

Ottawa eyes privatization of CMHC

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The federal government is quietly testing the waters about privatizing the national housing agency, **Canada Mortgage and Housing Corp.** — a move that could bring billions of dollars into Ottawa's coffers but would also upset social-housing advocates and possibly cause upheaval in the bond market.

A sale is not imminent, and observers believe there is no chance it would take place until after a federal election. Nor is there a cut-and-dried case in favour of privatization. But it's clear that the days of CMHC being a significant source of cash for the federal government are numbered — with or without privatization.

CMHC, a Crown corporation charged with making housing more affordable and accessible, is making about \$1-billion a year in profit and is sitting on a \$5-billion reserve of retained profits.

Those reserves are expected to rise to \$9.5-billion within four years, according to the agency's corporate plan.

The riches have raised a big red flag, and now CMHC faces pressure from all sides.

Private companies — mainly U.S.-based multinationals — are ready to rush in to the lucrative mortgage-insurance market that CMHC dominates.

Social housing advocates and opposition parties want the excess reserves to be transferred over to fund more affordable housing.

And the federal government has signalled it wants out of the housing business altogether, arguing that it's a provincial responsibility.

The solution to these pressures, sources say, could be privatization: selling the commercial parts of the agency to the private sector and keeping the social-housing parts of the corporation within government for now.

“Trial balloons are being floated around” and can be traced back to Finance Minister Jim Flaherty's office, one Bay Street source said.

“This has been in the wind for a couple of months now,” said another private sector source.

Rumours and speculation are rife among those with vested interests, although officials in Mr. Flaherty's office and at the CMHC all deny having any knowledge of such chatter.

The Crown corporation was created in the 1940s so that the state's access to cheap capital could be leveraged to make mortgages and home ownership affordable for most credit-worthy Canadian residents.

It now has four divisions: affordable housing, aboriginal housing, mortgage insurance and securitization.

The first two divisions depend on government funding of about \$2-billion a year. The mortgage insurance and securitization units are run like commercial operations, and that's where CMHC makes all its money. (The government does not let the agency cross-subsidize from one unit to another so that the mortgage insurance and securitization divisions are truly commercial.) About 96 per cent of the agency's profit comes from mortgage insurance. CMHC controls about 70 per cent of the country's mortgage insurance market, with the other 30 per cent held by **Genworth Financial**, a U.S.-based multinational formerly known as GE Mortgage Insurance Canada.

The duopoly in the growing and lucrative mortgage insurance market will officially come to an end this week. A change in rules passed earlier this year means that new entrants will be able to enter Canada's mortgage insurance market if they get approval from federal authorities, and now at least three U.S.-based companies are lining up to do so.

The first company to make it through the process, **American International Group Inc.'s** new Canadian subsidiary, plans to announce its official entry into the Canadian market this week.

While CMHC's securitization division doesn't make the agency much money, it is a key player in Canada's bond market. CMHC issues government-backed bonds based on pools of insured mortgages, and has become one of the largest bond issuers in the Canadian market. In 2004, it issued almost \$30-billion in mortgage-backed securities.

With liquidity in sovereign bonds deteriorating as governments pay down debt, investors increasingly rely on CMHC's securities for their contingent of government-backed bonds.

But the existence of CMHC is an anachronism in today's competitive environment, argues Derek Holt, assistant chief economist at Royal Bank of Canada.

“There is a weak case to be made for a Crown corporation to be involved in correcting private market failures that once restrained home ownership,” he writes in an analysis issued this summer. “As such, the CMHC should be fully privatized while pursuing other complementary policy reforms.”

But there are several key reasons that privatization of CMHC could well be rejected as a viable option.

For one, capital markets are hooked on the agency's bonds. While proponents of privatization argue that the markets will just have to learn to live with fewer government-

backed securities and make do with the ample supply of corporate bonds, there are signs that the Bank of Canada and the federal government wish to keep the government bond market highly liquid.

Plus, there's no guarantee that a sale of CMHC would be as successful as hoped. An auction would have to bring Ottawa a lump sum that more than makes up for CMHC's substantial revenue stream.

Privatizing CMHC would also be politically sensitive. Social-housing advocates fear that government support for affordable housing would get short shrift. “Behind this maze of commercialization, cost-cutting, downloading and competition are some very important questions about social housing,” says Michael Shapcott, a senior fellow at Toronto's Wellesley Institute.

CMHC's president, Karen Kinsley, argues in defence of her agency. About one-third of CMHC's insurance customers are people or organizations that the private-sector — Genworth, for now — won't touch, she said. *With files from reporter Elizabeth Church*