The Roots of the Crisis

Some basics about shelter and homeownership

The average house costs the equivalent of two to five years of the average person’s revenue, and few people ever save that much cash. Those who do have already been working for more than five to ten years, since they have to spend money to eat, get to and from work, and pay for their shelter during that time. If a couple in their twenties wants to marry and start a family, it may be difficult for them to own their own home, since their expenses will be rising as the family grows, and as parents they will probably not both work outside the home continuously. Yet these are precisely the people who would most benefit from owning a home.

How can young families acquire their own home? One solution is intergenerational solidarity. Parents can help children buy their own home. This can become difficult, however, if parents have several children in their twenties. The irony of the situation is that these same young people in their twenties will be earning more money in their fifties, when they no longer need such a large house to live in.

Mortgages are the solution to this problem.

A mortgage is a special kind of loan. By promising to cede ownership of their house to the lender should they cease to make regular payments over a long period of time, a couple can receive a loan of the cash necessary to buy a house. This is an elegant solution if both sides come out winning. This will be the case if the couple has access to better living conditions and eventually ownership of the home with a paid-off mortgage and if the person or company doing the lending also makes some money on the transaction.

Several factors need to be in place to assure this.
One is the terms of the mortgage itself: is it a fair deal? We will come back to this question later. For the time being, we will let the market be the judge: can the couple get a better deal elsewhere? Could the lender make more money doing something else with its money? For example, if the lender charges exorbitant rates, it’s not a fair deal. If the couple gets the mortgage almost interest free, it’s not a fair deal either.

Another factor is the mortgage’s appropriateness for the borrowers. Perhaps the terms of the mortgage are fair according to the market, but the borrowers will be unable to meet the terms. This could be because the borrowers are trying to buy a house that remains beyond their means even with the aid that a mortgage gives. If a cashier in Montreal tries to buy a mansion in Beverly Hills, California, or a condominium in Naples, Florida, or near Les Invalides in Paris, he or she would be unable to keep up the mortgage payments. Of course, this is not a problem of the mortgage, but of the underlying purchase. The terms of the mortgage may be inappropriate even if the house being purchased is unpretentious. If the payments are not uniform over time, or if the mortgage period is too short, it may become difficult to continue paying.

How should the mortgage be structured? There is room for judgement here. A young couple may have to pay off student debt for a few years, and anticipate an increase in salaries, and so prefer to pay less the first few years, increasing payments thereafter. This will work well if everything goes as planned. If the primary earner falls ill or is injured, this may affect the couple’s capacity to meet payments. To prevent this problem, they may have an insurance plan... or they may not. The terms of the mortgage may require this. Or not.

In various countries, governments intervene by establishing guidelines as to what is a standard structure for a mortgage, particularly with respect to:

- the absolute amount mortgaged (more expensive houses have their own risks);
- the portion of the price of the house which is lent to the borrower;
- and the borrower’s capacity to meet the loan payments.

In the United States, where the 2007–2010 financial crisis primarily originated, mortgages which do not conform to the first criterion above are called ‘jumbo asset’ mortgages. Mortgages which do not conform to the second criterion or for which there is incomplete documentation of the borrower’s income are called ‘Alt-A’ mortgages. ‘Subprime’