End of Mortgage Strategy and Funding Model

Introduction

The funding and governance of social housing is undergoing a fundamental shift in Ontario. Funding arrangements and obligations to provide rent-geared-to-income housing were contained in agreements that were tied to mortgages when social housing projects were built. Projects primarily funded by the federal government have almost no ongoing obligations once their mortgages end. Projects originally funded primarily by the provincial government must continue to provide rent-geared-to-income housing once their mortgage ends. The end of mortgage for these projects is accompanied by significant changes in their funding which creates uncertainty for the ongoing viability of their operations and capital asset.

The End of Mortgage Strategy developed by the City of Hamilton is defined by a key set of principles to guide negotiation of new agreements with housing providers. The strategy also outlines a process for working with Housing Providers to review the viability of their projects from an operating and capital perspective to determine financial supports that may be required.

The strategy for new agreements is comprised of four components: a set of principles and guidelines, funding options, a process approach, and a financial model.

Figure 1: Illustration of End of Mortgage Renewal Strategy Components

Strategy Principles

The principles explicitly acknowledge that the City of Hamilton will endeavor to retain all current social housing units. Through the establishment of principles and guidelines, the strategy aims to:

- Incentivize Non-Profit and municipally owned affordable housing providers to remain within the community housing portfolio thereby protecting existing rent-geared-to-income tenancies/affordable housing
- Maximize funding for capital repair needs to address the growing gap between provider capital reserve funds and capital repair work required
- Support Exit and Service agreement negotiations
- Support the co-development of a financial plan that addresses both capital and operating needs of housing providers
- Support a new relationship with housing providers that is equitable and transparent

A full-list of the principles and guidelines developed to support this strategy are detailed below. 'Subsidies' specifically refer to City of Hamilton operating and capital subsidies, while 'funding' connotes multiple funding sources which could include, but is not limited to, the City of Hamilton:

General Principles

- Social housing is recognized as a valuable publicly funded asset.
- Efforts will be made by the City of Hamilton to retain all current social housing units at End of Agreement/End of Mortgage, and ideally increase the number of affordable housing units available.
- Funding arrangements will enable social housing to remain financially viable, affordable and in good repair.
- Subsidies must be flexible to adapt to varying realities and changing contexts.
- Subsidies will be based on demonstrated need and applied through a transparent funding approach.
- Subsidies will be distributed with consideration to both operating and capital needs and will be responsive to municipal financial constraints.
- Subsidies will incentivize Housing Provider investment and accountability to reduce operating costs (i.e., to maximize revenue sources/efficiencies).
- Subsidies will support housing provider accountability and autonomy.
- Equity will be directed to current project operating and capital needs prior to leveraging new builds. Surplus equity may be used to leverage development with Service Manager approval.

Funding Principles and Guidelines

- To address capital needs, multiple funding sources are required for the continuity of a social housing project.
- Financial viability is defined as a project having a surplus that can be used to address a portion of capital repair costs rather than breaking even.

Based on the funding principles stated above, a comprehensive funding model was developed to support the long-term financial sustainability of social housing. Guidelines were created to develop a standardized approach for determining rent increases, housing provider capital reserve contributions, management and goals for operating surplus, funding mechanisms to increase housing provider revenue, and distribution of City of Hamilton subsidies. This model and the underlying assumptions on which it is based is used to assess both operational and capital viability of a housing project.

Guidelines for Rent-Geared-to-Income Rent

- Rent for rent-geared-to-income tenants will continue to be determined by either minimum rent, benefit unit max shelter or 30% of income (line 23600 of Notice Of Assessment)
- Calculating rent-geared-to-income rent based on maximum shelter allowance under social assistance rather than rent-geared-to-income rent scales will apply to and be piloted with new rent-geared-to-income tenants only.

Guidelines for Provider Capital Reserve Contribution

- The capital reserve contribution determined for each housing project will increase annually based on Statistics Canada Residential Construction Cost Index to keep up with inflating construction costs.
- Contributions to the capital reserve fund will be incorporated into the financial plan and adjusted every five years (or more often if deemed necessary) based on the Building Condition Assessments (BCAs) and reserve fund analysis.
- Initial anticipated contributions to the reserve fund are based on the current contribution amount plus the building condition assessment/reserve fund analysis.
- The City of Hamilton may provide a subsidy towards capital reserve funds based on Housing Provider needs and City of Hamilton fiscal constraints

Guidelines for Operating Surplus

- The target operating surplus for housing providers is 5% of revenue, calculated without any City of Hamilton subsidies.
- Housing Providers with a cumulative operating surplus of greater than 30% of revenue will be directed to contribute the remaining amount to capital reserves with consideration given to contributing an even larger portion of the surplus where possible.
- If capital reserves are sufficiently funded, City of Hamilton subsidies may be recovered or reallocated to new development projects.

Guidelines for Tax Exemptions

- CityHousing Hamilton projects that receive property tax exemptions will continue to receive these exemptions.
- In general, new property tax exemptions will not be considered for Housing Providers. Subsidy that includes the amount needed to cover property tax may be considered where need is demonstrated.

Options

Depending on the housing provider's net operating income and capital reserves, the following bundle of options, further described in the guidelines below, may be explored and/or applied:

- Rent-Geared-to-Income Subsidy/ Rent supplement
- Rent increases
- Obtaining a loan or refinancing
- Other external funding options grants
- City of Hamilton operating subsidy
- City of Hamilton capital subsidy
- City of Hamilton one-time capital injection
- Adjust rent-geared-to-income/market mix

Subsidies

The forms of subsidy and funding listed above will be considered based on the viability analyses conducted for each project. As baseline, housing providers who sign new operating agreements with the City of Hamilton will receive City of Hamilton rent-geared-to-income subsidies as per legislative requirements. The combination of the options to be used will ultimately depend on the housing project's unique circumstances.

Rent-Geared-to-Income Subsidy from City of Hamilton

- A rent-geared-to-income subsidy or rent supplement that covers the difference between what the tenant pays and what the housing provider would otherwise receive for that unit, will be paid for automatically as baseline funding for housing providers who enter into new operating agreements with the City of Hamilton.

Rent increases

- Market rent units will be maintained at levels that are affordable to low- and moderate-income households

- Housing Providers will be encouraged to raise rents in housing projects with mixed market and rent-geared-to-income buildings to 80% of Average Market Rent (or higher as deemed necessary for viability and as is advisable based on anticipated tenant impact).

Refinancing/Grants/Loans

- All housing providers will be encouraged to apply for grants and encouraged to maximize multiple funding sources for viability
- Where it is advisable, the option of applying for mortgage refinancing will be recommended to housing providers who are eligible

City of Hamilton Operating Subsidy

- An operating subsidy above the rent-geared-to-income subsidy will be considered if deemed required with the expectation that the Housing provider will have a plan to become financially viable within a determined period of time to qualify. The additional subsidy is limited by the Housing Divisions Social Housing Providers Investment fund for Operating.

City of Hamilton Capital Funding

- The City of Hamilton will provide information to Housing Providers about funding mechanisms and programs that are available to the project.
- An additional one-time capital injection from the City of Hamilton will be considered where needed, based on the project's Proforma limited by the Housing Divisions Social Housing Providers Investment fund for Capital repairs.
- Capital needs far exceed available funding sources for most projects. Subsidies are intended to help bridge rather than close the gap. Opportunities for maximizing City of Hamilton administered capital funding will be explored.

Market/Rent-Geared-to-Income Mix

- Shifting current rent-geared-to-income and market mix is generally a last resort. The impact of changing targets will be considered with respect to the City of Hamilton's Service Level Standard obligations.
- For projects that are currently operating below rent-geared-to-income targets, an individualized approach will be implemented. Where feasible, projects will be brought up to target level.

The guideline below was developed to support vacancy loss and rent-geared-to-income reconciliation:

Vacancy Loss & Rent-Geared-to-Income reconciliation

- The Service Manager will pay for vacancy loss for a subsidized unit up to a one-month period. An annual reconciliation of vacancy loss and rent-geared-to-income subsidy will determine the amount to be recovered from or paid to the Housing Provider.

Approach

This section outlines the approach that will be used with each provider as they reach End of Mortgage. It is anticipated this process will be collaborative and supported by City of Hamilton staff.

Phase 1: Preparing for End of Mortgage

a) Education and Stakeholder Engagement

Housing Providers are expected to be knowledgeable about and prepared for End of Mortgage. Housing Providers are also expected to make sure that their members and or Board are equally well-versed on End of Mortgage issues. To ensure that housing providers are knowledgeable of End of Mortgage legislative changes, opportunities and how to prepare, the City of Hamilton sent End of Mortgage communique’s to housing providers, hosted update and engagement sessions, and shared available resources. Housing Officers have also been doing ongoing outreach to housing providers to ensure that they, and their stakeholders, are aware of the End of Mortgage regulations and the End of Mortgage dates of their specific housing projects.

b) Review of organization’s post-End of Mortgage vision and review of governance framework.

City Staff have encouraged Housing Providers to consider their organization’s post-End of Mortgage vision and to review their governance framework. Although the role of the Board remains the same post-End of Mortgage, the new community housing legislation allows for greater partnership between the Service Manager and Housing Provider. This new framework enables the Board to make fresh decisions regarding the operations of their housing project. End of Mortgage also provides the opportunity for Boards to evaluate their capacity to continue as is or to take on planning or oversight of new or expanded activities.

c) Identify and resolve issues listed in the Operational Review and determine how successful practices can continue

In preparation of End of Mortgage, Housing Officers are working with Housing Providers through their operational reviews to identify areas for improvement. As part of the Service Manager obligation to ensure that social housing providers are operating in compliance with the rules and regulations mandated by the Housing Services Act, Housing Administration Officers conduct operational reviews for each project every two to three years. This comprehensive review examines operating procedures including administration procedures, governance, financial management, resident relations, and maintenance management. Performance is measured against the requirements set out in the Housing Services Act and its associated regulations and rules. Discussions based on the results from the Operational Review enable Housing Providers to address how problematic difficulties can be resolved and how successful practices can continue, especially as projects approach End of Mortgage.

d) Ensure projects have updated Building Condition Assessments

To prepare for End of Mortgage, Housing Providers have been made aware that updated Building Condition Assessments are required. The City has administered $200,000 to date through the Canada Ontario Community Housing Initiative (COCHI) to fund twenty-five building condition assessments. The remaining providers will be funded through this year's COCHI allocation once approved. A Building Condition Assessment (BCA) report indicates repairs required for the housing project in both the short and long term, along with estimated cost of completing these repairs. A Building Condition Assessment report is a valuable tool in helping to determine capital repair needs and capital repair reserve contributions. All projects that are entering End of Mortgage must have a Building Condition Assessment that was completed within the 3 years before project review. As part of the new Service Agreement, Building Condition Assessments need to be completed again before the 5-year financial review.

Phase 2: Negotiation

The following steps will be followed by Housing Services Division staff at End of Mortgage as they undertake the negotiation of new agreements with housing providers.

a) Review of portfolio and property financial health

Prior to conducting a viability analysis, Housing Services staff will review financial statements of the project with the Housing Provider to better understand sources of revenue and expenses. If the provider has external funding agreements for the project in question, the terms and conditions of these agreements will be reviewed and factored into the viability analysis.

b) Management of vacancies and rent

Staff will review chronic vacancies with housing providers and identify needs to ensure that units remain available. Rent-geared-to-income and market rent units will be discussed along with plans for future rent revenue for these units.

c) Property development plans

Providers will be encouraged to identify their longer-term goals regarding project and/or portfolio development. Opportunities to address these goals will be discussed.

d) Viability analyses

Viability analyses will be conducted by City of Hamilton staff in conjunction with Housing Providers to determine both operational and capital viability. A more detailed overview of the viability analyses is included below under the financial model and analysis.

e) Five-year financial plan

Housing Services Staff and the Housing Provider will jointly develop a 5-year financial plan. This plan will address how the housing provider's revenues will meet expenditures for the housing project, including projected capital expenditures. The plan will also address how rent for units will be set and will detail the City of Hamilton's financial obligations towards the project.

f) Operating Agreement

A standard Operating Agreement template has been developed by Legal Services. The regulations state that the minimum duration is ten years and that the financial plan must be reviewed at least every five years.

Phase 3: Monitoring and Review

a) Housing Provider Review Process

In general, projects that have reached End of Mortgage will be reviewed in chronological order. Housing Providers with multiple projects at End of Mortgage will have all projects reviewed at the same time.

Housing Providers with projects reaching End of Mortgage in the upcoming year will be contacted in September of the prior End of Mortgage year with a template and instructions outlining the process and data submission requirements.

b) Individual Project Financial Review

Housing Providers with multiple projects, i.e., a portfolio, typically pool their operating costs and capital reserves between projects. The viability analysis process requires a breakdown of finances on a per project basis. In recognition that our methodology for breaking down pooled costs may be imperfect, finance will review all portfolio projects at End of Mortgage after the first two years. As there is no perfect methodology to disaggregate costs for projects that are part of a portfolio, reviewing these projects within a two-year time frame will allow for the assumptions underpinning the model to be re-examined and adjusted as needed. For single project housing providers, the financial plan will be reviewed at the 5-year mark as per regulatory requirements. New Service Agreements will also contain the flexibility to re-visit the agreement earlier than obligated should the Service Manager feel this is required.

c) Budget Review

To ensure that our financial projections meet the needs of the City of Hamilton's obligations under legislation, a review of the financial framework and funding model will occur after the first 5-year mark of this new framework, which aligns with the financial review of providers as per regulatory requirements.

Financial Model

This financial model, to be used during the negotiation phase, will guide the analyses of the housing project's operating and capital viability.

Financial Model and Analysis

1) Determining the Financial State of a Project

Four factors will be reviewed to determine the financial state of the project at End of Mortgage:

- Revenue;
- Operating expenses;
- Current capital replacement reserve level; and
- Major costs of renovation/repair during the term of the agreement.

To help review the four factors listed above, the following information will be used:

- Building Condition Assessment;
- Assessment of rent-geared-to-income and market rents compared to average market rent;
- Financial statements for specific housing provider (e.g., Annual Information Returns, Rent rolls etc.); and,
- Debt-equity ratios to determine housing project eligibility and optimal loan amount for refinancing.

Prior to entering a new Service Agreement project data from the last one to three years based on actual rather than benchmark operating and capital amounts will be used to conduct an in-depth analysis of the project's financial viability. The analysis will reflect three time periods (present, 5-year and 10-year) and spanning three scenarios:

Scenario 1 - The first scenario will review the project's financial viability with all subsidies from the City of Hamilton removed. While rent-geared-to-income subsidies will be provided for housing providers to retain their housing projects within the community housing portfolio, providers wishing to exit would first be required to demonstrate their viability to operate and provide rent-geared-to-income subsidy to tenants without City of Hamilton assistance.

Scenario 2 – In the second scenario, a rent subsidy would be applied to all rent-geared-to-income units. A rent-geared-to-income subsidy is the minimum subsidy required under the Housing Services Act. If providers are funded sufficiently for both operating and capital requirements, then no further subsidy will be provided.

Scenario 3 - For projects whose operating or capital is not viable even with rent-geared-to-income subsidy, other funding options including City of Hamilton subsidies may be applied. In general, options available to the housing provider to increase revenue will be explored prior to service manager funding options.

An assessment tool based on an existing End of Framework assessment tool originally developed by Steve Pomeroy for the Canadian Housing and Renewal Association was created to help assess the financial impact and viability of housing projects at End of Agreement/End of Mortgage.

The tool undertakes two types of assessment: a) is the project viable, i.e., does it generate the operating surplus needed to be viable? b) is the project's capital reserve adequate? If either operating or capital needs are not sufficiently viable, a bundle of options to increase revenue (as detailed above) will be reviewed with the Housing Provider.

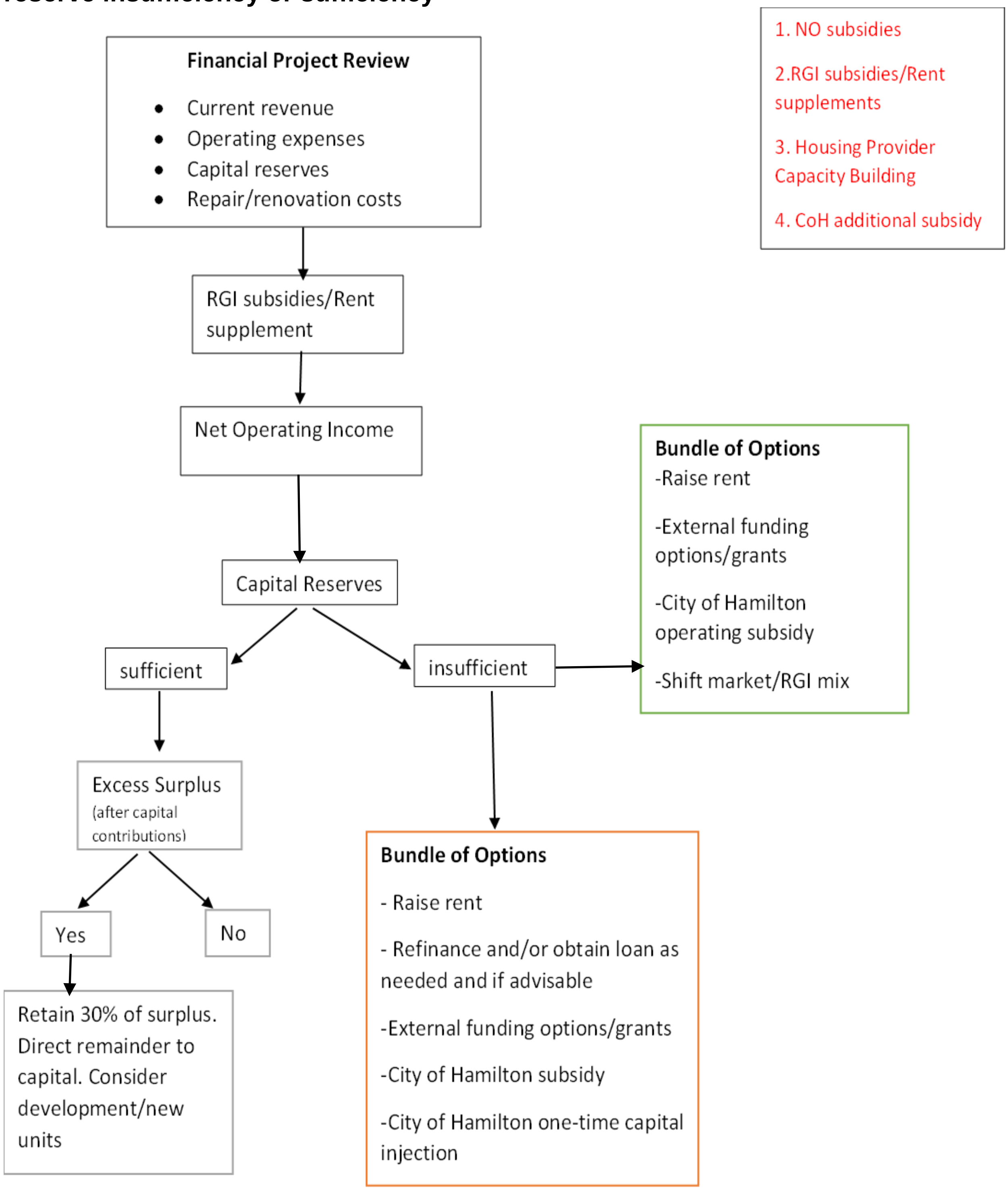
Each scenario will be projected to five and ten years with inflation factors applied to determine funding needs. As per legislative requirements, rent increases will follow provincial rent increase guidelines. Assumptions have been made around inflationary factors to project revenues and expenses over the 10-year span. Revenues will be projected based on the 5-year historical average of provincial indices for rent-geared-to-income rent, market rent and vacancy loss. Expenses (excluding Capital Reserve Contribution) will be projected based on the 5-year historical average of the City of Hamilton budget guidelines. The Residential Statistics Canada Construction Cost Index will be used to determine capital reserve contribution. The benchmark formula in the Housing Services Act for housing projects that have not yet reached end of mortgage uses the Canadian Price Index. However, the Canadian Price Index is not as robust to inflationary changes as the Residential Statistics Canada Construction Cost Index. The Residential Statistics Canada Construction Cost Index is used by Housing Services Corporation who is legislated in the Housing Services Act to assist housing providers and service managers. The increased contribution requirement for Housing Providers to their capital reserve will result in greater expenses and potentially cause a greater operating deficit for the project. This deficit is funded by the City of Hamilton through a subsidy and agreement with the provider to increase rents to ensure long-term viability where applicable and following an impact assessment of rent increases.

The model assumes that 5% of revenue is a reasonable target for operating surplus. Five percent is assumed to help providers meet the threshold of being financially viable rather than simply breaking even. Having a small amount of operating surplus is required for projects to respond to operating expenses that may not have been budgeted such as insurance claims, lawsuits, and unanticipated maintenance. An operating surplus is allocated to the operating reserve up to a capped amount. Monetary funds exceeding this percentage will be directed to capital reserves. Based on preliminary financial modeling, 30% of revenue is assumed as a viable operating reserve to cover three months of unplanned expenses. A cumulative accumulated surplus of greater than 30% will be directed to capital reserves.

Capital reserves should not be greater than the amount required to fund major capital repairs and replacement over a ten-year horizon. If the reserve exceeds this amount, Housing Providers will no longer be required to transfer operating reserves to capital and the City of Hamilton will stop providing operating subsidies. Should capital reserves be sufficiently funded, Housing Providers will be encouraged to invest in new developments or additional units. Preliminary analyses indicate that no housing projects should have over-funded capital reserves based on the proposed model.

The flow chart below outlines the options that will be considered for Housing Projects after a rent-geared-to-income subsidy is applied if operating income or capital reserves are either insufficient or sufficient.

Flow Chart- Project review and considerations for operating income or capital reserve insufficiency or sufficiency



City of Hamilton Budget/ Finance Strategy

Corporate Finance analyzed social housing’s existing operating budget and projected a 10-year budget using a 5-year benchmark average. The base budget was then revised by the percentage of projects reaching End of Mortgage as these projects would be funded differently from those still under the previous Housing Services Act regulations. A rent-geared-to-income City of Hamilton subsidy was applied automatically to projects at End of Mortgage. Based on a preliminary generalized analysis, and attributing 5% for operating surplus per project, the City of Hamilton anticipates staying within the operating base budget.

Capital was then examined for the multi-unit projects reaching End of Mortgage and CityHousing multi-unit projects at both End of Mortgage and End of Agreement. Capital needs for the single and semi-detached units were not reviewed as building condition assessments for these properties were not available. Current projections are based on high level assumptions. As more sophisticated information is worked through forecasts may change. The analysis suggests that additional municipal funding is required to help meet the extensive capital repair needs of our aging social housing stock. The majority of Social Housing Providers currently have an accumulated backlog of repairs requiring completion, reflecting the insufficiency of the previous funding formula. Based on 2016 Building Condition Assessments, reports that indicate repairs required for the housing project in both the short and long term, along with estimated cost of completing these repairs, the estimated amount for Social Housing Providers to address their capital costs is $643M.

Recognizing that a substantial municipal investment is required to address a portion of the capital repair costs, while simultaneously acknowledging finite resources and the need for Housing Providers to obtain additional funding through various sources, the City of Hamilton is proposing to partially bridge the capital repair costs by contributing 25% of capital repair costs to support and maintain units. Twenty four percent or 153M would be included in the levy based over the next 10 years, through an enhancement of 5.1M for four years to increase the base to 20.4 million. The other 1% would be derived from the Annual Municipal Social Housing Capital Repairs and Regeneration funding. The remaining 75% would be funded by providers internal financing, through a bundle of options including Canada Mortgage and Housing Corporation loans/grant requests and other Provincial funding such as Canada-Ontario Community Housing Initiative.

The chart below details the funding request and the current funding sources available to Housing Providers at End of Mortgage:

Chart 1: Capital Needs, Funding Request and Sources at End of Mortgage

	2023-2032	**Notes**
Capital		
Building Condition Assessments (BCAs)	643,000,000	Based on 2016 BCAs
Subtotal- capital needs	**643,000,000**	**May vary based on updated BCAs**
Funding Sources		
Provider – Capital Reserves		Will vary depending on base and financial situation
Provider- Loan/refinancing		Depends if eligible and advisable
Provider Grant/COCHI		Depends if eligible and awarded
Annual Municipal Social Housing Capital Repairs and Regen 6730041000	7,319,000	Approval pending through annual Capital budget process. $7.319M is the cumulative projection of requests for 2023-2032
Levy Base Request in recommendation (c)	153,000,000	5.1M annual enhancement from 2024-2027, cumulative $51M. Ongoing base of $20.4M 2028-2032, cumulative $102M *See Note 1 below
City of Hamilton Contribution at ~25%	**160,319,000**	**~25% = 160,319,000/643,000,000**

Note 1

Year	2024	2025	2026	2027	2028	2029	2030	2031	2032	**Total**
Levy Increase	$5.1M	$5.1M	$5.1M	$5.1M	0	0	0	0	0	**$20.4M**
Levy Base	$5.1M	$10.2M	$15.3M	$20.4M	$20.4M	$20.4M	$20.4M	$20.4M	$20.4M	**$153M**

While legislation only requires Service Managers to fund rent-geared-to-income assistance and not capital repair costs, Service Managers are required to fund projects in a manner that ensures that the project can be sustained and is viable. Without sufficient funding from the municipality, the City of Hamilton risks losing more affordable housing within our geographical boundary.