Managing the Step Down of Federal Funding and the End of Operating Agreements

Info Session for Local Housing Providers

May 19th, 2016

Agenda for today

- Setting the context
- Study findings and recommendations
- Perspectives for providers
- Planning for EOA
- Q & A
- Closing Remarks

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SETTING THE CONTEXT

Understanding the Funding Framework & EOA

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A Changing Operating Environment

BEFORE SHRA:

- OHC-LHA structure
- Project operating agreements (POA's)
- Rent Supplement landlord agreements

SHRA/HSA era:

- Terminated POA's (Prov. Reformed)
- Shareholder and/or Operating agreements (LHC's)
- Federal projects agreements remain
- SM/DSSAB service agreements

POST-EOA era:

- Terminated POA's (Federal)
- LHC's - ?
- Other NP providers - ?
- Other (i.e. Rent Supplement) - ?
- Federals - ?

Legislative obligations

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Key Concepts

Federal Funding Stepdown

- Traditional cost-sharing of legacy programs
- Federal share of subsidy varies by program
- Fixed Federal dollars flowed via Service Manager (SM)
- Sun setting of federal dollars as projects hit EOA date
- Continued decline in Federal funds to SM to 2034

Expiry of Agreements (EOA)

Date at which:

- Previous/current operating agreement expires
- Original mortgage/debenture for project property matures
- Federal funding terminates for cost-shared projects
- Rent supplement project funding agreement expires

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Why EOA matters

Legislative obligations

- Need to maintain service levels
- Continued affordability
- Maintain project in good order
- Changes in subsidy entitlement
- Shift in accountability structures

Funding Changes

- Stepdown of federal dollars for cost-shared programs
- Debt payments decrease with maturing mortgages/ debentures

BUT….

- Truncation or change in subsidy payable to provider

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Why EOA matters

Operating changes

- Some obligations terminate at EOA = new flexibility
- More SM discretion in program funding & delivery
- SM funding may <u>or</u> may not continue
- Provider relationship with SM is critical
- Some shifts in landlord/ tenant relationship

Capital implications

- Aging buildings face substantial repairs/ replacements
- Reserves to address capital needs are limited
- Subsidy changes can result in less funding available for capital
- Protecting built-up equity is key to sustainability

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Why EOA matters

The bigger picture

- Substantial value of public investment
- The magnitude of accumulating unfunded liability
- Increasing SM costs > tax base pressures
- Changing needs of residents/communities
- Limited new rental development, especially affordable
- Provider sustainability > affordable rental supply

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STUDY FINDINGS

Federal Funding & EOA impacts for the City of Kingston

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The Study Process

<u>Module 1</u>
Review of Federal funding step down

<u>Module 2</u>
Review of EOA implications

<u>Module 3</u>
Review of Rent Supplement programs

<u>Module 4</u>
Strategy and Implementation Plan

Program Categories

Public Housing program

- Former OHC stock, now LHC
- Federal/SM cost-sharing
- Non-defined funding obligation
- Debentures

Prov. Reformed programs

- Includes reformed non-profit and coop programs
- Prescribed funding formula, some federal cost-sharing
- Insured mortgages

Federal programs

- Includes LD, PNP, Urban Native
- Funding per operating agreement, federal-based
- Insured mortgages or assistance

Rent Supplement programs

- Former commercial + NP
- Subsidy-based funding only
- Various funding formulae, some federal/SM cost-sharing

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The Kingston Portfolio

'Brick and Mortar' Projects

- Public Housing = 967 units
- Provincial Reformed = 749 units
- Federal Programs = 51 units

1,767 units total

Rent Supplement

- Commercial and N/P rent supplement = 448 units

Prescribed portfolio = 2,215 units (91% RGI units)

Service level standard = 2,003 units (90% of prescribed units)

Non-legislated R/S Programs

MIK = 71 units
SCRS = 69 units
IAH-RS = 54 units
IAH-RS Housing First = 54

248 units total

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Projected Bottom Line Impacts

Operating Side

Estimated municipal subsidy costs by 2035 = $20M (net)

(annual increase of $10M from 2015)

Capital Side

Estimated capital shortfall by 2035 = up to $150M

(cumulative, up from $22.7M in 2015)

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Impacts Will Vary by Program

Subsidy Payable to Prescribed Providers by Source, City of Kingston (2015)

Total Subsidy to Prescribed Providers	Federal	Municipal	Total
Public Housing program (incl. debentures)	$1,376,254	$4,068,810	$5,445,064
Rent Supplement programs	$889,440	$2,385,755	$3,275,195
Provincial Reformed programs	$966,921	$3,809,066	$4,775,987
Federal Programs	$347,099	-$74,183	$272,916
Untargetted Federal funds	$146,821	-$146,821	$0
Net Funding (excluding debentures)	**2,636,657**	**$10,042,627**	**$12,679,284**
Total Funding	**3,726,535**	**$10,042,627**	**$13,769,162**

Per Unit Subsidy to Prescribed Providers	Federal	Municipal	Total
Public Housing program (incl. debentures)	$1,423	$4,208	$5,631
Rent Supplement programs	$1,985	$5,325	$7,311
Provincial Reformed programs	$1,291	$5,086	$6,376
Federal Programs	$6,806	-$1,455	$5,351
Untargetted Federal funds	n/a	n/a	n/a
Net Funding (excluding debentures)	**1,260**	**$4,800**	**$6,061**
Total Funding	**1,781**	**$4,800**	**$6,582**

Source: MMAH Federal funding allocation Charts and City of Kingston projections

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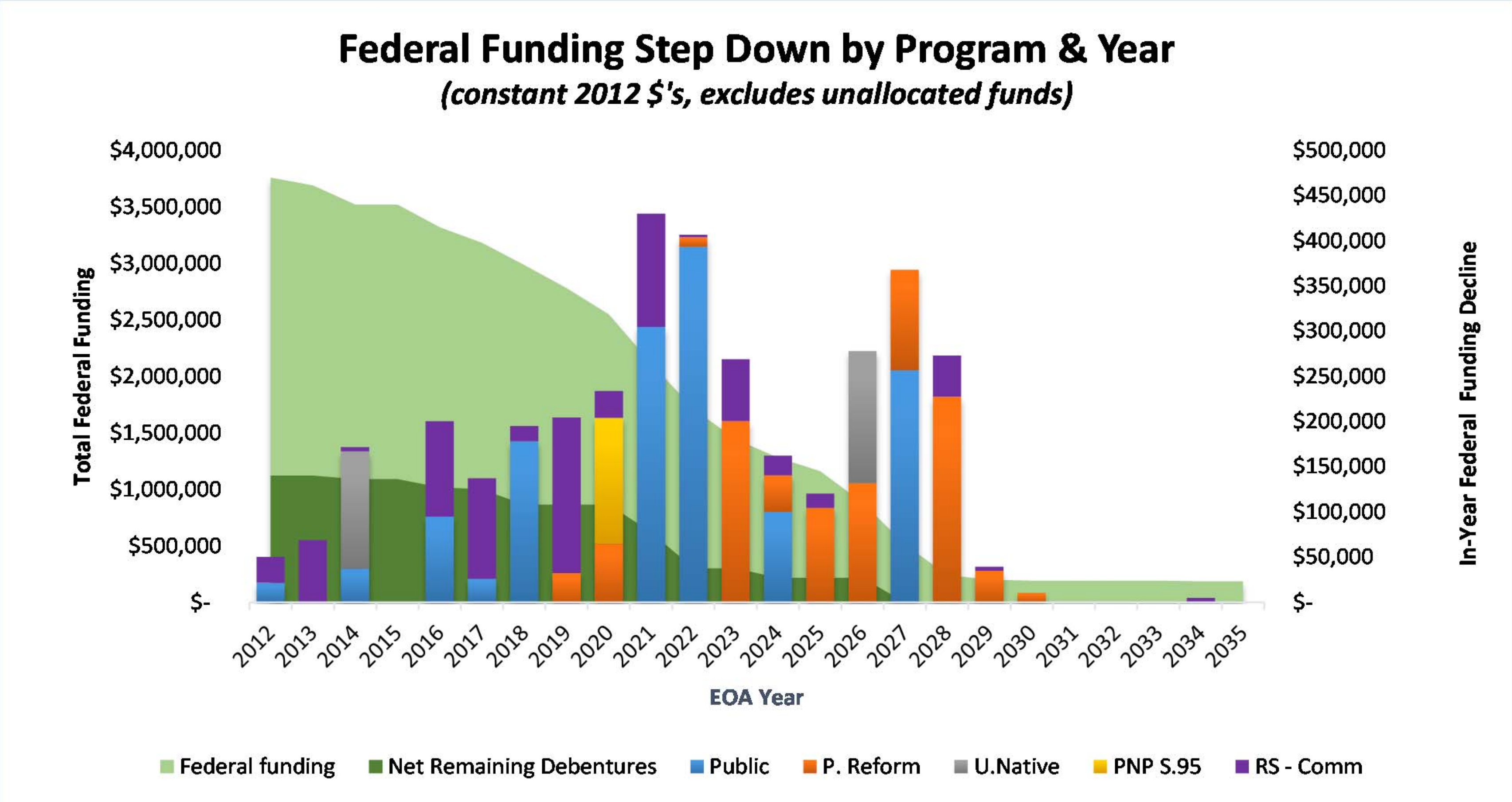
When Impacts Occur



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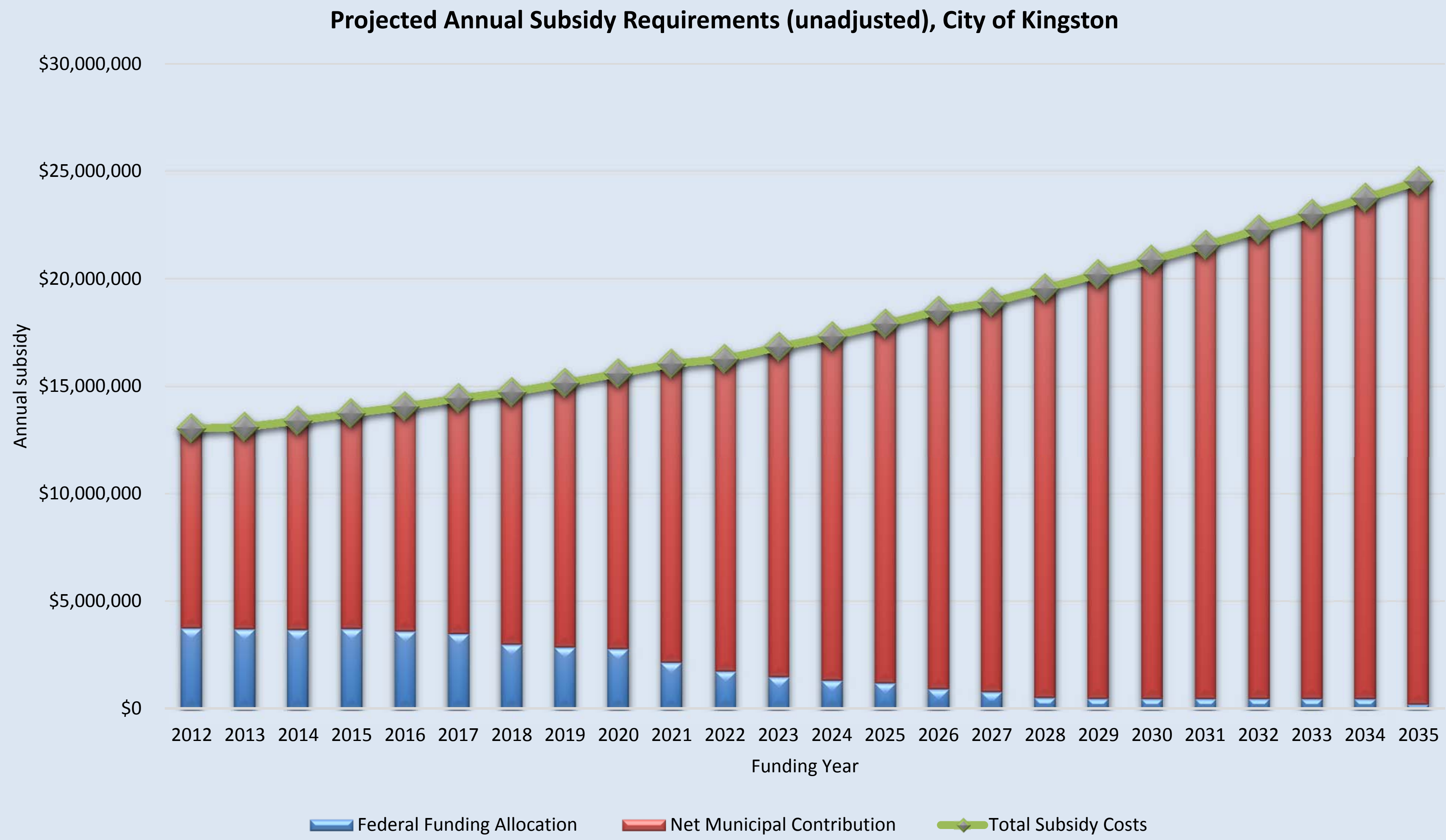
Growing cost, Declining funding



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Assessing Project Viability

Operational dimension

- Net Operating Income (NOI) as a measure of viability
- Excludes mortgage and subsidy for testing purposes

Capital dimension

- Reserve fund balance as a measure of viability
- Assumes capital needs are address as you go

Positive cash flow + Asset in good shape = A good start

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Project viability testing

Project Viability Testing Grid

Total n = 77

	Positive Capital Position	Negative Capital Position
Positive Operating Position	*today, n = 0* *at EOA, n = 0* ***Rating = 1*** Operating = pass Capital = pass **Most viable**	*today, n = 2* *at EOA, n = 1* ***Rating = 2*** Operating = pass Capital = fail
Negative Operating Position	*today, n = 12* *at EOA, n = 1* ***Rating = 3*** Operating = fail Capital = pass	*today, n = 63* *at EOA, n = 75* ***Rating = 4*** Operating = fail Capital = fail **Least viable**

** Figure based on matrix in prior research by Pomeroy, Connelly et al*

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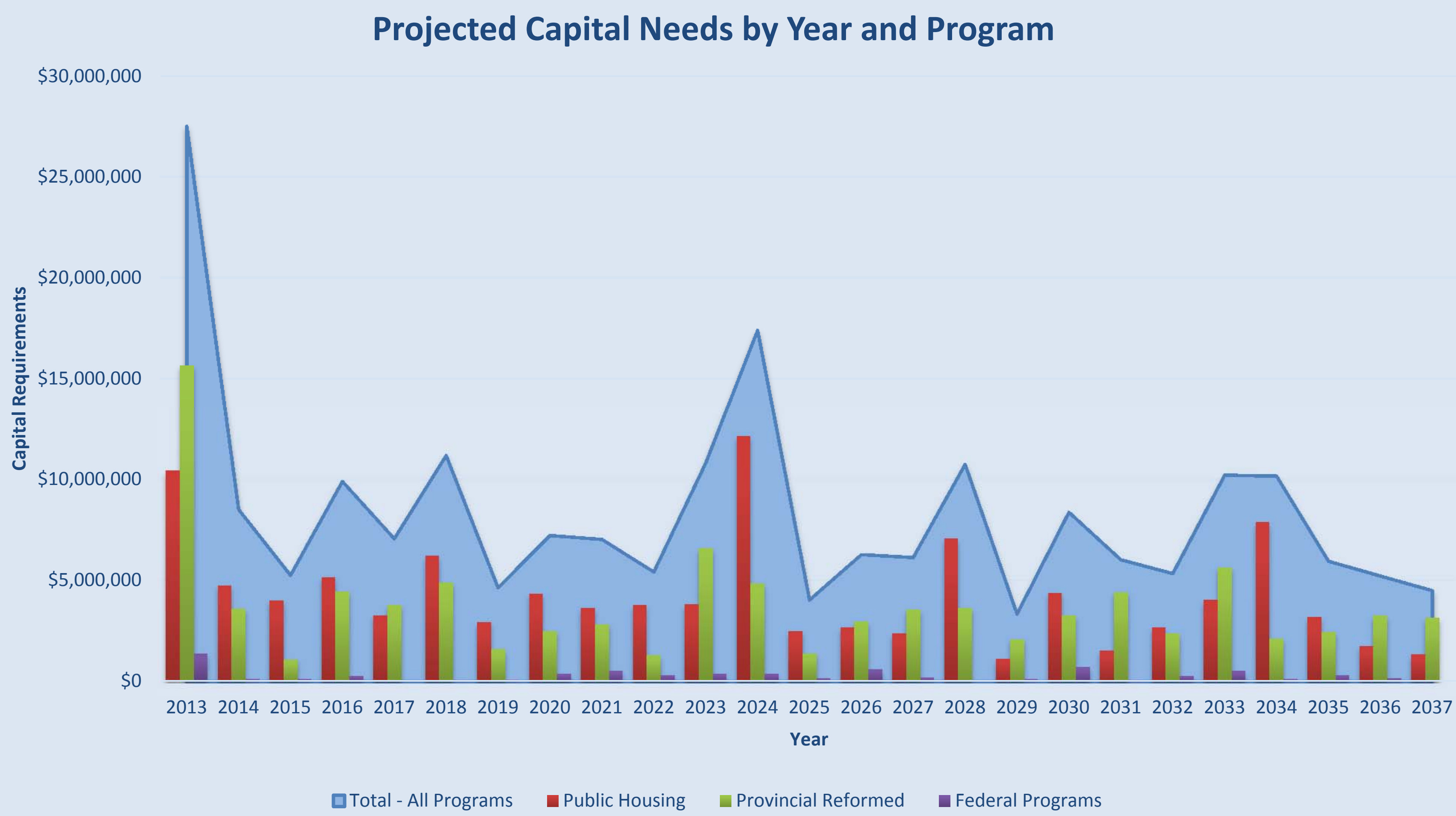
On-going Capital Pressures



EOA Realities

Funding Obligations

- Legal opinion confirmed post-EOA obligations by program (excl. federals)
- Only RGI units are to be counted towards SLS
- Substantial number of cost shared units & high SLS means on-going financial obligations post-EOA

Building Conditions

- Sizable capital requirements based on Asset Manager ($27.5M current backlog)
- FCI index shows ‘poor’ rating (> 30%) starting in 2021/2022 without capital infusion
- Prov. Reformed projects have many ‘fair’ ratings (10% to 30%)

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Projected EOA Impacts

Operating

- Projected 2035 annual subsidy of $9.5M Public Housing ($9,824/unit) and $8.6M Prov. Reformed ($11,482/unit)
- Cost savings opportunities are modest, up to $250K in total (est. at 2.6% of 'manageable' costs)
- Mortgage renewal savings are available pre-EOA ($850K cumulative)

Capital

- Current unfunded capital requirements of $22.7M continues to rise
- Cumulative capital requirements of almost $200M by 2035
- After accounting for planned contributions, projected capital shortfall of up to $150M by 2035

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Mitigation Options

Operating Side

Estimated municipal subsidy costs by 2035 = $20M (net)

- Versus -

Prospective Offsets:

- Pre-EOA mortgage renewals - up to $850K cumulative
- Operational savings - up to $250K
- Reduce to SLS only - up to $175K
- R/S substitution* – up to $465K
- Alternate rents** – $166K-$1.8M

Capital Side

Estimated capital shortfall by 2035 = up to $150M

- Versus -

Prospective Offsets:

- Leveraging equity through refinancing – $63M to $77M

BUT

- Add back subsidy costs of $4.4M for debt service (or more if higher loan ratio sought)

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Overall Synopsis for SM

- Sizable increase in subsidy costs are expected as federal funds decline, costs increase and projects hit EOA
- Direct impact on City as shareholder of KFHC and as SM
- Some cost adjustments, cost savings and R/S admin. practices may help to limit inevitable cost increases
- Capital shortfalls are a looming concern - projected requirements are well beyond SM financial capacity
- Need for additional SM legislative flexibilities in order to better address issues

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Study Recommendations

Strategic Directions

- Advocacy
- Active portfolio management
- Costs savings & program effectiveness
- Asset leveraging

Federal Funding Step Down

- *4 recommendations*

Expiry of Agreements

- 7 recommendations

Rent Supplement Program

- *8 recommendations*

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More recent changes…

- 2016 Provincial budget
  - New/expanded funding for VDV, CHPI and supportive housing
- 2016 Federal budget
  - New supply funding
  - Reno/repair funding for current stock
  - Aboriginal housing
- Province's LTAHS update
  - More affordable market housing
  - Social housing modernization
  - Legislative and program flexibilities
  - Transforming supportive housing

These changes can influence EOA issues and study recommendations

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PERSPECTIVES FOR PROVIDERS

Managing Federal and EOA Impacts

Obligation to fund differs post-EOA

Public Housing

- ‘sufficient’ funding + SLS

Provincial Reformed

- prescribed funding formula + SLS

Rent Supplement

- RGI rules << -- >> SLS

Federal programs

- No funding obliged but may be beneficial for SLS

DISCLAIMER: Providers should satisfy themselves as to their legislated obligations and may wish to seek independent legal advice in that regard.

Legislative interpretations, esp. around counting for SLS

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Maintaining Viability

- Providers need to maintain operations in order to remain solvent as an organization
- Serving residents in need remains a part of your corporate obligations (e.g. letters patent)
- Changes in program funding at EOA will create financial pressures & challenges
- Legislative obligations (other than HSA) apply to you as a landlord (e.g. RTA, OHSA, ESA, etc.)

Sustaining the Asset

- Maintaining the project has a direct effect on marketability/curb appeal
- On-going requirement to address lifecycle costs on top of regular maintenance
- Funding capital repairs is costly and is a challenge in the face of modest/depleted reserves
- Useful life – when does it no longer make sense to keep investing in the property?

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Other Implications…

Non-profit status

- Changes in subsidy assistance can influence non-profit or charitable status with CRA
- This can have tax and program eligibility implications ($’s)
- GAAP and RTA exemptions can also be tied to maintaining N-P status

HST status

- Preferred rebate rates enjoyed by providers depend on:
  - Level of subsidization to residents
  - Level of support from government
- Loss of preferred status can mean reduced rebates, increased operating costs

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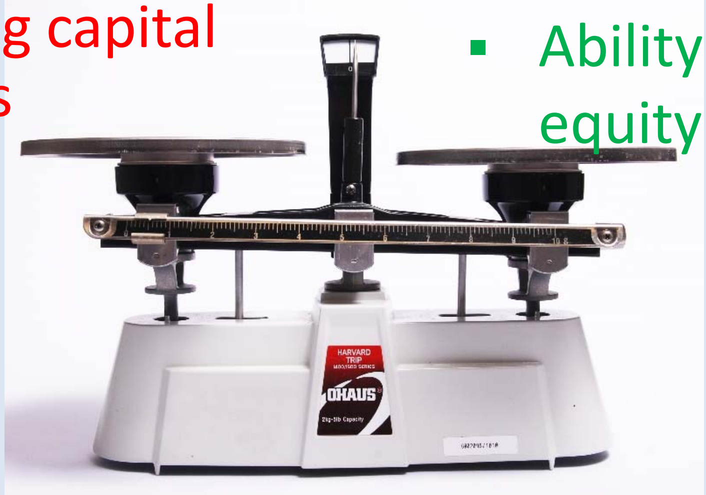
Balancing risks and opportunities

RISKS

- Maintaining on-going financial viability
- Sustaining affordability
- Managing capital shortfalls

OPPORTUNITIES

- New operational flexibilities
- More autonomy to make decisions
- Ability to leverage equity from the asset



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PLANNING FOR EOA

Taking steps to manage impacts

Mitigating options

General concepts from perspective of both SM and providers

- Increase operating revenues
- Decrease operating costs, finding efficiencies
- Raise working capital, leveraging of existing assets

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What providers have been or are doing

Fiscal fitness

- Getting the financial house in order - improving the balance sheet
- Establishing policies/ practices to maintain a healthy financial position
- Using monitoring and forecasting tools to inform financial decision-making

Shared services & mergers

- Bulk purchasing of goods/services to get scale pricing
- Shared property management models
- Integration of orgs. to reduce administrative overhead

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What providers have been or are doing

Re-financing

- Capture rate savings through mortgage renewals in low-rate environment
- Blend & extend mortgages to raise capital for repairs
- Internal financing from part of portfolio that is generating a surplus

Re-development

- Replacement of existing stock in poor repair
- Intensification of existing stock by adding units/changing size mix
- Divesting of assets with re-allocation of proceeds (e.g. scattered units)

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Mitigating your risks

Managing costs, revenues and cash flow

Minimize costs

- Bulk purchasing/ tendering
- Preventive maintenance program
- Lifecycle energy retrofit program

Maximize revenues

- Reduce arrears
- Utilizing current market rents
- Re-visit RGI tenant mix
- Alternate rent structure*

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Mitigating your risks

Seeking operational efficiencies

Organizational structure

- Review staffing and resource allocations
- Use of alternate management structures

Energy efficiency measures

- Curbing consumption to reduce operating costs
- User pays for add-ins (a/c, parking plug-ins, etc.)

Mitigating your risks

Strategic use of reserves/resources

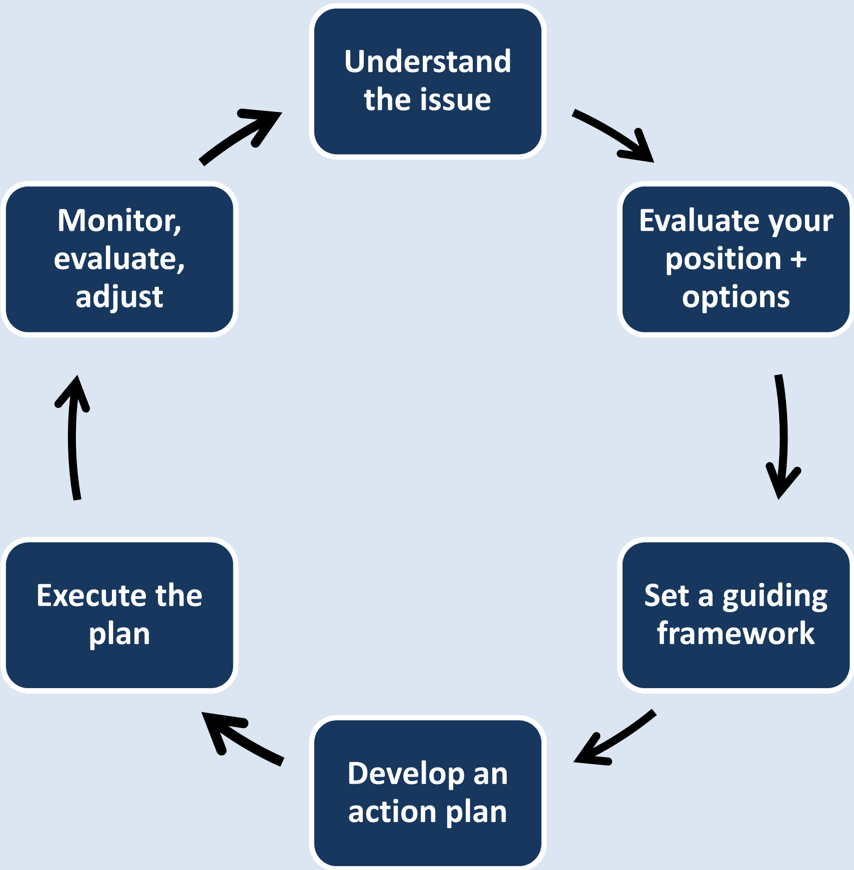
- Funding capital repairs with short payback
- Prioritize energy savings
- Seek energy grants for capital works
- Maximize return on investment for capital reserves
- Maximize SHRRP and related repair program funding

Mitigating your risks

Sustainability planning

- Governance review
- Corporate succession plan for Board & staff
- Up-to-date management policies & practices
- Building condition assessment
- Strategic asset plan for your portfolio
- Transition plan for post-EOA period

Planning for EOA



Considerations:

- Organizational capacity
- Working resources
- Potential partners
- Non-Profit/charitable status
- Tax status
- Legal requirements
- Tenant impacts

Available Tools and Resources

- Background studies and materials
  - HSC Share web site
  - ONPHA, CHF, CHRA
  - MMAH, CMHC
- Getting help
  - Sector assistance
  - Consulting resources
- Assessment tools
  - ONPHA, CHF, CHR
- Financial resources
  - Infrastructure Ontario
  - CMHC (underwriting)
  - Conventional lenders
  - Emerging – alternate funding, social impact bonds

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Steps for Moving Forward

1. Improve your organizational awareness of EOA issues/implications
2. Seek out available resources/tools/technical expertise
3. Develop basic plan to address portfolio needs – sooner rather than later
4. Collaborate on solutions together with other providers/partners
5. Work with your SM to plan forward for a smoother transition

Questions?

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