

**AN EVALUATION OF THE FEDERAL  
ASSISTED HOME OWNERSHIP PROGRAM:  
A SUMMARY**

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## 1.1 CONTEXT OF THE EVALUATION OF AHOP (1976)

This evaluation is undertaken as part of a commitment by Central Mortgage and Housing Corporation to evaluate the Federal Housing Action Program (FHAP). The FHAP evaluation has been conducted under the following terms of reference:

- (a) general control of government expenditures;
- (b) growing public pressure to demonstrate sound financial management by federal government;
- (c) rapidly growing budgetary component of NHA programs with long term implications;
- (d) fast growing programs at a time of fiscal restraint (FHAP, RRAP, NP/COOP)
- (e) the need to examine alternative methods for dealing with housing problems.

The FHAP evaluation has been undertaken to provide the Minister of State for Urban Affairs with a report to be presented to the Ministers of Treasury Board. It will serve two purposes:

- (i) inform about how the Federal Housing Action Program has worked over the last year and what the future implications of the program are likely to be; and
- (ii) as material for discussions in the context of the Inter-departmental Committee on Social Policy on Housing.

## 1.2 THE FHAP EVALUATION

The FHAP evaluation consists of three, separate, reports. These are titled:

- (i) An Evaluation of the Federal Assisted Home Ownership Program (1976)
- (ii) An Evaluation of the Federal Assisted Rental Program (Section 14.1)
- (iii) An Evaluation of the Federal Municipal Incentive Grant Program.

Each evaluation covers four main issues:

- (a) specification and review of the program goals and how well they have been attained;
- (b) an assessment of the delivery mechanisms being employed;
- (c) the costs associated with each program; and
- (d) the future implications of the programs in terms of costs and clients served.

## 1.3 SCOPE OF THE AHOP EVALUATION

The AHOP evaluation report covers the following:

- (a) an evaluation of how well the following goals have been met -
  - to subsidize homeownership for low income people
  - to stimulate the economy
  - to encourage the production of "modest" housing;

- (b) an evaluation of the delivery mechanism focussing upon -
  - the use of the maximum house price (MHP) technique
  - the use of approved lenders (the "P" technique)
  - the eligibility rules
  - other program criteria (grant level, lending role, GDS ratio); and
  
- (c) an examination of the costs of AHOP -
  - cash flow projections
  - estimates of the real subsidy involved
  - exploratory survey of pre 1976 AHOP recipients vis à vis change in income/expenditure
  - extrapolation of the downstream implications of the program: particularly the possible need for further federal assistance for clients.

## 2. BACKGROUND TO AHOP (1976)

### 2.1 HOME-OWNERSHIP ASSISTANCE UNDER THE NATIONAL HOUSING ACT

Central Mortgage and Housing Corporation was established as the Crown Corporation responsible for the federal government role in housing by the National Housing Act, 1944. Between 1946 and 1970 CMHC's role in mortgage lending to individual home-owners was limited to loan insurance. In 1970 a program of innovative housing was launched, the "Two Hundred Million Innovative Program", which had a subsidized home-ownership component via an interest reduction technique on designated low-priced units.

In June, 1973, the National Housing Act was amended to provide CMHC with explicit authority to subsidize home-ownership. The first

Assisted Home Ownership Program, introduced in 1973, was directed towards low income households with at least one dependent wishing to purchase a modest priced home. The home-ownership subsidy consisted of the interest reduction technique plus up to \$300 in a grant form.

Between June 1973 and November, 1975, when the Federal Housing Action Program was introduced, changes were made to the Assisted Home Ownership Program: assistance was confined to new units; the grant was increased to \$600; the market-specific base house price was changed to a maximum house price. The Federal Housing Action Program, introduced in November, 1975, significantly altered the Assisted Home Ownership Program, amongst other housing program shifts.

## 2.2 ASSISTED HOME OWNERSHIP PROGRAM (1976)

The form of AHOP introduced under FHAP provides assistance to any two person household wishing to purchase a modest-priced new home. This interest-free loan has to be repaid after five years. Low-income purchasers with at least one dependent qualify for a grant of up to \$750 per annum to reduce their payments to 25 percent of gross household income.

## 3. GOAL ACHIEVEMENT

### 3.1 HOMEOWNERSHIP SUBSIDY FOR LOW INCOME PEOPLE

In his report Lithwick distinguishes between two kinds of affordability problems. The former are expected by the Corporation to require

only temporary assistance, while the latter are not expected to "catch up" with the home-ownership market without a "no strings attached" grant.

### 3.1.1 HOUSEHOLDS WITH CASH FLOW PROBLEMS

Households having cash flow affordability problems are identified in the evaluation report as being assisted via the repayable loan technique (the interest-reduction loan or IRL). These households should have current moderate incomes but the prospects of rising income. Sixty percent of the AHOP approvals on file for 1976 received the IRL only. Before receipt of the IRL, fifty-four percent had gross debt service ratios of over twenty five percent. Eighty percent of these loan-only recipients were aged below 34; one half were two person households with no dependents. This is in utter contrast to the recipients of the additional grant recipients: only four percent of these were two-person only households. Eighty-five per cent of the recipients of a loan only had incomes over \$14,000.

To summarize on the characteristics of interest reduction loan recipients in 1976: they were predominately young; one half were childless; one half were two person households; and one half had incomes between \$14,000 and \$20,000.

The average value of loan assistance to IRL - only recipients was \$930 in the first year. Over the five years that loan assistance is given

this is equivalent, at a ten percent interest rate, to a subsidy in the form of interest foregone of \$930. This subsidy is higher in Toronto and Vancouver than in Montreal, that is the subsidy is higher in higher priced markets. The subsidy also rises with family income, reflecting the fact that higher income households are purchasing more expensive housing; the size of the IRL is directly related to the size of the mortgage.

### 3.1.2 RECIPIENTS OF GRANT ASSISTANCE

The recipients of IRL plus grant assistance are characterized as being amongst the sector of the population with traditional affordability problems. To identify the size of the target population for the home-ownership grant assistance, an estimate was made of the number of households above the low income line but below twice the low income line, previously renting and younger than 55 years of age. Applying these three criteria a total of 480,000 households might have been eligible for a grant under AHOP (1976). One and a half percent of the entire eligible population, 7,458 families, received grant assistance in 1976. The distribution was highest amongst households headed by persons under 34; in the Maritimes and British Columbia; and amongst households earning \$12,000 to \$16,000.

The average value of the IRL and grant to recipients was \$967 and \$515 respectively in the first year. Over the five years, the subsidy cost at a ten percent interest rate is \$2,145. The size of grant is designed



to decrease with income and does, in fact, decline both within individual market areas and between them.

### 3.1.3 PROVINCIAL SUPPLEMENTATION

Seven provinces offered supplementation for AHOP to lower the eligible income levels through a further grant. Such additional assistance is normally called "stacking". Quebec, Ontario and Alberta did not offer such supplements, mainly because they operated independent low income ownership programs.

Only 491 households received provincial supplementation in 1976.

Reasons offered for this very low take-up are:

- lack of a formal administrative agreement between CMHC and the provinces;
- pessimism by low income households that they would be in a repayment position after five years;
- reluctance of lenders to approve loans for the very low income.

Given that by April 30, 1977, a uniform federal-provincial agreement on AHOP supplementation was signed by Ontario, New Brunswick and the Northwest Territories, and agreed to in principle by British Columbia, Newfoundland and Nova Scotia, estimation of future take-up was difficult. It was estimated that, if a household receives \$750 in Provincial grant, the federal subsidy cost will almost double.

### 3.2 ECONOMIC STIMULATION: NUMBER OF UNITS GENERATED

The key question in estimating the effect of AHOP on employment is not how many units were built under the program, but how many additional units have been built and how many additional jobs have been created by the AHO Program. The approach adopted in this evaluation is to estimate the level of funds that would have been available for residential mortgages from private sources: the difference between this estimate and actual lending activity is attributed to AHOP.

It is estimated that, as a result of AHOP, approved lenders provided an additional \$185 million in mortgage funds for new residential construction. Translated into housing units this amounted to 5,448. An additional 5,680 units were attributed to the fact that AHOP units cost significantly less than conventionally financed units. Thus, the additional number of new housing units generated by AHOP was estimated to be 11,128, thirty five percent of total AHOP-eligible approvals in 1976.

Two effects were calculated separately to arrive at the effect AHOP has had on the level of new residential production as outlined above: the incremental effect and the price effect. Since average AHOP unit prices are lower than conventionally-financed units, for the same dollar volume of

mortgage lending, more units can be produced under AHOP. This is called the price effect, but for the purposes of calculating the employment generated by AHOP it must be disregarded. The additional man-years of employment are estimated on the basis of the incremental effect and secondary industrial production only. Together the direct and indirect effects of AHOP on employment are estimated at 7,862 man-years.

### 3.2.1 LAGS IN THE IMPLEMENTATION OF AHOP

A major concern of economic stimulation policy is the time-lag between original implementation and actual employment generation. In brief, if the lag between the introduction of the program and actual construction and occupancy results in economic stimulation after conditions have changed, then the desired objective may not be reached. Lithwick concluded that the usual lag effects inherent in developing and implementing a program, from announcement to occupancy of the unit, were found to be relatively insignificant.

### 3.3 PRODUCTION OF 'MODEST' HOUSING

AHOP was designed to hold down house prices in two ways: increase the supply of housing, thus dampening the pressure of demand; by increasing the number of low-priced new units, reduce the overall average price of new housing.

### 3.3.1 EFFECT OF AHOP ON HOUSE PRICES VIA THE SUPPLY OF NEW HOUSING

AHOP has resulted in an increase of approximately 20 percent in the overall supply of new owner-occupied housing in 1976. By increasing supply, AHOP was expected to satisfy a portion of the demand for new housing prices in general. Little evidence was found to support this theory, in fact inflation in new housing had begun to decline in most centres before the FHAP announcement.

This price decline is attributed to the rapid increase in mortgage interest rates.

### 3.3.2 EFFECT OF AHOP ON AVERAGE PRICE

The second effect AHOP was expected to have on the rate of inflation in new housing was by changing the mix of housing produced; however, the change in the mix of housing between 1975 and 1976 was found to be toward more expensive, not cheaper, housing. The program appears to have created a price gap; units are built at or very near the AHOP price ceiling or at or near the NHA price ceiling, with very little between them. As a result the average new house price has not declined.

### 3.3.3 "MODESTY" AND AHOP UNIT CHARACTERISTICS

Indications of economics in the provision of "unnecessary" housing characteristics are sought as evidence of a production shift towards "modest"

housing. Three shifts are identified: from single-detached to row housing units; a reduction in liveable floor area; location of AHOP units on cheaper land.

#### 4. THE DELIVERY MECHANISM

##### 4.1 THE MAXIMUM HOUSE PRICE

The maximum house price is different in each market area, providing CMHC with a potentially powerful tool for controlling the production of AHOP units on a market area basis. In an examination of the use of the maximum house price two questions are asked: does it reflect the price of comparable housing units across all markets? Does it control production in a desirable geographical pattern?

##### 4.1.1 THE MHP AS AN INSTRUMENT FOR PRODUCING IDENTICAL 'MODEST' UNITS

The original reason for having geographically different maximum house prices was to ensure that comparable housing could be built in all locations. This was modified to allow "acceptable units" for each market. Thus the MHP is one measure of price and acceptability. In order to estimate its effectiveness the MHP is compared with the Royal Trust Survey of House Prices, which compares identical units across markets. Substantial variation was found in relative house prices for AHOP vis-a-vis the Royal Trust price. This leads to the conclusion that AHOP maximum house prices do not reflect the prices of identical dwellings.

#### 4.1.2 THE MHP AS A PRODUCTION CONTROL INSTRUMENT

The next issue examined in the evaluation is whether the AHOP maximum house price is being used to control the level of production of AHOP units in particular units. That is whether the MHP is low, relative to the Royal Trust price, in those markets in which the construction industry is at full employment, and high in markets in which the construction industry is not very active.

The number of starts per capita in 1975 and 1976, are used as measures of the situation prior to AHOP and after the introduction of AHOP respectively. Because there is an inverse relationship between the level of the MHP and starts in both years, it is concluded that the MHP is, in fact, being used as a policy instrument in pursuing employment goals in the construction industry.

#### 4.2 THE USE OF APPROVED LENDERS

The Federal Housing Action Program was designed to shift the burden of financing from the Corporation to private lenders. CMHC would be engaged primarily in residual lending when private funds were not available. Two issues were raised at the time: discrimination against lowest income grant recipients; CMHC being drawn into funding low income persons even in metropolitan areas.

Despite fears at the inauguration of FHAP-AHOP, there appears to be no discrimination against the lower income grant recipients by private lenders. OMC has acted as a residual lender in smaller urban centres rather than amongst lower income metropolitan area applicants as had been expected.

#### 4.3 ELIGIBILITY ISSUES: OBSERVATIONS ON SPOUSE PARTICIPATION

There was found to be a low (nine per cent) female participation rate in the labour force amongst recipients of the AHOP grant and loan in 1976. When this is compared to other evidence on the decline of female participation rates per \$1,000 of income, it appears consistent. In this evaluation it is argued that, for a household where the head only works which is in receipt of full grant assistance, valued at \$1,560, a spouse with income of \$3,000 would be "taxed" at a rate of 52 per cent. By reducing net income of the spouse by 50 per cent through the application of AHOP grant calculation rules, the participation rate of the spouse may have declined by approximately eight percentage points.

In summary AHOP program definitions concerning household income provide a disincentive to spouses to work, in order to qualify for assistance.

##### 4.3.1 COSTS OF SWITCHING TO A 'HEAD ONLY' DEFINITION

Implementing a program based on the head of household's income only would increase program costs significantly. To offset this rise in costs, it would be necessary to raise the gross debt service ratio to thirty per cent.

The result would be a shift of benefits from poorer families, in which the spouse does not work, to those who have higher incomes because of a working spouse.

## 5. THE COSTS OF AHOP

### 5.1 COMMITMENTS

Commitments represent the sum total of funds required to pay grants and loans over the five years of the loan. The average commitment in 1976 was \$3,780 for approved lender units and \$3,208 for units directly financed by CMHC. Since these figures are based on mortgage rates of approximately 11½ per cent, the decline in mortgage rates in 1977 indicates that commitments will fall by 20 per cent in terms of units approved.

### 5.2 CASH FLOW

The cash flow required to make the Corporation's commitments is divided into non-budgetary (loans that are eventually repayable, such as the IRL) and budgetary (subsidies that are not repayable). Included in the latter is interest foregone on the IRL because it is interest-free over five years. To estimate costs, the long term cash flow implications of approvals in 1976 are examined. Future take-up and cash flow implications are then examined.

#### 5.2.1 CASH FLOW IMPLICATIONS OF 1976 APPROVALS

Cash flow on 1976 approvals will peak at \$25 million in 1977 and then decline, with a cash inflow occurring with repayment of IRL's in 1981.



The subsidy cost, as defined by the sum of grant and interest foregone, will be close to \$7 million per year for each year between 1977 and 1980 before it declines in 1981 to \$5 million.

#### 5.2.2 CASH FLOW IMPLICATIONS OF FUTURE APPROVALS

Assuming a future level of commitments of 30,000 units annually between 1977 and 1980 inclusive, total cash outflow will peak at \$102 million in 1980 and by 1982 the program will enter into net repayment.

#### 5.3 BUDGETARY COST OF AHOP - 1976

The budgetary cost of the program is the cost of the subsidy. The two principal direct costs of the program are the grant and the interest foregone on the IRL. The average subsidy cost for the 22,914 AHOP units approved in 1976 is estimated to be \$1,138 per unit; the overall subsidy cost for the program was \$26 million.

#### 5.4 EFFECT OF FHAP CHANGES IN COSTS: THE INTEREST REDUCTION LOAN

A major concern of OHC in widening the scope of the program was to reduce the per unit subsidy without imposing undue hardship. This change was effected by means of the IRL, which replaced a portion of the grant with an interest-free, repayable, loan. It is estimated that the savings made through the IRL average \$2,912 at a 10 per cent discount rate. For all grant recipients this represents a saving of \$27 million, or approximately the same amount

as the actual subsidy cost of AHOP in 1976.

#### 5.4.1 GROSS INCOME

The second major change in RHAP-AHOP was the use of gross income instead of adjusted family income. One effect has been to reduce the average size of the subsidy to the household. A second effect has been to increase the number of eligible households: a household with an income too low under the adjusted income definition might qualify for assistance under the gross income concept.

The change to gross income as a program criteria has resulted in a saving of \$80 per unit in the grant for the first year, or approximately \$0.75 million of the total subsidy cost.

#### 5.5 CONTINUED ASSISTANCE AFTER FIVE YEARS

Through the use of the IRL technique, the probability of continued assistance beyond the five year loan period is increased, especially if the rate of interest rises to 12 per cent at that time. Based on the experience of the first subsidized home-ownership program recipients, approximately five to ten per cent of AHOP grant recipients will require further assistance in 1982.

#### 5.6 COSTS OF PROVINCIAL SUPPLEMENTATION

Provincial supplementation greatly increases the cost to CMHC of providing AHOP assistance, since it allows lower income households to part-

icipate and increases the size of the outstanding IRL.

#### 5.7 COSTS OF AHOP RELATIVE TO PUBLIC HOUSING

One justification for giving deep subsidies to low income households is that it is cheaper to house a poor household in an AHOP unit rather than in public housing. For a household with income of \$7,500, the subsidy cost in AHOP is \$8,500, while in public housing it is \$17,700. Thus, if this household has more than a 50 per cent probability of living in public housing, it is cheaper for government to use AHOP than public housing.