

**Equity Building Program
Clarification of Questions Being Asked
In the Community**

1. How did the City determine there is a need for the program?

Addressing the housing needs in our community requires a broad range of support programs.

The current menu of support programs available through the City's plan and through other orders of government only applies to individuals and families who are below prescribed maximum income levels. The current maximum income levels are \$52,000 for families and \$44,500 for individuals and seniors.

However, falling through the cracks of the continuum are those individuals and families described as "moderate-income" (between \$44,500 and \$70,000). These households, who are employed and perhaps starting out in a new career, do not earn enough income to purchase full market housing and earn too much income to receive government-supported housing.

2. How is the City helping these households?

The average housing price in Saskatoon has risen from \$150,000 in 2005 to just under \$300,000 in 2010. Corresponding to this, monthly mortgage payments have risen from levels of around \$700 per month in 2005 to levels of approximately \$1,300 per month in 2010.

In the meantime, average household income levels have only increased from \$52,000 in 2005 to \$70,000 in 2010. Concurrent with this, average rent in Saskatoon has risen from \$600 a month in 2005 to \$935 a month for a two-bedroom suite in 2010.

In this environment, many moderate income households are not able to save sufficient funds for a down payment.

The thinking is that by helping these households move from renting to home ownership, the following financial benefits accrue:

- a. The impact of rising housing prices is eliminated. Once a home has been purchased, the price is fixed. Any increases in housing prices after that point only serves to increase the household equity in the property.
- b. The mortgage payments are fixed for a period of 5 years. Mortgage payments on a \$175,000 property using a mortgage rate of 4.64% amortized over 30 years would calculate to an order of magnitude figure of \$885 per month. The payments on the down payment loan under this program would amount to an order of magnitude

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- figure of \$175 per month. Although rental costs may be less than a mortgage payment at first, with average rent increases of \$25 projected over the next few years, any disadvantage at first may well be eliminated or significantly reduced over the intervening period of 5 years.
- c. Unlike rental payments which create zero equity, each mortgage payment is comprised of an interest payment and a payment towards the loan. This means that with each mortgage payment, the household is building equity in their property.
 - d. The down payment loans are currently projected to carry a 3.44% interest rate. Some households have placed the down payment on their credit card at rates in excess of 18%.
 - e. Under this new program, households are projected to build an equity position in their property after five years (without any inflation or other market corrections factored in). This is in clear contrast to rental property, where no equity whatsoever would accrue if they remained in a rental property.

Further to the above, after five years the down payment amount (5% of the original purchase value) would now be repaid. In addition, the principal amount of the original mortgage would have been reduced.

The City calculates that after the first five years of this program, the net mortgage debt owing on the property as compared to the original purchase value (i.e. without any inflation or other market corrections factored in) could indicate an earned equity position of as high as 10%.

3. Who loans the money to the eligible households?

Affinity Credit Union will authorize a down payment loan to eligible households. The down payment is repayable over 60 months with interest. The interest rate is set in an agreement between the City and Affinity Credit Union.

4. What is the role of the City in this program?

The role of the City is to provide the initial capital pool for the down payments. In addition, the City will carry 2/3 of any losses experienced in the down payment loan. (Affinity Credit Union will share 1/3). Otherwise, the Equity Building Program is considered an investment by the City of Saskatoon. The City receives 100% of the interest earned on the down payment loans as well as 100% of interest earned on any amount remaining in the investment

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account with Affinity Credit Union.

5. Where does this investment money come from?

The City of Saskatoon owns and operates many assets in the form of equipment, buildings and structures. Due to normal wear and tear, these assets need to be replaced or receive major reinvestment in order to provide the services associated with those assets.

Such replacements or reinvestment can entail several hundred thousand to millions of dollars when the replacement or reinvestment becomes necessary. These dollars come from the city taxpayers.

To avoid major spikes in the property tax mil rate, the City sets aside a portion of the required replacement/reinvestment cost into a reserve each year. When the time comes for the replacement or reinvestment, the money is on hand.

Although monies are drawn from these reserves from time to time to fund the replacement or reinvestment work those funds are designated for, there is an annual inflow of funds to build up other reserves for future work. In the end, there is a constant pool of funds on hand in any given year.

During the intervening years, the money in these accounts is used to purchase various investment vehicles (e.g. term deposits) and earn income for the City. This interest is placed in general revenues and serves to reduce the amount of property taxes required.

It is this pool of investment funds that is being used as a source of money for the investment fund with Affinity Credit Union. As noted in # 4 above, it is that investment account that is used as the source of monies for the down payment loans issued by the Affinity Credit Union.

6. What risks are there to the City's investment?

Recent statistics released by CMHC indicate that the arrears rate on mortgages in Saskatchewan is 1/3 of one percent. From a "worst case scenario," applying this to the entire \$3,000,000 investment in unsecured down payment loans, the experienced arrears can be expected to be \$10,000. If we assume that 100% of these arrears will result in a loss and we subtract the 1/3 share agreed to by the Affinity Credit Union, our expected loss can be

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calculated at under \$6,500 in any given year once our investment fund is fully applied.

This works out to a \$6,500 annual risk of loss against annual interest returns of \$103,200 (using an investment rate of 3.44%) once our investment fund is fully applied.

7. Is the \$3,000,000 transfer of money a one-time affair or is it repeated annually?

The \$3,000,000 transfer to the investment account with the Affinity Credit Union will only occur once and will remain at that amount unless otherwise directed by City Council.

In accordance with the terms of the agreement with Affinity Credit Union, the intention is to use one fifth of this money to provide approximately 50 down payment loans in any one fiscal year. All down payment loans must be repaid, with interest, over a period of 5 years. In this way, the investment fund will revolve which means that there will always be sufficient monies in this investment account to provide 50 down payment loans to eligible applicants in any one year.

8. What are the eligibility requirements and rationale behind them?

- a. Applicant must currently be renting a property within the boundaries of the City of Saskatoon for a period of at least six months.

The specified purpose of the program is to assist households to transition from rental accommodation to homeownership, so this is a logical requirement. It was never intended to assist households to exchange or upgrade their existing dwelling unit that they own.

- b. Minimum household income - \$44,500 for households with no children; and \$52,000 for households with children.

All support programs provided by the City and other orders of government have set these household income levels as maximum income thresholds. There are no supports at this time above these limits. Setting these limits avoids duplication of funding.

- c. Maximum household income levels – \$70,000

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In our market analysis with Affinity Credit Union, it was determined that households with income levels above \$70,000 are capable of achieving homeownership without any form of assistance. Setting this limit avoids using our limited funds for non value-added assistance.

- d. Must qualify at the 5 year rate as per Affinity Credit Union current posted rates.

It has been determined that all mortgages under this program will be for a 5 year term. This provides stability to successful applicants who can be assured that their mortgage payment will remain constant during that 5 year period.

There have been recent announcements and predictions that the Bank of Canada's lending rate to financial institutions is likely to rise over the next year to 18 months. The initial increase is predicted at 25 points and subsequent increases will likely come in 25 point increments.

These rate increases will not affect successful applicants during the initial 5 year term but may affect them at renewal time. However, at this time, the 5 year down payment loan will have been fully repaid, thus providing additional cash flow to offset any mortgage rate increases which have accumulated over the last 5 years.

In addition to the above, Affinity Credit Union applies sound lending practices to evaluate an applicant's qualifications.

This combination of factors ensures that the debt load entered into at the beginning of the program remains affordable in the future.

- e. Applicants must fall within prescribed debt load capacity levels.

Responsible debt management is critical. As such, the ratio of housing costs (mortgage payments, property taxes and heating costs) to household income must not be greater than 32%. The rate currently experienced in the market place is 40% or more. It is this level of debt that concerned the City in the first place and led us to seek out a program that would allow households to move towards more responsible debt levels as defined by our national banking system. It is believed within the banking industry in Canada that this restriction on debt load is a primary factor in the low mortgage arrear levels currently being experienced as compared to other

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countries.

In addition to this restriction, the total debt load housing costs plus any other debt (including the down payment loan payment associated with this program) must not exceed 40% of total household income. This restriction also ensures that the debt management of the household on other life expenditures is being managed responsibly.

It is important to note that mortgage default insurance is a requirement. As such, borrowers must also qualify under CMHC and Genworth standards. Potential borrowers will work closely with Affinity Credit Union professionals to determine what the best course of action is for them. The program isn't intended for everyone; not all applicants will be suitable for the program and not applicants will qualify.

f. Acceptable credit history

This is a standard requirement of any debt transaction with a financial institution.

g. Property being purchased can be located anywhere in the City of Saskatoon

Since the monies being used to leverage this program are from Saskatoon taxpayers, the funds should be invested within the boundaries of the City of Saskatoon.

9. The income support levels seem high.

When applying all of the eligibility requirements in # 8 above, a household with an income level of \$44,500 would qualify to purchase a property with an acquisition value of \$183,000. A household with an income level of \$70,000 would qualify for a property with an acquisition value of \$288,000. The average cost of a dwelling unit in Saskatoon is \$300,000.

10. There are other mortgage brokers who can offer a better mortgage rate than Affinity Credit Union.

Mortgage lending is complex. Seldom can products be compared as no two products are exactly the same. The products offered by the Affinity Credit Union are versatile, flexible and reliable. Comparing similar products, the rates offered by Affinity Credit Union are

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competitive and will adequately meet the needs of borrowers.

11. Why was Affinity Credit Union given exclusivity on this program?

As with other programs, the City approached those few financial institutions who, in the past, have demonstrated an interest in exploring new ideas. One institution lost interest after the initial briefing; one explored the possibilities with us for quite some time but eventually formally withdrew from further involvement because they felt it was not a viable venture for them.

Affinity Credit Union took the program to heart and worked with the City and the National Mortgage Insurers to find a solution – and it was the first of its kind. It was clear that to make this program work to the mutual satisfaction of all the stakeholders, some front end work was required to integrate the Equity Building Program with the national banking practices and procedures. It would also take the acceptance of some financial risk although it was felt that this risk could be managed and mitigated.

Affinity Credit Union came forward with a proposal to undertake all of the administrative and marketing effort associated with the proposed program, waive any revenue from the down payment and accept 1/3 of any losses incurred through the down payment loans.

Given the investment provided in the development of this program, the ongoing effort in the operation of the program and the fact that no other financial institutions were left at the table or expressing any form of interest in our overall Housing Business Plan, the Administration agreed to present their partnership offer to City Council.

There are two other factors that led your administration not to pursue any other financial institutions in the operation of this program:

a. Economies of scale

With the funding to approve only 50 down payment loans in any given fiscal year, distributing that to more than one financial institution would not have been cost-effective for anyone and would have been an inconvenience to potential applicants.

b. The Equity Building Program is 100% exportable

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There is nothing preventing any other financial institution from partnering with other partners to provide a similar program. No one has been excluded from the marketplace regarding the application of this concept. The City of Saskatoon and Affinity Credit Union are simply the first to pioneer this concept.

In fact, all of the development work has been done with the National Mortgage Insurers, so implementation should proceed much easier and quicker.

12. Will this create a demand for housing that Saskatoon cannot respond to?

There is a demand for housing in Saskatoon. Land developers and housing providers are all working to capacity to address this demand.

This program is about the type of housing – home ownership versus renting. Either way, there is a household who requires a dwelling unit.

This program helps some become more self-sufficient in achieving home ownership while at the same time freeing up a rental unit for those who need or indeed prefer rental housing. It does not drive nor hinder the demand for dwelling units in our community.

Considering that we are looking at a limited market in terms of who can qualify for the program (income, affordability, etc.), limited funds available in the program, and a very specific price range, the program should have little to no effect on the housing market as a whole.

13. What does the City do for households below the maximum income levels?

The City provides support for housing serving all points of the continuum, up to market level housing. Below is a list of supports currently available and the results of these supports since the Housing Business Plan was launched in 2008:

- a. Shelters, transitional and supportive housing projects all receive a 10% capital grant, plus a 5 year tax abatement. The development of 197 units is projected to be supported by the end of 2012.
- b. Affordable ownership is supported. The City's Mortgage Support Program supports 50 units per year by providing a 10% capital grant to the builder and a 5% down

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- payment grant to the homebuyer - 198 affordable homeownership units will be supported by the end of 2012.
- c. Affordable rental projects for families and individuals are supported with a 10% capital grant and a 5 year tax abatement - 344 units will be supported to the end of 2012.
 - d. Seniors' affordable rental projects are supported with a 10% capital grant and a 5 year tax abatement. 236 units will be supported to the end of 2012.
14. Can this program be compared to similar programs in the United States that caused the subprime mortgage crisis, and if so, are we putting people and the housing market in a vulnerable situation?

The housing market situation in the United States is complex and can't be isolated to any one factor. Having said that, there is little doubt that many of the programs put people into mortgages that they could not afford and into situations that were ultimately to their detriment. It was typical for subprime borrowers to have weakened credit histories and reduced repayment capacity. In many situations, buyers simply took over payments without properly qualifying for the mortgage. In addition, various mortgage options were unmanageable in the long term, such as adjustable rate mortgages, interest only mortgages and balloon payment mortgages, among others.

Tight mortgage regulations and strict lending rules will ensure that the Equity Building Program will be nothing like these programs in the United States. As mentioned in the answers above, applicants must meet strict conditions to qualify for this program. Payments on both the down payment portion and the mortgage are fixed for 5 years. In addition, the mortgage itself is insured by National Mortgage Insurers, CMHC and Genworth.