Reserve Fund Review and Capital Contribution Benchmarking for Social Housing in Ontario

Social Housing
Services Corporation

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1. *Introduction*

Like all general housing projects (private and public), the infrastructure of social housing faces a cycle of capital repair and maintenance that necessitates a method of accumulating funds in order to fund these eventual costs. These funds have historically been managed individually by each housing provider. As part of its legislated mandate, handed down in the *Social Housing Reform Act, 2000*, SHSC was given the responsibility for pooling these capital reserves (although all funds remain in the name of each individual provider) for the purpose of gaining a higher return on these funds, and in order to better match the investment horizon of the capital needs (often longer term).

As part of its management of the capital reserves portfolio, SHSC has conducted a study to better understand and review the state of capital reserves in Ontario, and make recommendations based on the findings, which may have consequences for the future funding of the reserves.

2. *Historical background of social housing and reserves*

The social housing portfolio is often subdivided into Non-profit housing and Public housing. The public housing portfolio is the former Ontario Housing Corporation portfolio of buildings, which was downloaded to the service managers. The Service Manager directly owns this portfolio and capital repairs have always been funded directed as an annual budget item. There have never been reserve funds for this portfolio of buildings. This issue is further examined in a separate SHSC study entitled “LHC Capital Reserve Review” and can be obtained either on our website or directly from SHSC.

Both the provincial and the federal governments constructed non-profit housing under a variety of programs. The provincial government constructed non-profit housing as federal/provincial (F/P) ventures (where the federal government provided some of the funding, and the provincial government built the housing and funded the balance) and as provincial only (P). There are minor variations in these programs but for this report they have been analyzed as a group. The Federal Government also developed non-profit housing under separate programs. For the purpose of this report the federal non-profits have been separated and analyzed separately.

2.1. *Non-Profit Capital Reserves History*

The non-profit program was structured to include reserve funds for future capital repairs. A portion of the annual subsidy to the non-profit was dedicated to a separate account for future capital repairs. Contributions were to be made from the first year of construction and the premise was that the contributions and interest would accumulate in the fund until such time as the money was needed for capital repairs. Key to the success of such a capital repair is determining the appropriate contribution amount in the very beginning, investing the money in the fund to achieve a good rate of return and ensuring the money is only used for the intended capital repairs.

Original Reserve Formula

The initial annual replacement reserve contribution to the reserve fund for the provincial non-profits was determined by formula. It was usually 0.65% of the construction costs. The program guidelines also determined Maximum Unit Prices (MUP) for geographic locations around the province. Virtually all of the non-profit projects were built to the MUP prices. A formula determined MUP and in turn a formula determined the annual contribution. Areas which were perceived as having high construction costs, would start out with a higher annual contribution amount. Each year the annual contribution may have been revised to reflect increases in inflation. There remains a wide variation in the annual contribution amounts for each individual provider.

1997 Top Up to Capital Reserves

The contributions to the reserve funds was further complicated by a moratorium on the contributions from 1992 to 1997. In 1997 the Province injected a $172 million "top up" to the reserve funds to cover the contributions that were not made during the moratorium period and in 1998 there was a further $31 million dollar "top up" to the funds.

1999 IBI Report

In 1999 the Ministry of Housing commissioned a report on the adequacy of the reserve funds (IBI Report). This was done on a sample of approximately 5% of the housing stock, comprising both provincial and federal buildings. The IBI report was only released in May of 2004. A comparison of the IBI Report, and a subsequent study done by SHSC in March of 2004, in which approximately 40% of the housing stock (provincial only, no federal providers) was sampled, appears later in this report using current provider contributions (the approximately 80% of total reserves currently administered by SHSCFI) in order to determine a possible future contribution benchmark.

Due to the age of the report (the data is almost 5 years old), the statistically smaller sample size and use of long asset life estimates (compared to the industry standard analysis of average service life) results from the IBI Report are seen to be less important in the context of analyzing the capital reserves issue than the more current data available in the SHSC survey and report.

3. *SHSC Studies Results – 2004*

SHSC performed a series of studies in early 2004 to establish an understanding of the capital reserves situation in the Province. SHSC sampled approximately 40% of the housing units in the province, based on 80% of the capital reserves (data gathered through SHSCFI) and projected both expected annual costs and projected annual reserves based on actual annual contributions.

SHSC Report Results

The current annual replacement reserve contribution amounts for a sample of the properties in the SHSC study are shown in the following table (some of the portfolio sampled had BCAs done only on the LHC portfolio which has no capital reserves allocations). They range from $424 per unit per year to $624 per unit per year for the Provincial (P and F/P) programs and about $389 per unit per year to $424 per unit per year for the federal providers. These are actual contributions amounts from the providers, grouped by Service manager and numbered below to respect confidentiality of data.

Annual Contribution per Unit

	Service Manager						
	1	2	6	7	8	10	11
Federal	$389	-	$424	$323	-	-	-
F/P and P	$424	$482	$624	$565	$492	$440	$540

Regional Analysis

SHSC's analysis of the reserves indicated that the current per unit capital reserves average is approximately $5,929 per unit, across Ontario for provincial units.

Also of note is that there is significant variation across the various regions of Ontario; in the North, the per unit average is $7,753 while conversely in the South and in the Eastern areas, they fall to $5,471 and $5,020, respectively. Finally, the Central region, excluding the exempt stock from Toronto Community Housing and Peel Region, has per unit reserves of about $5,514. The figures present very different pictures and very different scenarios for the available capital reserves, depending on the region affected.

Some of the regional variation in reserves can be attributable to the original MUP prices assigned to various regions of Ontario, where construction costs were perceived to be higher than other regions (leading to higher annual contributions, all things being equal). However, the results, are lower than what can be expected.

4. *Preliminary Conclusions based on SHSC Results*

Based on the comprehensive SHSC study as the guide for numerical data, some preliminary conclusions can be drawn, with the IBI Report as a "reality check" for the validity of any such conclusions based on the projected figures.

Current Reserve Fund Situation

The following table shows the amounts as reported for the buildings in the SHSC study. In most cases, they are less than the average reserve amounts reported by IBI. The numbers in the table are mostly as of the year 2004 while the numbers reported by IBI should reflect the amounts in the reserves in 1998 and 1999 when the IBI report was commissioned. If the amounts in the IBI report were correct and representative of these buildings then the reserve funds have not grown in the past 5 years and in fact may be depleting. This may be a reflection of the fact that the non-profit buildings are now of an age where capital replacements are required.

Amount in Reserve Fund per Unit

	Service Manager							
	1	2	4	6	7	8	10	11
Federal	$4,558	-	$9,434	$6,294	$2,843	-	-	-
F/P and P	$4,378	$5,567	$2,030	$7,097	$2,831	$5,728	$4,867	$5,804

The issues facing the housing providers (and therefore, their Service Manager) are significant and relatively near term. The following chart shows the years until projects deplete their reserve funds as a percentage of the provider's total portfolio. For instance Service Manager 1 has both federal (F) and provincial providers (P and F/P).

Years until Reserve Fund Balance Goes Negative

		Percentage of Projects											
		Service Manager											
		1		2	4		6		7		8	10	11
		Fed	P and F/P	P and F/P	Fed	P and F/P	Fed	P and F/P	Fed	P and F/P	P and F/P	P and F/P	P and F/P
Years	1-5	55%	28%	9%	63%	15%	67%	7%	69%	100%		60%	24%
	6-10	36%	32%	9%	13%	8%		11%				33%	59%
	11-15	9%	36%	64%		23%		16%			100%	7%	16%
	16-20		2%	18%				50%					
	21-25		2%		25%	54%		4%					
	25-30							2%					2%
	30+						33%	11%	31%				
	Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

SHSC findings, based on the existing reserves and estimates of the anticipated capital costs over the period in question, are that fifty-five percent (55%) of the federal providers will deplete their reserve funds in the next 5 years and 36 percent will deplete their reserves in the next ten years and none of the federal providers will make it past 15 years with any capital reserves. The federal projects face a serious problem in the next five years, which needs to be addressed immediately.

Projected Capital Reserve Depletion

In the same vein, many of the provincial projects will also encounter problems in the next 5 years, however the bulk of the depletions will occur in the 6 -10 and 11 - 15 year periods. Very few of the projects are projected to make it to the end of the 30-year period with a positive reserve fund balance.

There are various reasons for the difference between the federal and provincial stock, mainly to do with the age of the stock, when they were constructed and the actual materials and equipment used during construction.

As the provincial non-profit housing stock *tends* to be newer, their main capital renewal cycle is projected to occur about 5-10 years later than the federal projects which were constructed at least a decade (or more) earlier. Note that this analysis <u>does not</u> include the Local Housing Corporations, which face a completely different set of challenges, given their age, and their unique capital funding arrangements, which are explored in another study.

5. *Proposed Benchmark or Formula for Annual Replacement Reserve Contributions*

Based on the above analysis done by SHSC and the projections which show that current annual contributions are not sufficient going forward (and confirmed in the independent IBI Report), it would appear that a new formula or standard should be established for capital contributions by housing providers, in order to address the potential problem. Any new level of replacement reserve funding should be based on actual building condition assessments/reserve fund studies completed by third party consultants, and therefore have a strong basis in actual costing and realistic projections going forward.

It is problematic to predict an average amount or global amount for reserve fund contributions because of the individual circumstances, which affect each property. For example, successful mitigating strategies (explored in the SHSC study "*Mitigation Strategies for Capital Reserves Shortfalls*") can greatly influence maintenance and renewal cycles, thereby "stretching the capital dollar" such that the reserves are not depleted as quickly.

Also, the opening balance, and especially the timing of the expenditures will greatly affect the annual replacement reserve contribution required for the reserve fund to remain positive. For instance if the building is about twenty years old and the building is facing major capital repairs in the near term then the annual replacement reserve contribution required to bring the reserve back into line is significantly different than if the building is only 10 years old and there is time to accumulate some of the funding for a few years before the expenditures are required.

However, it is also a fact that mitigation strategies can only slow the depletion of capital reserves and perhaps delay but not completely solve this looming problem. Without a significant injection of funds into the overall capital reserves system, there are insufficient capital dollars in the system to address the deferred capital and maintenance problems in the social housing stock.

6. *Conclusions*

The data in this study found the average cost per unit per year for the non-profits to be about $1,225 in present value dollars to avoid a negative balance in the reserves. The annual contributions on average could be slightly less than this amount given that there is some money currently in the reserve funds now and there is the potential to earn interest each year.

This would result in an increase of $600 to $800 per unit/year in present value dollars.

Building type, age, and capital funding requirements per building and available capital reserves could further refine the $1,225 per unit per year figure.

New capital reserve study results commissioned by providers or Service Managers could be benchmarked with the proposed replacement reserve contribution level to determine if the level of reserve funding required is similar to the results in this study as justification to support the greater need of capital funds to City/County/Regional Council for additional funding.