Addressing the Expiring Subsidy Challenge: Options and Remedies

A guide for social housing providers in managing the impact of expiring subsidy agreements

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Introduction and purpose of this guide

This guide has been developed as a companion document and explanatory guide to the Simplified Assessment Tool (SAT). The SAT excel spreadsheet is a user-friendly tool designed to help social housing providers examine the likely impact of expiring subsidies.

A copy of the SAT can be downloaded at [insert link to CHRA website]

It is noted that related to the issue of project financial viability the expiry of Operating Agreements will substantially reduce total federal (and in some cases Provincial/Territorial) expenditures on social and affordable housing. There are important policy and advocacy issues related to this declining federal spending commitment. However these are outside the scope of this guide.

Understanding "Expiry of Operating Agreements (EOA)"

Social housing subsidies are beginning to expire as a result of funding agreements reaching maturity. When social housing projects were initially developed, providers entered into project-level contracts, known as Operating Agreements. The Operating Agreement specified the terms and conditions for receipt and use of subsidy payments.

Many pre-1986 agreements were with the Canada Mortgage and Housing Corporation (CMHC), but some pre-1986 and most post-1985 have been with provincial or territorial housing agencies (P/T agencies). Some are funded exclusively by the federal government (via CMHC) while others involved federal/provincial/territorial cost-shared subsidy arrangements.

As a result of an administrative arrangement between CMHC and most P/T agencies, federal subsidies may flow via the province/territory, even though all or part is federal money.[1] Ontario is an exception and is discussed separately.

The distinction between federally funded, cost-shared or unilateral provincial funding does not really matter. All agreements were similar in that they were contractual agreements that specified the amount and duration of subsidy funding alongside terms and conditions that providers had to meet.

Because the largest single project operating expense is typically mortgage payments, agreements were structured to flow subsidy for as long as the mortgage was being repaid. Once the mortgage is fully repaid and this large expense disappears, it was assumed that projects would generate sufficient rental income, even with low rents, to cover remaining operating expenses. Thus, the subsidy was scheduled to terminate at the same time.

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[1] Social Housing Agreements transferring administrative responsibility have been signed with all jurisdictions except Alberta, Quebec and PEI. In all other jurisdictions, federal subsidy flows via the province and is generally augmented with provincial funding because CMHC froze their contribution at the 1995/96 level.

Regardless of whether the subsidy flows directly from CMHC or from a province/territory, once the contract (Operating Agreement) matures all obligations terminate, unless specifically renegotiated. Neither CMHC nor P/T housing agencies have any legal obligation to extend or renew subsidy arrangements. Only in Ontario is there a legal obligation on municipalities and this is discussed later as a special case. Similarly, the provider no longer has any terms and conditions to meet and is no longer required to report to CMHC or the P/T housing agencies

P/T agencies *may* elect to offer new subsidies, or extended subsidy support, but this is not a given. Once the Operating Agreement has expired, the P/T has no legal obligation to extend new subsidy. To provide unilateral assistance shifts the subsidy burden entirely to the P/T and excuses the federal government from any further expenditure, something some P/Ts may be reluctant to do.

Accordingly, in this guide, remedies are explored under a hierarchy of situations:

1. Where the project becomes fully independent and has no further relationship with the P/T agency or with CMHC.
2. Where a new arrangement is negotiated to access ongoing P/T subsidy support (with appropriate terms and conditions)
3. Ontario-specific ongoing legislated conditions

The special case of Ontario

The options identified in this guide may not apply for many projects in Ontario.. In this province, as part of social housing funding reform in 1998, funding responsibility for any contractual provincial subsidy was transferred from the provincial government to municipalities. Municipalities also took over administration of federal subsidies, which were flowed through the municipal "Service Managers".

The process of funding and administration reform originally via the Social Housing Reform Act (SHRA 2000), more recently revised under the Housing Services Act (HSA 2012) effectively terminated all operating agreements in which the province of Ontario was a party and replaced the terms and conditions with the above noted legislation and associated regulations. Unlike the contractual Operating Agreements discussed earlier, this legislation has no scheduled termination. So both the operating obligations of the provider and subsidy obligation of the funder (municipality) continue indefinitely.

This means that for any Ontario project in receipt of subsidy under a federal-provincial cost shared or provincial unilateral program ("provincial reformed project"), the concept of expiring operating agreements does not exist. A provider will continue to have recourse to the municipal Service Manager who is legally obligated to maintain some level of subsidy to designated Rent-Geared-to-Income (RGI) units.

However, the federal portion of any subsidy funds, which flow via the municipal Service Manager, will terminate, reducing the overall funding available, such that in the face of the matured mortgage obligation (reduced expenses), a service manager may seek adjustment in the subsidy amount provided. ***This guide and the SAT are NOT designed to assess such Ontario projects.***

For projects that had Operating Agreements directly with CMHC ("former federal projects"), even though now administered by a municipal Service Manager, these Operating Agreements remain. These projects are not included in the SHRA/SHA and thus are not included in the Service Managers ongoing legal obligation. In these projects, both the federal subsidy and the terms and conditions in the Operating Agreement will expire and the project will face the same post-agreement challenges as those outside Ontario. Such providers of federal unilaterally funded projects can therefore use the SAT and the remedies included here.

Note that portfolio providers may have a mix of former federal and provincial reformed properties such that the tool may help for some parts of their portfolio.

To assist Ontario Providers with projects administered under the SHRA/HSA, a separate addendum is provided with Ontario-specific instructions and discussion.

Using the Simplified Assessment Tool (SAT)

For each project in their portfolio, the SAT enables users to determine what will happen at expiry. The tool requires users to input basic data from their most recent fiscal year statements and Annual Information Return (AIR). It then uses default inflation factors (which the user can adjust if appropriate) to forecast revenues and aggregate operating expenses to the year of expiry. Based on input data, the tool summarizes all rent revenue and operating expenses to determine the net operating income (NOI) for the current year (i.e. the year for which data is entered).

The *inputs must exclude any subsidy revenues and any mortgage payments* (principle and interest) because the SAT seeks to demonstrate what will transpire when the project no longer has to make a payment and no longer receives any subsidy.

In addition, the tool provides a basic test to explore whether the project capital replacement reserve is sufficient to manage normal replacement. This is a proxy test, based on norms and does not allow for extraordinary recent investment in capital replacement, which may have depleted reserves, nor for abnormally large planned expenses, which may exceed the proxy estimate. Additional examination is discussed below.

The SAT generates four possible outcomes at a project level and the following matrix is replicated from the tool's output page to illustrate these four potential outcomes

Three of these outcomes require remedial steps to address issues of non-viability or insufficient capital reserves. One generates a positive result (cell 1, top left).

The tool uses existing rent revenue as a key input. This includes RGI rent revenue for assisted households. In projecting to expiry it assumes that these households continue to pay the same rate (with a low inflation factor). That is, they remain subsidized. The tool does not try to identify any internal subsidy as an explicit variable. However, these households are receiving an implicit subsidy because they continue to have low rents.

Overall Assessment Matrix		
	Capital reserves	
	Sufficient	Insufficient
Positive NOI	(1) Project is viable, can maintain current RGI market mix and has sufficient capital reserve	(2) Project generates a cash flow surplus, but asset is under-maintained.
Negative NOI	(3) Project is not viable but has good reserves MY PROJECT IS HERE	(4) The project is not viable and replacement reserve is insufficient. Project is at risk

The next sections present some options and actions that providers can use to change their trajectory so that they will arrive at a sustainable outcome at EOA. Some of the options are not without consequences: they may have an impact on the affordability of units and number of lower rent RGI units. But first, some cautionary notes about interpreting the initial results need to be presented:

Some caveats on positive (cell 1) outcomes

Previous research has demonstrated that for many providers expiry will generate positive outcomes, at least in terms of operating viability. As such, many providers may find themselves in Cell 1. This will mean that the project generates positive cash flow and, based on the proxy capital reserve measure, appears to have sufficient reserves.

However, providers should not become complacent if a project falls into this category. It is important that providers carefully assess this apparently favourable outcome.

In particular, while net operating income (NOI) may be positive, is it solidly positive or only marginally so? The outcome will be influenced by the inflation factors used to project rent levels and operating costs. Did you change the default to more positive revenue growth, and is this assumption optimistic? Over the remaining operating period, how you select new tenants for vacant units will also affect your forecast rent revenues (i.e. for RGI unit vacancies, are you selecting households with much lower income than current vacating household?). Unanticipated increases in operating expenses such as insurance and utilities may also alter the forecast trajectory. For these reasons, it is advisable to periodically repeat the assessment exercise (ideally update the SAT analysis each year).

The larger unknown is the positive rating on adequacy of capital reserves. The tool uses some crude norms to develop a proxy measure as an indicator. But the tool does not include any information or input on recent trends in capital replacement – is the building well-maintained and upgraded, or is there significant deferred replacement? If there is deferral of investment which has allowed the reserve to accumulate, this may generate a false reading.

Ideally all providers should undertake a building condition assessment (BCA) and develop a capital plan. With such a plan in place you can more accurately determine if the current reserves plus planned annual contributions will in fact be sufficient to accumulate the amount required for investment in upgrading the asset.

Once a provider has undertaken this additional diligence and confirmed the positive outcome, they might then turn their attention to the opportunities to reinvest projected surplus to further the provision of affordable housing options.

It is assumed that providers will remain committed to their incorporated mission to provide affordable housing to households in need. So where surpluses are generated, it is assumed that providers will explore ways to lever these surpluses toward their stated mission. It is beyond the scope of this guide to expand on how they might pursue these actions.

Exploring options and actions

There are three other potential outcomes reflecting cells 2-4 in the outcomes matrix:

2. Financially viable but insufficient reserves
3. Sufficient reserves but not financially viable
4. Insufficient reserves and financially unviable

First, ways to improve viability are examined. This is followed by options to address insufficient capital reserves, although weak reserves are a function of available income to contribute, so actions designed to ensure financial viability also apply.

Addressing unviable or weak viability

This section relates to projects that fall in cell 3 or 4 in the matrix (negative net operating income or NOI).

Due to operating and funding constraints it is assumed that there are very limited opportunities to improve projected viability by cutting operating costs.[2] Thus, the actions examined all focus on increasing revenues.

[2] One area of potential savings may be through undertaking energy efficiency initiatives. Generally these use associated savings to finance the energy retrofit, so these options should be part of a broad asset renewal plan, which is beyond the scope of this brief. Availability of capital reserves may also be a consideration, as discussed later.

Although the proposed actions are designed to ensure the financial viability of a particular project, these actions may have an impact on the ability of providers to support the same number of low-income households to the same degree. Thus, the overall caveat to all the options outlined below is that they may negatively impact affordability, but that in the absence of external support, they will ensure that the project can continue to operate and serve tenants, even if rents increase for some or a smaller proportion are RGI-tenants.

That the options presented in this guide make social housing less affordable or reduce the total number of RGI units at time when significant wait lists for social housing exist reflects the inherent public policy dilemma of the EOA issue. Addressing this dilemma, however, is outside of the scope of this guide.

The first step is to determine the degree to which the project is unviable. Is NOI only marginally negative (i.e. less than $1,000 per unit per year, which is less than $100 per month), or is viability more serious? If only marginally non-viable, minor tweaks in the RGI/market mix or level of rents may suffice (just one of the following actions may suffice). If the deficit is more substantial, more severe adjustments will be required, potentially requiring a combination of actions.

A number of actions can be taken to increase rental revenues. These are not independent; a combination of options can be pursued in tandem. The options presented below begin with those that can be implemented by the provider with no approval or assistance from the provincial/territorial housing agency. Options requiring negotiation and support are subsequently reviewed.

a) Adjust market rents

b) Adjust RGI mix (at turnover)

c) Explore ways to improve RGI tenant income

d) Shift RGI to market

e) Abandon RGI rents in favour of low break-even rents

f) Review mix of working poor vs. social assistance RGIs households

g) Seek new subsidy assistance from funder

a) Adjust market rents

In mixed income social housing some proportion of units are not RGI-based and have rents set at "market" or "low end of market". Often these notional market rents are set well below prevailing market levels for similar accommodations. In Section 26 projects, for example, rents were set at a break-even rent, which is typically well below market. Such sub-optimal rents may be a contributing factor in weak viability.

Thus there is scope to increase rents in the non-RGI units, while still retaining very competitive and affordable rents. In cases where low-income tenants occupy a unit while awaiting access to an RGI unit, raising rents may not be realistic or desirable. But many existing tenants may have capacity to accept a modest increase on an annual ongoing basis.

A less intrusive way to implement an increase in the market rents is when a non-RGI (market) unit is vacated. Subject to specific provincial rent regulation, the rent for a new incoming tenant can be increased, and may still be relatively affordable and below true market. By implementing such higher rents well in advance of EOA, rent revenues can gradually be increased, ideally to point that project will be in a viable position at EOA.

A further variant (see option [h] below) is to add a specific levy to all market rents (assuming these are well below market) to cover specific costs such as capital replacement.

b) Adjust RGI mix

Although turnover rates tend to be lower among RGI tenants compared to market-rent tenants, there is nonetheless some turnover. One way to improve rental income is to increase future RGI rents when vacancies occur by selecting new tenants that are not the in the lowest income group (excluding social assistance, as discussed below). For example, a household earning $15,000 per year versus one leaving that had $12,000 per year would result in a revenue increase of $900 per year ($75/month).

A review of recent turnover trends may be useful in predicting how many RGI units might turnover in the remaining operating period and can be used to calculate potential increase in aggregate RGI rent revenues.

c) Explore ways to improve RGI tenant income

Another way to improve the rental revenue generated from RGI units is to help existing RGI tenants increase their income. Partnering with employment and skills building agencies, or with potential employers seeking trainee workers can provide support the xisting tenants and help them to improve their economic wellbeing. As the re-engage with the labour market, develop skills and experience there is potential for their income to increase, which in turn improves rental income.

d) Shift some RGI units to market units

Most providers have a mandate and desire to provide affordable housing and will be reluctant to reduce the number of RGI units available. However, at EOA and faced with the alternative of being unviable and going into receivership, a shift in the mix of RGI/market units is an option to explore. At expiry there is no longer any specific requirement to maintain a certain percentage of RGI units[3], as there is no longer an operating agreement.

This might simply involve shifting a small portion of units (again, at vacancy turnover) from RGI to market rents. For example, a unit may command a true market rent of $850, but generate only $185 on an RGI basis. Transforming the unit to market rent could therefore increase rental revenue by up to $665 per month, thus providing almost $8,000 per year in revenue.

e) Abandon RGI rents in favour of low break-even rents

The use of RGI rents in social housing is an attempt to create greater vertical equity – households with the lowest income receive the greatest assistance. However, the RGI 30% scale is imprecise and arbitrary and does not, for example, take into account different budgetary needs of households with several dependents, compared to those without dependents. It also requires administrative diligence. Once the agreements expire, providers no longer have an obligation to sustain RGI rents. Indeed, many early expiries will occur in the Section 26 portfolio, which did not have RGI rents and no ongoing subsidy (except where separate, stacked rent supplements were provided). Rents were established on a breakeven basis. Many such providers found this approach to be easier to administer and still allowed them to provide low, affordable rents.

So this option could be implemented after EOA. Existing RGI tenants could be grandfathered with breakeven rents implemented only for new incoming tenancies. Rent levels would be set to ensure financial viability following the EOA.

f) Review mix of working poor vs. social assistance RGI households

The preceding possible actions are all steps that a provider can implement independently; they do not require any support or approval of the provincial/territorial housing agency. The option outlined below, however, is more complicated and may require policy support from the P/T agency.

One of the key predictive factors determined in earlier research is that projects with very high levels of RGI and, even more, with deep targeting are less likely to be financially viable after EOA.[4] One important reason for this is because a large proportion of non-senior households are dependent on income assistance and more particularly because rent payments from provincial/territorial income assistance programs have been set at very low levels.

The structure of income assistance in all provinces/territories typically involves two components: a basic living allowance and a shelter component. The shelter component (SC) is a variable and the program pays a maximum SC “up to actual rent”. Because of a

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[3] Most but not all operating agreements have a minimum RGI requirement

[4] Connelly et al (2003) Expiry of Operating Agreements (for CHRA); Pomeroy et al 2006 Is Chicken Little Right (for CHRA)

conundrum in the formulas to calculate total assistance and RGI rent calculations (for which total income must be known), all provinces have established a schedule of rents specifically for recipients living in social housing. These are typically very low (e.g. $85-$185 per month). If the same household moved into unsubsidized private housing, they would pay market rent and be eligible to receive the maximum SC (provided that was not above the actual rent paid).

Once a project reaches EOA, even though it is operated on a non-profit basis, it is no longer subsidized social housing. It is in effect market rental and thus should no longer be captured under the definition of subsidized housing in the income assistance regulations and thus no longer constrained by administratively scheduled SC rents.

It should be possible to revise the rent levels, and increase it from the low administratively determined rent up to the maximum shelter component (SC) of the income assistance program. This will generate a significant increase in rental revenue, especially in projects with a high proportion of tenants on income assistance.

It is important to note that this should have no effect on the tenant, as the income assistance program will pay the higher rent, and their basic living allowance will not be impacted. This option simply moves the (pre-EOA) subsidy cost from the social housing budget to the income assistance budget.

This obviously impacts provincial/territorial social assistance expenditures, although the volume of projects expiring in any one year with social assistance tenants will not be huge so it will not create a drastic increase. One way to phase this in and minimize the impact is to impose the full SA rent only on new tenants or new recipients of social assistance.

The provisions that influence this option include the specific definitions of social or subsidized housing in provincial/territorial income assistance legislation or regulations, as well as the specifications and exceptions for social housing in residential tenancy legislation. Accordingly, this is a policy option that could be explored with provincial/territorial housing agencies.

If approved, this option will likely have the greatest single impact of all the options discussed (except for projects targeted to seniors where artificially low SC of income assistance is not applicable). However, it cannot be implemented until expiry, when the project is no longer classed as social housing. The other options all involve phasing in incremental increase in revenues in advance of EOA.

g) Seek supplementary assistance from funder

The final option involves renewing a relationship with the P/T housing agency. As noted at the outset, after expiry, there is no legal or contractual obligation for providers (outside of Ontario) to continue providing a subsidy. However, once the mortgage has expired, the operating deficit in non-viable projects will be much smaller than that in younger social housing.

Provinces and territories have a strong interest in sustaining existing non-profit assets, in part because the associated subsidy cost is far smaller than what it would cost to lose these assets and replace with new affordable housing and also because they wish to build on 35-50 years of past investment. Accordingly, P/Ts may well be willing partners in negotiating new subsidy agreements.

The best approach to doing so may be to create a specific rent supplement program to offer to social housing providers.

Previous research has clearly demonstrated that, over time, breakeven rents in non-profit housing rise at a much slower rate than do market rents.[5] Thus, non-profit housing is a cost effective platform on which to stack rent supplements. Moreover, where breakeven rents are below the market average, this advantage is enhanced. As discussed below, such ongoing rent supplement agreements might be linked to capital assistance for those with insufficient reserves to maintain their assets (cell 4 of matrix).

This option will require provinces/territories to design and implement specific rent supplements or other project-based subsidy mechanisms, potentially involving new agreements.

Addressing Insufficient Capital Reserves

On insufficient capital reserves, the first step is to understand why this outcome is generated. Are reserves and ongoing contributions truly insufficient, or is this a false negative? For providers that have invested heavily in capital renewal and have depleted reserves, the test will generate a negative result. But it does not consider recent expenditures and the quality of the building; in such a case the warning can be viewed as a caution to rebuild reserves.

If the building is not in sound condition and is in need of major replacements, but reserves and ongoing contributions (during the remainder of the agreement) are lacking, it will be necessary to determine if operating revenues can be increased to fund replacement.

As noted earlier, it is strongly recommend that providers undertake a building condition assessment (BCA) and from this develop a capital investment plan. This is a more detailed and purposeful way to manage capital maintenance and renewal, and it helps to quantify funding requirements.

Using a generalized formula, the outcomes matrix identifies two distinctly different scenarios. The first is cell (2) where capital reserves plus contributions are determined to be insufficient, but the project is financially viable and generating positive NOI. The

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[5] Pomeroy (2005) Invest or Subsidize: Comparative Subsidy Cost on Non-Profit and Private Market Units in Ottawa 1975-2004 (City of Ottawa) and Ekos (1997); and Ekos (1996) A Review of Alternative Rental Programs (for the Canadian Housing and Renewal Association).

other is cell (4) where both reserves are insufficient and cash flows are forecast to be negative.

Cell 2 is obviously a more favourable option so possible actions begin from this perspective. Additional options are then reviewed, most of which involve seeking assistance from provincial/territorial funders.

Before utilizing the options below, previously discussed scenarios (a-f) that correct for non-viable operations should be explored. Using one or some of the aforementioned viability scenarios may shift the project from cell (4) to cell (2), and thus enable use of the refinancing option (g).

Potential options are:

h) Borrow against surplus

i) Add a capital improvement levy to rents

j) Seek P/T approval to increase pre-expiry contributions

k) Seek P/T approval to re-amortize and borrow pre-expiry for replacement

l) Seek renewal of funding support

h) Borrow against surplus

For a project falling into cell 2 (positive NOI, but insufficient reserves) there is the potential to convert ongoing cash flow surplus into an infusion of capital by refinancing. This simply involves borrowing to fund capital renewal, and using the ongoing surplus cash flow as a source to cover new loan payments.

The SAT tool already includes a tab that allows providers to evaluate their capacity to borrow (SAT tab "potential leverage"). This tab determines how much a provider might borrow, depending on interest rate and term. As suggested in the SAT, it is preferable to minimize the borrowing term, so that future cash flows are not overly encumbered and capacity will remain for future borrowing, as other major capital components subsequently require replacement. When exploring the capacity to refinance, it will be helpful to have a BCA and capital plan against which to assess required borrowing.

One concern with this option is that it may delay capital replacement, since the capacity to refinance may not exist prior to expiry. When more immediate replacement is necessary or preferable, providers will need to negotiate an arrangement with the P/T housing agency to secure the necessary funding. This could involve a one-time subsidy grant, or potentially a deferred loan, with repayment commencing only at expiry. This will, however, require engagement and negotiation with the P/T housing agency as the Operating Agreement remains in place at this juncture.

i) Add a capital improvement levy to rents

The earlier remedies included an increase to market rents following EOA. While still benefitting from below-market rents, tenants may object to an arbitrary increase. However, where this is specifically associated with a building improvement (especially if unit specific, such as appliances or windows), it may be more acceptable to implement. With such a levy in place, it may be possible to undertake borrowing, as in (g) above.

j) Seek P/T approval to increase pre-expiry contributions

Where a capital plan has identified a necessary replacement, but reserves and current contributions are insufficient, providers may seek approval from the P/T housing agency to increase their contributions during the remainder of the agreement.

In a number of jurisdictions, funders are already permitting providers to allocate any surplus subsidy payments identified in annual subsidy reconciliation into their capital reserves, rather than repaying these to the funder. Where no surpluses are being generated, an increase in subsidy to cover larger contributions will be required.

In the SAT, it is already assumed that for pre-1986, Section 95 project funders will permit the provider to reallocate funds from a surplus subsidy fund (SSF) to capital reserves. However, this will require specific approval for each provider.

k) Seek P/T approval to re-amortize and borrow before expiry for replacement

As noted under (g), for certain capital improvements it may be preferable not to wait until expiry, when refinancing room is available (and prior approval is not required from P/T). To immediately undertake capital replacement, one option is to refinance in advance of expiry. Doing so will require the approval of the P/T housing agency to further encumber the asset. Such additional borrowing will increase the required subsidy to cover any operating deficit (pre-expiry); however, extending the amortization period on the existing loan might neutralize this. This might also require the P/T to extend the operating agreement subsidies to facilitate repayment.

An alternate approach is for the P/T to provide a separate loan specifically linked to the capital improvement cost. The subsidy will either be adjusted over the remainder of the term to cover the associated loan repayment or repayment will be deferred until after EOA (assuming the project has positive post-agreement NOI). Again, specific arrangements will need to be negotiated with the P/T housing agency.

l) Seek renewal of funding support

The final option, similar to option (f), above, is to negotiate the renewal or extension of operating funding to enable to project to operate on a viable basis and to undertake necessary capital improvements. This will involve negotiation with the P/T housing agency (albeit the P/T housing agency may, in turn, need to negotiate with CMHC as a significant portion of funds that end after EOA came from CMHC) Again, preserving existing assets may involve lower expenditures than the comparable cost to replace though new development elsewhere.

Extending subsidy, even via a one-time capital grant for replacement also offers a quid pro quo of extending terms and conditions to retain the units within the social housing sector and ensure that they continue to serve households in need.

Potential role of Provincial/Territorial agencies

The aforementioned outlined a range of options, some of which can be undertaken and implemented by the providers without P/T assistance. But many do require some support and potentially renewal of provincial/territorial spending.

This includes policy review and clarification with respect to how rents should be set for recipients of income assistance once projects are no longer receiving housing subsidies.

The other critical area is in enabling refinancing to facilitate capital improvements. It would be beneficial to create a financial facility and set of policies in each province/territory to assist and facilitate this process, rather than have each provider individually try and negotiate loans with lenders. This is especially important since lenders may be wary about lending to non-profits that no longer have the income security of subsidy payments and government backing.

Potential role of CMHC

This guide does not address the role of CMHC. Advocates and P/Ts have expressed concern about the reduction of federal contributions and there is much advocacy action on this matter. While inferred, these issues are accordingly not discussed in this guide.

That said, many of the options outlined involve negotiation with the pre-expiry funder. In most cases, as a result of the Social Housing Agreements (SHAs) that transferred the administrative responsibility of social housing to P/Ts, this role falls to the P/Ts and accordingly that nomenclature is used throughout. However, in Alberta, Quebec and PEI, these jurisdictions have not entered into a SHA and CMHC remains active. Consequently, in these jurisdictions, any and all options that suggest a funder role apply equally to CMHC.

A specific area where CMHC could play an important role is in the aforementioned financing of capital renewal. CMHC currently provides a financing facility for renewing mortgage terms on social housing mortgages. This facility generates very low lending rates, below those of retail lending, drawing on the federal crown-borrowing framework. CMHC direct lending authority is specifically linked to financing social housing loans. As these loans mature, CMHC will have increased financing room within the existing authority. This could be refocused on providing financing to existing non-profit (and co-op) providers requiring funds to undertake necessary capital improvement.

Appendix A: Ontario Addendum

As noted, Ontario is unique with respect to the concept of expiring Operating Agreements.

As a result of administrative reform, which transferred provincial subsidy expenditures and administrative responsibility from the Province of Ontario to local municipalities (municipal Service Managers) the concept of an operating agreement, and expiry of operating agreements EOA) does not apply to many projects in Ontario. As such the options set out in this guide may not be applicable to all projects in Ontario, and in some cases additional options are feasible (notably continues subsidy assistance).

This addendum clarifies if and when the previously discussed options are relevant, and which options are uniquely available to Ontario Providers.

As a result of social housing legislation (Housing Services Act 2012) two different categories of project now exist in Ontario:

- Provincial reformed projects (PRP); and
- Former federal projects (FFP)

The provincial reformed projects include any project where subsidy was originally provided on a federal-provincial cost shared basis and the project operating agreement was executed by the province of Ontario on behalf of the F/P partnership; or any project unilaterally funded under Ontario programs.

- A third type also exists, as a subset of the former federal projects. These are projects where there was a separate stacked rent supplement agreement that provided rgi assistance to some or all units.

This included the Community Sponsored Housing Program (CSHP) stacked on federal Sec 27/61 projects (pre 1978); and the Ontario Community Housing Assistance Program (OCHAP) stacked on the Sec 1995 (1978-1985) projects. In both cases subsidy was funded either cost shared or entirely by the province. The HSA does apply, in part, to the units received the additional rent supplements.

In the case of the first category (PRP), the former Operating Agreements have been terminated and replaced by legislation, which defines through the *funding model* what will occur when the mortgage matures.

In the case of category two (FFP), when the operating agreement expires the municipal Service Manager no longer has any control over the project nor any obligation to provide any subsidy support.

Potential ongoing subsidy support for Rent Supplements

The third category (i.e. FFP with separate, stacked rent supplement subsidy) has a further nuance. The project is outside the HSA legislation but because the stacked rent supplement provides RGI assistance, such RGI units are included in the targeted service level standards imposed on the Service Manager. This means that while the projects are not encumbered by any terms and conditions, the municipal targeting plan includes the rent supplement units in its minimal number of targeted units.[6]

The legislation does not bind the specific rent supplement units (or provider). It simply includes these units in an overall target number of RGI units that the Service Manager must sustain. And similarly, the Service manager has no obligation to that project/provider. But, because the expiring FFP units are at, or more likely slightly below, market rent, it may be cost effective for the Service Manager to extend these rent supplements (with a new agreement) versus subsidizing newer or higher rent units somewhere else in the municipality. Consequently the Service Manager *may* be interested in extending a rent supplement agreement to continue providing some RGI assistance to the project, should the provider wish to use this for RGI purposes.

Implications for using the simplified tool and the identified options

The SAT is premised on both the mortgage and the subsidy both ending, and calculates financial viability in the absence of both.

There is no question about the maturing of the mortgage and thus reduced expenditures. However, the matter of subsidy expiring or continuing depends on what category the project is in (FFP, PRP, as outlined above).

In any Former Federal project, the Operating Agreement, which has remained in place, will expire and the tool (which excludes both mortgage costs and subsidy revenue) will provide a realistic representation of likely outcome. Thus providers of such FFP projects can use the full list of options outlined in the guide.

For the PRP, as well as those implicated by a rent supplement covered under the HSA (2012), the SAT output ***will not correctly reflect the situation at expiry***. For the PRP's it is necessary to follow the funding model, as specified in the SHA regulations (Ontario Regulation 369/11), explained in the ONPHA guide, "Know Your Funding Model"[7]

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[6] The legislation establishes a minimum number of units that must continue to be targeted to eligible households and the municipal Service Manager is obligated to continue providing rgi subsidy to this number of units (the so called "minimum service level").

[7] The guide Know your Funding Model is available on the ONPHA web site at: http://www.onpha.on.ca/AM/AMTemplate.cfm?Section=Financial_Management&CONTENTID=11867&TEMPLATE=/CM/ContentDisplay.cfm

Again, the funding model applies some subtle variations depending on whether the project is a municipal non-profit (MNP) or private non-profit (PNP) or a co-op [8] and whether units are a mix or market and RGI or 100% RGI.

Leaving aside those subtle variations, the funding model has two basic components. It first calculates an operating subsidy using benchmarked and subsequently indexed operating expenses, actual taxes and actual mortgage payments. Secondly it calculates the RGI subsidy, premised on the lesser of Index Market rent or actually rents (if below market). The regulations (OR 369/11 clause 5) combine both of these components in a single formula:

> Indexed Operating Costs +Mortgage + Property Taxes - Indexed Revenue +RGI Subsidy - Surplus Repayment. [9]

So effectively, when the mortgage expired, the costs are reduced, but there is no change to the RGI subsidy (beyond any change in market rent or tenant incomes). Integrating both components in a single formula effectively means that if the operating subsidy is negative (after mortgage cost removed) this negative subsidy nets out to reduce the amount of RGI assistance required.

In short, for provincial reformed projects the legislated funding model obligates the municipal Service Manager to continue providing subsidy. This may help ensure that projects will have a breakeven or positive cash flow and will be financially viable on an ongoing basis.

In the case of insufficient capital reserves, the proxy model in the SAT may be used and may provide some insight into adequacy of current reserves (but with same caveats on the need to develop better understanding via a building condition assessment and capital investment plan).

In event that the capital reserves are deemed to be insufficient in Provincial Reformed Projects, potential actions will include seeking and securing approval of Service Managers to pursue certain actions. This could potentially include refinancing to cover cost of replacement. However, it is not possible to determine how much can be levered without first confirming the amount of any positive cash flow, as generated under the funding formula. So the use of the "potential leverage tab in the SAT cannot be used.

Refer to separate guidance from ONPHA and the Housing Services Corporation

Due to the program variations and complexity of the funding arrangements in Ontario, it is inappropriate to develop here any more detailed discussion of possible options. Ongoing initiatives at ONPHA and HSC are underway and will provide this additional guidance for provincial reformed projects.

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[8] The SAT and this guide do not seek to discuss any specific variations for co-ops. Coops should refer to guides and advise developed separately by CHF Canada.

[9] For definition and specification of the funding formula see Ont. Reg 369/11

It is suggested that PRP projects do not try and use the simplified Assessment Tool

Former Federal Projects

All identified options can be applied in the case of former federal projects.

In the case of those that have separate stacked rent supplements under either CSHP or OCHAP there may also be an opportunity to secure an extension of such rent supplement RGI assistance from the Municipality.

Appendix B: Copy of the simplified Assessment Tool

The SAT is an excel spreadsheet and can be down loaded from the CHRA website at [add url link]. The pages of this spreadsheet are replicated here.

Examining the impact of expiring operating agreements

A Simplified Assessment Tool

This tool has been developed by Steve Pomeroy, Focus Consulting Inc.

For:
The Canadian Housing and Renewal Association,
in collaboration with:
BC Non Profit Housing Association
Manitoba Non Profit Housing Association
Ontario Non Profit Housing Association
Réseau québécois des OSBL d'habitation
New Brunswick Non Profit Housing Association

This tool requires a number of pieces of data be input on the next tab (inputs). Results are then produced in the following two tabs (results and potential leverage). For more detailed instructions see last tab (user guide)

Providers may want to repeat this assessment periodically to monitor trajectory toward expiry

A separate guide " ***Addressing the Expiring Subsidy Challenge"*** discusses options and remedies that providers can explore to improve outcomes forecast by this tool

With respect to sufficiency of Capital Replacement Reserves, the tool provides a rough assessment, without input about recent investment nor any assessment of the current state of the structure(s). Regardless of the outcome from this tool, it is strongly recommended that providers complete a building condition assessment and develop a capital renewal plan. This will provide more detailed assessment of capital need and sufficiency of current reserves and contributions

Note to Ontario users: This tool assumes the termination of subsidy, and as such it does not necessarily reflect the situation of provincially reformed projects. See the separate guide and Ontario Addenda to clarify how to interpret the tool output.

Input Variables Required

These values should be readily available in both your Annual Information Return, or in your most recent year end financial statements

All values entered below should be annual values

Variable	**Input here**	**Comments & suggestions**
Project identifer (name/ref #)	sample 1	Just a ref # for your use if you are assessing more than 1 project
Last fiscal year end (data year only)	2011	The reporting year from your data source. Enter year only, without day month (i.e. "2012")
Year Operating Agreement terminates (year only)	2014	See your operating agreement. Enter year only, without day month (i.e. "2012")
Total units	70	Total rental units in project
Total revenues	405,000	Include: RGI and market rents, any parking, laundry or other but **exclude any subsidy revenue received**
Total operating expenses	415,000	Include: Taxes, insurance, admin, maintenance, etc. **Exclude: mortgage interest and principle**
Balance in Capital replacement reserve (end last fiscal yr)	125,000	Balance in Capital Replacement Reserve at end of last fiscal year
Annual allocation to Capital Replace Reserve	27,000	Use current/planned annual contribution amount
Sec 95 Surplus subsidy Fund (SSF)	40,000	Balance in surplus subsidy fund (applies only to pre 1986 sec 95 projects). Assume this can be reallocated to capital reserve
Expected (assumed) inflation and mortgage rates		
Expected rate of inflation in operating expenses	2%	**Note:** use these defaults, unless you have strong evidence for different rate. With RGI rents revenue is likely to grow more slowly than operating costs
Expected growth rate of rent revenue	1%	
Annual interest rate for refinancing	5%	

Assessment output		Explanation/interpretation
Project name/identifier	sample 1	
Expiry year	2014	
Years until expiry	3	if "#VALUE!" error ensure only year entered on input sheet
Total units (includes market and RGI)	70	
Test 1: Operating viability (*assumes subsidy and mortgage expired this year*)		
Total revenues (excluding any subsidy)	405,000	*This examines extent to which project is financially viable if subsidy and mortgage expired this year. It avoids the use of inflation factors as used in test 2. If unviable today, it is very unlikely viability will improve by expiry*
Total operating expenses (Excl mortgage P&I)	415,000	
Net Operating Income (NOI, (today)	(10,000)	Is this value less than $0 (negative)?
NOI **per unit per year**	(143)	To address negative NOI see "Addressing Expiring Subsidy Challenge" Larger deficitsmay require engagement with funder
Test 2: Projecting NOI to actual expiry year		
Assumed annual increase in operating costs	2%	*Applies selected (or default) inflation factors to revenues and operating costs to*
Assumed annual increase in rents	1%	*estimate what these values wil be in expiry year*
Projected revenue year of expiry	417,272	*With RGI units it is likely the rent revenues will grow at slower rate than the rate*
Projected operating year of expiry	440,401	*for increases in operating costs*
Projected NOI	(23,129)	Is this projected value less than $0?
NOI per unit at Expiry (annual)	(330)	See separate guide "Addressing the Expiring Subsidy Challenge"
Test 3: Adequacy of replacement reserves		
Last fiscal year end (data year)	2011	
Year Operating Agreement terminates	2014	
Remaining years before expiry	3	
Balance in replacement reserve	125,000	
Annual allocation to Capital Replace Reserve	27,000	
Sec 95 Surplus subsidy Fund (SSF)	40,000	*Assume SSF can be reallocated to capital reserve*
Available to spend on capital replacement each remaining year	82,000	
Available for capital replace per unit per year remaining	1,171	Is this value less than $750
		If Less than $750, reserves and contributions inadequate See separate guide "addressing EOA challenges"
Summary assessment		
Is project viable	NO	
Do you have sufficient reserves	YES	

Overall Assessment Matrix

	Capital reserves	
	Sufficient	**Insufficient**
Positive NOI	(1) Project is viable, can maintain current RGI market mix and is in sound physical condition	(2) Project generates a cash flow surplus, but asset is under-maintained.
Negative NOI	(3) The project is not viable but has good reserves	(4) The project is not viable, and is unable to undertake necessary capital replacement. Project is at risk
	MY PROJECT IS HERE	

The results will identify which quadrant your project falls into with label "MY PROJECT IS HERE"

Depending on outcome, you will need to examine your situation, and potentially explore potential option.

See separate guide "Addressing the Expiring Subsidy Challenge"

How much can you borrow with refinancing?

Where the project has an operating surplus, this provides cash flow that can *potentially* be used to borrow for capital replacement

This worksheet helps you assess how much you can borrow, based on projected net operating income (NOI) at expiry. **Data is automatically picked up from previous tabs - no input is required here**

Do you have capacity to refinance? To do so you must have some positive cash flow (NOI)

Check: is NOI positive at Expiry: NO (so cannot refinance)

It is recommended that you retain part of any surplus for an operating reserve. Here we use a debt coverage ratio (DCR) to reduce the amount used for new financing. A DCR minimum of 1.25 is recommended. This means that you preserve 20% of your surplus for an operating reserve, and use 80% for new financing.

Net Operating Income (projected to expiry year)	CANNOT REFINANCE
Available to lever financing at 1.25 DCR	n/a
Retained for operating reserve	n/a

How much can you borrow?

Assume financing rate * 5%

** You can adjust assummed refinancing rate on input tab*

Loan terms (years)	project	per unit
5	n/a	n/a
10	n/a	n/a
15	n/a	n/a

Here we identify how much you can potentially borrow at assumed interest rate and term. It is recommended that you seek shorter term financing than is typical of mortgages because you may need to refinance again in future and show aim to pay off this new loan as quickly as possible. You should also limit length of borrowing to less than the likely useful life of capital assets being replaced.

Examining the impact of expiring operating agreements

What happens at "Expiry of Operating Agreements"?

Most social housing was developed and is operated by non-profit and co-operative associations or corporations. Each was supported with financing through a mortgage, typically with a 35-year amortization. Operating Agreements also included ongoing assistance to help repay the mortgage and cover operating expenses. The agreement was linked to the amortization of the mortgage. It was assumed that once the mortgage was retired, social housing projects would generate sufficient rental revenue to cover their costs. For many providers this will be true; for some it will not.

Expiry of agreements means that *both* the mortgage payments end (a good thing!) and also that ongoing subsidy payments stop. This assessment tool is designed to help you determine the net consequence of these simultaneous events.

The tool uses existing rent revenue as a key input. This includes rgi rent revenue for assisted households. In projecting to expiry it assumes that these households continue to pay the same rate (with a low inflation factor). That is, they remain subsidized. The tool does not try to identify any internal subsidy as an explicit variable. However these households are receiving an implicit subsidy, because they continue to have low rents

Using this assessment tool

This assessment tool is designed to help social housing providers examine the likely impact of expiring operating agreements.

The tool is designed analyze a single project. It allows small providers to assess individual projects. It is expected that larger multi project providers have finance departments and the internal expertise to build a multi project worksheet. They can readily adapt the tool.

This tool provides a simple assessment. It does not undertake detailed exploration of alternatives. A companion document "Addressing EOA Challenges" suggests and discusses various options that you can explore based on the outcomes of this simple assessment.

The tool undertakes two types of assessment:

1. It determines if the project is viable: does it break even or generate a surplus?
2. It examines capital reserve adequacy.

This tool is a first step to help providers identify if they might face a challenge at expiry. The tool uses three basic tests: a simple rule of thumb and then two additional assessments that highlight viability and capital adequacy.

Moving through the spreadsheet

The tool requires you to input a few basic variables, all of which should be readily available to you. It assumes that you have basic ability to use a spreadsheet.

If you click on the "input" tab you will see the variables you will need to undertake an assessment.

The "results" tab uses these variables to present the results of the three tests described above. Near the bottom you will see an overall assessment that places your project in one of four quadrants. Ideally you want to be in cell #1, top left, but even here you should pay attention to the degree to which you are viable and are estimated to have sufficient capital reserves. If you are in any of the other three cells, you need to carefully review your operations and explore options to change your expected outcome.

The final tab "potential leverage" explores if you can use refinancing to help with capital replacement.

Test 1: Viability (assuming expiry occurs this year)

The first test is a viability test. It determines if you will generate an operating loss or surplus. . This test is done at two dates: your current year situation (Test 1) and then at expiry (Test 2).

Test 1 determines viability today because this is simple. It avoids the need to make assumptions about how rents and operating costs might change over the remainder of your agreement. Test 1 uses your most recent year-end data, which is available in the annual information that you are required to report to your funder (e.g. CMHC, province, territory or municipality). The viability test *does not* consider subsidy and mortgage payments (as we want to know what happens when these cease).

Test 2: Forecast Viability at Expiry year

Test 1 (current year) is supplemented with Test 2. Here, rents and operating costs are projected to the year of expiry, based on some assumptions about inflating rents and costs. Because we expect RGI rents to grow slower than operating costs, the projected values using the default inflation factors will typically produce a result with lower net operating income (i.e. a smaller surplus or a larger loss).

Test 3: Adequacy of replacement reserves

Test 3 helps you to understand if you have sufficient capital reserves and ongoing contributions to a capital reserve to be able to replace major capital items (e.g. roof, appliances etc.). This uses models based on typical replacement requirements and draws on an approximate value developed by researchers. It is a crude and general measure, but a useful indicator. This test determines if you have sufficient funds to be able to invest $750 per unit per year in capital replacement for the remainder of your operating term (i.e. through to expiry). You also need to review this result against the condition of your asset and any recent investments. If you have put off capital replacement, the $750 might be too low.

Pre 1986 Sec 95 projects are permitted to retain a portin of any operating surplus in a surplus subsidy fund. Here we assume that this can be reallocated to capital reserves and used to augment the capital reserve.

Potential to refinance for capital replacement

The assessment tool will reveal if the project is viable but has a shortfall in reserves and allocations for capital replacement. Where a surplus is generated, it may be possible to refinance and use part of the surplus to cover the related loan payments. A separate tab is provided to help determine the potential amount of leverage through refinancing, assuming that there is a surplus to support payments.

For more information on how to use this information and the steps necessary to develop remedies see the companion document "Addressing the Expiring Subsidy Challenge" Available on CHRA website