Financialization of Housing in Canada: Finding the Leverage for Change

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About Anhart Community Housing Society

Anhart Community Housing Society and its affiliates have fostered a decentralized network of interdependent non-profit housing and social employment initiatives in Canada, as well as a sustainable villages program in Sub-Saharan Africa. Anhart has recently expanded its operations in British Columbia and has incorporated non-profit affordable housing entities in all ten provinces and three territories.

Anhart's goal is to directly assist in the development of 20,000 affordable homes from coast to coast to coast through partnerships with municipalities, local housing non-profits, market developers, and senior levels of government. Anhart will utilize impact investment financing models combined with federal affordable housing loans and provincial grants.

Anhart co-authored a 2005 research initiative entitled "A Sociological Modeling of Emergence" which was funded by CMHC (Canada Mortgage and Housing Corporation). The study performed a longitudinal survey of 140 individuals at risk of homelessness in Vancouver. The research established a gold standard of best practices for privately owned rooming houses and found that tenants experienced a reduction in addiction and mental illness rates through the implementation of these best practices.

Summary

The brief explores the financialization of housing in Canada and its consequences, including increased costs, reduced availability, and inequality. It discusses how CMHC, originally established to promote affordable housing, now unintentionally contributes to the financialization of housing by increasing speculation capacity.

Effective intervention in the Canadian housing system is possible with an understanding of complex adaptive systems and non-linear leverage strategies. The brief highlights the role of alternative communities and small world networks in promoting localized affordable housing.

The Transformation of Housing: The Rise of Financialization

In the earliest years of Canada's economic development, the invisible hand of a deregulated market system harmonized supply and demand and made housing accessible to most Canadians. However, as houses increased in size, quality, and value, many Canadians required financing to own a home.

When banking became more sophisticated in the early 1900s, lenders were willing to open themselves to higher-risk loans. In the 1920s, Canadian citizens could borrow to buy commodities, including automobiles, housing, and stocks. In that decade, margin stocks could be purchased in North America with as little as a 10% down payment while borrowing for housing in that same period required the purchaser to put up 30 - 50% of the cost.

One hundred years later, an inversion has occurred. Now, margin stocks may require a 50% deposit, and some housing can be financed for 5% down. Housing speculation and increased access to financing, is an analogue to the stock market developments just before the crash of 1929.

In the late 1970s, a change in the housing market system occurred when Lewis Ranieri introduced the concept of mortgage bonds. He bundled individual mortgages into tradable securities known as mortgage-backed securities (MBS), enabling investors to capitalize mortgage payments. Ranieri's innovation allowed banks to transfer mortgage risk, stimulating lending and unlocking capital. The MBS invention changed the perception of housing in the financial system, shifting its value from an intrinsically recognized necessity of life to an income generator that produced profits from mortgage payments. Homes therefore became attractive to corporate structures looking for tradable assets.

Negative outcomes from the financialization of the housing market are evident in how real estate investment trusts (REITs) purchase existing multi-unit and single-family housing, creating high rent structures that increase shareholder profits.

Another form of financialization can be seen in the gentrification that occurs in Canadian inner cities, driven by the affluent returning to urban areas. This trend has encouraged speculative acquisition of housing as an investment opportunity which displaces low-income individuals who endured substandard inner-city housing during its decay phase from the 1950s to the 1990s.

CMHC: From National Housing Act to Financialization Challenges

The Canadian government created CMHC as an essential component of the National Housing Act, which was passed in 1944. The act promoted the development and improvement of Canadian housing and CMHC was given the responsibility of facilitating financing, construction, and maintenance of housing projects.

In the 1980s and 1990s Canada began to favor supply-side economic policies and reduced government spending on social programs. CMHC's "Social Housing Framework" was introduced in 1998 and altered its role from being a provider of social housing to that of collaborator with other levels of government, non-profits, and the private sector to facilitate affordable housing.

CMHC is one of Canada's largest crown corporations with $300 billion in assets and $3 billion in consolidated net annual income. CMHC performs four functions: mortgage loan insurance, affordable housing assistance, housing market analysis and research, and housing policy development and implementation.[1] CMHC is profitable, in part, because it has a 35% share in Canada's mortgage loan insurance market,[2] and earns income through mortgage-backed securities, capital market activities, and its affordable housing programs.

Affordable housing resources at CMHC are primarily focused on the Rental Construction Financing Initiative (RCFI). CMHC reports loans and expenditures for RCFI of $25.8 billion since its inception in 2017.[3] Some Canadians argue that RCFI is not aligned with the goals of the National Housing Initiative[4] and focuses on the supply-side aspects of the rental housing stock with limited affordability.

The current state of housing financialization in Canada is caused by a combination of factors, including a long-standing continuation of a deregulated market system, liberalization of lending that allows corporate and private housing speculation, the creation of mortgage-based investment tools that accelerate financialization in housing markets, and government policy that has not found a balance between supply and demand in the housing market. These factors have shifted Canada's housing system away from providing homes as a social good with intrinsic value to all Canadians, to becoming a profit-generating market instrument.

CMHC role in the financialization of housing is unintentional, but it contributes to the current housing shortages by increasing the borrowing power of Canadian homeowners and emphasizing housing supply over housing assistance. This expands the capacity of profit-focused lenders, developers and investors, further fueling speculation in an amplifying feedback loop.

Chaos to Order: Leveraging Alternative Communities

The analysis of complex adaptive systems, also known as complexity, observes how an ordered whole is created through the behavior of individual agents in a system. Canada's market housing system is governed by agent-based properties that follow simple rules and adapt at the micro level to create order. Complexity utilizes random interactions, feedback loops and pattern recognition to form an organized whole that cannot be derived solely from an examination of isolated parts.

The least effective leverage for system change focuses on numbers, stocks, flows and delays in the system. Intermediate leverage effectiveness is found in an analysis of system feedback and the rules of the system. The greatest system change occurs when the goals of the system are changed.[5]

The primary agents at play in the Canadian housing system are governments, non-profit housing organizations, financial institutions, investors, private developers and builders, homeowners (65% of Canadians), market renters (32% of Canadians), and institutional housing recipients or homeless persons (3% of Canadians). The agents benefiting from the financialization of housing are financial institutions, developers, builders, high-income investors, and property owners who are realizing increases in valuations. The agents being hurt by the financialization of housing are homeless persons and renters, including many indigenous persons, seniors, persons with disabilities, low-income wage earners, most new Canadians, and those in need of social housing.

The majority of the voter base, housing-focused corporations, and the government itself, are benefiting from the financialization of housing through high property values and an enriched tax base. Non-profits and theorists unintentionally benefit from financialization by creating dependency on solution services. If runaway market forces are not stopped, the market housing system will further break-down and a tipping point will make chaos the normative state of the housing system.

Random agent interactions and feedback from group selection of solution-based patterns can inform rule changes in the housing system to reverse financialization. Václav Havel, a Czechoslovakian playwright who was jailed under Communist rule but later became the first president of his country after the fall of the Soviet Union, was a non-Canadian recipient of the Order of Canada. Havel emphasized the benefits of alternative communities as a viral breeding ground for naturally energized complex systems and agent-based solutions.[6] In Canada, alternative communities are connected to individuals with the greatest housing needs, forming a network throughout the entire country in a system of hubs and nodes. These communities can be amplified to produce cost-effective affordable housing.

Recommendation # 1

Anhart recommends that CMHC gather and distribute knowledge of complex adaptive systems through an open-invitation series of online information sessions. These sessions will connect experts in complexity and agents in the housing systems who will learn how innovations can arise from system dynamics. By recognizing its role as an aggregate agent in the housing system, CMHC will be able to gather macro signal data from the random interactions of micro agents in the housing system. The leveraging of the properties of group selection inherent in Canada's housing system will help CMHC to choose system patterns that reduce financialization and benefit all participants.

Recommendation # 2

Anhart recommends that the Canadian government, based on the results of groups selection processes, modify the rules of CMHC underwriting procedures. This modification would enable the non-financialized creation of through partnership between indigenous groups, non-profits, credit unions, community-minded developers and builders, and impact investors. These partnerships would aim to balance the demand signals from alternative communities and Canadians who currently lack access to affordable housing, with the supply services of lenders, investors, and developers.

References

[1] **CMHC Annual Report 2022**
[2] **Canadian Mortgage Trends: March 2022**
[3] **CMHC Annual Report 2022**
[4] **Steve Pomeroy: Toward Evidence Based Policy: Assessing the Rental Construction Finance Initiative**
[5] **Donella Meadows: Leverage Points: Places to Intervene in a System**
[6] **The New Yorker: Václav Havel's Lessons on How to Create a Parallel Polis**

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