuable for Canadian policy makers to revise tax policy in order to reduce the tax shelter on principal residences (excluding Purpose-built Rental Buildings) in order to send a new, strong policy signal intended to stall the escalation in home prices.

A majority of group members converged around the policy idea presented below. There remains ongoing discussion within the group about whether the proportion of households affected by the proposed surtax and/or the surtax rates are sufficient to send a strong enough signal to slow down the escalation of home prices. Some members think the rates are not high enough, and don't apply to enough homes. Some think the rates are too high to be politically feasible, unless they are phased-in. Phase-in options are considered below.

While the information below provides enough specificity to begin plans to implement the proposal, all working group members concur that further economic modeling will be useful to fine tune the proposed surtax rates, as well as develop robust estimates of the anticipated impact on average home values across Canada, and in Ontario and BC specifically where average home prices are higher than in the rest of the country.

Policy Recommendation

Introduce an annual (deferrable*) surtax to the taxation of residential properties above $1 million (excluding PBR buildings) in order to reduce the tax shelter for high value homes and thereby dampen demand for homes above this threshold, while raising revenue to invest directly in new, green, affordable co-op and PBR homes.

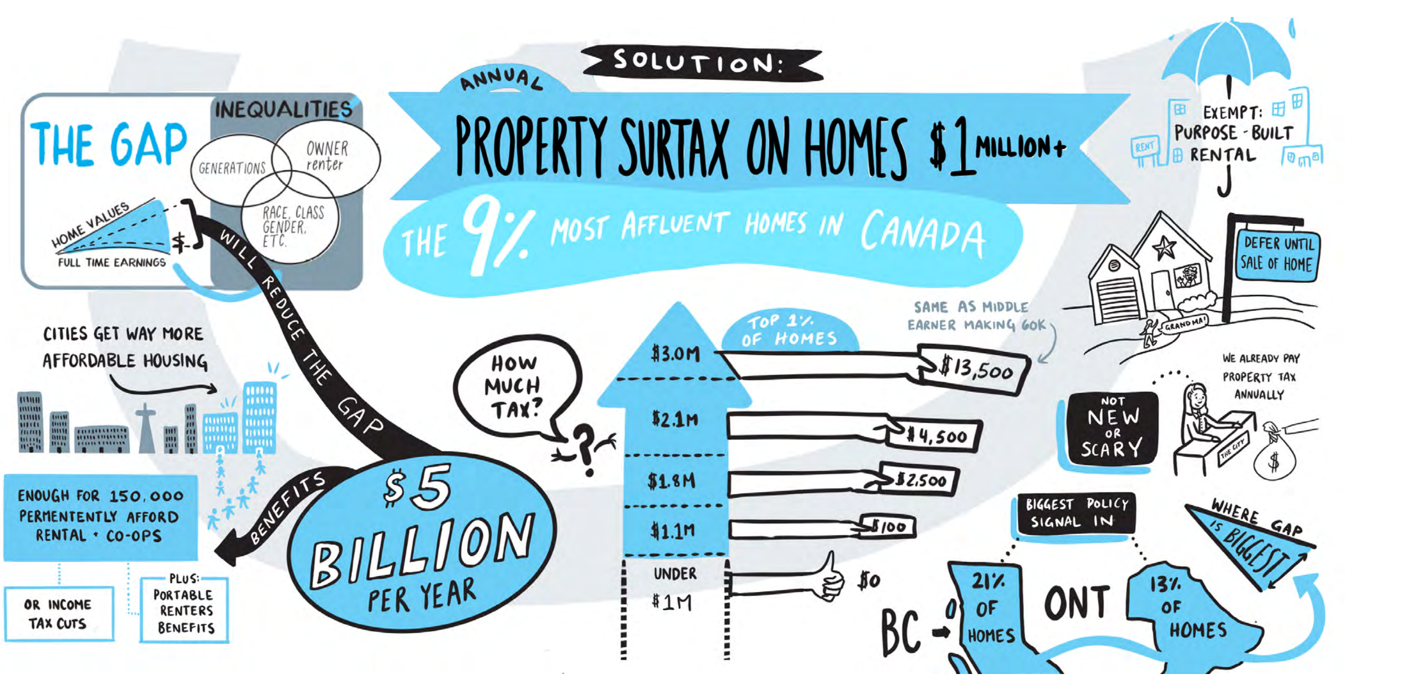
**Note: Deferrable means that the tax would not need to be paid until the home is sold, or the property inherited. This design detail would respond to the principle that policy adaptations should avoid imposing risks on individuals with limited income or wealth beyond the home in which they live. A competitive interest rate would be charged on any deferred tax payment. This deferral practice is already common across provinces when it comes to collecting annual property taxes from seniors.*

Policy Summary

Federal and/or provincial governments would implement an annual (deferrable) progressive surtax on home values starting at $1 million. Proposed surtax rates are presented in the Table below.

The recommended $1 million threshold ensures that **the vast majority of Canadians would NOT pay this tax.** Calculations using Survey of Financial Security data show that 91% of Canadian households do NOT own a property that is valued over $1 million. As a result, only the 9% of Canadian households living in the most valuable principal residences in the country will be subject to the tax.

Even in the two provinces with the highest average home prices, namely, BC and Ontario, the vast majority of residents will not be subject to the surtax. 13% of all Ontario households and 21% of BC households own properties that are valued above $1 million.



The proposed annual surtax will reduce the tax shelter that has historically privileged principal residences as an "investment strategy" by comparison with other sectors of the economy. The favourable tax treatment of principal residences incentivizes Canadians to rely more on rising home prices as a strategy for their savings and wealth accumulation than they otherwise would. By reducing the tax shelter, the policy change will disrupt feedback loops that fuel high and rising home prices. This will yield the following benefits:

- Slow down the escalation of home prices, and thereby improve affordability for those entering the ownership market, as well as many renters because rents are influenced by the prices of homes.

- Reduce inequalities in wealth, including between renters/owners, between younger/older Canadians, and along other intersecting axes of power related to race, class, gender, colonization, etc.

- Attract savings and credit towards economic activity beyond real estate that may produce more jobs and innovation than is often found in real estate. (Note: This objective aligns with themes emphasized by the Monetary & Lending Policy Working Group. See the previous section).

Revenue collected from this surtax could be used to provide:

- Benefits directly to renters (eg. helping low-income tenants pay their rents through direct financial assistance like portable housing benefits; or government-supported RRSP investments for renters to enhance their future savings, as rising home prices have done for many owners); and/or

- Investments in new green co-op and PBR units, as recommended by the Monetary & Lending Policy Working Group; and/or

- Investments required to initiate the "Off-Ramp Program and Bond" recommended by the Protective Policy Working Group (see description below).

The following Table provides an illustrative summary of possible surtax rates around which the majority of working group members converged. The Table provides two options, with the first providing a possible phase-in approach for the proposed surtax over its initial years.

Table 1: Possible Surtax Rates and Revenue

Home Value	% of households Canada	# of households Canada	Average Value	Surtax Rate	Avg Annual (deferrable) Surtax payment	Annual Revenue (Billion $)
$1 to $1.5 million	5.5	845,108	1,204,184	0.2%	$408	$0.35
$1.5 to $2 million	1.8	271,618	1,723,587	0.5%	$2,118	$0.58
$2 million +	1.6	246,063	3,121,013	1.0%	$14,710	$3.62
Total	**8.9**	**1,362,789**				**$4.54**

Home Value	% of households Canada	# of households Canada	Average Value	Surtax Rate	Avg Annual (deferrable) Surtax payment	Annual Revenue (Billion $)
$1 to $1.5 million	5.5	845,108	1,204,184	0.5%	$1,021	$0.86
$1.5 to $2 million	1.8	271,618	1,723,587	0.5%	$3,618	$0.98
$2 million +	1.6	246,063	3,121,013	1.0%	$16,210	$3.99
Total	**8.9**	**1,362,789**				**$5.83**

Source: Working group calculations based on Statistics Canada Survey of Financial Security (2016) data, adjusted for home price inflation to 2020

The proposed annual surtax differs from a capital gains tax in several important ways

- A capital gains tax would apply to all home owners, unless a specified value of lifetime capital gains was added to exempt some owners. By contrast, the proposed annual deferrable surtax is designed to exempt the vast majority of home owners, thereby increasing its political feasibility.

- A capital gains tax would require a new, complicated system for measuring and auditing the "gain", because investments in any home improvements would need to be subtracted from the home's market value at the time of sale. By contrast, the proposed surtax is simpler to implement because it can rely entirely on existing provincial infrastructure that already measures home values for the purpose of calculating annual property taxes.

- A capital gains tax would need to apply retroactively if it is to tax housing wealth gained as a result of home price increases over previous years. Many will question the fairness of implementing something retroactively; or raise questions about how far back in time the capital gains tax should apply. By contrast, this surtax option would be implemented only on a "go forward basis," which adds simplicity, increases political acceptability, and reduces concerns about fairness.

- If a capital gains tax were implemented without applying retroactively, it would continue to shelter the wealth that has so far been created by the growing gap between average home prices and earnings. It would thereby fail to address many of the wealth inequalities that initially motivated Solutions Lab participants to call for a review of the taxation of housing wealth. By contrast, the surtax proposal will collect additional tax revenue from the 9% of Canadian households with the highest levels of housing wealth – many of whom will have accrued this wealth as a result of previous housing price increases.

- The design of a capital gains tax may invite questions about the number of years in which a person has resided in the home as part of efforts to calculate "the gain" and/or to discourage the commodification and "flipping" of primary residences. By contrast, the proposed surtax would accrue annually regardless of the number of years in which the owner(s) live(d) in the home.

While the proposed annual surtax on homes over $1 million differs from a capital gains tax in these important ways, the two options share an important beneficial characteristic. Both would be collected at the time of sale when the owner's equity becomes liquid and readily accessible. The surtax also enables owners to pay the tax annually as it accrues if that is their preference.

Road map: to implement an annual deferrable surtax on homes over $1 million

Implementation

Which level(s) of government, and which ministries/departments would need to be involved in its implementation? What are key details that need to be worked out?

Either federal or provincial governments could implement more annual deferrable taxation of high-value housing wealth/consumption. While property taxation is currently the primary domain of municipalities, it does not make sense to roll out this recommendation city by city.

Federal/Provincial Ministries of Finance would be responsible for the policy, which should be monitored and evaluated in partnership with Ministries responsible for Housing.

Federal or provincial governments would rely on existing provincial organizations that estimate property values annually in order to calculate the annual surtax owed. Experts in our working group suggest that some provinces assess annual home values more effectively than others: eg. BC. This means some funding may be required to strengthen the property assessment organizations in each province to ensure public confidence in the estimate of land and building values to which the surtax would be applied.

Presently, the National Housing Strategy (NHS) does not mention the word "wealth." By failing to acknowledge wealth, the NHS risks overlooking that a primary reason why our country is struggling to restore housing affordability is that few Canadians think rising home prices are uniformly bad.

Many ‘everyday’ households benefit from price escalation, and therefore reinforce feedback loops that stimulate home prices to rise beyond local earnings. This weakness in the NHS could be remedied by framing implementation of an annual deferrable surtax on high value homes as part of the broad range of policy adaptations being developed in response to the NHS.

Rollout Strategy

How will the policy be rolled out?

Rollout should start by focusing on the federal government. However, the current federal government has said publicly it will not consider a “home equity tax.” So it may be necessary to begin by targeting some provinces: eg. BC and Ontario, which have the highest home values.

Either way, the implementation is a straightforward “technical” change to tax policy. Recent changes announced in BC as part of the “School Tax” legislation provide guidance. With this policy change, the province added multiple surtaxes for home wealth above $3 million. Members of the working group encourage further study to quantify the influence of the “School Tax” on BC home prices in order to provide evidence about the anticipated impact of their surtax recommendation.

A key question for the rollout strategy is whether the surtax would be **“phased in”**. Table 1 offers the option of introducing the deferrable surtax with the very low rate (0.2%) on home value between $1 to $1.5 million. For instance, one could phase in this recommendation starting at this low rate, and adding 0.1% in each of the next years until after four years the rate for this home wealth range would be 0.5%. That is the same rate proposed for home wealth between $1.5 and $2.0 million. Above $2 million, the proposed surtax rate is 1%.

Some working group members also considered whether there is value to having the annual surtax apply to a home only after it is next purchased. However, most in the group rejected this idea out of concern that such a phase-in strategy could create many horizontal inequities, and risk leaving many existing housing wealth windfalls sheltered from the proposed surtax. The latter would constrain the impact of the recommendation to reduce wealth inequalities, and reduce funds available in the short-term to invest in new portable renters’ benefits and/or scale up affordable, green housing co-op and PBR supply.

Regardless of whether a phase-in option is selected, the recommendation could be rolled out in the context of a shift towards wellbeing budgeting – now being prioritized by the federal government as a part of the Quality of Life Framework discussed earlier. Wellbeing budgeting measures benefits in various sectors like health, the environment, and prosperity with emphasis on reducing inequality and promoting sustainability. Our recommendation will contribute positively to both goals across all of these sectors.

The primary rollout challenge is the “framing” required to win the hearts and minds of citizens, and to reduce concerns from municipalities about the risks of crowding out their revenue supply.

Costs and resources required

What are the direct and indirect costs associated with policy implementation?

- This policy change will raise funds for governments; it would be a net gain for finances. Based on current home values, Table 1 projects that annual revenue across Canada would range from $4.5 to $5.8 billion, depending on the initial surtax rate.
- There may be minor costs to improve the annual assessment of home values currently led by organizations in each province: eg. BC Assessment; MPAC in Ontario; etc.
- There may be indirect costs to government coffers if, as is intended, this tax policy change dampens home prices. This could in turn depress the contribution of real estate to GDP. However, if other industrial sectors increase their contributions to GDP, this would compensate for the decline. This highlights a connection between our tax recommendation and the work of the Monetary & Lending policy group, which considered how to use lending policy to attract more investment beyond real estate.
- Departments of finance may need to consider what showing "deferred tax payments" does for their annual reporting of government surpluses/deficits and debts in their balance sheets. A competitive interest rate would be charged on any deferred tax payment, a practice common across provinces when collecting annual property taxes from seniors.
- There would be minor cost implications for collecting the tax.
- There would be costs involved for public relations work to "frame" the new tax so that the vast majority of Canadians learn right away that they are not subject to it.

Revenue and/or other benefits

What are the financial and other gains (or cost recovery), other than the main impact above?

- Using Survey of Financial Security data about current home values, validated by BC Assessment data, Table 1 above projects that this tax change would raise between $4.54 and $5.83 billion annually across Canada, depending on the initial surtax rate.

  9% of Canadians have homes above $1 million, or 1,362,789 households. Most of these are in Ontario and BC, where we most need to slow down the escalation in home prices. 768,348 of those homes are in Ontario (or 13% of its households); and 428,662 in BC (or 21% of its households).

  Note: the revenue estimate assumes current home values, and does not account for changes in values that would be expected as a result of current market forces, or as a result of the implementation of the surtax itself. So the estimate would benefit from further econometric and theoretical modeling.

  Note: the revenue potential of this tax policy change, by comparison with other tax policy options, has not been a primary motivation for its prioritization by the working group. Instead, we sought to develop a policy signal to reduce the tax shelter currently available for high value homes in order to disrupt the common cultural attitude that housing is an especially strong investment opportunity -- rather than primarily an affordable place to call home.

- To put this $4.54 billion annual revenue estimate in context, it is one-quarter of the funding that the Co-operative Housing Federation (CHF) of Canada estimates is required over the next seven years to subsidize building 90,000 co-op and affordable purpose-built rental homes, as well as convert an existing 60,000 low-rent homes into permanently affordable supply. In other words, this annual surtax could pay for the entire subsidy required to meet this ambitious goal of adding new affordable supply – with substantial funds left over to contribute to the new Canada Housing Benefit that aims to close the gap between some renters' incomes and their actual rent payments. In addition, the surtax would raise sufficient revenue to cover the $1 billion required to initiate the Off-Ramp program and Bond recommended by the Protective Policy group (see below).

- Improved housing affordability may (eventually) result in reduced government investments into this policy area, with opportunities to re-allocate to other pressing needs/priorities.

- Reducing housing unaffordability reduces stress, which is the biological mechanism by which adverse characteristics of the environment negatively influence human health. So existing evidence gives strong reason to anticipate that improvements to housing affordability, and reductions to inequality, will improve population health, quality of life, etc.

Risks: Political and Other

What are the risks associated with implementing this policy? Unintended consequences?

1. Risks tied to anticipated resistance to new taxation:

While new taxes are often unpopular, there is growing evidence that Canadians are open to additional taxation of the "wealthy". Moreover, the emergency response required during the pandemic may be shifting public attitudes about the importance of government programs.

However, it is important to note that much of the dialogue about the "wealthy" in Canada refers to people with tens of millions in assets. Our conversation is focusing on home wealth or consumption at considerably lower levels – $1 million and up. So we must anticipate resistance. The level of resistance is likely to be directly related to the threshold at which the surtax begins.

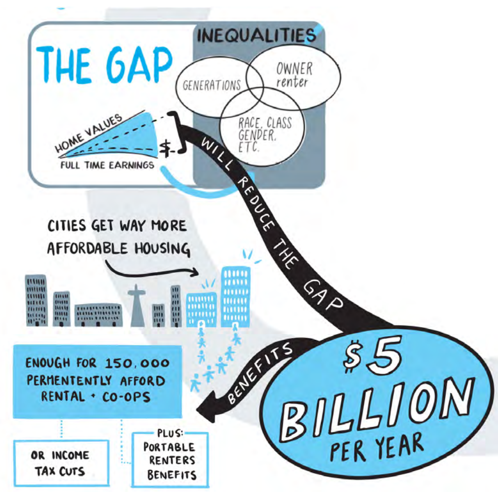
There is a tradeoff between the impact of the policy on affordability and inequality on the one hand, and the amount of political resistance on the other. Less resistance likely aligns with less impact. The rates and thresholds recommended above aim to find the right balance between what will be impactful, and what will be politically possible. If the initial introduction of the surtax has insufficient impact to dampen price increases, then the

threshold at which the surtax applies could be reduced, and/or the rates increased. Resistance to the proposal should be reduced substantially *if*:

- We can show that the majority of people are unaffected by the new tax. This is easy to do with our surtax proposal because it only applies to the top 9% of household values.
- It is made clear that the new tax on housing wealth will contribute to paying for additional benefits for renters, or the development of affordable housing.

2. Jurisdictional risks:

   Provinces may claim that property taxation falls under their jurisdiction. In the face of this risk, the recent Supreme Court Decision about the federal pricing pollution legislation provides a model to follow. The federal government could set a national framework for a property surtax on high value homes. This framework would give room for the provinces to implement their own version that meets the minimum characteristics laid out by our recommendation above. Any federal money collected in non-participating provinces could be delivered back to the provinces.



   Similarly, municipalities may worry that this recommendation invites senior levels of government to crowd out their primary source of revenue (while they also worry that federal and provincial governments have been downloading responsibilities in recent years/decades). The risk can be reduced if the benefits resulting from new revenue are generally allocated to addressing municipal priorities. Or, the policy could explicitly direct some of the revenue back to municipalities.

   For example, if local governments received grants for innovative projects that increase density, promote energy efficiency, etc., there could be less resistance to creating a mix of rental units and owner-occupied housing in any given neighbourhood. Some such projects could also include child or senior day care centres, so that there is that additional benefit to the community of surrounding home owners. With the surtax collected by a higher level of government, local governments don't have to take the blame for raising property taxes, but they could take credit for attracting projects that are financed by these revenues.

3. Owners of homes approaching the $1 million threshold may be discouraged from investing in home repair.

4. Owners of homes valued over $1 million that include informal rental suites may try to recover the surtax by passing some of its cost on to renters.

Evaluation (system scale)

How will success be defined and measured?

Anticipated Impacts: What are the anticipated system-level results of the policy, both positive and negative?

Whereas foreign buyers taxes, and speculation/vacancy taxes, etc., impact a very small portion of actors in the housing system (often under 1%), our proposal is designed to wield a larger systems-level impact (9% of households), while still sheltering the vast majority of Canadians from the proposed surtax in order to increase political "acceptability".

The 9% of impacted owner-occupied households are concentrated in Ontario (where 13% of residents will be affected) and BC (where 21% of residents will be affected). It is a strength of this recommendation that it will target BC and Ontario, where home prices have risen the most, and where affordability pressures are especially great. These are the provinces that require the largest disruption to system feedback loops that fuel high and rising home prices.

Adding progressivity to property taxation adds incentives for redevelopment at higher density. This may contribute to upzoning, and more liveable communities with amenities, transit, etc. near higher density development, and thereby improve quality of life while reducing GHG emissions.

A new surtax on housing wealth above $1 million can be expected to lower consumption of housing at values above that threshold. <u>A key question to consider</u> is where the people who are no longer in the market for $1 million+ homes shift their demand.

> *Note: There is a risk they would bid up the price for more modest housing. Some experts in our working group suggest it is likely that more buyers would be attitudinally-driven to target their purchases just below the threshold in order to avoid the surtax. The low rate of the surtax just above the $1 million mark, and the application of the tax only to the amount of value in excess of $1 million should make the effect modest.*
>
> *Any behavioural changes that result in people purchasing homes valued just below the threshold may, in turn, cause people to advocate for policies that reduce housing price escalation so as not to be subject to the surtax. Were the latter to happen, there would be a change in Canadian culture about home prices, and potentially greater alignment between the interests of owners and renters. Further theoretical and econometric modeling is required to evaluate these details).*

After-tax inequalities in wealth would be reduced, which could improve health and social outcomes in the population.

The allocation of new revenue towards priorities such as affordable housing, medical care, child care, pharmacare, etc. would be associated with system impacts proportionate to those investments.

Indicators

- Average home prices (modelled/assessed relative to the status quo), with stalled or (moderately) falling prices (relative to incomes) judged favourably. Any corresponding influence on rents would also be monitored.

- After-tax inequalities in income and wealth (using, for example, the Gini), with reductions in inequality judged favourably.

- Investment/lending shift from owner-occupied residential real estate to other industries (reinforcing goals identified by the Monetary & Lending Policy Working Group).

- An increase in Government revenue

- Reduction in rates of "home flipping."

- Consider how average data about the above indicators could be disaggregated to examine impact on renters, as well as those in precarious housing broken down by gender, race/ethnicity, income, ability, household composition, etc. Data from the Survey of Financial Security could inform this analysis.

- Longer term: quality of life and health outcomes and their distribution across the population

Evaluation (individual scale)

Impacts: What are the anticipated individual-level results of the policy, both positive and negative? E.g. household, individual businesses.

The majority of residents would not be directly affected by the proposed deferrable surtax on high value homes. Presently, 91% of households would be exempt from the surtax.

9% of households would be impacted by higher (deferrable) taxes. See Table 1 above for examples of the taxes that would be levied to stall the escalation of high home prices, and raise revenue to pay for more housing affordability, and reduce inequalities.

Deferability would ensure that no one is required to pay the progressive surtax until the home is sold, or the property is inherited. As a result, low-income, high-housing-wealth individuals would not be at risk of needing to leave their homes because they can't afford to pay the tax while still living in them. This policy detail is likely critical for ensuring the tax change is "acceptable."

A modest number of individuals owning households over $1 million may be so highly leveraged that their mortgage lenders may not permit deferral of the annual surtax. It will be necessary to monitor if this risk emerges, and its consequences. Governments could explore how to encourage

Lenders to accept a deferral in these circumstances. If unsuccessful, the recommendation of the Lab's Protective Policy Working Group may offer risk mitigation strategies to deploy in these rare circumstances.

New entrants to the housing market will generally face average home prices for ownership that are slowed down by this tax -- although there may be price escalation pressures that are slightly exacerbated at home values slightly below the threshold at which the surtax is charged.

The surtax may incline people with homes above the threshold to reduce their liability by turning a basement into a secondary unit, etc, which could contribute to rental supply.

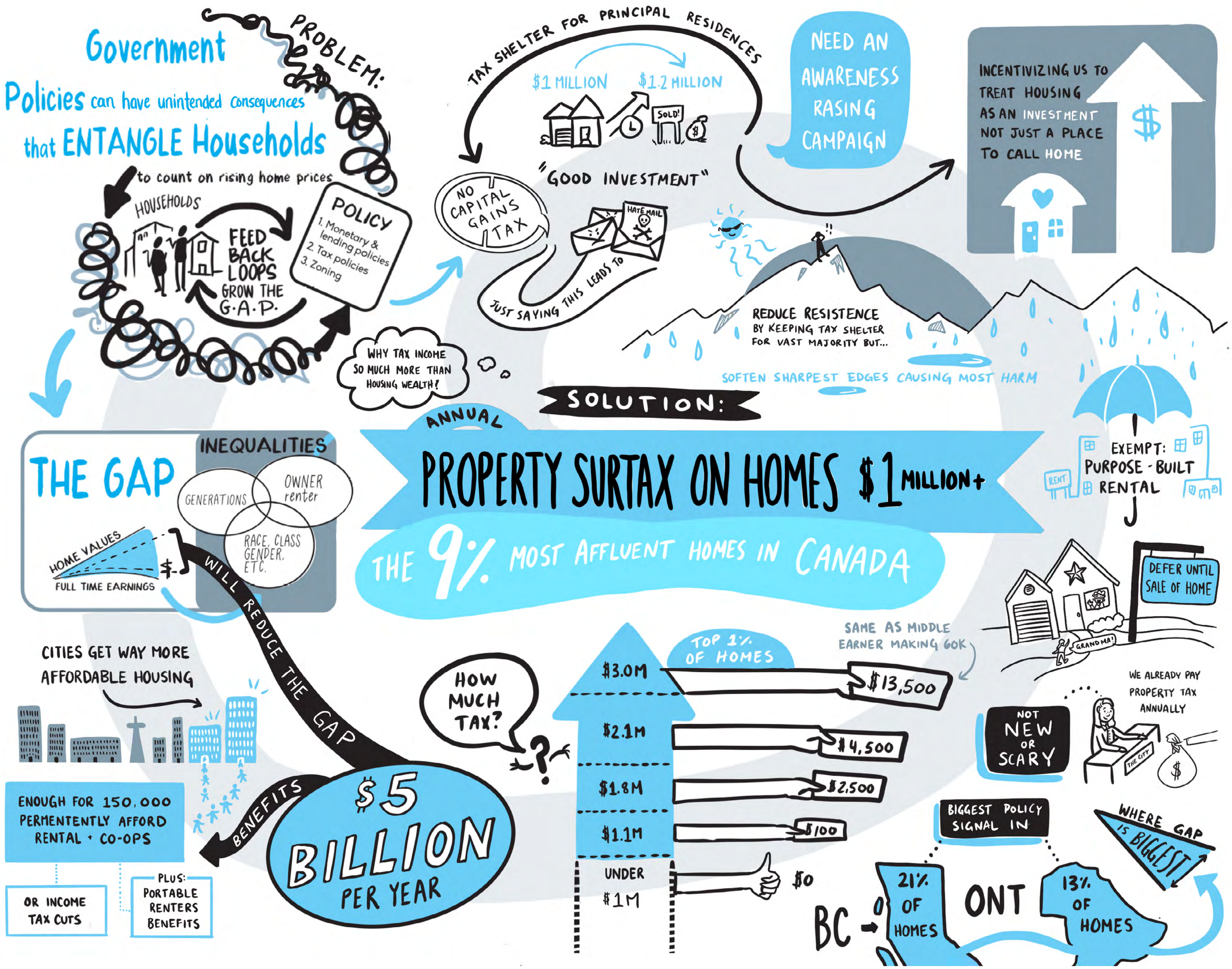
Downstream benefits of better affordability and less inequality, including better quality of life, sense of community, health, transportation, etc.

Indicators

- The % of residents who pay no additional tax, but benefit from additional public investment in priorities and/or (s)lower average home prices.

- Disaggregated outcome data (benefits/drawbacks by race/ethnicity, class, gender, ability, etc.)

- The average new tax bill for those paying the surtax on high value homes relative to their home equity -- compared to tax rates applied to income for people in the top income quintile.



Government Policies can have unintended consequences that ENTANGLE Households to count on rising home prices
PROBLEM:
HOUSEHOLDS
FEED BACK LOOPS GROW THE G.A.P.
POLICY 1. Monetary & lending policies 2. Tax policies 3. Zoning
WHY TAX INCOME SO MUCH MORE THAN HOUSING WEALTH?
TAX SHELTER FOR PRINCIPAL RESIDENCES
$1 MILLION
$1.2 MILLION
SOLD!
"GOOD INVESTMENT"
NO CAPITAL GAINS TAX
HATE MAIL
JUST SAYING THIS LEADS TO
NEED AN AWARENESS RASING CAMPAIGN
INCENTIVIZING US TO TREAT HOUSING AS AN INVESTMENT NOT JUST A PLACE TO CALL HOME
REDUCE RESISTENCE BY KEEPING TAX SHELTER FOR VAST MAJORITY BUT...
SOFTEN SHARPEST EDGES CAUSING MOST HARM
SOLUTION:
ANNUAL
PROPERTY SURTAX ON HOMES $1 MILLION+
THE 9% MOST AFFLUENT HOMES IN CANADA
THE GAP
INEQUALITIES
GENERATIONS
OWNER renter
RACE, CLASS GENDER, ETC.
HOME VALUES
FULL TIME EARNINGS
WILL REDUCE THE GAP
CITIES GET WAY MORE AFFORDABLE HOUSING
ENOUGH FOR 150,000 PERMENTENTLY AFFORD RENTAL + CO-OPS
BENEFITS
$5 BILLION PER YEAR
OR INCOME TAX CUTS
PLUS: PORTABLE RENTERS BENEFITS
HOW MUCH TAX?
TOP 1% OF HOMES
$3.0M
$13,500
SAME AS MIDDLE EARNER MAKING 60K
$2.1M
$4,500
$1.8M
$2,500
$1.1M
$100
UNDER $1M
$0
EXEMPT: PURPOSE-BUILT RENTAL
RENT
DEFER UNTIL SALE OF HOME
GRANDMA!
WE ALREADY PAY PROPERTY TAX ANNUALLY
THE CITY
NOT NEW OR SCARY
BIGGEST POLICY SIGNAL IN
WHERE GAP IS BIGGEST
BC
21% OF HOMES
ONT
13% OF HOMES

Section 7: Protective Policy Working Group Recommendation

Members*

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- Dallas Alderson, Co-Operative Housing Federation of Canada
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- Jason Allen John, Partna, and independent Mortgage Broker
- Jill Atkey, BC Non-Profit Housing Association
- Kira Gerwing, Vancity Credit Union
- Kristjana Loptson, CMHC
- Nick Montgomery, Arts in Action Society
- Thom Amrstrong, Co-Operative Housing Federation of BC
- Vicki Martin, CMHC

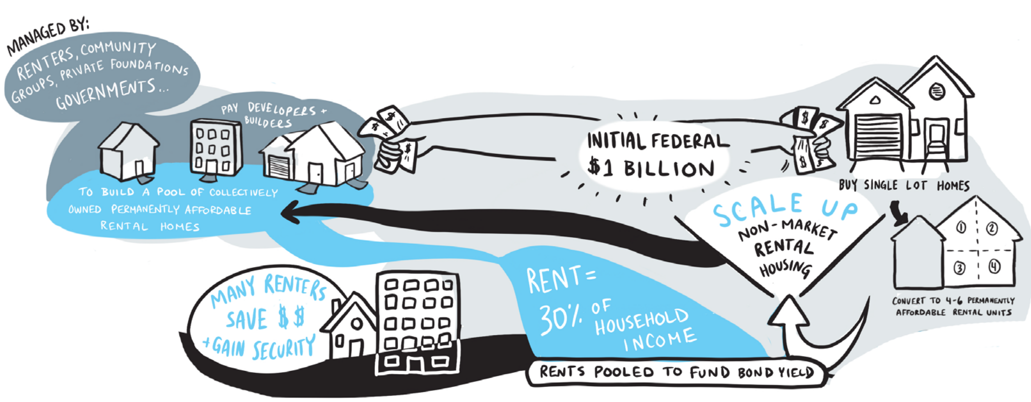
**Note: The recommendations presented below were co-developed by the members of the working group. The recommendations on which we landed have the support of the large majority of group members as individuals; but do not necessarily represent the positions of the organizations with which they are affiliated.*

Policy Recommendation: Permanent Housing Affordability Off-Ramp Program and Savings Plan

Policy Summary:

The Off-Ramp has two mutually-supporting components:

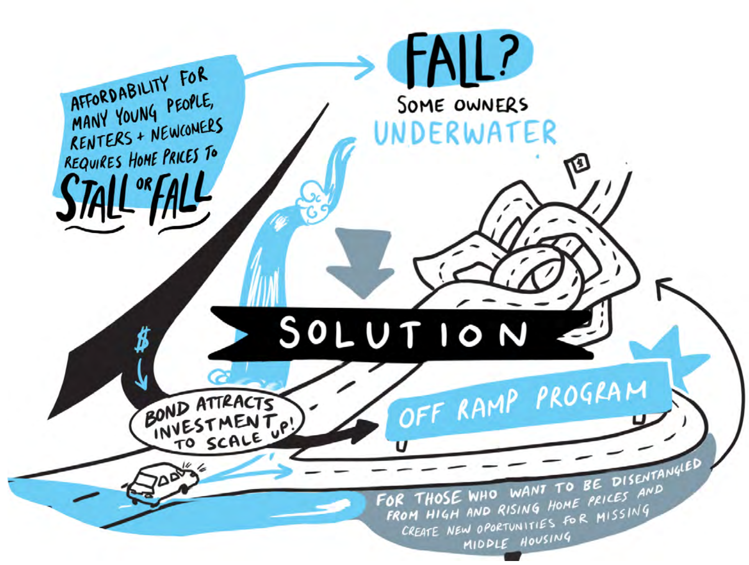
- **Off-Ramp Program to transition low-density housing into a pool of permanently affordable rental units.** The first component is a new federally-guaranteed, arms-length Off-Ramp program, which will purchase existing low-density housing from individual households across Canada to address the problem of "missing middle housing." Each low-density lot will be redeveloped into 4-6 units, and the new units will be pooled into a large, diverse and distributed stock of higher-density, permanently affordable rental homes for which rent will be charged at 30% of the tenants' gross household income. Converting existing single-family homes is a focus due to the development potential, but other low-density housing forms also play a role in scaling the program.



The Off-Ramp program will start with a minimum $1 billion investment from the federal government so funds are available to purchase properties from potential sellers.

For individual homeowners who wish to sell their property to the Off-Ramp program, the sale would:

- Be executed at appraised market value,
- Pay out in cash all net equity owned by the seller, and any outstanding mortgage balance to the lender,
- Provide the seller the right to continue to live onsite in a home that meets their needs after their low-density housing is converted to 4-6 permanently affordable units, and
- Include 100% debt relief for those who are underwater.



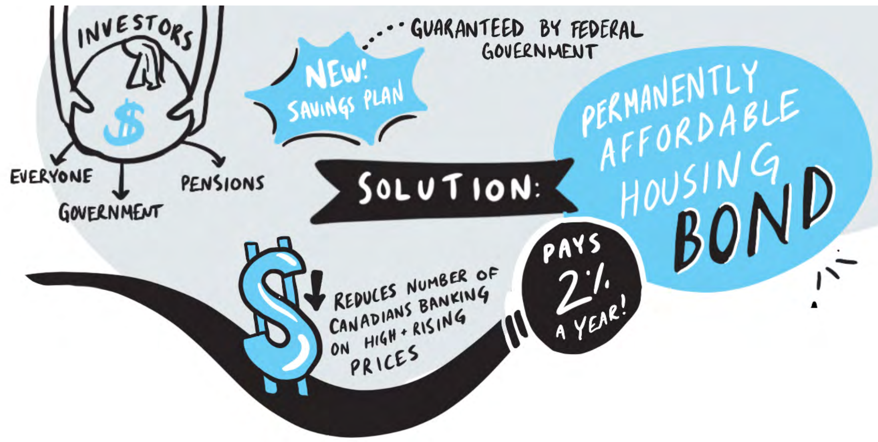
The home's ownership will pass from private to collective and will sit in a legal vehicle to be governed by a number of stakeholders, including residents, community groups, private foundations, developers and government. The legal vehicle will be governed according to Key Performance Indicators established by those directly involved in the Off-Ramp program.

The Off-Ramp program would be universally available. While home prices are still rising, the Off-Ramp may attract current homeowners via a variety of motivations, including a values-aligned desire to support a shift to permanently affordable housing, access to accessibility or other improvements via conversion, financial benefits from the sale of their home and lower monthly costs, etc.

Should home prices stall or fall, the Off-Ramp program's intention to scale up "missing middle housing" also has potential to attract and protect those most at risk of being "under water." It does so by providing 100% debt relief for those who join the program to convert their single lot (or other low density housing) into 4-6 permanently affordable rental homes. However, this offer of "protection" is used as an incentive to achieve the program's primary objective -- to scale up missing middle permanently affordable rental housing. The Off-Ramp program is NOT proposing that governments directly subsidize homeowners with underwater mortgages.

2. **Off-Ramp Savings Vehicle:** Once the Off-Ramp program is initiated by an injection of government funding, the Off-Ramp can be scaled up with additional financing raised by issuing a new Perpetual Affordable Housing Bond ("PAHB") that delivers a stable and attractive return

to investors that will be guaranteed by the federal government for 10 years. The PAHB returns are anchored by the pooled rental income generated by the homes converted through the Off-Ramp program, along with a portfolio of supplementary community wealth assets that are built up over time (e.g. car share, energy generation, etc.). As a result, the Off-Ramp's transition from low-density to permanently affordable "missing middle housing" will be paid for by a wide range of capital sources (as opposed to just using public funds).



The PAHB would be available to everyone and serve as a stable retirement savings vehicle, which will pay 2% annually (or payments could be indexed to inflation, etc.). This savings vehicle will reduce the number of Canadians counting on high and rising home values in individually-owned properties for their future financial security. As such, the PAHB will contribute to the cultural shift needed to disentangle Canadians from current policy incentives that sustain the large gap between home prices and local earnings.

The success of the Off-Ramp program will be enhanced if Municipalities are incentivized to streamline the redevelopment process for Off-Ramp housing. However, redevelopment applications can also proceed per the status quo.

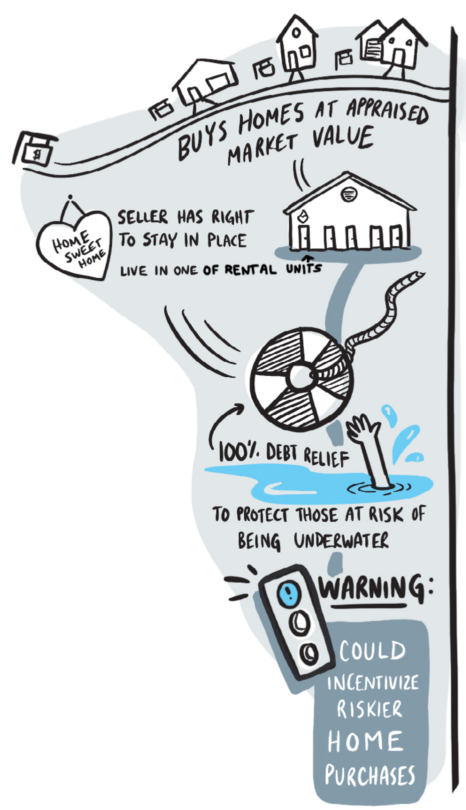
Road Map for Implementing the Off-Ramp Program and Off-Ramp Savings Vehicle

Implementation

Which level(s) of government, and which ministries/departments would need to be involved in its implementation? What are key details that need to be worked out?

Initiation: The Off-Ramp program establishes a base stock of housing in specific communities (see the Rollout Strategy below), after which local owners are free to approach the program to initiate the conversion of their own privately-owned home(s) into Off-Ramp Housing. This conversion may be motivated by an owner's desire to escape from debt, to pay lower monthly costs, to age in place in a renovated and accessible unit, to contribute to local housing solutions, etc.

Buyout: The purchase is executed at appraised market value, and includes 100% debt relief for those who are underwater. Owners



with an equity surplus have the option of receiving a 100% cash payout (or X% in Off-Ramp bonds and/or rent credit).

Densification: Municipalities are encouraged to pass citywide upzoning provisions for Off-Ramp housing (e.g. 1-4 or 1-6 conversions in keeping with Vancouver's "Making Home" proposal, but geared to rental), perhaps with a list of pre-approved designs. The benefit to the local government is an influx of funding and affordable housing. Development fees are used to cover local costs.

Availability: The Off-Ramp is available to all potential sellers, and the resulting increase in housing supply is available to all Canadians. Waitlist details TBD.

Service agreements: The development and operation of Off-Ramp housing is done by an ecosystem of local service providers (developers, builders, not-for-profit housing agencies, etc.), the activities of which are guided by service agreements that set key performance indicators ("KPIs") such as energy efficiency, etc. Developers' roles are less about timing the market, and more about the efficient delivery of quality homes and KPIs.

Monthly rent calculation: Tenants pay 30% of their household's gross income (opting to use previous year's income OR an estimate of current year's income). Monthly rents cannot drop below a "rent floor" of X (still to be determined), nor rise above a "rent max" defined by 30% of the local top quintile median income, set in perpetuity and adjusted for inflation. Rent payments administered via digital smart contracts.

Rent insurance: If taking 30% of a tenant household's income produces an amount higher than the "rent max," this additional income (or a portion thereof) will be taxed via a special federal levy every year and deposited in a rental insurance fund/policy that covers Off-Ramp tenants who are temporarily unable to pay the rent floor.

Bond details: The bond is a perpetual bond (no maturity date), with a notional yield of 2% (could also be designed to float with interest rates), guaranteed by the federal government for 10 years, and available to everyone.

Governance: The activities of Off-Ramp are governed by an entity with representation from the federal government, service providers and local communities. Exact governance structure TBD.

Rollout Strategy

How will the policy be rolled out?

Program established with initial $1 billion investment.

Bond issued.

Base stock of Off-Ramp housing is attracted by inviting municipalities to opt in to the Off-Ramp program via facilitative upzoning.

Contract with developers/builders to construct base stock of new multi-family homes in participating communities, reserving X% of units for owners attracted to participate in the Off-Ramp program while their homes are being redeveloped.

Build out base stock in other communities as needed.

Rents from the growing stock of permanently affordable housing are pooled together to pay bond yields. The bond attracts more private investors. Their funds are reinvested to scale up Off-Ramp housing.

Costs and resources required

What are the direct and indirect costs associated with policy implementation?

- An initial public capitalization for Off-Ramp Funding (e.g. $1 billion to leverage $10 billion of private capital, or $10 billion to leverage ~$100 billion) to initiate the conversion of low-density homes into more units of permanently affordable rental units; and to anchor the Permanently Affordable Housing Bond (PAHB).

- Federal guarantee of the bond

- A dedicated team of staff to manage The Off-Ramp Program

- A governance and outreach team to onboard and work with service providers

Revenue and/or other benefits

What are the financial and other gains (or cost recovery), other than the main impact above?

Public returns on the Perpetual Affordable Housing Bond are proportional to public investment in them.

Operation of the Off-Ramp program could be paid through direct cost recovery from the pooled supply of rental income generated by the conversion of low-density homes into more units of permanently affordable rental supply.

Indirect public financial benefits through avoidance of social and economic costs caused by housing indebtedness, insecurity and unaffordability.

Many mortgages are federally insured already. The scaling of this program could see a reduction in those costs long-term.

Risks: Political and Other

What are the risks associated with implementing this policy? Unintended consequences? How might these be mitigated?

The protection offered “underwater homeowners” could create inflationary pressure on prices and lead to even greater risk-taking.

Too few current homeowners may be attracted to sell to the Off-Ramp program.

Too few private investors may be attracted to invest in the Perpetual Affordable Housing Bond to scale up the necessary funds to build and maintain the Off-Ramp.

Success of the program depends significantly on municipal approvals.

Developers need to see this model as profitable (with profit coming from efficient service delivery vs. speculative gains). Some/many developers may not be attracted to partner with the Off-Ramp program.

Evaluation

Impacts: What are the anticipated key system-level and individual-level results of the policy, both positive and negative?

Positive system impacts

✓ Macroeconomic risks of housing-debt-induced recession(s) or downturns are mitigated.
✓ Accelerated scaling of non-market, permanently affordable housing.
✓ Fewer households in core housing need, and the associated downstream benefits to population health and economic productivity.
✓ Provides a counter-cyclical development mechanism that helps normalize the supply of housing, labour and construction costs and better matches it to demand for actual homes.

Negative system impacts

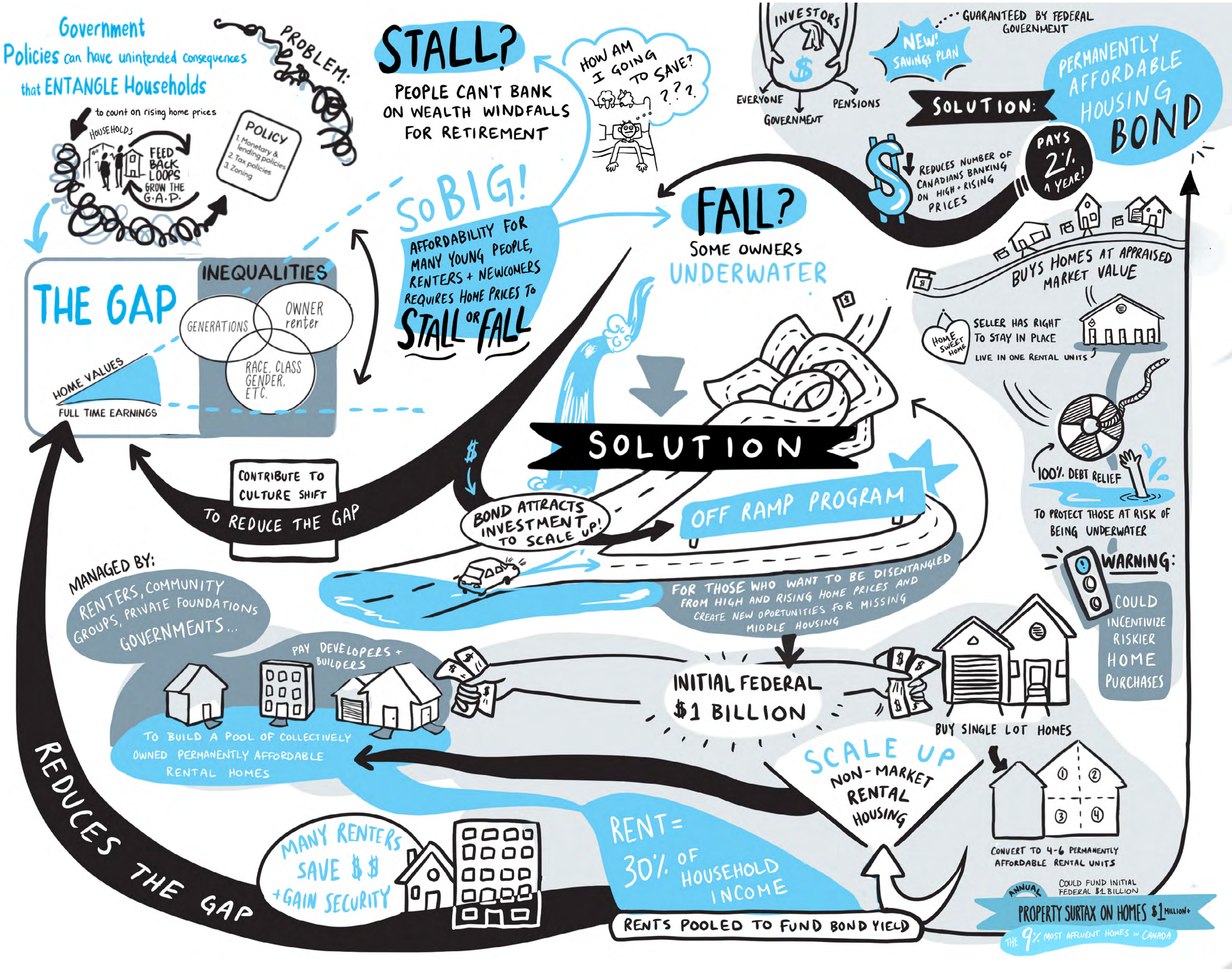
X The protection for underwater homeowners could create inflationary pressure on homeownership costs
X As the model scales it could become disruptive to the scaling of other housing models (including non-profit models that leverage ownership).

Positive individual impacts

✓ Underwater owners are no longer trapped by debt.
✓ Affordable, secure housing and all the individual benefits that come from that.
✓ Many will save on monthly costs.
✓ Psychological benefits from being unplugged from the volatility of the private market (avoiding the fear, insecurity, etc.)

<u>*Indicators:*</u>

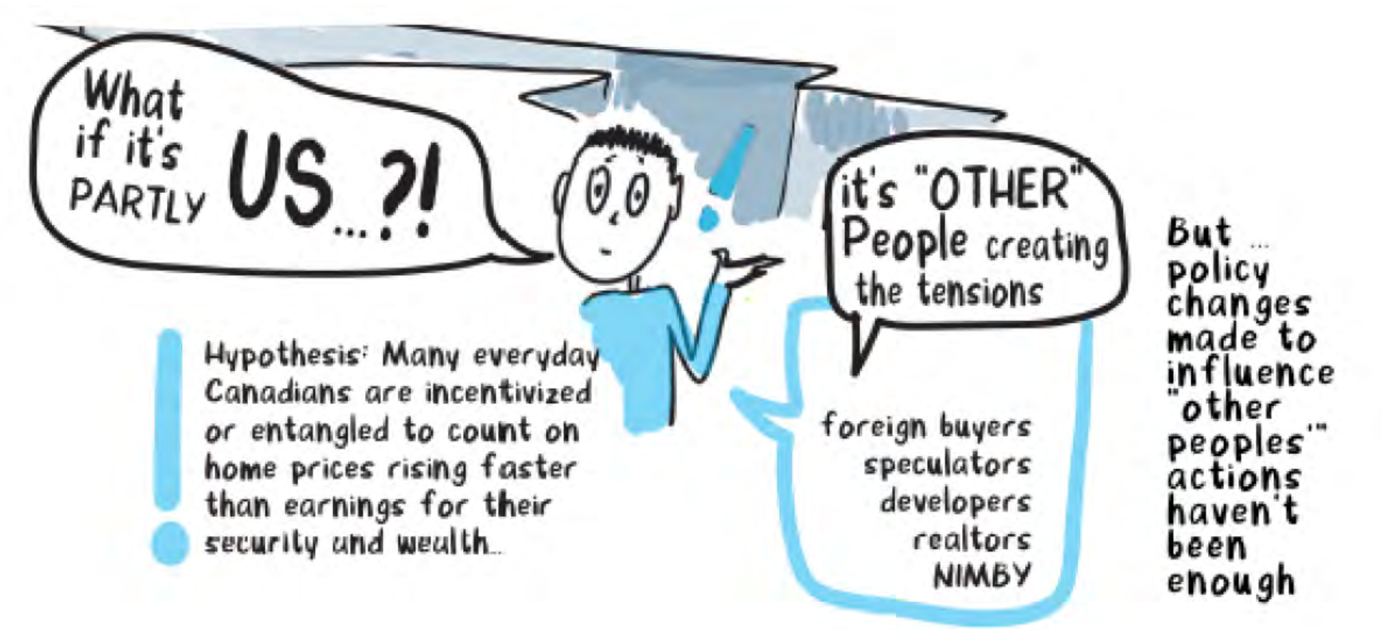
- Number of new permanently affordable homes created.
- Decrease in the # of Canadians in core housing need.
- Number of households ‘rescued’ from being “underwater”.
- Performance of the bond and Fund.
- Social impact return on the pooled assets (TBD).


Government Policies can have unintended consequences that ENTANGLE Households
PROBLEM:
to count on rising home prices
HOUSEHOLDS
FEED BACK LOOPS GROW THE G.A.P.
POLICY
1. Monetary & lending policies
2. Tax policies
3. Zoning
THE GAP
HOME VALUES
FULL TIME EARNINGS
INEQUALITIES
GENERATIONS
OWNER renter
RACE, CLASS GENDER, ETC.
STALL?
PEOPLE CAN'T BANK ON WEALTH WINDFALLS FOR RETIREMENT
HOW AM I GOING TO SAVE? ???
SO BIG!
AFFORDABILITY FOR MANY YOUNG PEOPLE, RENTERS + NEWCOMERS REQUIRES HOME PRICES TO STALL OR FALL
FALL?
SOME OWNERS UNDERWATER
INVESTORS
EVERYONE
GOVERNMENT
PENSIONS
NEW! SAVINGS PLAN
GUARANTEED BY FEDERAL GOVERNMENT
SOLUTION:
PERMANENTLY AFFORDABLE HOUSING BOND
PAYS 2% A YEAR!
REDUCES NUMBER OF CANADIANS BANKING ON HIGH + RISING PRICES
BUYS HOMES AT APPRAISED MARKET VALUE
HOME SWEET HOME
SELLER HAS RIGHT TO STAY IN PLACE
LIVE IN ONE RENTAL UNITS
100% DEBT RELIEF
TO PROTECT THOSE AT RISK OF BEING UNDERWATER
WARNING:
COULD INCENTIVIZE RISKIER HOME PURCHASES
SOLUTION
CONTRIBUTE TO CULTURE SHIFT
TO REDUCE THE GAP
BOND ATTRACTS INVESTMENT TO SCALE UP!
OFF RAMP PROGRAM
FOR THOSE WHO WANT TO BE DISENTANGLED FROM HIGH AND RISING HOME PRICES AND CREATE NEW OPPORTUNITIES FOR MISSING MIDDLE HOUSING
MANAGED BY:
RENTERS, COMMUNITY GROUPS, PRIVATE FOUNDATIONS GOVERNMENTS...
PAY DEVELOPERS + BUILDERS
TO BUILD A POOL OF COLLECTIVELY OWNED PERMANENTLY AFFORDABLE RENTAL HOMES
INITIAL FEDERAL $1 BILLION
BUY SINGLE LOT HOMES
CONVERT TO 4-6 PERMANENTLY AFFORDABLE RENTAL UNITS
SCALE UP NON-MARKET RENTAL HOUSING
RENT = 30% OF HOUSEHOLD INCOME
MANY RENTERS SAVE $$ + GAIN SECURITY
RENTS POOLED TO FUND BOND YIELD
REDUCES THE GAP
COULD FUND INITIAL FEDERAL $1 BILLION
ANNUAL PROPERTY SURTAX ON HOMES $1 MILLION+
THE 9% MOST AFFLUENT HOMES IN CANADA

Section 8: Silver Buckshot

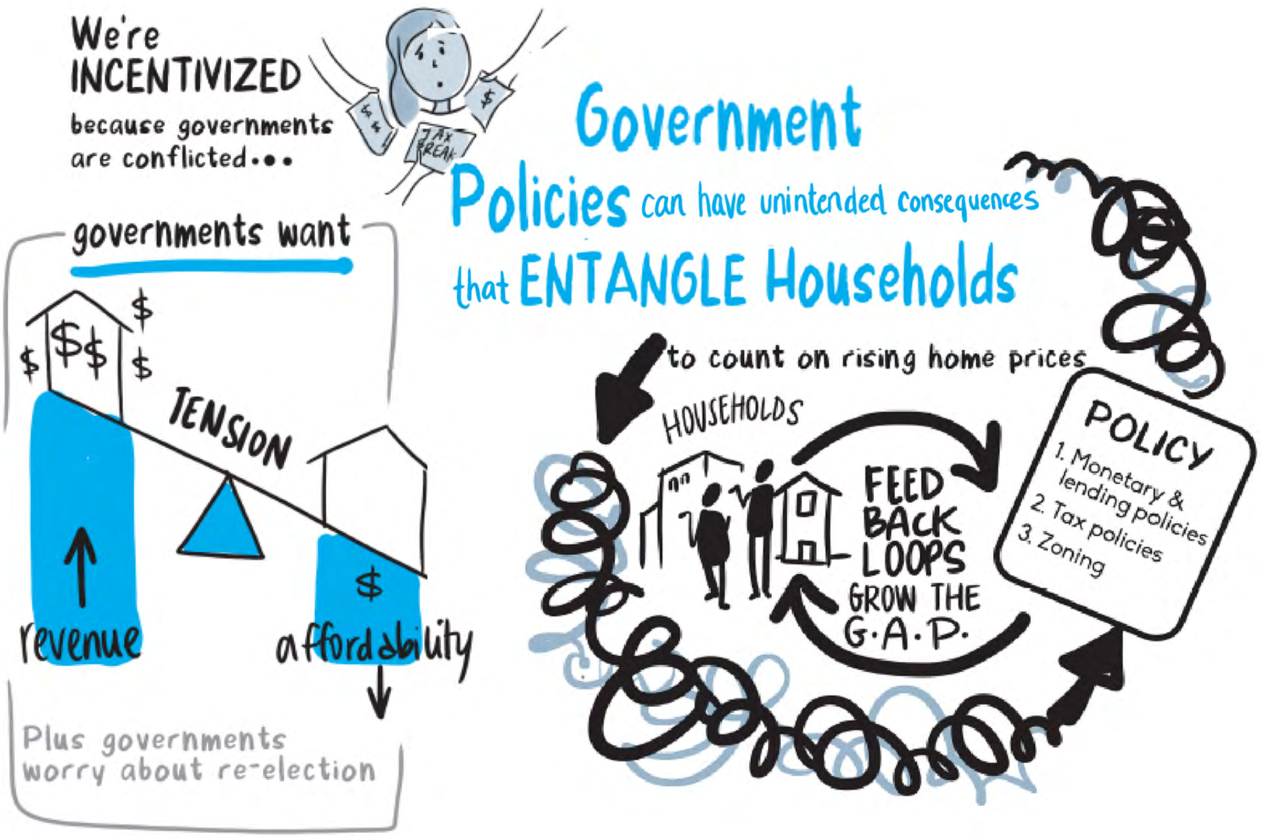
There is no silver bullet to restore housing affordability in Canada. Many factors are at play. But a "silver buckshot" approach can work, if we pursue the full range of policy tools that shape our housing system.

In order to bring the full range of policies into the mix, we will need to engage more people in the provocative, difficult conversation advanced by this Solutions Lab. Our work invites many 'everyday' Canadians, especially owners, to consider how we may be reinforcing feedback loops that sustain, or drive, home prices further out of reach for local earnings by responding to incentives in the market that attract us to organize our wealth accumulation strategies to bank on high and rising home prices.



This does not discount that ways in which unaffordability is shaped by a range of more commonly discussed actors in the housing system, including foreign investors, money launderers, speculators, NIMBYs, etc. But our policy makers have taken a variety of actions to address these contributors to Canada's unaffordability saga, as Gen Squeeze and many others have encouraged. There now exist foreign-buyers taxes, speculation taxes, empty homes taxes, new measures to address money laundering, new efforts to resist NIMBY'ism, new rent control policies, new expectations for developers, new regulations for realtors, and lots of efforts aimed at building more supply of housing. Unfortunately, the persistent, growing gap between home prices and earnings – including throughout the pandemic – shows that the measures we have taken so far are insufficient to stall home prices, or to close the frightening gap between home values and what local residents earn in our cities.

This reveals that housing unaffordability isn't just a problem caused by someone else – an easy "villain" for the rest of us to root against. The reality is more complicated. Many everyday households, myself included, respond to policy feedback loops that accelerate housing costs beyond what people earn.



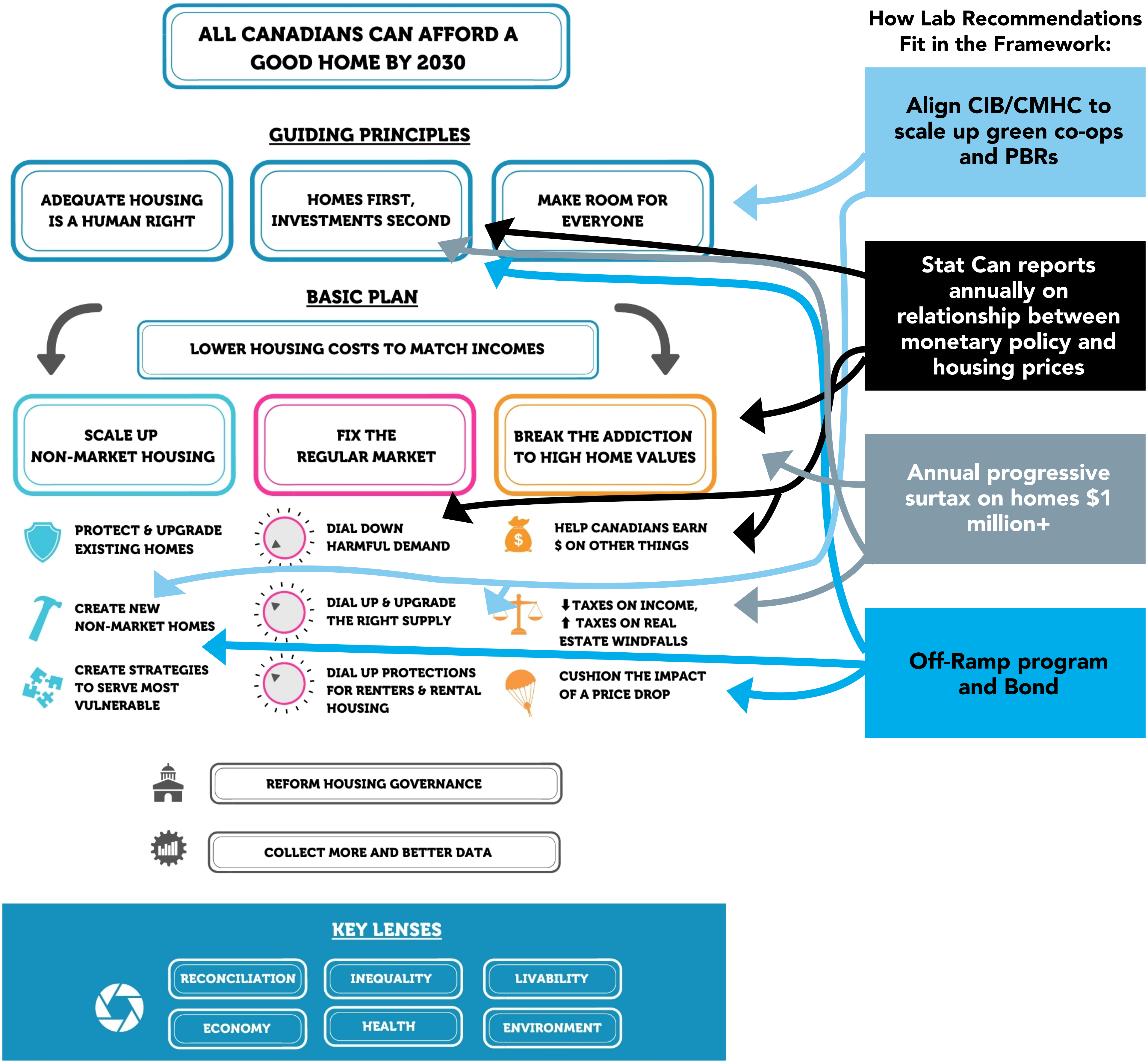
The Lab focused on three policy areas that contribute these harmful feedback loops: monetary & lending policy; tax policy; and the absence of what Lab participants came to call "protective" policy. Groups of Lab participants in turn developed proposals to adapt policy in these areas to disrupt the feedback loops (while also encouraging ongoing research and modeling to support their refinement).

These policy recommendations developed by the Working Groups are innovative, and important. However, we are the first to acknowledge that they do not represent the entire answer to restore housing affordability in Canada. Our proposals add key pieces to the silver buckshot; but more ingredients are still required.

To understand how these policy recommendations fit in the mix of policy changes required to ensure all Canadians can afford a home that meets their needs by 2030 – the bold CMHC goal – it is useful to examine them in the context of the comprehensive policy framework that Generation Squeeze has co-created with experts in the Balanced Supply of Housing community-university partnership. See the following figure.

Figure 3: Comprehensive Policy Framework to Restore Housing Affordability

(Source: Generation Squeeze and Balanced Supply of Housing University-Community Partnership)



At this [interactive version of the Policy Framework], readers can click on each box to learn more about the many adaptations we still need to make in Canada's housing system to achieve the CMHC goal. The Game Plan is guided by three overarching principles. Housing is a human right. Housing should first be for homes, and only secondarily for investments. And we need to make room for everyone, overcoming attitudes commonly associated with "Not In My Back Yard" (NIMBY) sentiments articulated by some who resist adding more density in their neighbourhoods, especially rental supply.

Guided by these principles, the Game Plan features three pillars of activity. Actions to scale up the non-profit sector, because the market is failing to deliver housing that is in reach for wages paid by local labour markets. Actions to fix the regular market, because the majority of Canadians will continue to rely on it to make a home, even if the non-profit sector is doubled, tripled or even quadrupled in size. And actions to break the cultural addiction to high and rising home prices, because this addiction reinforces feedback loops in the housing system that fuel home prices beyond earnings, making it much more challenging to succeed at the work required by the first and second pillars.

Collectively, the recommendations of the three working groups in this Lab respond to many elements of this comprehensive policy framework to restore housing affordability.

The recommendation to align the mandates of the Canada Infrastructure Bank and the CMHC to scale up energy-efficient co-ops and purpose-built rental homes responds directly to the "Make Room for Everyone" principle by proposing novel financing to grow 150,000 new affordable units across Canada. The success of this recommendation will require resisting the NIMBY'ism that can obstruct the development of new co-op and rental supply in neighbourhoods that have less experience with these tenures. If successful, the recommendation would scale up substantially the supply of new and renovated non-market homes, which would in turn have reverberations in the regular market by shifting demand patterns.

The recommendation to task Statistics Canada to review its treatment of "owned accommodation" in the calculation of the CPI, and to report annually on the influence of monetary policy on home prices, responds directly to the "Homes First, Investments Second" principle that aims to disrupt and reduce the over-commodification of housing. The additional evidence, and increased public dialogue, sought by this recommendation aim to create opportunities for policy makers to dial down inflationary demand for housing fueled by low interest rates, even as pandemic recovery may require macroeconomic stimulus provided by low interest monetary policy. The same research should also lay a foundation to explore new ways in which monetary and lending policy could support Canadians to invest and save in areas of the economy with greater potential to fuel wage increases for a broader share of the Canadian labour market than does the real estate, rental and leasing sector, where Canadians find less than 2% of employment despite it representing 14% of GDP.

The proposal to implement an annual (deferrable) progressive surtax on homes over $1 million also responds directly to the "Homes First, Investments Second" principle, because it would add a dampening influence to slow down home prices at the most expensive end of the market, while inviting those especially likely to have benefitted from wealth windfalls produced by rising home prices to contribute a little more toward the construction of affordable homes. In this way, the proposed surtax contributes importantly to the "Break the addiction to high home values" pillar, because it would reduce the tax shelter on returns from real estate investments, and thereby nudge people to consider investment strategies in other industrial sectors. It also provides opportunities for governments to consider cutting taxes on incomes for middle- and lower-earners. This would help the disposable income side of the housing affordability gap, because the revenue would be compensated for by additional taxation of the 9% of households that own the most expensive residential properties in the country.

Finally, the proposed Off-Ramp Program and Bond also aim to temper the over-commodification of housing, as urged by the "Homes First, Investments Second" principle. In doing so, these measures seek to incentivize and finance efforts to scale up the supply of non-market homes, while also cushioning the impact of any substantial price decline in the housing market. The latter may improve affordability for those entering the housing system, but harm those who have made their initial purchases in the market recently while prices are currently very high.

Next Steps

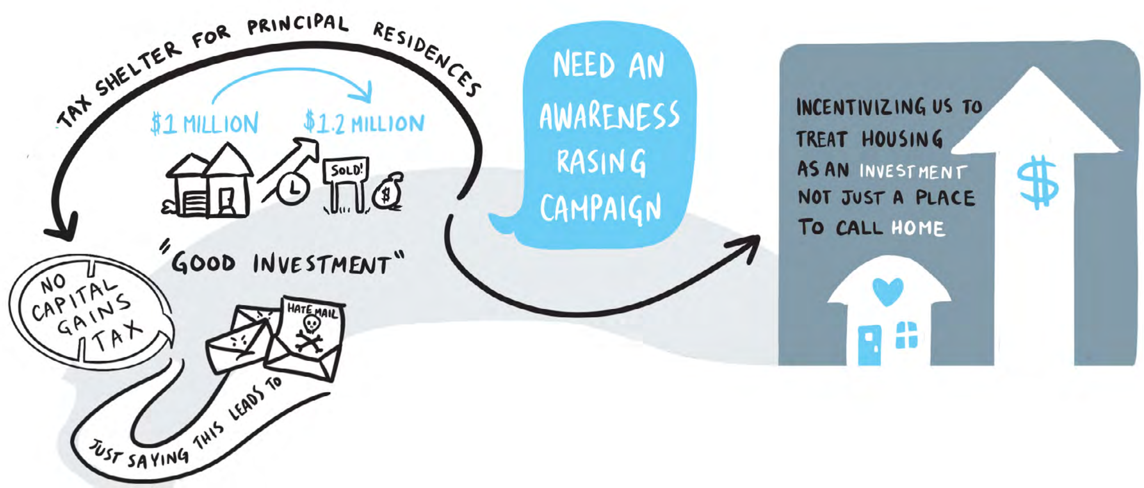
This report marks the end of the Solutions Lab. It offers a summary of our engagement activities, deliberations and policy recommendations.

But the report does not mark the end of the work. The Lab was not initiated to produce a final document that grows stale in some inbox, file folder or archive. We brought together diverse stakeholders to fuel bottom-up collaboration to identify concrete actions that we can collectively take to address elements of the housing system that had been receiving limited attention in government circles, and in public discourse. The Lab has helped to shape and refine opinion among leaders of the housing system by exposing participants to different viewpoints. It has helped to refine people's beliefs about policy problems, and more importantly, the adaptations to policy that can contribute solutions. The result is three policy innovations that can be added to Canada's agenda for policy reform on route to implementing the comprehensive Game Plan to restore housing affordability for all by no later than 2030.

Generation Squeeze intends to mobilize resources to move the agenda into action. This will take building coalitions of supporters around each idea in order to grow the political cover for elected officials to disrupt the status quo that is failing to deliver affordability, and to set our country along a path that can restore affordability forever. Stewardship teams have emerged from all of the working groups to nurture efforts to move the Lab's recommendations from ideas to action. New fund development efforts are needed to sustain this work, and we are hopeful that we can secure the necessary resources.

Meanwhile, we work with what we have to initiate change. The Lab has already facilitated stronger connections between leadership at the Canada Infrastructure Bank and the CMHC. The Off-Ramp proposal has already been presented to select CMHC team members.

By contrast, tax policy is a red herring politically. Several actors already politicized the fact that our Lab was exploring tax policy to signal (incorrectly) that the Government of Canada is considering a capital gains tax on principal residences. It is not. The federal government has explicitly ruled out this idea, as has the official opposition. Nor does our Lab have any dialogue underway with government representatives about the proposed annual (deferrable) surtax on the 9% of most valuable homes in the country – except in the case of official opposition MPs who called on Lab organizers to appear



multiple times before the federal Standing Committee on Finance to speak about Lab deliberations. The fact that tax policy is such a red herring is part of the problem that prevents achieving the goal of affordability for all. It obstructs dialogue about policy incentives that entangle Canadians to pursue wealth via their search for, or at least celebration of, real estate windfalls that grow wealth for owners, but erode affordability for those who follow. Accordingly, Gen Squeeze will prioritize knowledge mobilization activities that aim to shift the cultural mood to be more accepting of a "tax shift" – potentially lower taxes on earnings, especially for middle- and lower-income households, paid for by higher taxes on high value homes – all done to slow down home prices and generate resources to make better investments for young and old alike. We need to shift the hearts and minds of the Canadian public on this issue enough to make it politically safe for politicians to act courageously in response to the evidence.

There is no time to lose – either for action on the ideas developed in this Lab, or for other actions identified as necessary by the comprehensive Game Plan to restore affordability. There is no time, because the Office of the Parliamentary Budget Officer has already reported that our country's current trajectory is not on pace to achieve the CMHC 2030 goal. Despite the important investments of the National Housing Strategy (NHS) to date, the PBO estimates that the number of households in core housing need will rise from 1.5 million when the NHS was initiated, to 1.8 million by the middle of this decade.

Canada can and should do better. We all have a role to play. This includes exploring how many of us may be implicated, unintentionally or otherwise, in reinforcing feedback loops that have generated a massive gap between average home prices and local earnings – a gap that yields wealth for many lucky enough to own residences, while compromising affordability for those who do not.

Our Lab has jumpstarted this work. Let's carry it on together. Onwards.