Exchange Traded Funds Can Help Solve High House Prices
Concept Paper

Canadian homes are more than just four walls and a roof. Thanks to uniquely favourable tax laws and financial programs, they provide not only shelter to our families but also tax-sheltered, high-return investments. Today, the only way to get in on the bonanza is to buy a house, which requires the typical Canadian family to take on a massive mortgage and renders them financially dependent on high house prices. Unsurprisingly, the Canadian economy has become increasingly reliant on unproductive residential real estate investment and Canadian politics has been gripped by equally unproductive debates about "affordability" and (mostly foreign) scapegoats.

High house prices are no longer a symptom of underlying dysfunction, they have become the problem. Our families, our economy, and our government are in thrall to them. Fortunately, a familiar financial instrument – the Exchange Traded Fund (ETF) – can help set us all free.

The Challenge: Financialization Meets Housing

Canadian homes are financial assets. Decades of federal law and policy, from the principal residence exemption to Canada Mortgage Bonds and beyond, have made sure of that. As a result, demand for Canadian houses is not just demand for shelter in this country but also for the outsized tax-exempt returns that homeowners have recently enjoyed. As house prices rise, homeownership often appears to be the only path to prosperity in Canada. Now, those high prices have become a trap for many families and a constraint on our governments, which appear unable to contemplate measures that could meaningfully reduce prices. To make our families and our economy more resilient, we need to create more ways for Canadians to participate in the housing market. Since we are not going to put market forces back in the proverbial barn, we need to learn how to ride them.

The (Paradoxical) Solution: More Financial Innovation

Just as increasing the supply of new homes can help meet the demand for shelter, new financial instruments can help meet the demand for the financial benefits of homeownership. Specifically, two exchange traded funds that track the average Canadian house price (the Reference Price) would provide households and investors with more targeted and affordable ways to participate in the housing market:

Canada House Price ETF	Value rises when house prices increase
Inverse Canada House Price ETF	Value rises when house prices fall

These ETFs would be structured and sold on the public securities market like other ETFs based on stocks, bonds, currencies, or commodities. They would be retail investments that are priced and traded accordingly: much less expensive than a house, bought and sold incrementally, with no need for a down payment or a mortgage. They could be combined with existing tools (e.g. Tax Free Savings Accounts) to level the playing field between incumbent owners, renters, and new entrants to the housing market, such as young Canadians and recent immigrants.

- The Canada House Price ETF would be an ideal investment to save for a down payment, as it would track the average Canadian house price rather than an uncorrelated stock or bond index.

- Renters could create a portfolio that mimics the benefits of homeownership by renting a home and holding units of the Canada House Price ETF in a tax-free account.

- Investors could use both ETFs to speculate on house prices without buying and selling the actual homes that families need.

- Homeowners who anticipate a windfall return (or who have borrowed large amounts to buy a house at current prices) could use the Inverse Canada House Price ETF as a hedge against a potential drop in house prices.

The Benefits: Financial Resilience and Policy Flexibility

These ETFs would democratize the housing market by creating more ways for more Canadians to participate in it. They would reduce the barriers to entering that market and absorb much of the speculative demand that has contributed to high house prices.

These ETFs would complement – not replace – other government efforts to address the house price crisis, such as funding new construction and cutting the GST on new rental buildings. They would enable governments to speak more directly about the need to reduce high house prices and would give governments more policy room to deliver a "soft landing," because homeowners would be able to buy insurance against lower prices. Finally, these ETFs would be cheaper to introduce and faster to implement than the various measures proposed to increase the supply of actual houses.

The Blueprint: A Role for Government

Although the market would do most of the work, the federal government does have a role in establishing this solution. Among other technical matters, the federal government would:

1. Set the Reference Price: Work with the financial and real estate industries to establish a transparent and reliable Reference Price.

2. Facilitate the Financing: If needed, back the swap agreements that drive these ETFs, either through credit support or as a direct counterparty.