LEGISLATIVE ASSEMBLY OF THE NORTHWEST TERRITORIES

5TH COUNCIL, 28TH SESSION

REFERENCE FOR ADVICE NO. 6-28

September 21, 1964.

NORTHWEST TERRITORIES

REFERENCE FOR ADVICE NO. 6
SECOND SESSION, 1964

INTEREST RATE ON LOANS UNDER LOW COST HOUSING ORDINANCE

The Commissioner requests the advice of the Council on the question of reducing the interest rate on loans available under Territorial mortgage loan programs.

Interest Rate on Loans under Low Cost Housing Ordinance

When the Government of the Northwest Territories decided to provide funds for the issue of loans to Territorial residents to enable them to build low cost homes there existed already a Territorial program for lending up to $2,000 on second mortgages to home builders constructing under the National Housing Act with a first mortgage loan from the Central Mortgage and Housing Corporation. Consequently, the interest rate for loans under the Low Cost Housing Ordinance was established on a par with the interest rate established already for these second mortgage loans, that is at 1% higher than the rate charged by CMHC when making direct loans.

On this basis, the Memorandum for Cabinet dated May 11, 1961, which proposed low cost housing programs for the Yukon and Northwest Territories using money borrowed from the Federal Government, included a reference to the repayment of first mortgage loans for low cost housing at the interest rate of 7¾%; or at the same rate as was then current for second mortgage loans. This Memorandum for Cabinet also provided for the Federal Government to make a grant of $1,000 to the Territorial Government for each low cost house built, with the Territorial Government passing on this grant by an interest-free ten-year second mortgage. Quoted below is Section (f) of the Memorandum for Cabinet:

> "(f) the difference between the Federal interest rate (currently 5¼%) and the interest rate of 7¾% on Territorial first mortgages and home improvement loans would be used to cover administrative and risk costs".

This northern low cost housing scheme for both Territories was considered and approved at a Cabinet Meeting held on August 31, 1961, with the qualification that the proposed system of home improvement loans would not be implemented at that time.

The Council of the Northwest Territories passed the low cost housing bill in January, 1962, and the rate of interest was approved at 7½%, or 1% higher than the current CMHC rate which had dropped in the autumn of 1961 from 6¾% to 6½%. A further decline in the CMHC interest rate to 6¼% has been followed by corresponding changes to 7¼% in relevant Territorial legislation.

The availability of Territorial second mortgage loans of $2,000 administered by the CMHC and for issue to home builders already qualified for CMHC first mortgage loans pre-dated the Yukon Territory and Northwest Territories low cost housing schemes and was the first attempt made by the Yukon and Northwest Territorial Governments to meet the problem of residential construction costs in the north substantially higher than those in southern Canada. The development of this secondary mortgage scheme progressed painfully but the benefits of this slow evolution were available when the low cost housing proposal was advanced. For this reason, a reference to the development of the second mortgage scheme is necessary to understand the present interest rates applicable to loans for low cost housing.

The first departmental proposal for the $2,000 second mortgages, considered by the Cabinet on October 6, 1959, was for loans with interest rates at the prevailing rate for first mortgages borrowed under the National Housing Act, namely 6¾%. The Cabinet was hesitant about this proposal in general and the precedent it might establish for the provinces and directed the Department to give the proposition further study in conjunction with the Department of Finance and the Housing Corporation and then to resubmit it. The Department of Finance questioned leaving the interest rate to be charged for these mortgage loans at the NHA rate and argued that an interest rate of 2% higher than the NHA rate would make certain the provincial governments would not ask the Federal Government for loans to enable them to introduce similar schemes. The intention was that the 2% surcharge would be halved and shared between the CMHC and a risk reserve fund. The CMHC would receive its share to cover operating costs while the reserve fund would give some protection to the Territorial Government in case of foreclosure proceedings.

Subsequently, it was agreed the interest rate on territorial second mortgages would be 1% higher than the current rate charged at any time by the CMHC instead of 2% as proposed by the Department of Finance. This development was based on the knowledge the CMHC rate is usually about 1% higher than the interest rate charged when the Territorial Government borrows money from Canada. This fact meant a Territorial loan interest rate only 1% higher than the CMHC rate would still permit a 1% fee to cover CMHC operating expenses and leave 1% of the total interest charged to be devoted to cover the admittedly higher risk in the north because of the slow market for disposing of housing obtained under the foreclosure proceedings. In other words, with a borrowing rate of 5½% interest the charge to mortgagors of 7½% on second mortgage loans would allow the payment of 1% for the CMHC fee and 1% to build the risk fund. This policy was embodied in the Memorandum for Cabinet dated February 27, 1961, in the terms of the subsection quoted below:

> "1. <u>Second Mortgage loan</u>
>
> (b) The mortgages would not exceed $2,000 and would have a maximum term equal to the first mortgage. They would bear interest at a rate of one per cent higher than the NHA first mortgage rate at the time of issue. This one per cent would be paid to CMHC by the Territorial Governments as a fee to cover costs of the Administration".

By P.C. 1961-721 and P.C. 1961-722, each dated May 18, 1961, the Governor General in Council approved the proposal that the Governments of the Yukon and Northwest Territories be empowered to make secondary mortgage loans to residents of the Territories.

At present funds borrowed by the Territorial Governments and also by the CMHC from the Federal Government bear interest at 5 3/8%. The current interest rate charged by CMHC for direct housing loans is 6¼% and the CMHC lending program in 1963-64 netted in the neighbourhood of ten million dollars after meeting operating expenses. As a result, the Corporation's high interest rate is critized in some quarters. The Federal Government takes the position that a lower interest rate would reduce the amount of private lending under the National Housing Act. This, in turn, would place pressure on the Federal Government to meet the expected increased demand for loans while at the same time it would seriously damage the incentive of private lenders to supply as much of these funds as possible.

Apart from the CMHC it appears the interest rate charged borrowers under various lending programs, such as the operation under the Veterans' Land Act, is frankly subsidized. Some years ago provincial assistance in the housing field was investigated and it was found only Ontario and Quebec had schemes and that these, too, were subsidized. A few months agp the Farm Credit Corporation raised its interest rate from the subsidized rate of 5% to 6 3/8% to bring it more in line with current lending rates. Unlike many other Crown Corporations the Farm Credit Corporation has not been a self-supporting operation and administration expenses are a Federal charge. The Federal Government's published expenditures for 1963-64 show a loss of $1,118,796 in the operation of the Farm Credit Corporation. Perhaps the new interest rate will reduce this loss.

While a case could be made for the Government of the Northwest Territories to follow governmental practice elsewhere and provide subsidized loans for houses, this would clearly be contrary to the intent of the current fiscal agreement between the Federal and Territorial Governments. In the report on the Northwest Territories produced by the Interdepartmental Committee on Federal and Territorial Financial Relations, and which is the basis of the current five-year fiscal agreement between the two governments, there is no specific reference to housing mortgages or mortgage earnings. However, a study of the report reveals that various taxes were recommended for increase and new sources of tax revenue were explored with the aim of producing more income within the Territories. The Committee noted, for example, that although the net liquor profit in the Northwest Territories was higher than in the provinces, it should not be decreased to the provincial level but should remain unchanged. Obviously, any move that would in any way increase the present dependence of the Northwest Territories on federal financial aid would be unlikely to gain favour.

In actual practice there has been little demand from the Northwest Territories for a decreased interest rate although the proposition has been advanced. The current interest rate for first mortgage loans quoted in the Ottawa area by private lending institutions is 7½%, or the same rate charged by the two Territorial Governments. Direct CMHC loans are only available in those isolated places where private lenders are not in business. Interest rates in Ottawa for second mortgage loans are 12% to 13%.

One undoubted reason for general satisfaction with the current interest rate charged for Territorial first mortgage loans derives from the interest-free second mortgage (grant) of $1,000 available to the builders of low cost houses. At present, an applicant for low cost housing loans can borrow $6,000 at 7½% on a first mortgage and obtain a $1,000 grant for a total of $7,000. The table below illustrates the advantage in obtaining $7,000 for 20 years (the usual period) from the N.W.T. Government instead of from the CMHC: -

	N.W.T. Loan	CMHC Loan
	$6,000 @ 7½% for 20 years =	$7,000 @ 6½% for 20 years =
	$11,289.60	$12,201.60
	1,000.00 (interest free and forgivable)	
Total repayable amounts of principal and interest.	$11,289.60	$12,201.60

The CMHC has reported that it can administer second loans on behalf of the Government of the Northwest Territories for less than the 1% fee now paid. As Federal civil servants administer the first mortgage loans the present 1 7/8% yield over the borrowing rate of 5 3/8% is entirely available for the reserve risk fund. This means the interest rate on each type of loan could be reduced from ½% to ⅞% and still maintain the parallel rates and the 1% charge to cover risks. However, it is unlikely Cabinet would agree because of the fear that such a reduced interest rate might make similar schemes attractive to the provinces. Furthermore, our experience in the operation of these loans is yet so limited there is merit in accumulating a risk reserve fund at an expanded rate until we know for sure the direction this program is taking.

RECOMMENDATION

While the making of subsidized housing loans is obviously a worthwhile goal it should be noted that Ontario has dropped this scheme and only Quebec still offers some such assistance. In other words, there is no general pattern of provincial governmental aid in this way. As regards the Northwest Territories, the need to borrow money from the Federal Government to finance housing loans means the Federal Government must be convinced that any proposed reduction in the low cost housing loan interest rate is in the overall interests of northern development. It seems conclusive that this stage has not yet been reached and cannot be demonstrated. Accordingly, on balance, no change in the present interest rate structure is recommended as a proposition to place before the Cabinet for consideration.