

# CMHC



Central Mortgage  
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EVALUATION OF THE  
FEDERAL HOUSING ACTION PROGRAM (1976-77)  
EXECUTIVE SUMMARY  
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Prepared for the Steering Committee:  
Evaluation of the  
Federal Housing Action Program

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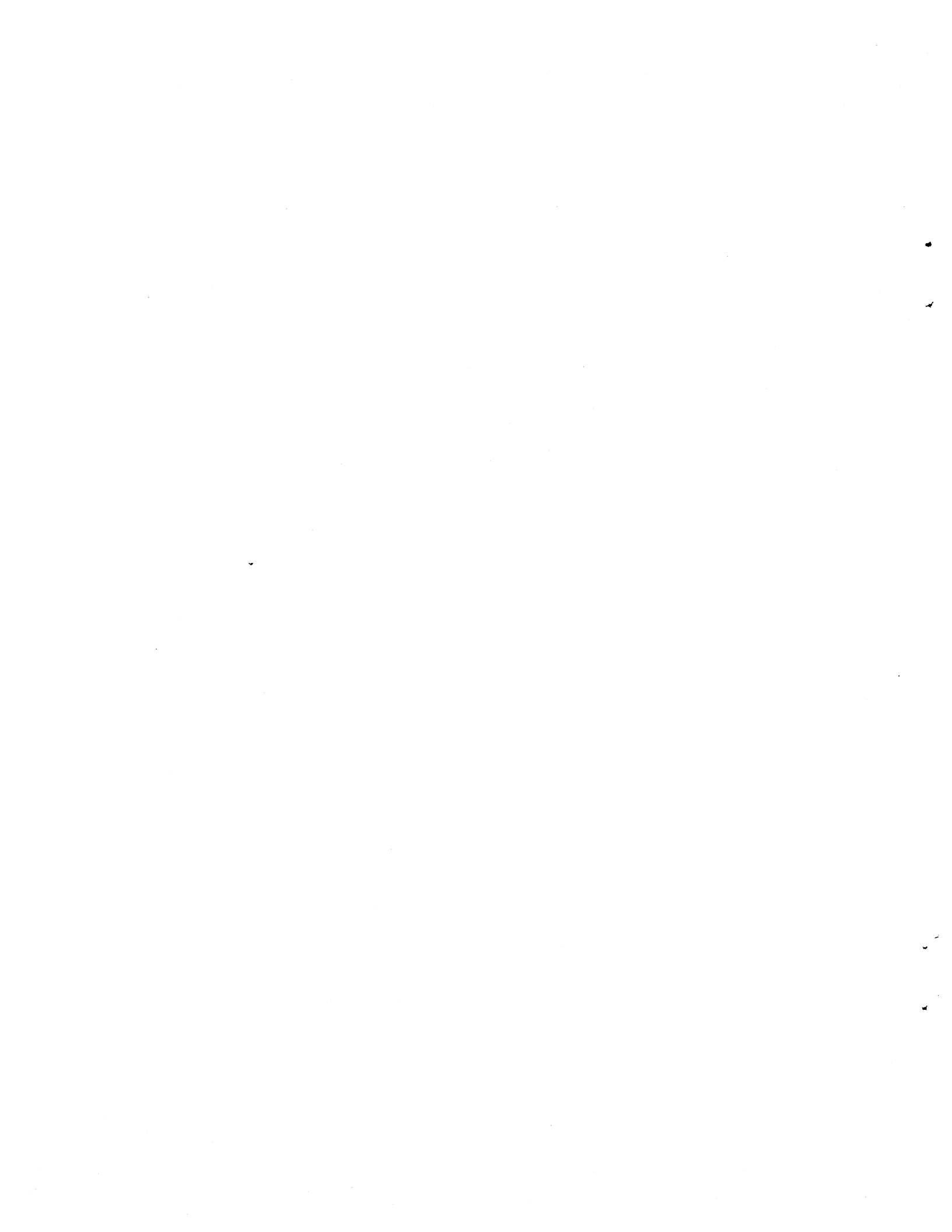


## FOREWORD

This report summarizes a detailed evaluation of the Federal Housing Action Program (FHAP) carried out in the summer and fall of 1977. The Executive Summary and the accompanying technical reports have been prepared to allow the Minister of State for Urban Affairs to report to the Prime Minister and the Ministers of the Treasury Board on the achievements of FHAP and the issues facing it. In addition, the reports may be considered one component of an overall review of shelter policy presently being conducted within the federal government. The FHAP evaluation was guided by a steering committee comprising senior officials from CMHC, the Department of Finance and the Treasury Board secretariat. A working group of officials from these agencies carried out the necessary staff work to produce the reports.

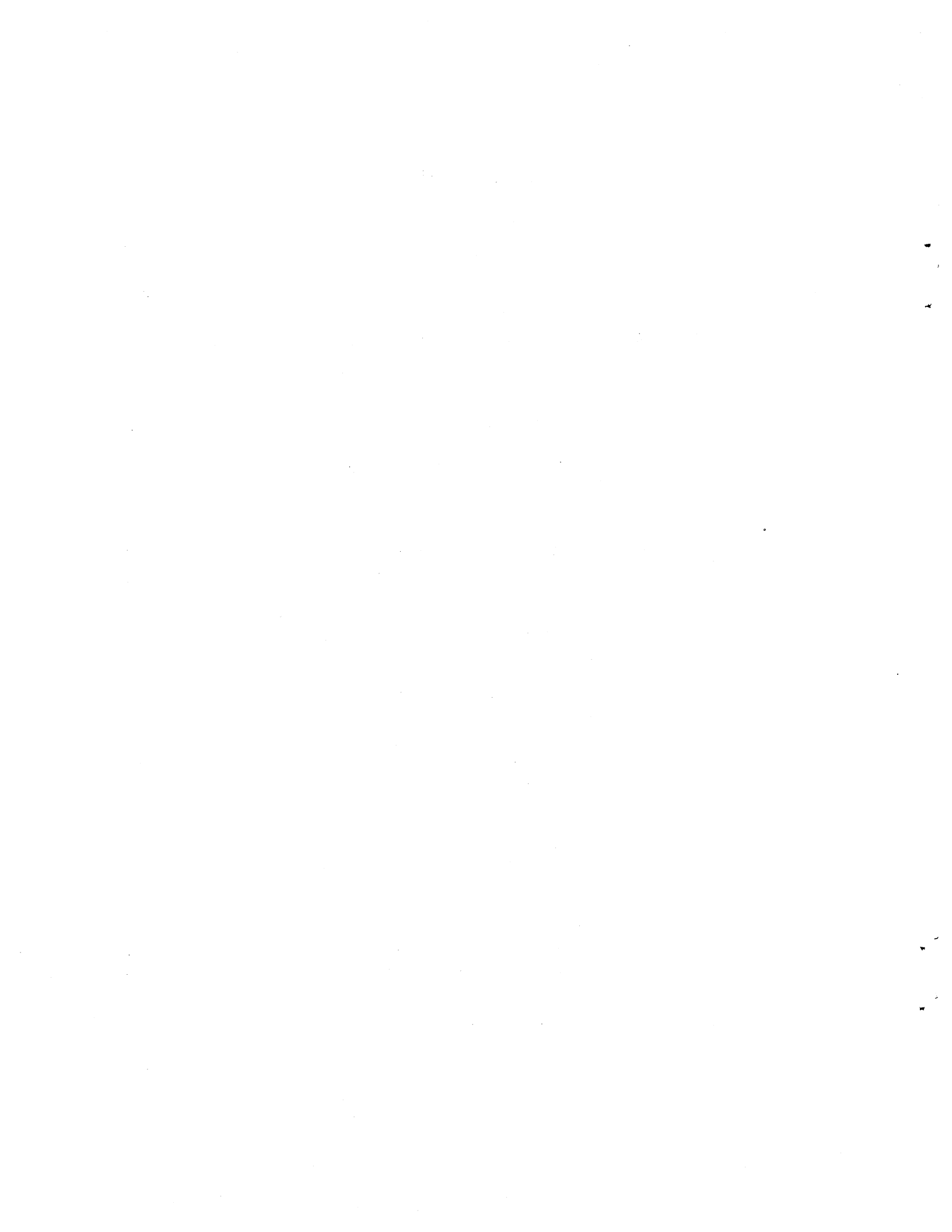
The Executive Summary synthesizes the findings of the technical studies. Its purpose is to enable the reader to understand the objectives of the programs involved, the resources allocated to achieving those objectives, the degree of success or failure in attaining them and the important economic and social issues raised in the evaluation.

There are four components in the Executive Summary: Part I deals with the background to the Federal Housing Action Program; Part II presents an evaluation of the Assisted Home Ownership Program (AHOP); Part III presents an evaluation of the Assisted Rental Program (ARP); and Part IV summarizes the results of the Municipal Incentive Grant Program (MIG) to the middle of 1977. Detailed evaluations of the three component programs are provided in the technical reports accompanying this summary.



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## I. THE FEDERAL HOUSING ACTION PROGRAM (1975-77)

### Housing Problems Facing Canadians in 1975 and Beyond

The Federal Housing Action Program (FHAP) was conceived in 1975 and announced in November of that year by the Minister of State for Urban Affairs. The overall objective of the program was to tackle a number of important housing problems facing Canadians:

- insufficient production of moderately-priced housing
- affordability problems faced by prospective homeowners
- excessive demand for higher-priced housing
- lack of incentives for the construction of rental accommodation

The problem concerning supply and price had two facets. First, in 1975 it seemed unlikely that production to 1979 would keep pace with projected needs. Production, both public and private, reached a level of 231,500 units in 1975. Over the following four years it was calculated that a further 1,000,000 units would be required. Related to the question of supply was the fact that units being produced for ownership were increasingly priced beyond the means of even moderate-income Canadians. Second, the supply problem in the rental sector was particularly acute, with production decreasing dramatically and vacancy rates of less than 2 per cent in most Canadian cities.

The affordability problem also had two components. The first had become evident in Canada in the early 1970s. Increasing construction costs, compounded by increased interest rates, had placed homeownership beyond the reach of many families. Second, rental entrepreneurs were faced with a rapidly growing deficit between the costs of building and operating rental units and the rents which could be charged. Combined with rent controls across Canada, this factor discouraged investment in new rental accommodation.

The problem of excessive demand for higher priced housing was a difficult one to quantify and deal with. Many Canadians who had bought homes under more favourable conditions of house price, mortgage interest rates and income were now in a position to demand higher quality housing, and were bidding prices up. The fact that housing was obviously a good investment also contributed to price inflation. The resources of the residential construction sector were in large part being diverted to satisfy this demand, to the detriment of low-and moderate-cost housing.

#### The Objectives of FHAP in 1975

To tackle these problems the federal government announced FHAP late in 1975. The principal objectives of the program were:

- to stimulate the residential construction industry to ensure an adequate supply of housing to meet the needs of middle and lower income families

- more mortgage funds for modest homes and rental units
- control of high ratio loans
- increase the market for modest homes via government programs
  
- to introduce a greater degree of stability for the industry to function well
  - target of 1,000,000 additional units by the end of 1979
  
- reduce affordability problems
  - reduce the carrying cost of modest homes
  - make rental construction attractive to investors
  
- stimulate employment in the residential sector

Measures Introduced to Achieve Objectives of FHAP

The measures introduced in 1975 included: (i) modifications to the existing Assisted Home Ownership Program, the Assisted Rental Program, and the Sewage Treatment Program; (ii) the introduction of one new program, the Municipal Incentive Grant; (iii) a request to continue the Capital Cost Allowance provisions of the Income Tax Act as applied to non-principal business rental entrepreneurs; and (iv) a series of other measures to encourage investment in residential mortgages, to restrict high-ratio mortgage lending and to ensure that production targets were met.

TABLE 1

CHANGING SHARE OF NHA FINANCING  
IN THE HOUSING MARKET (1971-74)

Year	Total Units	Conventional and Other	NHA Regular	AHOP	ARP	Low Income
		p.c.	p.c.	p.c.	p.c.	p.c.
1971	233,653	44	40	3	-	13
1972	249,914	46	40	2	-	12
1973	268,529	60	29	2	-	9
1974	222,123	71	15	5	-	9



These measures were designed to rectify the problems described previously. It was also intended that FHAP would re-establish a strong federal presence in the Canadian housing market. Since 1971 the relative share of market activity influenced by the NHA had declined drastically, from 56 to 29 per cent by 1974 (Table 1). The implications of this decline for the production of low income housing are evident from Table 1. The significant change in NHA insured lending (Section 6) from 40 to 15 per cent over the same period implied that production for moderate income purchasers was also being affected by the decline in government activity. A major intention of FHAP, therefore, was to establish a viable market in which moderate income home purchasers could buy within their means.

The present evaluation is directly concerned with the performance of AHOP, ARP and MIG. Since the Capital Cost Allowance provisions heavily influence participation in ARP, they are an integral part of the evaluation.

## II. THE ASSISTED HOME OWNERSHIP PROGRAM

### The Nature of the Housing Problem Addressed by AHOP

The problems addressed through AHOP were identified primarily as those of affordability, in light of rapid price escalation and a lower rate of growth of real incomes, and insufficient production of moderately priced housing to meet demand. Table 2 quantifies the nature of this problem in Canada over a period of 20 years. The real costs of ownership

TABLE 2  
CANADA: COSTS OF HOMEOWNERSHIP (1957-76)

Year	(1)	(2)	(3)	(4)	(5)
	Average Price New NIA Single-Detached Bungalow Dollars	Conventional Mortgage Interest Rate Per Cent	Annual Principal and Interest* Payments Dollars	Average Wages and Salaries Dollars	Real Costs of Ownership ( (3) ÷ (4) )
1957	14,044	5.40	933	3,531	0.26
1962	14,684	6.95	1,112	4,188	0.27
1967	18,529	7.88	1,513	5,344	0.28
1972	22,168	9.37	2,042	7,759	0.26
1976	37,823	11.93	4,195	11,860	0.35

\* 25-year mortgage

fluctuated between 1957 and 1972, but then began to rise steeply. By 1975 it had become clear that further government measures would be required to modify the situation.

#### Changes to AHOP With the Introduction of FHAP

The Assisted Home Ownership Program was introduced in 1973 as one of a number of far-reaching amendments to the National Housing Act. By 1975 the program had two basic components: (i) AHOP(D) in which a mortgage loan at a preferential interest rate was made directly to a household by the Corporation; and (ii) AHOP(P) in which CMHC would insure such a preferential loan made by a private lending institution. In practice, AHOP(D) proved to be the more popular program of the two since it was more generous. It is also important to note that by 1975 the commitment level for AHOP was about \$470 million per annum and requiring about a quarter of the CMHC capital budget.

The amended program in 1975-76 attempted to shift the burden of financing from the public to the private sector by making the terms of AHOP (D) and AHOP(P) identical. Several other important shifts were made:

- (i) the interest reduction grant was replaced by a five-year, decreasing, repayable loan designed to bring the aggregate debt service down to an 8 per cent equivalent in the first year;
- (ii) a grant to bring the GDS ratio down to 25 per cent was retained, but was restricted to families with at least one dependent, presumably those in greatest need. It was set at a maximum amount of \$750 per annum in the first year; and

- (iii) a widened scope was given to AHOP by allowing two-person families to participate in the loan program and by removing the income test for those applicants requiring no grant.

The regulations to relate AHOP prices to market prices in particular regions were retained through the AHOP Maximum House Price mechanism.

### Evaluation of Program Performance in Relation to the Goals

The approach taken in this evaluation has been to examine AHOP specifically in relation to the goals of the program:

- reduce problems of affordability problems for low-and moderate-income households purchasing a home;
- help stimulate the overall economy through increased investment and the creation of jobs in the housing sector; and
- create a pool of moderately-priced, modest homes available to the lower and lower-middle income purchaser.

(i) The Affordability Goal. This evaluation distinguished between two types of Canadian households with affordability problems: (a) households with cash flow problems which were temporarily having difficulty in buying a house (with rising incomes those problems would be expected to lessen); and (b) households with more or less permanently low incomes and with little prospect of significant increases. The first group are generally speaking those requiring preferential mortgage assistance (the Interest Reduction Loan) only. The latter group would require

both preferential mortgage and grant assistance to overcome their problems.

The evaluation examined the socio-economic and housing characteristics of 18,526 households receiving assistance under AHOP in 1976 (Table 3).<sup>1</sup> The principal conclusions drawn from this part of the evaluation were:

- AHOP enabled a large number of Canadians to enter the homeownership market in 1976.
- Most households benefitting from AHOP had moderate incomes (between \$10,000 and \$18,000).
- Only a few very low income Canadians participated in the program in 1976.
- Households with cash flow problems in AHOP numbered about 11,000. They were characteristically young, with an even split between childless couples and families with children.
- The average loan to IRL recipients was \$930 in year one. The fact that the IRL is interest-free for five years implies a subsidy of \$942 on the average for the whole five year period.
- Recipients of grant assistance numbered about 7,500 families, were also young with families and the majority earned less than \$14,000 per annum.
- Less than one-quarter of all AHOP recipients had incomes over \$18,000 per annum.
- The average loan and grant assistance to grant recipients in the first year was about \$1500. The grant and the interest subsidy together average \$2,145 per household for the whole five year period.

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<sup>1</sup>Approximately 23,000 households purchased AHOP houses in 1976. Socio-economic information was available for 18,526.

TABLE 3  
CHARACTERISTICS OF HOUSEHOLDS RECEIVING  
AHOP ASSISTANCE IN 1976

Characteristics	Grant Recipients	IRL-Only <sup>1</sup> Recipients	All Canadian Families
	Per Cent	Per Cent	Per Cent
<u>1. Age of Head</u>			
25 years or less	22	30	6
26-35 years	56	50	23
36-55 years	20	18	44
56 years or more	2	2	27
<u>2. Family Status</u>			
Married with children	91	49	55
Married without children	0	38	29
Not married with children	9	3	9
Other	0	10	7
<u>3. Family Size</u>			
2 persons	4	49	30
3 persons	46	21	20
4 persons	34	19	21
5 persons	11	7	14
6 or more persons	5	4	15
<u>4. Family Income</u>			
Under \$8,000	3	0	29
\$ 8,000- 9,999	11	1	9
10,000-11,999	29	4	9
12,000-13,999	33	10	9
14,000-15,999	18	17	8
16,000-17,999	6	17	7
18,000-19,999	0	18	6
20,000-24,999	0	24	23
25,000-29,999	0	6	
30,000 plus	0	3	

NB. Based on 18,526 AHOP recipients.

<sup>1</sup>IRL = Interest Reduction Loan

Provincial supplementation of AHOP to further reduce affordability problems was becoming more common as 1976 progressed, and has accelerated in 1977. While such supplements will certainly increase penetration down the income scale, they might exacerbate repayment problems faced by recipients in five years time. In addition, AHOP operating agreements with the provinces impose extra costs on the federal government because they permit the province to withdraw from assistance first, leaving CMHC with increased assistance to pay.

(ii) The Economic Stimulation Goal. This section of the evaluation attempted to estimate the extent to which AHOP induced "extra" mortgage investment in new housing in 1976. Once identified, the quantitative estimate could be readily converted into numbers of units built and man-years of employment generated directly and indirectly by the program.

Although there were few precedents for the evaluation to follow it was decided to base the estimates of economic stimulation upon the RDX2 Model used by the Bank of Canada to forecast changes in the overall economy. This model was selected because it has a mortgage component based on quarterly data, and is therefore sensitive to changes in the conditions which affect the level of investment in residential mortgage lending.

Briefly, the main steps in estimating the impact of AHOP in 1976 were as follows:

TABLE 4  
INCREASE IN MORTGAGE APPROVALS ATTRIBUTABLE TO AHOP<sup>1</sup>

Institutions	(1) Total Mortgage Approvals 1976	(2) Increment in Mortgage Lending Due to Government Programs	(3) Shift in Mortgage Lending into New Construction	(4) Total Increase in Mortgage Activity	(5) Increase in Activity Attributable to AHOP <sup>3</sup> (Incremental)
Chartered Banks	2,806	0	112	112	58
Life Insurance Companies	1,181	17	16	35	17
Trust and Loan Companies	6,205	192	51	243	128
Total	10,192	209	179	388	203

SOURCE: See text.

<sup>1</sup>In millions of dollars.

<sup>2</sup>Column (2) plus column (3).

<sup>3</sup>Column (4) times 52.5 p.c.

NB. In 1976, total residential and non-residential mortgage approvals from these institutions totalled \$11.6 billion, of which \$3.3 billion was allocated to NHA housing as follows: (i) Chartered Banks - \$1.074 billion; (ii) life insurance Companies - \$0.421 billion; (iii) trust companies - \$1,014 billion; (iv) loan companies - \$0.509 billion; and (v) others - \$0.227 billion.



(i) Lending behaviour by major institutions was analyzed over the period 1958-72. Projections to 1976 were made based on this behaviour and compared with observed lending behaviour in that year.

(ii) It was assumed that 90 per cent of extra mortgage investment in 1976 could be attributed to FHAP.

(iii) The 90 per cent was then divided between AHOP (52.5 p.c.) and ARP (37.5 p.c.) on the basis that, although both had equal numbers of units approved in 1976, the average AHOP mortgage was 40 per cent greater than the average ARP mortgage.

(iv) Estimates were also made of the extent of the shifts in investment from non-residential to residential mortgages, and from investment in existing housing to new housing, by analyzing the lending patterns before and during 1976 by major institution.

(v) The "incremental effect" of AHOP, in terms of the number of extra units produced, was then calculated by dividing the total additional mortgage funds induced by the program by \$34,000 (the average AHOP mortgage in 1976).

(vi) It was further recognized that AHOP had a "price effect" in that, for the same amount of investment, more AHOP units than non-AHOP units can be built, since the former are about 17 per cent cheaper than the latter. The estimates above were increased to account for this factor.

(vii) Finally, the total unit estimates were converted into man-years of employment generated directly and indirectly by AHOP.

The approach outlined above made it possible to generate global estimates of the extent to which AHOP had achieved its economic stimulation goal in 1976, and the relative degrees of contribution made by chartered banks, life insurance companies, trust companies and loan companies in the process. The main conclusions drawn from the analysis were:

- In aggregate, AHOP (1976) generated about \$1.2 billion for 32,000 new units in initial mortgage approvals.

TABLE 5

## NUMBER OF ADDITIONAL UNITS ATTRIBUTABLE TO AHOP IN 1976

Lending Institution	Estimated Increase in New Units			AHOP Eligible Approvals
	Incremental Effect	Price Effect	Total	
Chartered Banks	1,729	2,355	4,084	15,577
Life Insurance Companies	509	290	799	2,442
Trust and Loan Companies	3,752	1,652	5,404	13,431
Total	5,990	4,297	10,287	31,450

TABLE 6

ADDITIONAL EMPLOYMENT GENERATED DIRECTLY BY AHOP IN 1976

Housing Type	Man-Years of Employment Per Unit <sup>1</sup>	Additional AHOP Units <sup>2</sup>	Additional Man-Years of Employment <sup>3</sup>
Single Detached	1.267	3,438	4,356
Semi-Detached	1.068	653	697
Row	0.940	1,412	1,327
Apartment	0.811	487	395
Total	--	5,990	6,775

<sup>1</sup>Estimates generated by L. Hansen, Labour Requirements for Residential Construction Industry (Ottawa: CMHC, Market and Industry Analysis Division, 1976).

<sup>2</sup>Distribution among housing types follows the distribution for all AHOP approvals in 1976.

NB. If an additional 0.3 man-years of employment per unit is generated in ancillary trades (furniture, appliances), then 1,797 man-years must be added, to bring the overall total to 8,572 man-years.

- The aggregate level of additional mortgage funds induced by AHOP in 1976 into new housing in Canada was of the order of \$203 million.
- Trust and loan companies showed the greatest shift in lending patterns, contributing about 60 per cent of the aggregate additional funds (Table 4).
- AHOP generated in excess of 10,000 additional new, modest housing units in Canada in 1976 (Table 5).
- In terms of employment, AHOP created an additional 8,500 man-years in 1976 (Table 6).

(iii) The Housing Price Inflation Goal. This section of the evaluation examined the degree of success of AHOP in creating a pool of moderately-priced, ownership units, and in affecting the general housing price spiral in Canada. The approach was to (i) analyze program data and compare AHOP and non-AHOP (NHA) homes by unit type, floor area and selling price; (ii) to analyze change in the Statistics Canada Price Index for identical, new houses in twelve metropolitan areas, from 1971-76; and (iii) to analyze price changes in new, NHA single-detached homes from 1971-76.

The 1976 program contributed an additional 23,000 units to the 54,000, moderately-priced units produced under various federal homeownership programs since 1971. The rate of growth of this "pool" of moderately-priced homes accelerated considerably as a result of the program under FHAP.

An important point about this shift is that it signals the increasing dominance of NHA-sponsored housing in the moderate price segment of the homeownership market. While it is difficult to state precisely the share of NHA-sponsored units, because of the lack of price data on conventionally-financed homes, it is certain that AHOP is the dominant source of homes for ownership in the lower price sector of the market.

The effect of AHOP on the general housing price spiral is not so evident, although the increased volume of production in 1976 and 1977 might now be having an effect in some centres. The most obvious effect in 1976 relates to the above discussion. The price distribution of new homes in many centres had two main components: one clustered round the AHOP maximum, and the other around the NHA insured lending maximum.

There is some evidence that AHOP has helped introduce a measure of economy in house production and consumption. Housing built under AHOP contributed to a shift from single detached to row housing. The average livable floor area of an AHOP home was about 10 per cent less than that of an average non-AHOP home in 1976. Together, these constitute a contribution to conservation of resources and the tempering of expectations about housing consumption on the part of Canadians.

#### The Present and Future Costs of AHOP

While the program clearly achieved its major goal of shifting

the burden of new home financing from the public to the private sector, there remains a considerable amount of financial involvement in AHOP on the part of the federal government. The evaluation therefore attempted to clarify the nature of that involvement, the implications of it for financial planning (particularly for downstream cash flow) and a number of issues related to the financial structure of AHOP (e.g., the impact of provincial stacking), which are dealt with in a later section.

(i) The Costs of 1976 Approvals. The 22,914 units approved in 1976 imply a financial commitment of approximately \$160 million on the part of the federal government. On a per unit basis this implies about \$3,500 per AHOP unit generated. Table 7 shows the cash flow implications of 1976 commitments and separates repayable loans from direct grants and interest subsidies (i.e., interest foregone on the IRL). The following points should be noted here:

- AHOP enters into repayment after the fifth year; the program then generates revenue for the federal government
- the total subsidy cost of the program is about \$35 million, or about \$1500 per unit approved.
- Under the pre-FHAP regulations for AHOP, the 1976 program would have cost \$2,800 per unit more. (i.e. about \$4,300 per unit).

TABLE 7  
CASH FLOW AND BUDGETARY IMPLICATIONS OF 1976 APPROVALS  
FOR AHOP

Year	Average Per AHOP Recipient <sup>1</sup>			Budgetary Costs <sup>2</sup>		
	Grant	IRL	Interest Foregone	Grant	Interest Foregone on IRL	Total
1976	69	315	16	1.58	0.37	1.95
1977	179	906	77	4.10	1.16	5.26
1978	97	785	161	2.22	3.69	5.91
1979	35	645	233	0.80	5.34	6.14
1980	3	474	288	0.07	6.60	6.67
1981	0	-889	269	0	6.17	6.17
1982	0	-2234	112	0	2.57	2.57
Total	--	--	--	8.77	25.90	34.7

<sup>1</sup>Dollars. This is calculated on a calendar year basis with one-third in first year and two-thirds in second.

<sup>2</sup>Millions of dollars.

NB. Assuming lump sum repayment in sixth year.

Assuming a 10 per cent simple interest rate. Total cash flow for 22,914 approvals.

TABLE 8  
PROJECTED COMMITMENTS AND CASH FLOW FOR AHOP (1976-90)

Year of Disbursement	No. of Units	Commitments <sup>1</sup>		Cash Flow <sup>2</sup>	
		IRL	Grant	Lump Sum Repayment	Stair Step Repayment
1976	22,914	80.6	79.9	8.80	8.80
1977	38,730	99.6	66.7	39.73	39.73
1978	38,732	107.5	59.3	77.85	77.85
1979	43,190	107.3	59.6	112.44	112.44
1980	43,140	107.4	58.1	144.01	144.01
1981	43,140	107.4	58.0	142.23	167.75
1982	43,140	107.4	57.0	83.42	180.95
1983	43,140	107.4	57.0	62.37	183.85
1984	43,140	107.4	57.0	61.09	176.66
1985	43,140	107.4	57.0	53.12	154.47
1986	43,140	107.4	57.0	55.84	129.50
1987	43,140	107.4	57.0	58.65	88.76
1988	43,140	107.4	57.0	61.57	43.82
1989	43,140	107.4	57.0	64.65	20.86
1990	43,140	107.4	57.0	67.89	12.50

<sup>1</sup>Millions of constant 1977 dollars.

<sup>2</sup>Millions of current dollars.



(ii) The Cash Implications of Future Commitments. Should the Federal Government commit itself to continue AHOP, in its present form, to 1990 at the level of commitment shown on Table 8, the implied commitment is about \$160 million per annum. Cash flow will peak at about \$184 million in 1983 and then decline as units enter into net repayment.

#### Controls on the Delivery Process of AHOP

In examining the delivery process of AHOP in the field, the report attempted to evaluate the advantages and disadvantages of the regulations governing the program. A synopsis of the findings follows.

(i) The Maximum House Price. Units become eligible for the AHOP program only if they meet specified criteria. Of these, the Maximum House Price is the most important. The MHP varies from centre to centre in order to permit households equal access to the benefits of the program whether they live in low-cost or high-cost housing areas. Thus in Toronto the MHP is \$47,000 while in Trois-Rivières it is \$31,000 reflecting the relative cost of modest homes in those centres. These figures should be compared with much higher average home prices in those centres (e.g., around \$60,000 in Toronto).

The evaluation made these points about the MHP technique:

- When compared with the Royal Trust Index of the inter-regional price of identical housing, the MHPs do not appear to reflect the differences in the price of modest housing among different centres.

- The MHP has been used deliberately to control production, and by implication employment levels, rather than as a pure price control measure. A high MHP would encourage housing starts, and a low MHP would discourage them.

(ii) Other Regulatory Implications. Presented briefly here are the main points concerning the implications of other program regulations and policies

- It was expected that the large shift to AHOP(P) from 1976 onward would result in discrimination against lower income borrowers on the part of the major lending institutions. This did not appear to be the case.
- As expected, CMHC played the part of a residual lender under AHOP(D), with the changes to the program in 1976; lending mainly in small towns and rural areas.
- If CMHC switched the income eligibility rules in AHOP to include only the income of the head of the household, many more people would be eligible for grants.
- By including spouse income in the eligibility regulations for grants, AHOP discourages the participation of females in the labour force.
- If the Gross Debt Service ratio of eligible participants in AHOP was raised to 30 per cent of income, fewer low-income families would participate, but the cost of AHOP to government would be lower.
- If the interest rate floor was raised from 8 per cent then the number of grant recipients and the subsidy costs of the program would rise significantly. The opposite effect would occur if the interest rate floor was lowered.

### The Issues Facing AHOP

AHOP (1976) succeeded to a considerable extent in attaining its economic objectives. It also added significantly to the growing pool of moderately-priced homes in Canada. In the process it established NHA-sponsored housing as an important part of the housing market serving lower middle income Canadians. Participation in AHOP by some provincial governments relates to this latter point, and may result in AHOP facing two issues in the future:

- Participation by the provinces in AHOP generally means that federal government costs under the program are greater than if it were a unilateral federal program. The reason for this is that provincial assistance usually runs out first, leaving a need for federal assistance beyond the intended five-year period.
- With penetration into the low-income groups, either unilaterally or with provincial stacking, the federal government runs the risk of creating a group of marginal homeowners who might not be in a position to repay assistance or carry the costs of a home after assistance runs out.

### III. THE ASSISTED RENTAL PROGRAM

#### The Problem Facing Producers of Rental Housing in 1976

As noted earlier, the rate of construction of new rental accommodation in Canada dropped off rapidly after 1972. Consequently, vacancy rates in many metropolitan areas were below the commonly accepted rate of 3 per cent of the apartment stock, and in many centres were at historically low levels.

The major reasons for this slowdown in investment in rental accommodation in metropolitan areas were that increases in the capital costs of construction and interest rates were not matched by increases in rents, and that entrepreneurs were deterred by rent control. Table 9 illustrates clearly the differential rates of growth in principal and interest payments and in rents. At the same time, other operating costs rose fast (e.g., utilities). Table 10 shows in detail the problem faced by a rental entrepreneur in 1976. A unit built at the current cost would have to compete with the bulk of rental units built under more favourable financial conditions. Consequently, it would not command a rent sufficient to cover costs and to make a reasonable profit.

A "gap" had therefore developed between the rents that had to be charged for newly-constructed units and the rent levels that could be charged in the rental housing market. The major objective of ARP was to reduce this gap and make investment in rental accommodation attractive to entrepreneurs.

#### Changes to ARP with the Introduction of FHAP

The Assisted Rental Program was introduced in 1975 to boost rental starts. It was financed through mortgages from private lending institutions and supplemented by grants of up to \$600 per unit per annum over five years to reduce costs and allow a fair return on equity (5 per cent). As ARP was intended to serve low and moderate income renters, there

TABLE 9  
TRENDS IN COSTS AND REVENUES FOR NEW RENTAL HOUSING (1970-76)

Year	Median Capital Cost Per Unit <sup>1</sup>	Interest Rates on Rental Loans <sup>2</sup>	Annual Principal and Interest Payments, per Unit	Average Unsubsidized Monthly Rents	Index Of P & I Payments	Index of Rent
	Dollars	Per Cent	Dollars	Dollars	1970 = 100	1970 = 100
1970	14,000	10.59	1,318	167	100	100
1971	14,700	9.13	1,240	193	94	116
1972	15,000	9.08	1,260	202	96	121
1973	16,400	9.78	1,463	197	111	118
1974	18,900	11.27	1,912	213	145	128
1975	22,100	11.81	2,337	221	177	132
1976	26,200	11.59	2,719	261	206	156

<sup>1</sup>Limited Dividend and normal Section 6 approved lender rental loans.

<sup>2</sup>At December 31, 1970-76.

TABLE 10  
COMPARISON OF HYPOTHETICAL COSTS IN RENTAL PROJECTS, 1971 AND 1976

Components of Costs and Expenses	Unit Built in 1971		Unit Built in 1976
	1971 Cost Dollars	1976 Cost Dollars	1976 Dollars
Price per Unit	15,000		24,000
Equity	1,500		2,400
Size of Mortgage	13,500	12,875	21,600
Interest Rate	8½%	8½%	11 3/4%
Principal and Interest	1,250	1,250	2,848
Taxes	300	377	377
Utilities	100	173	173
Other Operation	200	527	527
Total Expenses	1,850	2,107	3,725
Rent	153	176	310
	2,000	2,755	
	167	230	

were restrictions on entry. In 1975, the program produced 358 projects, for a total of 21,792 rental units.

Changes to ARP introduced as part of the FHAP package attempted to make it conform to the AHOP regulations and to reduce the direct subsidy costs to the federal government. The major change was the replacement of the grant with an interest-free assistance loan to bring rents down to market levels. The assistance loan (or AL) is set at a maximum of \$1,200 per unit in the first year and normally decreases by one-tenth in subsequent years, and is repayable after the tenth year. Other important features of the present ARP program are (i) that units be of a "modest" size and priced below the AHOP MHP; (ii) that no restrictions be placed on who occupies units; (iii) that market rent levels be agreed upon between CMHC and the entrepreneur in year one. If changes in rents or costs increase the yield on equity, the AL is reduced accordingly in subsequent years by more than one-tenth; and (iv) that entrepreneurs be allowed to make use of the CCA provisions of the Income Tax Act in addition to ARP assistance.

#### The Success of ARP in Attaining Program Goals

ARP has two major related goals: to increase the supply of new, modest rental housing in Canada; and to create jobs in residential construction and related industries.

TABLE 11

ESTIMATED INCREMENTAL INVESTMENT AND UNITS GENERATED BY  
ARP THROUGH LENDING INSTITUTIONS IN 1976

Lending Institution	ARP Units Approved in 1976		Estimated Incremental Units	Mortgage Funds Approved for ARP in 1976		Estimated Incremental Funds
	Number	Per Cent		\$Millions	Per Cent	
			Number			\$Millions
CMC	257	1.0	152	5.8	1.0	3.5
Life Insurance Companies	8167	32.3	4902	193.6	33.2	116.2
Loan Companies	2874	11.4	1730	60.6	10.4	36.4
Trust Companies	8145	32.2	4886	192.2	33.0	115.3
Chartered Banks	3876	15.3	2322	83.3	14.3	50.0
Other	1971	7.8	1182	46.6	8.1	28.0
TOTAL	25,290	100.0	15,174	582.1	100.0	349.4

1

28

1



TABLE 12  
ESTIMATED ADDITIONAL DIRECT EMPLOYMENT GENERATED BY ARP, 1976

Type of Unit	Per Cent of Total ARP Approvals	Estimated Number of New Starts <sup>1</sup>	Employment Per Unit <sup>2</sup>	Total Employment
	Per Cent	Number	Man-Years	Man-Years
Single-Detached	0	0	1.267	0
Semi-Detached and Duplex	1.5	228	1.068	243
Row	7.5	1,138	0.940	1,069
Apartment	91.0	13,808	0.811	11,198
Total	100.0	15,174	4.086	12,510

<sup>1</sup> Assuming 60 per cent of the 25,290 ARP approvals are net additions.

<sup>2</sup> Hansen, L., Labour Requirements for the Residential Construction Industry (Ottawa: Central Mortgage and Housing Corporation, March, 1976), Table 6, p.40.

(i) The Supply and Employment Goals. In order to identify the additional amount of investment generated from private lending institutions for rental housing in 1976, the approach taken for AHOP had to be modified for ARP, because the Bank of Canada model takes no account of the important "gap" phenomenon. Since the amount of new rental construction attributable to ARP in metropolitan areas varies widely (e.g., 100 per cent in Winnipeg), it was assumed that at least 60 per cent of rental units constructed nationally in 1976 could be considered as net new starts. About 15,000 units could then be considered "incremental". This is equivalent to about \$350 million of extra mortgage investment, or an average of \$23,000 per unit (Table 11). The additional units also helped create 16,000 extra man years of employment in construction and related industries.

In total, ARP generated \$540 million in private mortgage funds in 1976, for a total of 25,290 rental units. This was above the 1975 level, and is expected to more than double again in 1977 (to about 58,000 units). ARP has therefore succeeded in adding significantly to the stock of moderately-priced rental accommodation.

(ii) The Goal of Producing Modest Housing. In order to promote the construction of modest rental housing, units approved under ARP are regulated according to size (as measured against a scale of square feet and number of bedrooms) and price (the AHOP Maximum House Price for local markets). The results of the evaluation with respect to this goal are as follows:

- ARP prices are generally well below the AHOP MHP since one-and two-bedroom units are the norm under ARP. In effect, the MHP restriction has had little influence to date on the size of ARP units. (Table 13).
- Only a few ARP projects appear to have incorporated luxury features (e.g. dishwashers).
- Most units built under ARP have been in low-rise, apartment structures (Table 13).
- Partly due to the CCA provisions, about 77 per cent of all ARP units are in wood-frame structures.

(iii) The Tenants of ARP Units. Although there is no control over tenant selection and tenants are expected to pay market rents, it is useful to identify who is being served by ARP for comparison with other housing assistance programs. It is difficult to do this without actually surveying ARP projects, but Table 14 presents a profile of typical ARP tenants based on some assumptions. Since ARP units rent at the upper end of the rental scale, it was assumed that ARP tenants would be paying above-average rents. Table 14 shows that in comparison to the total population the typical ARP renter an urban dweller with a higher than average income, is younger and is unlikely to have children.

#### The Costs of ARP

It was noted previously that the Capital Cost Allowance (CCA) provisions of the Income Tax Act were regarded as an integral component of ARP. It has been argued that without the CCA the ARP program would be in-

TABLE 13  
CHARACTERISTICS OF ARP UNITS (1976-77)

Characteristics	ARP Approvals	
	1976	1977 <sup>1</sup>
1. Number of Units	25,290	19,276
2. Per Cent of Units With Selected Characteristics		
A. <u>Exterior Construction</u>		
Wood Frame	79	74
Masonry	21	26
B. <u>Type of Heating</u>		
Oil	2	3
Gas	14	24
Electricity	57	53
Not Known	26	20
C. <u>Dwelling Type</u>		
Duplex, Triplex, Semi Row	2	1
Apartments 1-3 floor	5	10
4 - 10 floor	56	49
11 + floors	25	22
	12	19
D. <u>Number of Bedrooms</u>		
Bachelor	7	6
One	29	33
Two	49	47
Three	14	14
Four Plus	0	0

<sup>1</sup>To July 31, 1977.

TABLE 14  
CHARACTERISTICS OF ARP UNITS AND TENANTS IN 1976

Characteristics	Renters Paying More Than the Average Rent		Total Population	
	Number	Per Cent	Number	Per Cent
1. Total Households	1,113,000	100	6,590,000	100
2. Number of Bedrooms				
Bachelor	32,000	3	197,000	3
1	309,000	28	959,000	15
2	448,000	40	1,720,000	26
3	263,000	24	2,558,000	39
4	49,000	4	858,000	13
5	11,000	1	296,000	5
3. Income <sup>1</sup>				
Under \$5,000	131,000	12	951,000	14
\$5,000 - 10,000	227,000	20	1,350,000	21
\$10,000 - 15,000	303,000	27	1,511,000	23
\$15,000 - 20,000	227,000	20	1,205,000	18
\$20,000	210,000	19	1,482,000	23
4. Relation to Low Income Line				
Below	191,000	17	1,196,000	18
Above	922,000	83	5,394,000	82
5. Age of Head				
Under 25	264,000	24	682,000	10
25-35	360,000	32	1,440,000	22
35-55	281,000	25	2,449,000	37
55-65	96,000	9	998,000	15
65	113,000	10	1,021,000	16
6. Type of Household				
Unattached Individual	341,000	31	1,357,000	21
Married, No Children	256,000	23	1,402,000	21
Married, With Children	350,000	31	2,995,000	46
Single Parent	108,000	10	393,000	6
Other	58,000	5	442,000	6
7. Urban Size Group				
Over 100,000	746,000	67	3,447,000	52
30,000 - 99,999	119,000	11	652,000	10
15,000 - 29,999	84,000	8	446,000	7
1,000 - 14,999	93,000	8	758,000	12
Rural	71,000	6	1,287,000	20
8. Provincial Distribution				
Newfoundland	10,000	1	118,000	2
Prince Edward Is.	3,000	-	30,000	-
Nova Scotia	28,000	3	226,000	3
New Brunswick	26,000	2	172,000	3
Quebec	363,000	33	1,731,000	26
Ontario	409,000	37	2,468,000	37
Manitoba	47,000	4	311,000	5
Saskatchewan	32,000	3	269,000	4
Alberta	90,000	8	511,000	8
British Columbia	107,000	10	752,000	11

SOURCE: Survey of Household Income, Finances and Equipment (HIFE), 1973, special tabulation; percentage figures may not add to 100 per cent because of rounding.

<sup>1</sup>1973 incomes multiplied by 1.25 to approximate 1976 incomes.

effective. While the technical evaluation report deals with CCA provisions at some length, it will suffice here to present only the main points.

(i) ARP Cash Flow. Because of the lag between mortgage approval and initial occupancy, units approved in 1976 were only beginning to generate cash flow from CMHC by mid-1977. Table 15 indicates what the average cash requirement per unit would be on the basis of 1976 and 1977 experience. This shows that the total federal dollar commitment over 10 years would be \$5,627 and that the subsidy value of the interest foregone on the loan is \$2,169 per unit over the period.

Table 16 presents three scenarios showing the cash flow implications for 1976 approvals and extensions of ARP to 1981 and 1994 respectively.

(ii) Costs to Government of ARP and CCA. If ARP had continued as a grant program, the average subsidy per unit would have been \$4,338, which is twice the amount of the subsidy implied in the interest-free AL. Since the AL is a loan, it is not counted as income for tax purposes. For a typical wood-frame structure built under ARP, costing \$17,700 per unit, the cost to the federal government from the CCA is \$1,982 in foregone interest. For a unit in a masonry building it is \$1,133. On average, the subsidy cost per unit of ARP and CCA combined is \$3,956. For the 25,290 units approved in 1976 this constitutes a total federal subsidy of about \$101 million.

TABLE 15

CASH FLOW AND SUBSIDY IMPLICATIONS PER UNIT OF AN AVERAGE ARP APPROVAL IN 1976

Year	Year of Receipt Basis					
	Assistance Loan	Discounted Value of Assistance Loan at 10 p.c.	Cumulative Assistance on Loan	Interest Foregone on Assistance Loan <sup>1</sup>	Discounted Value on Interest Foregone	
	Dollars	10 p.c. Dollars	Dollars	Dollars	5 p.c. Dollars	10 p.c. Dollars
						15 p.c.
1	1023	1023	1023	102.3	97.4	93.0
2	921	837	1944	194.4	176.4	160.7
3	818	676	2762	276.2	238.6	207.5
4	716	538	3478	347.8	286.1	237.6
5	614	419	4092	409.2	320.6	254.1
6	512	318	4604	460.4	343.6	259.9
7	409	251	4013	501.3	357.3	257.2
8	307	158	5320	552.0	360.1	248.2
9	205	96	5525	552.5	356.1	234.5
10	102	43	5627	562.7	345.4	216.9
Total	5627	4339	5627	3938.8	2881.5	2169.4
						1622.9

SOURCE: Analysis of CMHC Approvals File by the author. See Appendix D for cash flow implications

<sup>1</sup> 10 per cent of value of cumulative Assistance Loan.

TABLE 16  
CASH FLOW IMPLICATIONS OF ARP  
TO 1994

Year	Situation One: 1976 Approvals Only		Situation Two:1 Approvals to 1981		Situation Three:1 Approvals to 1994	
	New Approvals	Total Cash Outflow	New Approvals	Total Cash Outflow	New Approvals	Total Cash Outflow
	Number	Millions of Dollars	Number	Millions of Dollars	Number	Millions of Dollars
1977	25,290	12.9	25,290	12.9	25,290	12.9
1978	--	24.6	60,000	47.9	60,000	47.9
1979	--	22.0	28,000	78.2	28,000	78.2
1980	--	19.4	25,000	92.4	25,000	92.4
1981	--	16.8	25,000	104.6	25,000	104.6
1982	--	14.2	--	103.5	25,000	116.1
1983	--	11.7	--	89.2	25,000	127.1
1984	--	9.1	--	75.2	25,000	137.9
1985	--	6.4	--	60.8	25,000	147.7
1986	--	3.9	--	47.1	25,000	157.7
1987	--	1.3	--	32.7	25,000	166.1
1988	--	-1.3	--	18.5	25,000	174.1
1989	--	-3.9	--	-4.1	25,000	181.2
1990	--	-6.4	--	-10.0	25,000	187.7
1991	--	-9.1	--	-24.3	25,000	192.9
1992	--	-11.7	--	-38.4	25,000	197.7
1993	--	-14.2	--	-52.7	25,000	201.0
1994	--	-16.8	--	-66.7	25,000	203.4

<sup>1</sup>Assuming a 10½ per cent mortgage interest rate and an 8 per cent inflation rate.



(iii) Provincial Supplementation of ARP. The evaluation examined provincial stacking in British Columbia and Ontario. It concluded that:

- In British Columbia the effect of assistance lowers the cost per unit to the federal government by about one-third.
- In Ontario provincial assistance does not directly cost the federal government more per unit, but by inducing a greater number of entrepreneurs into the program the risk of default or extension of assistance increases.

(iv) The value of ARP to the Rental Entrepreneur. The evaluation report estimated that the cost of the CCA, if used, averaged about 6.4 per cent of the value of a masonry building and 11.2 per cent for a wood-frame structure. In addition, the average cost of the assistance loan was about 9 per cent of the value of the typical unit. The total governmental subsidy, therefore, ranges from 15 to 20 per cent of the value of a typical ARP project.

The value of the subsidy to the owner, as an inducement to build rental housing requires a slightly different calculation. The evaluation attempted to cost this out, and the results are presented on Table 17. A few points can be made about this table:

TABLE 17

ASSISTED RENTAL PROGRAM: FINANCIAL BENEFITS TO OWNER<sup>1</sup>

Year	Cash Flow to Owner in Dollars			
	No Program	CCA Only	ARP Only	CCA and ARP
1	-1,281	-494	-258	529
2	-422	296	498	1,217
3	-376	280	440	1,096
4	-329	269	381	980
5	-283	265	321	867
6	-238	260	260	759
7	-195	260	199	654
8	-122	261	170	553
9	-25	262	170	457
10	66	262	170	366
11	149	260	149	260
12	221	252	117	148
13	279	279	71	71
14	320	320	-8	-8
15	339	339	-77	-77
16	-63	-6,784	-7,730	-14,451
Net Present Value	-2,330	-100	-175	2,051
Simple Interest Equivalent	-8.3%	3.6%	3.2%	15.1%

<sup>1</sup>Assuming that the building is sold in the sixteenth year.

<sup>2</sup>Rents increase at 8 per cent per annum and operating costs at 12 per cent. Marginal tax rate is 50 per cent and discount rate is 10 per cent per annum.

- If an entrepreneur were faced with an investment decision and no assistance was available from either ARP or CCA, it is highly unlikely he would invest. This is the significance of the minus 8.3 per cent value of the yield over 16 years.
- If either CCA or ARP existed alone then the yield to equity would be comparable (3.6 and 3.2 per cent), but not very lucrative to the entrepreneur.
- With the present situation, both the CCA and ARP, the average current yield is about 15 per cent. Clearly, this is the reason why the program has been successful.

#### Issues Facing ARP

The evaluation report dealt in detail with two issues currently facing the program, and identified two others. Briefly, these are as follows:

- There has been some pressure to tailor the program to suit small and large communities
  - in small towns because of generally lower rents a higher AL has been advocated. There is little reason for CMHC to subsidize low rents in rural areas. But if ARP assistance was calculated as in AHOP (write down IRL to 8 per cent), the problem might be eased.
  - in large cities the floor area limits might be too low in relation to local by-laws and the nature of local demand. It is suggested that price mechanisms would be better than the floor area maximum to control unit size.
- There has also been pressure to extend ARP to existing rental projects. While it would be contrary to the goals of ARP to extend such

assistance to all such projects, extension to limited dividend and other NHA-financed rental buildings which might be repossessed would save the federal government money in the long run.

ARP might possibly face a large number of defaults on projects in arrears on repayments in the future. This is not yet the case with ARP (1975), which CMHC has been monitoring closely.

#### IV. THE MUNICIPAL INCENTIVE GRANT PROGRAM

##### The Objectives of MIG

The Municipal Incentive Grant Program was introduced with FHAP to encourage municipalities to develop more land for modest housing at medium density, and generally encourage the economic use of land. Under the program grants of \$1,000 are made available to municipalities for units meeting the program criteria of building permit date density and unit size.

The program was designed, therefore, to increase the supply of land for housing, to change attitudes towards the provision of medium-density housing and to reduce urban sprawl. It is difficult to evaluate such a program, especially when it has been in operation for a little over one year. The evaluation report, therefore, focussed upon the performance of MIG to date and upon delivery issues. The evaluation of impact can only be carried out over a longer term, when trends are better developed.

##### Program Performance to Mid-1977

The following points summarize the main findings of the evaluation report concerning the performance of the program:

TABLE 18

MUNICIPAL INCENTIVE GRANT PROGRAM 1976-77  
DISTRIBUTION OF APPROVALS BY PROVINCE

Province	Approvals	
	Units	Per Cent
Newfoundland	713	3.6
Prince Edward Island	-	-
Nova Scotia	341	1.7
New Brunswick	1,294	6.4
Quebec	6,658	33.3
Ontario	5,526	27.6
Manitoba	258	1.3
Saskatchewan	1,070	5.3
Alberta	1,939	9.7
British Columbia	2,219	11.1
Yukon & Northwest Territories	-	-
TOTAL	20,018	100.0

SOURCE: Central Mortgage and Housing Corporation, Land Assembly and New Communities Division Municipal Incentive Grant Program, Section 56.2 NHA, Activity to July 31/77.

- To mid-1977 approximately \$20 million had been disbursed for 20,000 units. This compares with a program target of \$128 million to the end of 1978.
- Most of the approvals have gone to Québec (33.3 per cent) and Ontario (27.6 per cent) as shown on Table 18.
- Land already serviced for housing accounted for about 40 per cent of MIG approvals, and newly-serviced land about 58 per cent.
- Most of the MIG approvals have gone to the smaller urban centres -- 54 per cent to centres less than 50,000. Surprisingly, 30 per cent of all approvals have gone to centres of less than 10,000.
- The sale/rental ratio of approvals was one-to-two, with most ownership units being row houses and most rental units apartments.
- It was not possible to determine the proportion of approvals that had gone to AHOP and ARP units, but MIG appears to be achieving its goal of promoting medium-density, modest units.

#### Issues Associated With MIG

The evaluation attempted to document a few issues related to the running of this program. Briefly, these are as follows:

- It appears unlikely that municipalities have altered their residential standards and by-laws just to take advantage of MIG.
- It was impossible to say whether the approval process for residential development had been speeded up. MIG units appear to be developed faster than would be expected, but many factors could explain this.

- The program is taking too much administrative time for CMHC staff.
- The lack of conformity of MIG guidelines with those for ARP (unit size) and AHOP (unit density) is a cause for concern by municipalities.

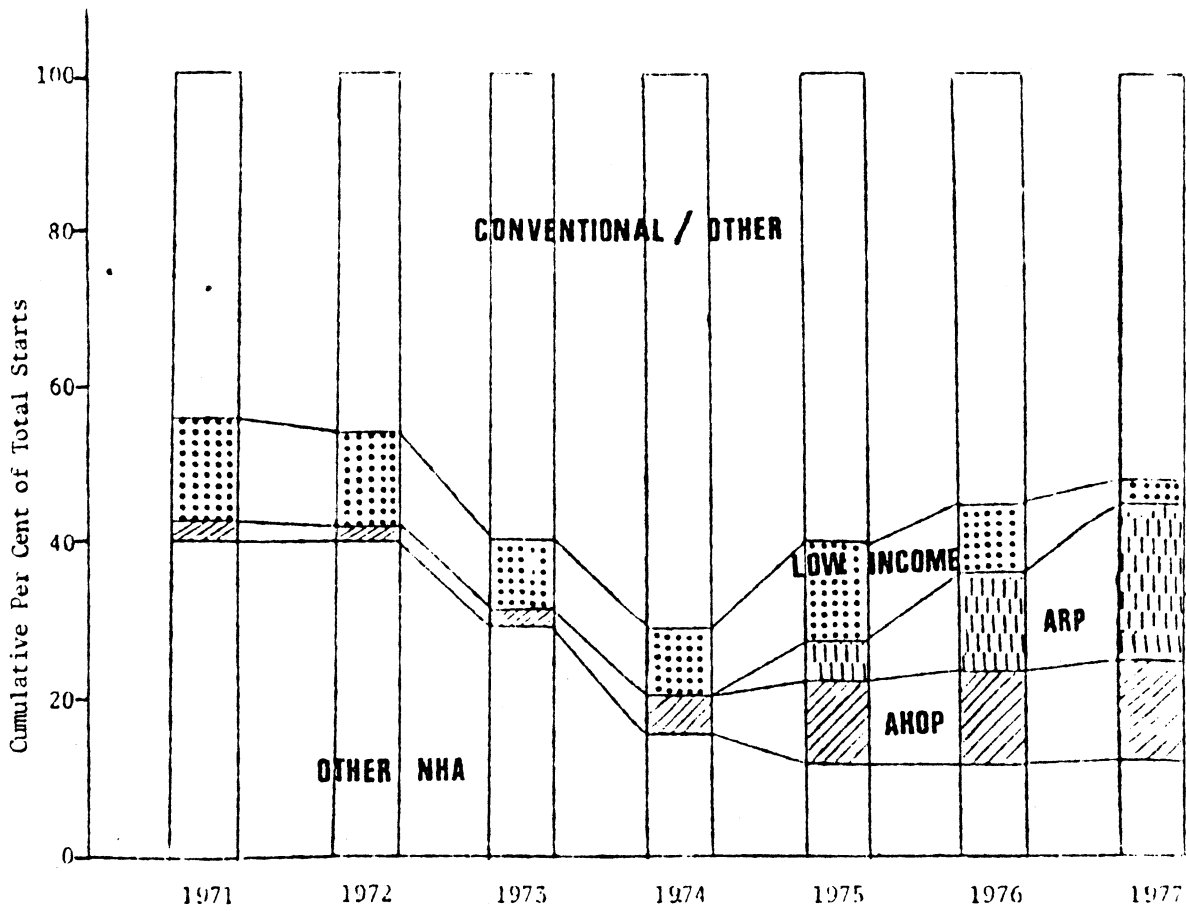
## V. CONCLUSIONS

The Federal Housing Action Program was introduced at a time when there was real concern on the part of the federal government about (i) the level of housing starts in Canada in relation to projected demand; (ii) the dramatic slowdown in the construction of rental accommodation; (iii) the increasing inability of low-and middle-income Canadians to purchase their own homes; (v) the rate of inflation in house prices and the overly-high expectations of Canadians; (vi) bottlenecks in the supply of serviced land for housing; and (v) wastefulness on the part of suppliers and consumers alike in the resources used for and related to residential construction.

The program, therefore, addressed itself to serious social and economic issues, both at the national level and in relation to the individual consumer. This evaluation has concluded that, for the most part FHAP has been successful in meeting its goals.

- The overall supply of housing for ownership and rent has increased by over half a million units since FHAP was conceived.

FIGURE 1  
THE CHANGING SHARE OF NIA-SPONSORED HOUSING  
IN CANADIAN HOUSING MARKETS (1971-77)





- The construction industry is consistently producing at a high rate per annum in a stable environment.
- The private lenders have shifted their lending patterns considerably to invest in AHOP and ARP (\$1.3 billion in 1976).
- AHOP has created a large pool of modest, moderately-priced homes accessible to Canadians in the middle and lower middle income ranges.
- ARP has stimulated massive investment in rental construction geared to producing modest rental units.
- MIG is helping to shift development patterns to higher density forms .
- Federal expenditures are only a small component of the total investment. The leverage concept has been successfully demonstrated.

The success of FHAP has led to significant changes in the housing market.

- The NHA share of total starts is now rapidly returning to the level it occupied in the early 1970s (Figure 1).
- ARP and AHOP together have helped create a new housing market structure in Canada through the development of a growing pool of new modest units at moderate cost for middle-and lower-middle-income Canadians.
- The conventional market is still functioning to provide more expensive units for the upper income groups.

