Brief for OSFI on risk management guidelines for home ownership assistance models and shared-appreciation mortgage products.

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For the

Canadian Home Builders' Association (CHBA)

June 2018

Executive Summary

This brief examines the experience of assisted ownership programs and the potential impact of recent macro-prudential regulation, most notable the B20 guideline issued by the Office of the Superintendent of Financial Institutions (OSFI).

The issue at hand is the ambiguity created in the OSFI guideline that uses a footnote to exempt publicly funded assistance programs, but is silent on related programs that operate without public funding support. This adds uncertainly for lenders working in partnership with these programs.

This puts the programs and their development and “lending” activity at risk, and creates uncertainty that their borrowers will be able to secure first mortgage financing if a federally regulated financial institution (FRFI) interprets the B20 guideline as precluding these programs from eligibility for first mortgage financing and adopts a practice of avoidance.

The context

Recent escalation in home prices across many metropolitan regions, but particularly in Vancouver and Toronto has raised concerns that the level of household indebtedness may pose a threat to overall financial stability in Canada’s economy.

In response, federal policy-makers have implemented a number of macro-prudential policy changes with the objective of constraining access to credit and thereby managing risk associated with high levels of household debt (as measured by the household debt-to-income ratio).

Following a period of consultation, OSFI issued two guidelines outlining prudent practice for federally regulated financial institutions (Guideline B20) and for federally regulated mortgage insurance institutions (Guideline B21). These set out sound practices to be adopted by regulated institutions with a view to managing potential risks to the broader financial system as a result of systemic or institutional vulnerability.

Both guidelines identify requirements for financial institutions to establish and follow a comprehensive Residential Mortgage Underwriting Policy (RMUP). This establishes prudent practice and includes key criteria such as mortgage loan parameters (e.g. maximum loan size, loan-to-value “LTV” ratio; and allowable loan term and amortization length).

In both cases (B20 and B21), the requirement to qualify at a higher rate than that actually secured results in a reduction in the maximum amount of the mortgage loan. With a lower loan amount, the payment will decline, and reduce the underlying loan debt to the income ratio. This may however be offset by an increase in downpayment required. Alternatively it may force the buyer to seek a lower priced home (or stall purchase)

Guideline B20 also discussed the form of down payment: With respect to the borrower's down payment for both insured and uninsured mortgages, the guideline directs that "Where non-traditional sources of down payment (e.g., borrowed funds) are being used, further consideration should be given to establishing greater risk mitigation"

This guideline is further expanded in a footnote in B20, expressly exempting affordable ownership loans in cases where the additional secured funding (for down payment) *is provided by a municipal, territorial, provincial or the federal government*. By explicitly identifying contributions from public sources, the exemption implicitly appears to preclude assistance from the funds of non-profit facilitators, such as Options, HOA or Trillium often operating without government subsidy.

It should however be noted that this guideline may not have been intended to preclude loans for affordable ownership, and merely requires that the lender establish greater risk mitigation and/or additional premiums to compensate for increased risk. However the footnote creates ambiguity and has resulted in some federally regulated lenders expressing concern that the non-profits involved in these assistance programs may be in contravention of the guideline.

This brief seeks to explain this problem, show that there are appropriate risk mitigations and practices in place and proposes that OSFI issue an amendment to remove the ambiguity in guideline B20.

In order to develop a better understanding about these non-profit assisted ownership enabling programs, and the risks associated with them, a survey of the main providers was undertaken. This captured information from the six main providers (4 in Ontario, 1 in Calgary and 1 in Quebec).

With the exception of Calgary's Attainable Homes (with a small down payment contribution of $2,000, in the form of a forgivable loan), the review found that there is no cash advanced. In all other cases the sponsor contribution is in the form of a deferred capital receipt, which was based on a differential between a discounted price and market value.

Risk management underwriting criteria used in the programs

For the four providers using primarily FRFIs to finance the first mortgage the underwriting standards of the lender provide sound risk management and comply with OSFI guidelines. The 1st Mortgage lender effectively provides the underwriting screen for the soft second – if a borrower is unable to attain a first mortgage, they are ineligible for the assistance program.

For the two that predominantly work with credit unions (Artscape and Trillium), these credit unions also follow industry norms (with the exception of having to comply with the stress test requirement).

Review of the broader international use of the shared appreciation model

A brief review of experience in other jurisdictions found widespread use and an evolution from a mechanism used to overcome the affordability impact of high mortgage rates to one that increasingly is used as a way to offer price discounted homes and management of speculative risk from flipping such discounted properties.

Leading researchers and analysts in the US have suggested that various forms of participating mortgages can offer a more resilient product and help to mitigate risk.

These mechanisms also make the financial intermediation system more resilient to economic shocks, more efficient and thus more liable to foster economic growth.

Participating mortgages (with shared equity) are also seen as superior to other mechanisms that seek to improve access by lowering initial payments (negative amortization) or interest only loans (no principle reduction) as they enable the purchaser to increase their equity over time.

Conclusion from risk review

This review shows that while there are some risks, such as an unpredictable repayment schedule, default triggered by cross default with the first mortgage, and appreciation risk, the providers all work with federal or provincially-regulated lenders (credit unions) and employ standard underwriting prudential standards. In short they have imposed appropriate risk mitigation measures to manage and mitigate risk.

The review confirms that these assisted ownership intermediaries and their lenders do exercise prudent underwriting and have not adopted any practices of avoidance.

Recommendation

It is recommended that OSFI revise wording in B20 – to amend footnote on page 12 to state that any assisted ownership programs, regardless of any public financial support, but with appropriate risk mitigation measures are exempted from the guideline.

1. Setting the context

Recent escalation in home prices across many metropolitan cities, and an overall increase in the level of household indebtedness has raised concern that this may pose a threat to overall financial stability in Canada's economy. In response, federal policy-makers have implemented a number of macro-prudential policy changes with the objective of constraining access to credit and thereby managing risk associated with high levels of household debt (as measured by the household debt-to-income ratio).

The suggested response to managing risk is to establish stress testing that effectively reduces the number of new loan originations to borrowers with above guideline debt levels (with a debt to income ratio of 450% identified as a key threshold). The implication is that by restricting credit only to households with a larger cushion in event of a challenging economic scenario, potential defaults, price devaluation and economic impacts will be minimized.

Following a period of consultation, OSFI issued two guidelines outlining prudent practice for federally regulated financial institutions (Guideline B20) and for federally regulated mortgage insurance institutions (Guideline B21). These set out sound practices to be adopted by regulated institutions with a view to managing potential risks to the broader financial system as a result of systemic or institutional vulnerability.

Both guidelines identify requirements for financial institutions to establish and follow a comprehensive Residential Mortgage Underwriting Policy (RMUP). This establishes prudent practice and includes key criteria such as mortgage loan parameters (e.g. maximum loan size, loan-to-value "LTV" ratio; and allowable loan term and amortization length). It also covers borrower qualification including undertaking a reasonable inquiry into a borrower's background and demonstrated willingness and capacity to service debt, identify required documentation to validate borrower capacity and establishing minimal down payment.

In addition to requiring adoption of RMUPs, both guidelines recommend stress testing to manage access to credit:

- In the case of insured loans (LTV equal or greater than 80%), this was implemented through guideline B21 in January 2016. The "stress test" requires that a borrower's gross debt service (GDS) ratio (the carrying costs of the home, including mortgage payment, property taxes and heating costs relative to the borrower's income) must be no greater than 39%, *based on the greater of the actual mortgage rate or the Bank of Canada's posted 5-year rate*. In addition, the total debt service (TDS) ratio (the carrying costs of the home plus all other debt payments, relative to the homebuyer's income) must be no greater than 44%.
- The stress test was subsequently adopted under Guideline B20 for uninsured loans (LTV under 80%), financed by Federal Regulated Financial Institutions (FRFIs).

> However B20 added a further risk mitigation measure, by using the greater of *the Bank of Canada's posted 5-year rate or the contracted rate plus 200 bps*. To the extent that rates on conventional loans are already higher than those on insured loans, the 200 bps criteria is more often the constraint on the maximum loan amount.

In both cases, the requirement to qualify at a higher rate than that actually secured results in a reduction in the maximum amount of the mortgage loan. It does not reduce the level of payment, but rather the ratio of the underlying loan debt to the income ratio. The new requirement is intended to ensure that homebuyers have some buffer to be able to continue servicing their debts even in a higher interest rate environment at time of renewal. It also tends to impose a larger amount of collateral as loan security in event of a foreclosure. It does not however protect against a reduction in income (e.g. via job loss or income change).

Guideline B20 also seeks to limit certain forms of down payment: With respect to the borrower's down payment for both insured and uninsured mortgages, the guideline directs that "Where non-traditional sources of down payment (e.g., borrowed funds) are being used, further consideration should be given to establishing greater risk mitigation"

A footnote in the B20 guideline appears to exempt affordable ownership loans in cases where the additional secured funding (for down payment) *is provided by a municipal, territorial, provincial or the federal government*.

But by explicitly identifying contributions from public sources, the exemption appears to preclude assistance from non-profit facilitators, such as Options, HOA or Trillium often operating without government subsidy.

It should be further noted that while this guideline was not intended to preclude loans for affordable ownership, and merely requires that the lender establish greater risk mitigation and/or additional premiums to compensate for increased risk it has created uncertainty. Some lenders have taken an extreme interpretation, and may avoid loans other than to programs with public support. This response would severely constrain the efforts of these non-profit organizations, delivering programs without public funding to enable access to ownership.

So the critical consideration is whether current assisted ownership intermediaries and their lenders do in fact exercise prudent underwriting, or whether they adopt a practice of avoidance.

2. Review of existing SAM models and existing risk management/mitigation features.

A number of non-profit organizations have implemented affordable homeownership programs to facilitate access to ownership to moderate-income households. Their target buyer might be considered marginal buyers because they have limited down payment equity and their moderate incomes limit that capacity to cover mortgage payments especially with home prices rising faster than incomes. In many cases however these potential buyers are spending a similar or higher amount to rent and have proven capacity to manage these costs.

One of the characteristics of current affordable ownership programs, and especially those offered by HOA and Trillium Housing is that while the purchaser has a small down payment (usually 5% and thus a LTV at 95%, which would invoke the B21 guideline (greater of contract rate or BoC posted rate). However, the contribution of equity (but not cash) by the affordable ownership intermediary reduces the LTV ratio to below 80%, (and thus invokes B20).

As noted earlier, a footnote in B20 explicitly exempts publicly assisted (municipal, provincial or federal) programs, but is silent when the provider organization is a non-profit, providing innovative assistance without government funding. This implies that such programs are subject to the guideline.

In order to develop a better understanding about these non-profit assisted ownership enabling programs, and the risks associated with them, a survey of the main providers was undertaken. This captured the following information from the six main providers (4 in Ontario, 1 in Calgary and 1 in Quebec):

- A brief description of how program makes units affordable to purchasers
- The extent to which cash is advanced and investor capital is at risk
- Whose cash (if any) is at risk
- Total active mortgages/default rate
- Any recent change in the percentage of purchasers borrowing with a 1st mortgage over 80 LTV
- Any recent change in the percentage of purchasers with a 1st mortgage under 80% (and thus the group impacted by B20)
- The percentage of purchasers obtaining first mortgage from an OSFI regulated financial institution vs. from a credit union or non - OFSI regulated FI
- Any trend of buyers seeking to access financing via non regulated alternative lenders?
- What risk management underwriting criteria are being used in the programs?

It is noted that two of the sponsoring organizations are subsidiary non-profit corporations of municipalities, and as such would be covered by the exemption footnoted in the OSFI B20 guideline. Three are private non-profit and one is a private developer.

Across the six organizations surveyed more than 8,000 households have been assisted, the majority in Toronto and Montreal. HOA are the longest running commencing in 1998. Since that time they have provided assistance financing to 3,200 households, with just under 600 remaining in place (i.e. 2,600 repaid). The Accès Condos program has been operating for 12 years, and half of these loans have been repaid. The key features of these programs are summarized below.

Affordable Ownership Programs Surveyed		
Municipal Non Profit		Loans
	Attainable Homes Calgary Corporation	704
	Accès Condos, SHDM, Montreal	4,000
Non-Profit		
	Options / Home Ownership Alternatives, Toronto	3,200
	Artscape, Toronto	112
	Trillium Housing, Toronto	n/a
Private (for Profit)		
	Daniels Corp, Toronto	212
	Innovative Residential, Saskatoon	xx
Total		**8,228**

How these programs work

In each of these affordable ownership programs, the non-profit sponsor uses various measures to build or acquire homes at below market value. The sales price of program units are typically discounted, with various forms of shared equity mechanisms designed to offer buyers a lower price and lower payments in exchange for a share of future appreciation.

Such "savings" can include reduced development soft costs, especially elimination of costly marketing and sales activities (which can add 10-15%); forgoing a developer profit; and in some cases, the sponsors non-profits have also been able to negotiate discounted pricing on presales with the development partner. This is beneficial to developer as it accelerates their ability to reach a benchmark of presales necessary to secure construction financing and proceed with construction. In other cases, the program negotiates with private developers to purchase remaining unsold units to assist the developer in closing out their sales program. Some have also received municipal fee waivers, or land at a discounted value.

The result is that the sponsor group gains access to units at discounted prices, with these savings passed onto eligible buyers. The objective is both to improve access to marginal buyers and to perpetuate the benefit of the discounted pricing to facilitate future affordability. The sale at a discounted price could create a risk that a benefiting original purchaser could flip the unit for a profit, however this is precluded through the program mechanisms, so that the discount benefit is recaptured.

To manage both objectives, the sponsoring organizations place a covenant or second mortgage on title placing restrictions on resale and securing a share of future appreciation. These are structured as interest-free deferred loans.

It is important to note that there are no ongoing payments – the "loan" is repaid by capturing a share of the appreciated value upon resale, failure to occupy (i.e. rent unit out) or voluntary payout by the borrower.

In the two largest programs (Accès Condos and HOA) more that half of the loans have been repaid – initially on average within 7-8 years, but more recently within 5 years (coinciding with first mortgage rollover). Proceeds from these repayments are then used to recapitalize an investment fund, which sponsors use to invest in new properties to add additional affordable opportunities to eligible buyers.

The extent to which cash is advanced and investor capital is at risk

With the exception of Calgary's Attainable Homes (with a small down payment contribution of $2,000, in the form of a forgivable loan), there is no cash advanced. In all other cases the sponsor contribution is in the form of a deferred capital receipt, which was based on a differential between a discounted price and market value.

In the event that properties fail to appreciate, or depreciate (as occurred in the Calgary Attainable Homes program) there is no appreciated value to share. Consequently there is a risk that the sponsor foregoes this capital gain, with no recourse on the borrower. But because it was paper equity no investor capital is lost or placed at risk (again with the exception of Calgary where the cash contribution of $2,000 is lost).

The other risk is the timing of repayment, since this is not scheduled and depends on the original owner selling or seeking to refinance. So this is a form of patient investment (albeit with no actual cash expended). In practice sales or refinancing have tended to commence within a few years as households seek to move up in market, relocate or seek to refinance to release accumulated equity. In Montreal, for example, roughly 200 Accès Condo loans have paid out annually and to date after 12 years over 2000, have paid out the loan.

Total active mortgages/default rate

As noted above over 5,000 loans have been issued, and almost half repaid. There have been some defaults, primarily in Montreal and Calgary, which reflect a 2% default rate. This was largely associated with employment and income loss, with default of 1st mortgages triggering default of the soft second mortgages.

Affordable Ownership Programs - Defaults

	Loans	Defaults	Default Rate
Attainable Homes Calgary Corporation	704	11	1.6%
Accès Condos, SHDM, Montreal	4,000	79	2.0%
Options / Home Ownership Alternatives, Toronto	3,200	6	0.2%
Artscape, Toronto	112	0	0.0%
Trillium Housing, Toronto	n/a	n/a	n/a
Daniels Corp, Toronto	212	0	0.0%

Trends in borrower LTV (over/under 80%)

The amount of discounted assistance for three of the providers exceeds 20% of the market price (value) and thus they are below the 80% LTV captured B20 (HOA, Artscape, Trillium); the others are typically above 80% and as high ratio loans accordingly worked with mortgage insurers and their underwriting standards.

The providers report no change in the proportion of buyers above/below 80% LTV following imposition of the guidelines.

Use of OSFI regulated financial institution vs. credit union or non - OFSI regulated

Four of the six providers tend to work with FRFIs, and therefore loans are underwritten following industry norms and follow industry Residential Mortgage Underwriting Policy.

Those with first mortgages above 80% are not permitted by insurers to use non-regulated alternative lenders, and those below also have a practice of working only with FRFIs and Credit Unions.

Trillium and Artscape works extensively with specific credit unions with which they have built a relationship so that the specific credit union is fully briefed and understands the affordable purchase mechanism. Some Artscape buyers have been refinancing with FRFIs.

Risk management underwriting criteria used in the programs

For the four providers using primarily FRFIs to finance the first mortgage the underwriting standards of the lender provide sound risk management and comply with OSFI guidelines. The 1st Mortgage lender effectively provides the underwriting screen for the soft second – if a borrower is unable to attain a first mortgage, they are ineligible for the assistance program.

For the two that predominantly work with credit unions (Artscape and Trillium), these credit unions also follow industry norms (with the exception of having to comply with the stress test requirement).

A number of programs, and in particular the Calgary Attainable homes include pre purchase financial literacy counseling and education, and completion of this program is a mandatory pre-requisite to loan qualification.

The other aspect of risk mitigation, as noted earlier, is the fact that the soft second loans have no payments and therefore reduce the effective borrower DCR and LTV ratio.

Moreover, while the provider is acting as a quasi-lender, in implicitly lending the value of their deferred capital return, there is no cash involved in the loan and no out of pocket loss in rare event of a default (except Attainable Homes where a $2,000 cash contribution is at risk).

Because there is no third party investor capital at risk, there is no formal creation of a risk reserve. However due to repayments on the soft second loans, each organization has built up an investment account, which until redeployed to invest in new developments can act as reserve.

Conclusion from risk review

This review shows that while there as some risks, such as an unpredictable repayment schedule, default triggered by cross default with the first mortgage, and appreciation risk, the providers all work with federal or provincially-regulated lenders (credit unions) and employ standard underwriting prudential standards. In short they have imposed appropriate risk mitigation measures to manage and mitigate risk.

The review confirms that these assisted ownership intermediaries and their lenders do in fact exercise prudent underwriting.

The issue at hand is the ambiguity created in the OSFI guideline that uses a footnote to exempt publicly funded assistance programs, but because it is silent on these programs that operate without public support, adds uncertainly for lenders working in partnership with these programs. This puts the programs and their development and “lending” activity at risk, and creates uncertainty that their borrowers will be able to secure first mortgage financing if a FRFI interprets the B20 guideline as precluding these programs from eligibility for first mortgage financing and **adopts a practice of avoidance**.

3. Brief Review of experience in other jurisdictions

In order to provide further insight a review of literature was conducted to examine the experience with shared appreciation and deed restricted type products in other jurisdictions, and more particularly any risk mitigation features that have been used.

This review focused initially on peer reviewed journal articles. The documentation and critical assessment of such mortgage models is not extensive.

The earliest versions of shared appreciation loans were introduced in the US in the 1980's largely in response to high mortgage rates. In response to high interest rates, these involved a mechanism to lower the contract interest rate, with a share of appreciation used to compensate the lender. For example, rates were reduced from 18% to 12% in exchange for a 25% share of the appreciation on home value.

A variant of a shared appreciation mortgage was also introduced in the UK with two participating institutions, the Bank of Scotland and Barclays. These were effectively a form of equity release (similar to a reverse mortgage), marketed to pensioners. These exchanged a zero interest loan covering 25% of home value for a shared of appreciation set at 75% of the increase in value (Shiller 2000). This has proven to be quite punitive in confiscating much of the equity gain for the homeowner, and has resulted in legal action and suspension this lending product.

The long and unpredictable nature of the payoff period appears to have been the chief reason that the Bank of Scotland withdrew its shared-equity mortgages from the market (Caplin et al 2008).

In the late 1990s, the UK government implemented a new mortgage instrument that could allow the purchaser to pay for their home through a mix of interest and shared equity payments. *Homebuy* involved a government provided shared equity mortgage - funded from public funds - where the eligible purchaser could choose their own dwelling on the market and obtain an interest free equity mortgage on 25 per cent of the value of the dwelling Jackson, 2001; Housing Corporation, 2003).

These earlier variants were of a distinctly different form than the models being used in Canada by HOA and Trillium. Rather than using the shared appreciation mechanism to lower the access price and manage unearned windfall from discounted pricing, these earlier versions were designed to improve access by reducing interest rate and payments, in exchange for a share of appreciation.

Subsequently, following the 2008 financial crisis, participating mortgages were identified as a potentially useful mechanism to restructure underwater loans (Caplin et al 2008, Ebrahim et al. 2011). A lender could reduce the balance to current value and placed a second lien against the property to share appreciation as way to recover reduced principle amount as property values recovered. While the theoretical advantages were identified, there was also limited use of this approach, again related to market acceptance as well as tax liability issues [1] (Alvayay et al 2005; Ebrahim et al. 2011).

Ebrahim et al 2011 suggest that various forms of participating mortgages (PMs) can offer a more resilient product and help to mitigate risk.[2] PMs make the financial intermediation system more resilient to economic shocks, more efficient and thus more liable to foster economic growth. PMs also offer better risk management to lenders in periods of inflation (especially in US due to fixed rate long term loans under which lender bears the interest rate risk). PMs are also seen as superior to other mechanisms that seek to improve access by lowering initial payments (negative amortization) or interest only loans (no principle reduction) as they enable the purchaser to increase their equity over time (Caplin et al 2008, Scanlon et al 2008).

As a version of a PM, SAMs facilitate purchase of owner occupied homes by reducing the impact of the two constraints of down payment and regular debt payments that restrict access to funded homeownership. In contrast to a subprime mortgage, this is accomplished without subjecting the homeowner to high, fixed debt payments.

Caplin et al 2007 further add that prospective owners would prefer PMs to such popular affordability-oriented instruments as interest-only and negatively amortizing mortgages. They also suggest that lenders and financial markets place high value on shares in individual housing returns. A 25 percent shared equity mortgage combined with a regular mortgage for 65 percent of the value of the house provides the first mortgage lender with significant protection and compensation (Caplin et al 2007).

In addition to lender generated products, in the US many jurisdictions have designed and implemented various forms of shared equity assisted ownership programs in order to provide access to ownership to moderate income households (Sherriff, 2010, Temkin 2010). Typically these involve public subsidy (state and local) as well as cost savings in construction as a way to reduce the price to qualified purchasers.

In order to negate flipping and short-term windfall gain, as well as to ensure ongoing benefits to future purchasers these utilize resale price restrictions. This involves repayment of the price discount as well as a share of equity appreciation. In some cases there are requirements to sell back to the sponsoring non-profit who then facilitates a resale to another qualified purchaser, to pass on the initial discount.

US States and localities also have access to tax exempt bond financing mechanisms that enable them to offer below market rate loans, further enhancing affordability. Any mortgage lender who finances a resale price-restricted home must develop policies and

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[1] Ever since issuing an extremely narrow ruling in 1983, the US Treasury has placed SAMs on the no-rulings list. This has made it impossible to get advance rulings on the ownership implications and the tax status of borrowers and lenders using SAMs.

[2] Participating Mortgages includes products like shared appreciation, shared equity and shared income mortgages in which part of the lenders financial compensation is through an equity share of increasing value, rather than solely through a contracted interest rate.

procedures to ensure that the lender's security interest and ability to foreclose on the property are not compromised by the community's affordable housing restrictions.

The sponsoring non-profits manage purchaser selection and qualification and often provide pre and post purchase financial education and counseling to ensure purchasers fully understand their obligations and conditions.

In one of few empirical reviews of shared equity ownership, Temkin et al (2010) conclude that only a very small number of shared equity homeowners lose their home because of foreclosure; and a very high percentage of these low income, first-time homeowners (over 90 percent in the three programs for which data were available) remain homeowners five years after purchasing a shared equity home.

In a number of states, resale price restrictions on shared equity purchasers are implemented in conjunction with a Community Land Trust (CLT), with individual homes leased with a longer-term ground lease A 2011 research report (Thaden 2011) examined delinquencies and foreclosures in CLT shared equity programs and found a substantially lower rate of arrears and delinquencies when compared to conventional fixed rate mortgages reported by the Mortgage Bankers Association's National Delinquency Survey (MBA).[3]

A key factor in this much lower default rate is an active stewardship role for the sponsoring non-profit CLTs. The CLTs provided direct or indirect assistance to promote better outcomes than foreclosure. These include five types of stewardship conducted by CLTs: (1) approval of home financing; (2) pre-purchase and post-purchase education of prospective home buyers; (3) interaction with mortgage lenders; (4) intervention in delinquencies; and (5) intervention in foreclosures. The results shed light on how delinquencies and foreclosures are prevented in CLT assisted homeowners. The sponsoring non-profits are also diligent on underwriting monitoring. A large majority of the CLTs have a contractual right to oversee the financing of their resale-restricted homes: 84% had the right to review and approve first mortgages before purchase.

In the UK, shared equity mechanisms have also evolved. As in the US, they were initially suggested as a way to manage high mortgage rates. More recently, Shared Ownership and Shared Equity products have been implemented to target marginal buyers and provide access to ownership.[4] It is argued that when used to stretch the capacity to buy of marginal purchasers, these may in fact add, rather than manage and mitigate risk

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[3] 1.30% of the mortgage loans held by CLT homeowners were seriously delinquent (defined as loans at least 90 days delinquent or in foreclosure proceedings) at the end of 2010, compared to a delinquency rate of 8.57% of mortgage loans in the conventional market reported by the MBA. Meanwhile, 0.46% of the mortgage loans held by CLT homeowners were in foreclosure proceedings at the end of 2010, compared to a foreclosure rate of 4.63% reported by the MBA among the owners of market-rate homes.

[4] In the UK a unique shared ownership model involves a purchase of a partial share in a home with the residual share held by a non-profit housing association with rent paid of this residual share. Shared equity involves purchase of 100% but with part of the cost financed with an equity mechanism rather than a debt instrument.

(Whitehead 2010). However Whitehead further sets out ways in which shared equity products can be more intentionally designed and can mitigate risk.

The scope for SO/SE products for risk management comes mainly from putting the emphasis on sustainable home-ownership rather than on marginal purchasers and particularly in ensuring that the impact is not simply that consumers buy more housing.

While the objective has been to increase access to owner-occupation, the products, by their nature of substituting equity for debt, have some risk reduction attributes in the context of volatility (Whitehead 2010). Purchasers who use SE hold a traditional mortgage only on the proportion they are purchasing, so the impact of changes in interest rates is smaller. So shared equity loans reduce the risk from interest rate changes by reducing the size of the traditional mortgage.

4. Conclusions

This review of current practice shows that the existing non-publicly funded home ownership assistance programs have evolved to play a small but important part in Canada's housing ecosystem. They help some thousands of modest-income households to attain homeownership, within a framework of managed risk. All work in close collaboration with either federal regulated financial institutions (FRFIs) or provincially regulated credit unions, both of which employ prudent underwriting standards in assessing borrowers for first mortgage loans.

The affordable housing providers, while notionally providing "loans" are doing so without advancing and capital and without placing capital at risk. They are simply deferring a capital receipt into the future, without placing any investor or depositor capital at risk.

Their underwriting is premised on approval by the first mortgage lender and thereby incorporates sound risk management practice, to ensure that high risk borrowers are not approved.

Review of the broader international use of the shared appreciation model reveals widespread use and an evolution from a mechanism used to overcome the affordability impact of high mortgage rates to one that increasingly is used as a way to offer price discounted homes and management of speculative risk from flipping such discounted properties.

Leading researchers and analysts in the US have suggested that various forms of participating mortgages (PMs) can offer a more resilient product and help to mitigate risk. PMs make the financial intermediation system more resilient to economic shocks, more efficient and thus more liable to foster economic growth. PMs also offer better risk management to lenders in periods of inflation (especially in US due to fixed rate long term loans under which lender bears the interest rate risk). PMs are also seen as superior to other mechanisms that seek to improve access by lowering initial payments (negative amortization) or interest only loans (no principle reduction) as they enable the purchaser to increase their equity over time.

This international review suggests that participating mortgage mechanisms, such as those delivered by the intermediary non-profits reviewed in this brief can play an important role in Canada's housing system. They can facilitate access to ownership while concurrently mitigating any risks to broader financial stability.

The primary risk to these now well established assisted ownership programs in Canada is the ambiguity created by the OSFI B20 guideline that appears to preclude non-publicly funded providers from an exemption under the regulation that is granted to publicly funded assistance programs.

While OSFI has clarified that it is not their intent to preclude non-publicly funded providers from access to financing, provided that appropriate risk management measures are in place, **OSFI has not published a revised guideline or public notice to make their intent transparent and to ensure that all FRFI's are aware of their position.**

Recommendation

It is recommended that OSFI revise wording in B20 – to amend footnote on page 12 to state that any assisted ownership programs, regardless of any public financial support, but with appropriate risk mitigation measures are exempted from the guideline.

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