ANATOMY OF A CRISIS

Canadian Housing Policy in The Seventies

Lawrence B. Smith

THE FRASER INSTITUTE

ANATOMY OF A CRISIS

ANATOMY OF A CRISIS

Canadian Housing Policy in The Seventies

LAWRENCE B. SMITH
Professor of Economics and Associate Chairman
Department of Political Economy, University of Toronto

THE FRASER INSTITUTE
1977

Canadian Cataloguing in Publication Data
Smith, Lawrence Berk, 1939-
Anatomy of a crisis

(Fraser Institute housing studies ; 3)
Bibliography:
ISBN 0-88975-009-2

1. Housing — Canada. 2. Housing — Ontario.
I. Title. II. Series: Fraser Institute,
Vancouver, B.C. Fraser Institute housing
studies ; 3.
HD7305.A3S65 301.5'4'0971 C77-002112-3

First published 1977 by the Fraser Institute.

Printed in Canada.

Contents

Preface

This monograph on Canadian Housing Policy is the third in the Fraser Institute Housing Studies series. The two previous housing studies dealt respectively with rent control[1] and housing policy in British Columbia as a case study.[2] In the present volume, Professor L.B. Smith considers the content and objectives of Federal housing policies from 1935 to the present. In the course of his deliberations, he also provides commentary on provincial programmes in Ontario. A valuable catalogue of Canadian housing policies and their effects, the monograph also documents the philosophical shift that has occurred in the reasoning behind government policy.

Professor Smith's conclusion is that housing policy is more and more being used as a vehicle for redistributing income in Canada and that as a by-product, the policies are destroying the private sector's incentive and ability to supply housing. Increasing direct government involvement in the ownership of rental accommodation, together with

various dis-incentives to investment in rental property, have produced dramatic changes in the nature of the Canadian housing market. It is Professor Smith's view that "unless governments soon recognize the implications of their policies . . . the story of housing during the next decade will be quite different than the previous few decades. Canadian housing standards will markedly decline and the public cost of housing programmes will rise substantially".

Previous Fraser Institute publications have demonstrated that while the objectives of housing policies may be social, the mechanisms of policy are always economic. The best economic policy to deal with income problems is an income supplement programme. A recent Institute study has shown that a basic standard of accommodation can be guaranteed for all at less cost than the current hodge-podge of policies.[3] The income supplement programme and associated supply-side policies that the Institute proposes would be a way of achieving the goals that current policy is apparently geared to attaining without the disastrous side effects that Smith foresees if current policies continue.

Written in everyday language, this monograph provides excellent illustrations of how government policy, when single-mindedly pursued, can produce effects opposite to those desired. As an historical commentary, it is useful; as a foreshadow of the future, it merits the attention of everybody concerned with housing in Canada.

The Fraser Institute is pleased to be able to publish Professor Smith's work in the interest of public information. However, owing to the independence of his work, the views expressed may or may not conform severally or collectively with those of the members of the Institute.

M.A. Walker

[1] *Rent Control: A Popular Paradox,* F.A. Hayek, Milton Friedman, et al., The Fraser Institute, 1975 (ISBN 0-88975-007-6).

[2] *The Do's and Don'ts of Housing Policy,* Raymond Heung, The Fraser Institute, 1976 (ISBN 0-88975-006-8).

[3] Heung, *Ibid.*

Anatomy of a Crisis

Canadian Housing Policy in the Seventies

LAWRENCE B. SMITH
Professor of Economics and Associate Chairman
Department of Political Economy, University of Toronto

THE AUTHOR

Lawrence Berk Smith was born in Toronto, Ontario in 1939. After receiving his B.Com. at the University of Toronto in 1962, he went to Harvard University, where he obtained his Ph.D. in Economics in 1966. Professor Smith has held teaching positions at both Harvard University and the University of Toronto, where he has been a member of the Department of Political Economy since 1966. He is currently a Professor of Economics and Associate Chairman of the Department of Political Economy. In the academic year 1973-74, he was a Visiting Scholar in the Graduate School of Management, University of California at Los Angeles.

Professor Smith is widely-known and respected as one of Canada's leading specialists in housing and land economics. He is the author of two books on housing, his more recent being *The Postwar Canadian Housing and Residential Mortgage Markets and the Role of Government* (University of Toronto Press, 1974), and is co-editor, with L.H. Officer, of two books on Canadian economics, the more recent being *Issues in Canadian Economics* (McGraw-Hill Ryerson, 1974). His research monographs have been published by both the Bank of Canada and Central Mortgage and Housing Corporation. Professor Smith has also contributed widely to scholarly journals, including articles in the *American Economic Review, The Quarterly Journal of Economics, The Journal of Political Economy, The Canadian Journal of Economics, The Journal of Finance, Land Economics, The Journal of Money, Credit and Banking,* and *The Journal of Monetary Economics.* He has delivered papers on a variety of aspects of urban economics to such diverse groups as the American Real Estate and Urban Economics Association, the American Finance Association, the Canadian Economics Association and the Canadian Tax Foundation.

Professor Smith is a member of the Editorial Advisory Board of the Fraser Institute.

Anatomy of a Crisis

Canadian Housing Policy in the Seventies

LAWRENCE B. SMITH
Professor of Economics and Associate Chairman
Department of Political Economy, University of Toronto

I. INTRODUCTION

In 1969 the *Report of the Task Force on Housing and Urban Development* stated that Canadian housing achievements since 1945 were impressive in both qualitative and quantitative terms,[1] and that future housing needs could and should be met through the private market with government providing the necessary regulatory framework to encourage the private sector.[2] In 1971 a study prepared for the Minister Responsible for Housing reiterated this view. Nevertheless, housing policy in the 1970's in Canada underwent a major shift in orientation involving the substantial growth of government participation in the housing sector, the concomitant decline of the private rental sector, and the widespread use of housing policy as a vehicle for income redistribution.

The shift in policy coincided with the increasing acceptance of the view that housing was no longer a good or service whose consumption should be subject to the usual income or wealth constraints, like any other good, but rather was a fundamental right for all. This position is clearly reflected in statements by the then Minister of Urban Affairs

that the federal government has "adopted the basic principle that it is the fundamental right of Canadians, regardless of their economic circumstances, to enjoy adequate shelter at reasonable cost,"[3] and by the Ontario Ministry of Housing that "adequate housing at affordable prices is a basic right of all residents of Ontario".[4] More important, this position is clearly embodied in the set of recent government policies affecting the housing sector.

The purpose of this essay is to examine the general thrust and economic implications of recent policies affecting housing in Canada, and in particular in Ontario. The essay begins with a brief discussion of pre-1970 housing policies and then describes and analyzes post-1970 housing policies, looking both at specific housing policies such as the construction and subsidization of new dwellings for low income households, the provision of rental assistance and cash grants to home buyers, rent control and amendments to the Landlord and Tenant Act; and non-specific housing policies such as revisions in tax regulations, the introduction of new taxes such as the Ontario Land Speculation and Land Transfer Taxes, controls on foreign investment and regulations under the Anti-Inflation Act. The discussion concentrates primarily on federal programmes and on provincial programmes in Ontario. Finally, the subject of land use controls such as zoning, servicing and government approvals, which are vitally important in understanding the impact of government on the construction industry, are ignored in this essay but are the subject of a future Fraser Institute study.

II. POLICY COMPOSITION OF CANADIAN HOUSING STARTS

A discussion of government housing policies in Canada is extremely complicated because of the tripartite nature of government involvement. Prior to 1964 the area was almost exclusively the preserve of the federal government, although the municipalities and provinces did exercise control of zoning, servicing, building regulations and some low-income housing developments. In 1964, partially in response to new

cost-sharing arrangements offered by the federal government, the provinces entered the housing field more directly and the emphasis in housing programmes began to shift to incorporate more income distribution features. Nevertheless, this shift was relatively minor until 1970 and, consequently, housing policy in Canada can be considered to be primarily federal housing policy until the late 1960's.

Prior to 1970 federal influence upon the housing and residential construction markets in Canada mainly took the form of selective credit programmes designed to influence and operate through the capital market, rather than the form of direct intervention via government ownership or specific aids to low income groups.[5] After 1969, however, the importance of the latter form of intervention increased dramatically.

The relative importance of various federal housing programmes can be seen from Table 1, which shows the proportion of housing starts financed privately and by various forms of government programmes for the periods 1946-69 and 1970-75.[6] The Table indicates that direct government involvement in the residential construction sector rose rapidly after 1969. During 1946-69, government programmes financed 38.4% of all housing units started in Canada, but only 4.4% of all starts were government-owned or specifically designed to assist low income households. During 1970-75 government programmes still financed just under 40% of all housing starts, but 15.7% of all starts were specifically designed to assist low income households. Since these figures refer only to the composition of new housing starts and ignore government impacts via rent subsidies, home purchase grants and mortgage subsidies, they considerably underestimate the shift in emphasis in favour of income redistribution programmes.

TABLE 1
COMPOSITION OF CANADIAN HOUSING STARTS, 1946-69 AND 1970-75 (bracketed)

Total Housing Starts
100%

- **Conventional and Other**
  61.6% (54.2%)
- **National Housing Act**
  38.4% (45.8%)
  - **CMHC Lending**
    13.9% (18.0%)
    - **Low Income Housing**
      4.4% (15.7%)
      - **Limited Dividend and Non-Profit (Sections 15, 15.1, 34.18)**
        2.0% (5.3%)
      - **Public Housing (Sections 40, 43)**
        1.9% (6.4%)
      - **Student Housing (Section 47)**
        0.2% (0.1%)
      - **Rental and Ownership Loans (Sections 34, 15, 58, 59)**
        0.3% (3.9%)
      - **Housing for Elderly** (from Limited Dividend and Non-Profit, and Public Housing)
        0.8% (4.6%)
    - **"Unrestricted Lending" (Sections 58, 59)**
      9.5% (2.3%)
  - **Approved Lender**
    24.5% (27.8%)
    - **Regular**
      24.5% (25.6%)
    - **Assisted Home Ownership**
      0.0% (2.2%)

TABLE 2
COMPOSITION OF CANADIAN HOUSING STARTS, 1975

- **Total Housing Starts** 100%
  - **Conventional and Other** 60.2%
  - **National Housing Act** 39.8%
    - **CMHC Lending** 19.3%
      - **Low Income Housing** 19.3%
        - **Limited Dividend and Non-Profit (Sections 15, 15.1, 34.18)** 6.1%
        - **Public Housing (Sections 40, 43)** 5.8%
        - **Student Housing (Section 47)** 0.0%
        - **Rental and Ownership Loans (Sections 34, 15, 58, 59)** 7.4%
      - **"Unrestricted Lending" (Sections 58, 59)** 0.1%
    - **Approved Lender** 20.4%
      - **Regular** 6.7%
      - **Assisted Home Ownership** 13.7%

Housing for Elderly 4.5% (from Limited Dividend and Non-Profit and Public Housing)

A more complete indication of the shift can be seen by looking at the composition of housing starts in 1975, which is shown in Table 2. In 1975 government-assisted low income housing starts were 19.3% of all housing starts[7] and another 13.7% of all starts were privately financed by approved lenders with subsidies under the Assisted Home Ownership Programme (AHOP).[8] In addition, as Table 3 indicates, federal subsidies under the federal-provincial rental housing and public housing programmes were over $85 million in 1975 (compared to only $7.7 million in 1969),[9] and these were matched by provincial and municipal subsidies. Thus, 33% of all housing starts in 1975 were government-assisted low income starts or subsidized AHOP starts, and over $170 million in federal, provincial and municipal subsidies were paid for the operation of existing rental and public housing.

TABLE 3

FEDERAL OPERATING SUBSIDIES PAID FOR PUBLIC AND FEDERAL-PROVINCIAL RENTAL HOUSING

($ million)

	Federal-Provincial Rental Housing	Public Housing
1965	2.0	—
1966	2.1	.1
1967	2.3	1.2
1968	3.2	1.8
1969	3.6	4.1
1970	4.5	9.8
1971	7.4	21.7
1972	11.1	56.2
1973	13.2	52.5
1974	17.2	68.1
1975	20.5	64.6

Source:

Central Mortgage and Housing Corporation 1975, p. 60 and earlier issues.

III. PRE-1970 HOUSING POLICIES

Although fiscal and monetary policies have a significant impact upon the housing market it is difficult to claim that prior to the 1970's these policies were used to any large extent primarily to influence residential construction activity.[10,11] Consequently, a discussion of Canadian housing policies prior to 1970 can be confined to policies specific to the housing sector.[12]

1. PRE-1954 DEMAND POLICIES

The thrust of federal housing policy during its first twenty years, from 1935 to 1954, was to increase residential construction activity by making mortgage credit available on greatly liberalized terms to stimulate demand. To facilitate this, a new debt instrument, the National Housing Act (NHA) mortgage, was created.

The initial principle of the National Housing Act was that the federal government would make mortgage loans jointly with authorized lending institutions. In order to stimulate the demand for new residential construction, the government charged a substantially lower interest rate on their portion of the loan and thereby provided an interest subsidy to the borrower. The government also determined lending terms and conditions on joint loans, and used these powers to stimulate demand by increasing the "loan to value ratio" and the term to maturity for joint loans.To ensure that an adequate supply of funds would be forthcoming from financial institutions, the government allowed institutions to charge a higher rate of interest on their portion of the loan, and established a system of guarantees that virtually eliminated all risk of capital and interest loss for lending institutions. Thus, during this period, government policy clearly sought to increase the efficiency of the private sector and work with it to stimulate residential construction and upgrade housing standards.

Despite the apparent theoretical advantages of the joint loan technique, NHA mortgages became firmly established only with life insurance companies because they were the

only institution prepared to commit a high proportion of their funds for a term of 25 years.[13] Nevertheless, by increasing the loan to value ratio, the amortization period and the maturity term, and by reducing the interest rate, the programme enabled many additional families to enter the housing market.

2. POST-1954 SUPPLY POLICIES

Although stimulating housing demand remained a long-run objective of federal housing policy, the emphasis of federal policy shifted in the mid-1950's (and continued until the mid-1960's) in favour of increasing the availability of funds for residential construction. This shift was manifest in changes in the NHA joint loan programme, in attempts of Central Mortgage and Housing Corporation (CMHC; the federal housing agency), to develop a secondary market in NHA mortgages, in changes in the NHA mortgage instrument to overcome market imperfections, and in the large scale entry of the federal government as a direct supplier of mortgage loans.

i. The Federal Loan Insurance Programme

In 1954 the federal guarantee and joint loan programme was replaced by a federal loan insurance programme in which the government insured private lenders against loss on loans made under a revised National Housing Act.[14] The government retained the right to determine lending terms, including the maximum interest rate that qualified for insurance, and thus remained in a position to exercise considerable influence over the willingness of lenders and borrowers to participate in this market. Provision was made for the establishment of a secondary market in NHA mortgages and the chartered banks, who were previously excluded from this market, were empowered to initiate NHA loans. The primary objective of these changes was to increase the availability of mortgage funds from the private sector. Thus, government policy still sought to encourage the private sector rather than to replace it with direct government involvement.[15]

In the 1960's government policy was primarily directed toward increasing the availability of private mortgage credit by increasing the efficiency of the capital market and removing imperfections in the mortgage market. During the first half of the 1960's the government tried to increase the liquidity of NHA mortgages by sponsoring auctions of packages of NHA mortgages to develop a secondary market in these mortgages, but after five years the auctions were abandoned.

The government was more successful in removing yield and liquidity imperfections associated with NHA mortgages. Yield imperfections were removed as the government relinquished its discretionary authority over the maximum rate of interest that qualified for NHA insurance. In 1966 the government tied this rate to the average yield on long-term government of Canada bonds, and in 1969 the government eliminated the rate maximum entirely and allowed the NHA mortgage rate to find its own level in the market.[16] Liquidity imperfections were substantially removed in 1969 when the government created a quasi-variable interest rate NHA mortgage by reducing the minimum term on a NHA mortgage loan from 25 years to 5 years, although the amortization period was left unchanged between 25 and 40 years. This change greatly increased the attractiveness of NHA mortgages for deposit-taking institutions since these institutions could now better match the maturity term of their liabilities and their NHA mortgage investments.[17] Consequently, NHA mortgages became a much more attractive investment and NHA mortgage approvals rose from 30% of financial institutions' total mortgage approvals in 1963-66 to 57% in 1970-73.

ii. Central Mortgage and Housing Corporation Direct Lending

In 1957, in response to fears that the availability of private funds would not be sufficient to finance the desired volume of residential construction, Central Mortgage and Housing Corporation began actively intervening in the mortgage market by making loans to private borrowers or builders to stimulate construction activity. This intervention continued

on a large scale until 1970,[18] and during this period almost 20% of all new housing starts were financed by CMHC.

Despite this massive intervention, government philosophy was clearly to *assist* rather than *replace* the private sector and to avoid distorting market mechanisms as much as possible. CMHC lending was theoretically "residual" in the sense that borrowers had to demonstrate, via rejected loan applications, that they were unable to obtain private financing on NHA terms.[19] Of course, regardless of the screening procedures established, this lending was not completely residual because offsets in the private sector were inevitable.

The offsets or displacement of private sector financing occurred for two reasons. First of all, NHA financing removed mortgage demand from the conventional market that would have been satisfied at a slightly higher interest rate appropriately reflecting the riskiness of the borrower. Secondly, the funds used to finance NHA mortgages had to be borrowed by the government and the additional demands by the government both raised the level of interest rates and reduced the availability of private funds for housing. Nevertheless, 75-80% of this lending was residual in the sense that it provided a net addition to the supply of mortgage credit.[20] Moreover, prior to 1968 the programme was used primarily to make general mortgage loans rather than loans specifically for low income housing.[21] Thus, although government involvement through this programme went considerably beyond increasing efficiency in the private sector, it worked primarily in conjunction with the private sector by making loans available on a non-income-restricted basis when private credit shortages arose.

This brief discussion indicates that federal housing policy prior to the 1970's was designed to operate *in conjunction with* the private sector. Policies were primarily aimed at stimulating residential construction by stimulating demand and by increasing the availability of mortgage credit.[22] The main techniques for this were the removal of mortgage market imperfections,[23] the upgrading of the NHA debt instrument, and the direct supplying of mortgage credit on a residual basis to the private sector.

TABLE 4

INDICATORS OF HOUSING STANDARDS

	Basic Facilities % of Dwellings with Piped hot & cold water	installed bath or shower	flush toilet
1951	56.9	60.8	68.3
1961	80.2	80.9	85.9
1971	93.5	93.4	95.4
1975	96.7	96.9	97.4

Crowding Indicators

	% of households with more than 1 person per room	% of families not maintaining their own household	% of housing units occupied by non-family households
1951	18.9	9.6	11.3
1961	16.5	5.6	13.3
1971	9.4	3.4	18.4
1975	n.a.	n.a.	n.a.

Affordability

	% of household income devoted to shelter		
	Overall	Tenants	Homeowners
1951	n.a.	n.a.	n.a.
1961	18.6(1)	18.3(1)	15.7(1)
1971	16.1(2)	17.9(2)	14.7(2)
1975	n.a.	n.a.	n.a.

Sources:

Calculated from Central Mortgage and Housing Corporation 1975, pp. 87, 90; and M. Walker, 1975, p. 29.
(1) in 1962
(2) in 1972

3. HOUSING STANDARDS AND THE EVOLUTION OF HOUSING POLICY

The result of this public and private co-operation was that Canadians entered the 1970's very well-housed. An indication of the standard of housing can be seen from Table 4. In terms of basic facilities, Canada ranked second only to the United States as 95.4% of Canadian dwellings had flush toilets (compared to 68.3% in 1951), 93.5% had piped hot and cold water (56.9% in 1951), and 93.4% had installed bath or shower facilities (60.8% in 1951). In terms of occupancy and crowding, Canada was tied with the United States for the lowest occupation density with 1.6 rooms per person, and ranked first in the Western World with an average of 5.3 rooms per dwelling. The percentage of families not maintaining their own household (i.e. doubled-up) was a relatively low 3.4% in 1971 (9.6% in 1951), while the percentage of housing units occupied by non-family households was a relatively high 18.4% (11.3% in 1951). The percentage of households with more than one person per room was only 9.4% (18.9% in 1951).[24] Moreover, in terms of affordability, Canada also fared well. A recent study by the Fraser Institute showed the proportion of income spent for housing services in 1972 was 16.1% and in 1969 was 16.0%, compared to 18.6% in 1962 and a generally accepted rule of thumb of 25.0%.[25] Between 1961 and 1971, the tenancy cost component of the consumer price index rose only 22.5% and the homeownership component rose 74.2%, while personal disposable income per capita rose 87.7%.

i. Government or the Market?

On the other hand, government assistance for low income housing prior to 1970, and especially prior to 1968, was relatively minor. During the period 1957-69 only 5.2% of all new construction was to provide housing for low income families, and only 22% of CMHC direct lending was to assist in the construction of low income housing.[26] Moreover, in 1969 federal housing subsidies under the National Housing Act for federal-provincial rental housing and public housing amounted to only $5.4 million.[27] In contrast, the primary

benefit of government housing assistance accrued to middle income families who purchased medium-priced homes. In 1969, for example, only 5.7% of NHA loans for new housing went to the 40.8% of Canadian non-farm families with incomes below $7,000, while 84.9% of these loans went to the 48.6% of the non-farm families with incomes between $7,000 and $15,000.[28]

ii. Housing not a Good but a Right?

In response to the uneven income distribution implications of federal housing policies, the provinces entered the housing field in the second half of the 1960's and the federal government began to shift the emphasis of its policies. This shift coincided with the adoption of the belief that housing is not a good but a right, and that decisions concerning its production and distribution should not be left to the market but must be politically determined.[29] The increasing acceptance of this belief prompted governments at all levels to intervene more actively and directly in the market than ever before and caused Canadian housing policy to undergo a complete transformation during the first half of the 1970's. Rather than continue to assist and improve the market system that, despite its shortcomings, had provided an extremely impressive standard of housing for most Canadians, government policy increasingly took the form of direct intervention and regulation. Federal and provincial intervention took the form of specific housing policies such as:

- the construction or subsidization of new dwellings for low income households,
- the provision of rental assistance and cash grants to home buyers,
- the introduction of rent control, and
- revisions to Landlord and Tenant Acts:

and non-specific housing policies such as:

- alterations in tax regulations,
- the introduction of new tax legislation,
- controls on foreign investment, and
- Anti-Inflation Act regulations.

In addition, municipal policy, which goes beyond the scope of this paper, often reinforced federal and provincial policy, since it included:

- down-zoning,
- height limitations, and
- building freezes.

IV. POST-1970 HOUSING POLICIES

Consistent with the notion that housing is a fundamental right to be shared by all, Canadian housing policy in the 1970's has *encouraged* private homeownership, and government and non-profit ownership of rental dwellings. At the same time, however, it has strongly *discouraged* the private ownership of rental dwellings. In addition, housing policy effectively became an instrument to redistribute income in favour of lower income households.

1. SPECIFIC HOUSING POLICIES

i. Subsidized Rental Programmes

A major component of government housing policy in the 1970's was the direct intervention of government in the provision of housing by constructing and subsidizing the construction of low income housing, and also by providing rental supplements and subsidizing the operation of low income housing.

As Table 5 indicates, federally-assisted housing starts for low income families rose from 4.4% of all starts in 1946-69 to 15.7% in 1970-75, and 19.3% in 1975. In 1970, 26.1% of all housing starts were federally-assisted low income starts, and 83.4% of Central Mortgage and Housing Corporation direct lending went to aid low income groups, compared to 22.0% in 1957-69 and 58.0% in 1968-69.[30]

TABLE 5

FEDERALLY-ASSISTED HOUSING STARTS FOR LOW INCOME FAMILIES AS A PERCENTAGE OF

	Total Housing Starts	Total Publically-Funded Starts
1962	4.7	31.0
1963	4.0	23.3
1964	2.8	14.6
1965	2.8	14.4
1966	5.6	18.6
1967	7.0	25.3
1968	7.8	57.7
1969	9.6	67.5
1970	26.1	83.4
1971	16.9	88.9
1972	14.7	91.5
1973	11.7	97.6
1974	14.8	97.8
1975	19.3	99.7

Source:

Calculated from Central Mortgage and Housing Corporation 1975, p. 14.

This intervention took a variety of forms with the most common being:

- Rent-Geared-to-Income-Housing (Public Housing),
- Limited Dividend and Non-Profit Housing,
- Assisted Rental Housing, and
- Rental Supplement Housing.[31]

A summary of these programmes is presented below.

(a) *Rent-Geared-to-Income-Housing:* Under the Rent-Geared-to-Income Housing Programme the province and the federal government construct rental dwellings and rent them to low income tenants at a rental geared to a tenant's income. Capital costs under this programme are provided 90% by the federal government and 10% by the province, and operating losses are borne 50% by the federal government, 42.5%

by the province and 7.5% by the municipality. In Ontario, housing under this programme is available for low income families with children and senior citizens over 60. Rents are a maximum of 25% of income, and in 1974 in Toronto the average household income of tenants in this housing was $5,028.[32] The programme accelerated sharply in 1970 and between 1970 and 1975 it accounted for 6.4% of all Canadian housing starts.

(b) *Limited Dividend and Non-Profit Housing:* Under the Limited Dividend and Non-Profit Housing Programmes the federal government, rather than constructing the dwellings, provides 95% mortgage finance at a favourable interest rate to groups who will control rents in order to limit profits for a fixed period of time, and who will rent primarily to low income tenants. These programmes also accelerated sharply in 1970 and accounted for 5.3% of all housing starts in 1970-75.

(c) *Assisted Rental Housing:* Under the Assisted Rental Housing Programme the federal government provides subsidies to developers of moderate and low priced rental housing to enable them to reduce the rent charged to tenants to an amount that would be "deemed reasonable, having regard for the probable income of the lessees." The rental subsidy is provided for a period of 5 to 15 years. In January, 1976 the maximum subsidy was $600 per unit per year and the subsidy was to decrease in equal amounts over the subsidization period. In addition, reduced interest loans are provided under the programme to builders who create housing at rental rates agreed to by CMHC. In 1975, the first year of the programme, private lenders made loans for 21,792 units under this programme.[33]

(d) *Rental Supplement Housing:* Under the Rental Supplement Housing Programmes, the Ontario government provides first or second mortgages on favourable terms to private landlords who agree to rent 25% of their units to tenants receiving rental supplements. The province provides the

mortgage credit and the federal, provincial and municipal governments share the rental supplement costs. These programmes began in 1971 but are still relatively minor, accounting for under 0.5% of Ontario housing starts.[34]

The foregoing programmes are all designed to increase the construction of low income rental housing. Since the majority of these programmes require government, community or non-profit ownership, it is clear that government is intervening directly in the housing market on a large scale. In fact, this direct intervention is only one facet of a series of measures that are shifting the emphasis in the rental housing market from private to public or non-profit ownership as private participation is discouraged and replaced with government or non-profit ownership. Between 1970-75, these and similar programmes accounted for approximately 12.7% of all new construction and 24.4% of all non-single detached housing starts in Canada.[35] In addition, loans for 21,792 units were approved by private lenders under the Assisted Rental Programme in 1975 so that the proportion of government assisted multiple dwelling starts will rise considerably in the future. These programmes are likely to increase the total housing stock by stimulating and making effective low income demand, although they generate considerable offsets in the private sector by shifting demand and reducing the availability of private capital. Unfortunately, it is still too early to measure the private market offset and thus determine the net impact on the housing stock and housing standards.

The programmes also contain a considerable income redistribution component since they involve subsidies in the construction and/or operation of the housing. In 1975, housing units started under these programmes embodied interest subsidies of approximately $15 million annually,[36] and the federal, provincial and municipal subsidies for the operation of existing housing under these programmes approximated $170 million.[37]

ii. Subsidized Home Ownership Programmes

A second component of government housing policy was the encouragement of the demand for homeownership. This occurred both in non-specific form through tax incentives which encouraged the investment aspect of homeownership (these are discussed in Section 2), and in specific form through homeownership subsidies which sought to increase the affordability of homeownership. The subsidies appeared in many forms with the three most prevalent being cash grants, mortgage subsidies and land lot leases in Ontario.[38]

(a) *Cash Grants:* Cash grants to home purchasers were provided in 1975 by both the federal and the Ontario governments to stimulate demand for homeownership. The federal programme gave a cash grant of $500 to any first time home purchaser of a newly constructed dwelling below a specified price (which in Toronto was $43,000). Ontario provided a $1,500 grant to the first time purchaser of any dwelling, new or old, irrespective of the income of the purchaser or price of the dwelling.[39] Since it was possible to obtain both the federal and the Ontario grants and since the average multiple listing sale price of a home in Toronto was $55,000 at the end of 1974, (and about 25% less in much of the rest of the province), the rebate represented a significant reduction in the cash required for a downpayment if it did not generate upward pressure on the price of houses.

The effects of the rebates on prices and housing activity are difficult to disentangle. However, since both programmes were confined to one year they probably exerted considerable pressure on demand without an initial increase in supply. This was likely because the rebates would not initially generate many additional housing starts because production time lags would prevent the houses from being completed in time to be eligible under the programmes. Hence, most of the homes eligible for the programmes were already in existence or under construction and the increase in demand from the rebates was likely to exert considerable upward pressure on the price of these homes during the operation of the programmes. On the other hand, because of the short term nature of the programmes, much of the increased demand

was likely to have been a shifting forward of future demand. Therefore the termination of the programmes would have been followed by a reduction in demand below the level that would have existed in their absence. At the same time, since the programmes reduced inventories of unsold homes, they created the financial ability and climate for builders to increase construction toward the end of 1975 and into 1976. Thus, the rebate programmes probably initially increased the price of houses, stimulated construction activity with a lag, and contributed to a surplus inventory of unsold homes after they were terminated.[40]

(b) *Mortgage Subsidies:* Mortgage subsidies were introduced in 1973 by the federal government under an Assisted Home Ownership Programme (AHOP). Under this programme moderate income families with children could obtain low cost, high "loan to value ratio" mortgages from Central Mortgage and Housing Corporation to finance the purchase of a newly constructed home, or could receive a subsidy of up to $1,200 a year to compensate for paying the market interest rate for a loan obtained from a private lender. Limits were imposed on the price of the dwelling purchased and the family income that qualified for this programme. In Toronto, in 1975 the maximum dwelling price that qualified was $43,000 and maximum income for a family with one child was $21,000. The subsidy increased as income fell, with a family income of $16,000 or less qualifying for the maximum subsidy.[41]

The effects of mortgage subsidies are more clear-cut than temporary cash grants. Because the subsidies increase the affordability of a home they increase demand and construction of eligible homes. On the other hand, there are considerable capital market offsets. Because mortgage costs beyond some level are subsidized there is less borrower reluctance to increasing mortgage rates from private lenders. These lenders are thus encouraged to shift funds into this programme and away from non-subsidized borrowers with the result that the programme probably increases the mortgage rate and somewhat reduces non-subsidized demand. The programme also redistributes funds from non-residential

uses, such as industrial expansion, and it is not clear that this is a desirable trade-off for the economy. In 1975 assisted home ownership and rental loans from private lenders totalled $749.9 million and covered 30,769 units, and CMHC loans totalled an additional $456.8 million and covered 16,734 new housing units. In addition, federal subsidies under the programme in 1975 amounted to over $6.0 million.[42]

(c) *Home Ownership Made Easy:* In 1967, the Ontario government introduced a Home Ownership Made Easy (HOME) Plan in which the province acquires land and arranges for houses to be built on it. The government then provides a high "loan to value ratio" first mortgage at a low interest rate to cover the purchase price of the house, and leases the land to the house-buyer (with an option to purchase). Under another variant of the plan the lot is sold to the home purchaser and the province provides a 100% second mortgage at a favourable interest rate to cover the cost of the lot purchase. The subsidy provided by this plan is considerable and arises in the price of the lot, the interest rate and the size of the loan. In 1975, the programme was available for families with incomes up to $17,000.[43]

The foregoing programmes are all designed to stimulate housing demand by subsidizing middle and low income purchasers. Unlike most of the programmes in the rental sector they are designed to operate in conjunction with the private sector and do not involve permanent government ownership. The extent to which these programmes actually increase the volume of construction as opposed to housing prices is difficult to assess because of their small scale and/or newness. It seems clear that a considerable impact of the temporary cash grants programmes initially fell on prices because of the short duration of the programmes. However, to the extent that they enabled developers to reduce inventories of unsold homes they created the financial ability and climate for increased new construction in the future. But the short term of the programmes also meant that much of their impact came from *shifting demand forward* as opposed to *generating increased demand* so that much of their impact was offset in

subsequent periods. The mortgage subsidy programmes are more stimulating because of their permanence, but they also generate some offsets through the capital market since they increase the mortgage rate and redistribute funds from non-subsidized to subsidized borrowers.

The programmes all have significant income redistribution implications, but there is little uniformity or consistency to the redistribution. For example, under the cash grants programmes a household with a qualifying income who purchased a qualifying home for the first time in 1975 obtained a considerable subsidy, while another household with the same income who had previously purchased a home, who purchased a non-qualifying home or who delayed a purchase for a year, received no subsidy. Under the AHOP programme funds are redistributed toward subsidized borrowers, and mortgage costs are raised for non-subsidized borrowers. The public in general and other sectors of the economy also lose through higher borrowing costs and taxes (or inflation) to finance the subsidies.

iii. Rent Control and Landlord and Tenant Act Revisions

A third and dominant feature of housing policy was the discouragement of private ownership of rental dwellings. This was a major feature of the non-specific policies to be discussed in Section 2, below, and also occurred specifically through the introduction of rent control and revisions in provincial Landlord and Tenant Acts.

(a) *Rent Control:* Although it is a provincial responsibility, rent control now exists throughout most of Canada. The majority of provinces enacted rent control at the request of the federal government in October, 1975 as part of the federal government's Anti-Inflation Programme.[44] However, rent control is much more than a reflection of federal policy at the provincial level because Canada's three major provinces independently had previously either introduced rent control (Quebec and British Columbia) or promised it (Ontario). It should, therefore, not only be viewed as part of the federal government's Anti-Inflation Programme but also as another manifestation of the special treatment of

housing as a basic right, and of the attempt to use housing for income redistribution.

Rent control legislation varies considerably between provinces. In Ontario, the rent for July, 1975 is deemed to be the base rent for every rental dwelling, and any increase in rent is subject to a maximum percentage set annually by the government.[45] If either a landlord or tenant feels the maximum percentage increase is inappropriate for his dwelling, he can appeal to a rent review officer and rent review board. However, the appropriateness of the base rent is not subject to appeal. The only grounds for appeal are that the controls cause the landlord to suffer a loss or that cost increases justify a different percentage increase. The legislation is not concerned with equity between tenants since it provides for the same percentage increase for a tenant whose rent was increased as of July, 1975, and who can be assumed to have a market rent as of the base date, and for a tenant whose rent was set by a lease two or three years earlier, and who can be assumed to have a substantially below market rent as of the base date. Similarly, the legislation is not concerned with equity for landlords since it rules out rate of return on investment as a basis for appeal and since it discriminates against landlords whose rents were below market in July, 1975.[46]

The undesirable effects of rent control on the allocation of resources, on the volume of rental construction, on repairs and maintenance for existing dwellings, and on housing standards in general are well known.[47] Nevertheless, the rent control that was introduced in most of Canada made little or no attempt to mitigate these undesirable effects. For example, the base date for rent control was made retroactive in Ontario, the maximum percentage rent increase allowed in Ontario is considerably below the overall inflation rate, and the maximum percentage rent increase allowed in British Columbia in 1975 was only 1/3 of that recommended by a special government appointed commissioner.[48] There is, therefore, no doubt that the form of rent control introduced in Canada will significantly discourage private ownership of rental housing and will substantially reinforce the shift from private to public ownership of rental housing as has occurred in other countries such as the U.K.

(b) *Landlord and Tenant Act Revisions:* Recent revisions to the Landlord and Tenant Act in a number of provinces are another illustration of the shift to the assumption that housing is a basic right. By and large, these revisions have also tended to discourage private ownership of rental housing, especially by small landlords. Without going into detail, the revisions have tended to reinforce tenant rights and limit landlord rights in such a way that it is extremely costly and difficult for a landlord to terminate a tenancy. In Ontario, the procedure runs approximately four months from the date of the notice to terminate and requires the landlord to show cause for termination.[49] Consequently, the management of rental housing has become considerably more complex and costly, discouraging investment in rental dwellings.

2. NON-SPECIFIC HOUSING POLICIES

Canadian housing markets were profoundly influenced in the 1970's by policies not specifically designed for the housing sector, such as federal tax revision, the Ontario Land Speculation and Land Transfer Taxes, controls on foreign investment and Anti-Inflation Act regulations. The major impact of these policies was to discourage private ownership of rental dwellings and encourage homeownership.

i. Federal Tax Revision

The Canadian tax revision of 1971 included a number of changes that significantly affected the housing sector. The most important of these changes were:

- the introduction of a capital gains tax for gains on all financial and real investments except on the sale of a principal residence, with half the gain treated as earned income;
- the creation of a separate depreciation class for each rental building with depreciation being recaptured and treated as income in the event of a sale of a depreciable asset above depreciated value;

- the elimination of the use of real estate as a tax shelter for non-real estate income by prohibiting real estate losses to be used to offset other income, and
- the deemed realization on death of half the difference between depreciated cost and market value on real estate holdings.

In addition, a 1974 tax change required the capitalization of carrying costs (interest and property taxes) on undeveloped land, rather than allowing these costs to be treated as operating expenses.

The implications of these revisions for housing are quite profound and are generally consistent with other government policies since they substantially reduce the desirability of investment in residential rental property and encourage homeownership.[50]

Incentives for homeownership and the acquisition of higher valued principal residences follow directly from the introduction of a capital gains tax on all gains other than on a principal residence since an investment in a principal residence is the only way to realize a capital gain without tax.

Moreover, in 1975, the federal government further revised the tax regulations to encourage homeownership by allowing a taxpayer with no ownership interest in residential real estate to create a Registered Home Owner Savings Plan (RHOSP). Under this plan a taxpayer can make tax deductible contributions of $1,000 a year to a maximum of $10,000 to a Plan which can be used for the purchase of a home or homefurnishings. These contributions are income tax exempt when used for such purposes. Thus, federal tax changes stimulate the demand for housing by increasing the desirability of housing for investment purposes vis-à-vis other equity investments, and thereby encourage increased house construction. On the other hand, the non-deductibility of carrying costs for undeveloped land discourages developers from advanced land acquisitions and might reduce construction activity by increasing uncertainties and interfering with long range planning.

The tax disincentives for investment in rental properties come from the elimination of real estate as a tax shelter,[51]

the deemed realization on death of half the gain on real estate investments, the imposition of the capital gains tax, and the recapture and treatment as income of accumulated depreciation upon the disposition of a property. These changes significantly reduce the after tax yield for investment in residential properties, reduce the desirability of real estate investment for estate planning, and reduce the liquidity of real estate investment by taxing capital gains and accumulated depreciation on the sale of an asset.

The introduction of the capital gains tax, while reducing the desirability of residential rental investment, had a smaller effect than might be imagined because all equity investments were similarly affected.[52] On the other hand, the elimination of the tax shelter and tax on recaptured depreciation was highly significant since it substantially reduced the relative attractiveness of real estate investments compared to other equity investments. The elimination of the tax shelter was felt to be so important that in December, 1974, when private multiple dwelling starts had fallen to 56% of their 1969 level while private single dwelling starts had risen by 45%, the federal government temporarily reversed its position and reallowed losses on new rental housing for which construction was started prior to the end of 1975 to be applied against other income. In late 1975, after a year of operation, the federal government extended this write-off provision for another year to the end of 1976. Nevertheless, despite this temporary reversal of policy it is clear that the tax revisions have substantially discouraged private investment in residential rental dwellings by reducing its liquidity and after-tax return absolutely and relative to all other forms of equity (except other investment real estate) and debt investments. In fact, in contrast to this, the desirability of debt investments has been increased by allowing a $1,000 of interest income to be treated as non-taxable income each year.

An interesting secondary implication of these tax changes is their tendency to increase the concentration of the ownership of residential investment property in the hands of a few large corporations. This occurs because the tax changes systematically work against small private investors by reducing the estate planning features of real

estate, the tax shelter aspect of real estate and the liquidity of real estate through changes in the recapture provisions. Since these features of real estate investment are much less important to large corporate investors, the small private investor is increasingly forced out of the market and the concentration of ownership is increased.

Thus, tax revision encouraged individual homeownership but substantially discouraged investment in residential rental properties, especially by the small private investor.

ii. Ontario Land Speculation Tax

The Ontario Land Speculation Tax and Land Transfer Tax were introduced in April, 1974 by a majority Conservative government in response to a sharp rise in the price of dwellings in Ontario. The purpose of these taxes was to restrain the rise in the price of housing services by stemming speculation in land and residential properties, and by discouraging foreign investment in Ontario real estate.

The Ontario Land Speculation Tax[53] imposes a 20% provincial tax which is non-deductible for federal income or capital gains tax purposes on all gains made on the disposition of real estate situated in Ontario except for gains made on the disposition of a principal residence or vacation property, a developed non-residential commercial or industrial property, a residential investment property owned for over 10 years, or a property substantially improved by building a new structure or renovating an existing structure. Since short term gains in real estate are usually treated as income in Canada, the combined speculation tax and income tax applicable for a gain in real estate is likely to exceed 70% and may reach 86% of the gain. The significant features of the tax for our purpose are, *(a)* that it applies to residential investment property (i.e. rental property) held for less than 10 years (although it does not apply to developed commercial or industrial property), and, *(b)* that principal residences are exempt. The rationale for the different treatment of residential and non-residential investment property is obscure, but probably is another manifestation of the belief that housing is special or different than other goods and investments.

Although the Speculation Tax considerably reduces the

volume of transactions that are subject to the tax, the economic effects are quite different than its framers envisioned.[54] One of the major impacts of the tax was to reduce the desirability of investments in residential property by reducing the after-tax return on, and liquidity of, these investments both absolutely and relative to alternative investments, including other forms of real estate. After-tax returns are significantly reduced by the 20% non-deductible tax unless the property is held for a substantial period of time. Liquidity is reduced by the tax disincentives for holding for less than ten years[55] and by the elimination of short-term investors and speculators from the market. Consequently, the tax reduces the availability of private funds for residential investment. This lowers the capital value of these investments and reduces the volume of new private residential rental construction, thereby creating upward pressure on rents in the absence of rent control, and increased shortages under rent control.

Another major impact of the tax was to discourage speculative holdings of single family residences because the tax associated with any gain was increased by approximately 35%. This initially lowered the price of houses as speculators and short-term investors attempted to sell their existing holdings and new speculative purchases were reduced. However, this price effect was short-lived as speculative holdings were a relatively small proportion of the total housing stock and the demand for ownership was increased by fears of rising rents and the encouragement the tax provided for homeownership by exempting gains on a principal residence from the tax. A comparison of changes in housing prices in Ontario and the rest of Canada suggests that after one year the tax had deflated housing prices in Ontario by approximately 2.5%.[56] On the other hand, the tax significantly reduced the liquidity of these homes. As Table 6 indicates, the monthly "multiple sales to listings ratio" in Ontario was 56% lower during the year immediately following the tax than the year immediately preceding it. Consequently, the reduction in the price of houses in Ontario corresponded to a reduction in one of the attributes of a house, namely its saleability.

TABLE 6

MULTIPLE LISTING SERVICE SALES TO LISTINGS RATIO FOR RESIDENTIAL PROPERTIES IN TORONTO BY QUARTERS

1973	I	.53
	II	.49
	III	.39
	IV	.45
1974	I	.69
	II	.23
	III	.20
	IV	.26
1975	I	.24

*Land Speculation Tax Act introduced on April 9, 1974.

Source: Toronto Real Estate Board

Finally, probably the most important implication of the tax is its tendency to increase the degree of concentration in the construction industry and in the ownership of residential investment property. Concentration is encouraged by reducing the liquidity of these investments, by taxing gains on the disposition of real estate directly but not gains on the disposition of non-controlling shares in real estate corporations, and by exempting certain gains on real estate if combined with development activities. These factors all discourage small investors and developers much more than large scale investors and developers who require less liquidity from each investment and who have sufficient resources to undertake the full development process. Consequently, small participants are forced out of the field, increasing concentration in the construction industry and in the ownership of residential investment property.

Thus, although the tax sought to restrain increases in the price of housing services, its main impacts have been to discourage private investment in residential real estate and to increase the degree of concentration in what private sector participation remains.

iii. Ontario Land Transfer Tax

The Ontario Land Transfer Tax[57] imposes a 20% land transfer tax upon the acquisition of any property located in Ontario by non-residents of Canada unless a special exemption is granted. The primary purpose of this tax was nationalistic, to preserve the ownership of Ontario lands for Canadians, but the secondary purpose was to reduce real estate prices by reducing demand.[58]

There is little doubt that the tax reduced upward pressure on real estate prices in those sectors that were major recipients of foreign capital, but it is not clear that this reduced the price of housing services. Since very little demand for principal residences was foreign, little price advantage was gained here. However, foreign investors supplied significant amounts of capital for residential investment properties. The reduction of this demand and subsequent decline in the capital value of these investments reduced the volume of private sector participation in the construction and ownership of residential rental properties, and exerted upward pressure on rents.

Moreover, in a somewhat unanticipated development, the deterioration in the equity investment climate in Ontario for foreigners, (together with the reduced capital value of residential investment property as a result of the Land Speculation Tax and Land Transfer Tax), reduced the availability of foreign mortgage credit, and further reduced private sector participation in the residential rental market.

iv. Foreign Investment Controls

In November, 1973 the federal government passed the Foreign Investment Review Act (FIRA) which provided for the review of takeovers of existing Canadian businesses and investments by non-residents, and the review of expansion into unrelated activities and investments by non-resident corporations currently operating in Canada. The criterion for acceptance of new foreign investment was the demonstration of significant benefit to Canada, but the primary motivation for the legislation was nationalism.[59]

The extent to which FIRA applies to real estate is unclear, but a proposed foreign takeover of several apartment blocks in Montreal was rejected under the Act.[60] In May, 1975 the government announced that the application of the Act to purchases of rental real estate was being studied, and that pending the outcome transactions involving developed rental real estate were to be considered compatible with the objective of increasing the supply of rental accommodation.[61] Since then there have been no proposals for investment in apartment projects although three proposals with respect to commercial complexes were approved. However, in February, 1976 the federal government announced that it would propose amendments to the Citizenship Act to allow the provinces to prohibit the sale of real estate to non-Canadians. Consequently, while it is likely that most real estate transactions would be approved at the current time, there is a clear indication of future restrictions in this area. Moreover, because of the costs, uncertainties and delays in the review procedure, the Act presently discourages foreign investment in Canadian residential real estate, thereby further constraining private participation in this sector.

The implications of controls on alien landownership vary considerably according to the form of real estate on which the controls are placed.[62] The most significant effects occur for controls on investment properties since the prohibition of foreign investment removes investors who, for investment diversification purposes, are willing to accept a lower return on their investments than Canadians. Controls therefore constrain the capital values of these investments; this reduces the volume of construction activity, reduces the equilibrium stock of these investments and increases rents on the existing stock. On the other hand, controls on the alien ownership of vacation properties, primary residences and agricultural land have few economic consequences other than to constrain the price of these properties since the controls have little effect on the supply of these real estate forms. The Foreign Investment Review Act, to the extent that it applies at all to real estate transactions, applies to the alien ownership of investment real estate. As such, it dis-

courages the most beneficial forms of alien landownership and ignores those forms of ownership with the least economic benefits.

v. Anti-Inflation Act Regulations

The regulations under the Anti-Inflation Act of 1975 introduced a number of controls on Canadian business which had a serious impact on the construction industry.[63] The most significant of these regulations was the limitation of profit margins on land sales to 95% of the average of the five previous years' margins. Although this profit margin limitation was a general limitation imposed on profit margins in many industries, it had particularly severe implications for land development because the long historic cost base used in the development industry meant that the profit margin reduction was being applied on an artificially large base (i.e. on all the increase in land value from the date of acquisition rather than from the recent past). Had such a limitation been maintained it could have led to a reduction in the availability of land for development since the large price reductions might have encouraged developers to withhold land and would have discouraged acquisitions for future development. However, the regulations were modified by allowing the profit margins to be calculated on an adjusted cost base which accrued pre-October 13, 1975 price gains onto the base price. This modification removed the differential impact on the construction industry from the regulations and means that regulations under the Anti-Inflation Act should not be considered to discriminate against residential construction. Nevertheless, the reductions in margins resulting from the regulations and the possibility of even greater reductions prior to the modifications have probably discouraged some advanced land acquisition by developers, and this will ultimately be reflected in reduced construction activity because of the increased uncertainties it introduces in development planning.

3. SUMMARY AND IMPLICATIONS OF POST-1970 POLICIES

The overall thrust of policies affecting housing in Canada and especially in Ontario during the 1970's has clearly been:

- to severely discourage the private rental market or at least the construction for private ownership of non-low income rental housing,
- to replace private rental housing with public or non-profit rental housing for low income households,
- to encourage the demand for homeownership, and
- to use the housing sector to redistribute income toward lower income households.

Much of this follows naturally from the assumption that housing is special and that Canadians have an inherent right to consume housing services which must be protected from the vagaries of the market.

Discouragement of private participation in the residential investment market follows from the disincentives and restrictions placed on the private sector, from direct government ownership of rental dwellings, and from government encouragement of non-market forms of ownership of rental dwellings.

Disincentives for the private sector are provided by:

- federal tax reform primarily through the elimination of real estate as a tax shelter and the removal of the opportunity to postpone the tax on recaptured depreciation,
- by controls on foreign investment which depress capital values and reduce liquidity,
- by the Ontario Land Speculation and Land Transfer Taxes which reduce the liquidity of investment real estate and discriminate against residential investment,
- by municipality opposition, and
- by rent controls and revisions to the Landlord and Tenant Acts.

It should be noted that many of these disincentives not only discourage new investment in housing but, even more important, encourage disinvestment or deterioration in the existing housing stock.

Direct government involvement in the provision of rental accommodation occurs primarily in the forms of public housing, assisted rental housing, non-profit housing and limited dividend housing.

Incentives for homeownership are provided in a variety of ways. The exemption of gains arising from the sale of a principal residence under both the capital gains tax and the Ontario Land Speculation Tax encourages the investment aspect of homeownership. The direct subsidization of homeownership via the provision of large, low interest loans, the subsidization of interest payments on private mortgage loans, the granting of land leases, the provision of outright cash grants, and the generally lower assessments on owner-occupancy type dwellings assist homeownership by increasing the affordability of homes.

On the other hand, one of the side effects of these incentives has been an increase in housing prices since demand is increased without corresponding incentives to increase supply. In fact, government planning and approval policy, zoning regulations and servicing policy tend to restrict current supply, while tax changes with respect to the non-deductibility of land carrying costs and Anti-Inflation Board regulations tend to restrict future supply by discouraging future development.

Income redistribution toward lower income Canadians is implicit in most housing policies. The redistribution follows from tax reform and the introduction of new taxes on gains in the housing sector, from the payment of cash grants and interest subsidies to middle and lower income home purchasers, and from the provision of low cost accommodations and rent subsidies to low income tenants.

An indication of the impact of these policies on housing starts can be seen from changes in the composition of housing starts in 1975 even though the effects of rent control, foreign investment control and the Ontario Land Speculation and Transfer Taxes are not fully reflected.

In 1975 private multiple starts were only 50,238 units or 21.7% of all housing starts compared to an average of approximately 76,000 units or 43.6% of all housing starts in 1965-69; and total multiple starts were only 70,361 units or

30.4% of all starts compared to an average of 85,000 units or 48.2% of all starts in 1965-69.[64] This sharp decline in the proportion of private multiple starts is clearly shown in Table 7.

TABLE 7

PRIVATE AND TOTAL APARTMENT STARTS AS A PERCENTAGE OF TOTAL HOUSING STARTS

	Privately Financed Non-Low Income Apartment Starts as a % of Total Housing Starts	Total Apartment Starts as a % of Total Housing Starts
1963	37.3	40.2
1964	41.8	45.3
1965	43.2	46.8
1966	32.0	38.3
1967	36.4	45.2
1968	46.6	52.5
1969	45.9	52.7
1970	30.2	48.2
1971	34.5	45.4
1972	33.4	41.5
1973	32.4	39.6
1974	26.2	33.3
1975	21.7	30.4

Source:

Central Mortgage and Housing Corporation 1975, pp. 9 and 17 and earlier issues. Private apartment starts for 1969 and earlier years were calculated by subtracting 80% of non-single detached publically funded starts from total "apartment and other" starts.

Moreover, the decline in private multiple rental housing starts is even more dramatic since a very high proportion of 1975 multiple starts were condominium units. The exact number is unknown since data are available only for NHA loans approved. However, since over 17,000 NHA condominium loans were approved by private lenders in 1975 and

since there were likely a considerable number of conventionally financed condominium units started, it is reasonable to estimate private multiple rental starts for 1975 at approximately 30,000 units or only 13% of all starts,[65] and total multiple rental starts at approximately 46,000 units or under 20% of all starts in 1975.[66]

In 1975 government-assisted low income starts were 19.3% of all housing starts compared to 6.2% in 1965-69,[67] and 13.7% of all housing starts were subsidized under the Assisted Home Ownership Programme.[68] Thus, 33% of all housing starts in 1975 were government assisted low income starts or subsidized AHOP starts. In addition to the interest subsidies implicit in these programmes, over $170 million in federal, provincial and municipal subsidies were paid in 1975 for the operation of existing rental and public housing, i.e. excluding interest subsidies on the capital cost of the housing stock.[69]

The nature of the Canadian housing market has thus changed dramatically in the last few years in response to government policies. Most of these policy changes are the result of a substantial philosophical shift with respect to housing and not the result of a market failure. Consequently, they are likely to be quite harmful to our standard of housing. Unless governments soon recognize the implications of their policies and move to reverse the destruction of the private sector, the story of housing during the next decade will be quite different than the previous few decades. Canadian housing standards will markedly decline and the public cost of housing programmes will rise substantially.

NOTES AND REFERENCES

Notes

Earlier versions of this paper appear in *Public Sector Impacts on Housing and Real Estate: Issues and Problems,* F. Case, editor (Housing, Real Estate and Land Studies Program, Graduate School of Management, University of California, Los Angeles, 1977) and in *Recent Perspectives in Urban Land Economics: Essays in Honour of R.V. Radcliff and P.F. Wendt,* M.A. Goldberg, editor (Faculty of Commerce and Business Administration, University of British Columbia, Vancouver, 1976).

[1]Task Force on Housing and Urban Development *Report* 1969, p. 6.

[2]L.B. Smith 1971, p. 23.

[3]Honourable Ron Basford, *Hansard,* January 11, 1973, p. 186, quoted in the Ontario Economic Council, 1976, p. 5.

[4]Ontario Ministry of Housing, 1974, p. 1, quoted in Ontario Economic Council 1976, p. 5.

[5]For a detailed discussion of these policies see Central Mortgage and Housing Corporation 1962; M. Dennis and S. Fish, 1972; Economic Council of Canada, 1974b; J.V. Poapst, 1962; Report of the Royal Commission on Banking and Finance, 1964; Task Force on Housing and Urban Development 1969; and L.B. Smith, 1968, 1971 and 1974a.

[6]Since the major provincial and municipal programmes receive federal finance most of these programmes are reflected in the federal figures.

[7]Central Mortgage and Housing Corporation 1975, p. 14.

[8]*ibid.,* p. 51.

[9]*ibid.,* p. 60.

[10]There were, however, exceptions such as the exemption of building materials from the sales tax prior to 1966.

[11]For a discussion of the implications of monetary policy for housing, see J. Guttentag, 1961; L. Grebler and S. Maisel, 1963; R. Fair, 1972; and L.B. Smith, 1969 and 1974a.

[12]It is interesting to note that historically federal housing policies were motivated as much by general macroeconomic considerations as by specific housing objectives. See Central Mortgage and Housing Corporation 1962 p. 8; and L.B. Smith 1974a, pp. 140-53.

[13]Other institutions preferred conventional mortgages because they usually had a 5 or 10 year term which allowed these institutions to better match the maturity terms of their assets and liabilities.

[14]For a fuller discussion of specific aspects of this programme see Central Mortgage and Housing Corporation, 1962; J. Gillies, 1953; J.V. Poapst, 1956 and 1962, pp. 171-78; L.B. Smith, 1971, pp. 70-80, 1974a, pp. 140-49 and 1974b.

[15]An inadequate private supply of mortgage credit, however, led CMHC to become a direct supplier in 1957, as is discussed below.

[16]For a discussion of the implications of the interest rate ceiling and the elimination of the ceiling on NHA mortgages see L.B. Smith 1967b and 1977.

[17]For a discussion of financial institution mortgage lending behaviour in Canada see L.B. Smith 1967a; L.B. Smith and G.R. Sparks 1970 and 1973; and J.V. Poapst, 1975.

[18]For a discussion of specific aspects of this programme see L.B. Smith, 1971 pp. 78-80 and 1974a, pp. 149-51; and H. Johnson and J. Winder, 1964 p. 273.

[19]For an elaboration of this view see J.V. Poapst 1962 p. 100; Central Mortgage and Housing Corporation 1962, p. 4; and the Royal Commission on Banking and Finance, 1964, p. 273.

[20]L.B. Smith 1974a pp. 143-151.

[21]During the period 1957-68 just over 14% of CMHC direct lending was for low income housing.

[22]Some attempts were also made to upgrade the existing stock by extending the NHA programme to the purchase of existing homes and loans for home improvements, but these programmes were not heavily used.

[23]Included here were changes in the Bank Act that allowed and widened chartered bank participation in the mortgage market.

[24]Task Force on Housing and Urban Development 1969 p. 6; M. Walker 1975 pp. 3-36; and Economic Council of Canada 1974a, pp. 73-88, and Central Mortgage and Housing Corporation, 1975 p. 87.

[25]M. Walker, 1975 pp. 29-32.

[26]Central Mortgage and Housing Corporation 1975, p. 14.

[27]*ibid.*, p. 60.

[28]*ibid.*, p. 80.

[29]For a statement of this position see M. Dennis and S. Fish, 1972, especially pp. 1-27.

[30]Central Mortgage and Housing Corporation 1975, pp. 14, 45-54.

[31]A summary of these programmes can be found in the Ontario Ministry of Housing, 1974, pp. 5-24, and 1975. For a discussion of some of the implications see Ontario Economic Council 1976, pp. 15-38. The assisted rental housing programme is also discussed under the mortgage subsidies heading in section ii, b.

[32]Ontario Economic Council, 1976 p. 19. This programme was in existence for a long time but was used quite sparingly until 1967. In 1970 it became very actively used.

[33]Central Mortgage and Housing Corporation 1975, pp. xx, 51.

[34]Ontario Economic Council, 1976, p. 20.

[35]The latter number assumes all low income rental starts were non-single-detached starts.

[36]Calculated as the difference in the NHA interest rate on approved lender rental loans and the applicable lending rate for each programme for finance associated with housing started in 1975. Calculations from Central Mortgage and Housing Corporation 1975, pp. 45-55, 67.

[37]*ibid.*, p. 60.

[38]A summary of these programmes may be found in the Ontario Ministry of Housing 1974, and 1975. Some of their implications are discussed in Ontario Economic Council 1976, pp. 15-38.

[39]A $1000 was rebated in the year of the purchase and $250 was rebated in each of the next two years if the purchaser still owned the home.

[40]The rebates programmes also probably shifted demand away from the rental sector.

[41]Ontario Economic Council, 1976, p. 27.

[42]Central Mortgage and Housing Corporation 1975, pp. 51, 55 and 60.

[43]Ontario Economic Council, 1976, p. 25.

[44]Government of Canada, 1975.

[45]Government of Ontario, 1975a.

[46]In a period of unexpected inflation this includes all landlords who offer longer than monthly leases.

[47]Gunnar Myrdal, one of the architects of the Swedish welfare state, stated "rent control has in certain western countries constituted, maybe, the worst example of poor planning by governments lacking courage and vision." Quoted in S. Rydenfelt "The Rise and Fall of Swedish Rent Control" in F.A. Hayek et al., 1975, pp. 163-187. For a discussion of the impact of rent controls in six western countries see F.A. Hayek, et al. 1975.

[48]See J.G. Cragg 1974 and S.W. Hamilton and D. Baxter 1975.

[49]Government of Ontario, 1975b.

[50]For a more detailed discussion of the implications of many of the revisions see L.B. Smith 1970, pp. 374-83.

[51]The revisions eliminated real estate as a shelter for all non-rental income but allowed losses to be applied against other rental income.

[52]However, it discouraged equity investment vis-à-vis investment in debt instruments because a higher proportion of the total yield on equities is in the form of capital gain as opposed to rental, dividend or interest income.

[53]Government of Ontario, 1975d.

[54]For a detailed discussion of the implications of the Land Speculation Tax see L.B. Smith, 1976a, pp. 1-12.

[55]The tax decreases as the holding period increases between three and tens years for apartments.

[56]L.B. Smith 1976a, p. 6.

[57]Government of Ontario, 1975c.

[58]For a discussion of this tax see R.S. Smith 1975, pp. 410-21.

[59]For a discussion of foreign investment controls see S. McFadyen, 1976, pp. 65-77 and R. Hobart and S. McFadyen, 1976.

[60]R. Hobart and S. McFadyen, 1976, p. 11.

[61]*ibid.*, p. 9.

[62]This analysis ignores the effects of controls on the balance of payments and the exchange rate. For a discussion of these effects see L.B. Smith 1976c.

[63]Government of Canada, Anti-Inflation Board, 1975.

[64]Calculated from Central Mortgage and Housing Corporation 1975, pp. 1, 17.

[65]Figures are only available for NHA financed condominium units approved. Since all 1975 approvals were unlikely to generate starts in 1975 NHA financed condominium units started are likely to be less than 17,351. However, since there were also likely to be a considerable number of conventionally financed condominium units started, the estimate of 30,000 multiple rental starts is probably reasonable. Central Mortgage and Housing Corporation 1975, p. 62.

[66]CMHC condominium loans were 4,323 units in 1975. *ibid.*, p. 62.

[67]*ibid.*, p. 14.

[68]*ibid.*, p. 51.

[69]*ibid.*, p. 60.

References

Central Mortgage and Housing Corporation, *Submission to the Royal Commission on Banking and Finance* (Ottawa, 1962).

____________________________________, *Canadian Housing Statistics, 1975* (Ottawa, 1975).

Cragg, J.G., *Rent Control Report* (Province of British Columbia, 1974).

Dennis, M. and S. Fish, *Programmes in Search of a Policy: Low Income Housing in Canada* (Toronto: Hakkert, 1972).

Economic Council of Canada *Eleventh Annual Review: Economic Targets and Social Indicators* (Ottawa: Queen's Printer, 1974a).

Economic Council of Canada, *Toward More Stable Growth in Construction* (Ottawa: Queen's Printer, 1974b).

Fair, R., "Disequilibrium in Housing Models," *Journal of Finance,* 27, (May, 1972), pp. 207-21.

Gillies, J. "Some Financial Aspects of the Canadian Government Housing Programme: A History and Prospective Developments," *Journal of Finance,* 8, (March, 1953), pp. 22-33.

Government of Canada, *Attack on Inflation: A Programme of National Action,* a policy statement by the Minister of Finance, October 14, 1975 (Ottawa: Queen's Printer, 1975).

Government of Canada, Anti-Inflation Board, *Anti-Inflation Act Regulations,* 1975.

Government of Ontario, "An Act to provide for the Review of Rents in respect of Residential Premises", Bill 20, 1st Session, 30th Legislature (Toronto: Queen's Printer for Ontario, 1975a).

Government of Ontario, "Extracts from the Landlord and Tenant Act" Section 1 and Part IV, December 1975 (Toronto: Queen's Printer for Ontario, 1975b).

Government of Ontario, "The Land Transfer Tax Act, 1974" in Statutes of Ontario 1974, Chapter 8 as amended by 1974 Chapter 16 (Toronto: Queen's Printer for Ontario, 1975c).

Government of Ontario, "The Land Speculation Tax Act, 1974," in Statutes of Ontario 1974, Chapter 17 as amended by 1974 Chapter 107 and 1974 Chapter 121 (Toronto: Queen's Printer for Ontario, 1975d).

Grebler, L. and S. Maisel, "Determinants of Residential Construction: A Review of Present Knowledge," in *Impacts of Monetary Policy,* Research Studies prepared for the Commission on Money and Credit (Englewood Cliffs, New Jersey: Prentice Hall, 1963), pp. 476-620.

Guttentag, J., "The Short Cycle in Residential Construction," *American Economic Review,* 51, (June, 1961), pp. 275-98.

Hamilton, S.W. and D. Baxter, *Landlords and Tenants in Danger: Rent Control in Canada* (Winnipeg: Appraisal Institute of Canada, 1975).

Hayek, F.A. et al., *Rent Control: A Popular Paradox*, (Vancouver: The Fraser Institute, 1975).

Hobart, R. and S. McFadyen, "Foreign Investment Controls and Real Estate" (Ottawa: Ministry of State for Urban Affairs, 1976) mimeographed.

Johnson, H.G. and J. Winder, *Lags in the Effects of Monetary Policy in Canada*, a working paper prepared for the Royal Commission on Banking and Finance (Ottawa: Queen's Printer, 1962).

McFadyen, S., "The Control of Foreign Ownership of Canadian Real Estate" *Canadian Public Policy*, II:I (Winter, 1976), pp. 65-77.

Ontario Economic Council, *Housing: Issues and Alternatives: 1976*, (Toronto: Queen's Printer for Ontario, 1976).

Ontario Ministry of Housing, *Housing Ontario/74: An Initial Statement of Policies, Programmes and Partnerships* (Toronto: Queen's Printer for Ontario, 1974).

Ontario Ministry of Housing, *Housing Programmes in Ontario* (Toronto: Queen's Printer for Ontario, 1975).

Poapst, J.V., "National Housing Act, 1954," *Canadian Journal of Economics and Political Science*, XXII, (May, 1956), pp. 234-42.

__________, *The Residential Mortgage Market*, a Working Paper prepared for the Royal Commission on Banking and Finance (Ottawa: Queen's Printer, 1962).

__________, (editor), *Developing the Residential Mortgage Market*, Vol. I (Ottawa: Central Mortgage and Housing Corporation, 1975).

Royal Commission on Banking and Finance, *Report* (Ottawa: Queen's Printer, 1964).

Rydenfelt, S., "The Rise and Fall of Swedish Rent Control," in *Rent Control: A Popular Paradox*, F.A. Hayek et al., (Vancouver: The Fraser Institute, 1975), pp. 163-87.

Smith, L.B., "Financial Intermediary Lending Behaviour in the Postwar Canadian Mortgage Market," *Quarterly Journal of Economics*, 81, (August, 1967a), pp. 493-514.

__________, "On the Economic Implications of the Yield Ceiling on Government Insured Mortgages," *Canadian Journal of Economics and Political Science*, 33, (August, 1967b), pp. 420-31.

__________, "Postwar Canadian Housing Policy in Theory and Practice," *Land Economics*, 44, (August, 1968), pp. 339-50.

__________, "A Model of the Canadian Housing and Mortgage Markets," *Journal of Political Economy*, 77, (October, 1969), pp. 795-816.

__________, "Effects of the White Paper on the Demand for and Price of Real Estate" in the *Report of the 1970 Conference on the White Paper Proposals for Tax Reform*. Canadian Tax Foundation, 1970, pp. 374-83.

__________, *Housing in Canada: Market Structure and Policy Performance,* research monograph #2, *Urban Canada Problems and Prospects* (Ottawa: Central Mortgage and Housing Corporation, 1971).

__________, *The Postwar Canadian Housing and Residential Mortgage Markets and the Role of Government* (Toronto: University of Toronto Press, 1974a).

__________, "Housing Policy in Postwar Canada," in *Urban and Social Economics in Market and Planned Economies,* Vol. 2, A.A. Brown, J.A. Licari and E. Neuberger (editors), (New York: Praeger, 1974b), pp. 31-51.

__________, "The Ontario Land Speculation Tax: An Analysis of an Unearned Increment Land Tax," *Land Economics,* 52, (February, 1976a), pp. 1-12.

__________, "An Analysis of the Effects of the Removal of the Yield Ceiling on Federally Insured Mortgages in Canada," *Journal of Finance,* 1977, forthcoming.

__________, "Economic Implications of Restricting Alien Landownership," *The Financial Post,* October 9, 1976c, p. P-10.

Smith, L.B. and G.R. Sparks, "The Interest Sensitivity of Canadian Mortgage Flows," *Canadian Journal of Economics,* 3, (August, 1970), pp. 407-21.

____________________, *Institutional Mortgage Lending in Canada 1954-1968: An Econometric Analysis,* Bank of Canada Staff Research Study #9, Ottawa, 1973.

Smith, R.S., "The 1974 Ontario Land Transfer Tax: An Economic Evaluation" in the *Report of the 1974 Conference of the Canadian Tax Foundation* (Toronto: Canadian Tax Foundation, 1975), pp. 410-21.

Task Force on Housing and Urban Development, *Report* (Ottawa: Queen's Printer, 1969).

Walker, M., "What are the Facts?" in *Rent Control: A Popular Paradox,* F.A. Hayek, et al., (Vancouver: The Fraser Institute, 1975), pp. 3-36.