Alternative Sources of Capital for the Social/Affordable Housing Sector in Canada

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Executive Summary

Underfunding and capital shortfalls have been critical issues affecting the financial viability and health of existing social and affordable housing in Canada for many years. There has also been limited funding for new development, and the operating funding/rent-geared-to-income (RGI) subsidies associated with it, over the past 10-15 years. There is a need to reinvest in existing housing stock and a need to build new housing for low- and moderate-income households. There is already some capacity to address these issues in the sector and there are opportunities to invest capital in areas that will reduce operating costs over time. While this can free up money in the system, there is still a need to find alternate sources of capital to address the sector's needs because the needs are so great. The need to repair, replace and/or regenerate is estimated to be a minimum of $1.5 billion in Ontario alone[1]. The question is how to bring in new capital in an era of government funding withdrawal?

The purpose of this research is to review and analyze different models of alternative capital for the sector. It is oriented towards providing practical information about the feasibility of implementing one or more of these approaches in the future. Four models were selected and nine case studies conducted on the following: hybrid legal structures; social and affordable housing real estate investment trusts; capital raising and lending facilities; and housing bonds.

Hybrid legal structures are politically potent statements about an organization's community purpose butthe new legal forms have not created a storm of alternative sources of impact investing money. REITs can provide an excellent way of introducing private sector capital into the affordable housing sector when property ownership is not an issue, and when there is a dedicated group of people interested in preserving housing affordability for low- and moderate-income households. Facilities are already operating in Canada that raise and lend capital, and there is room for another– particularly if it were aggregating the needs of multiple providers to support the creation of scale and lower the costs of funds. There is no question about the need for a lending facility in Canada; however, the key question is, how should it be established and how can it be adapted to operate in the Canadian market with many small players with varying capacity? Bonds have already been successful in Canada, the US, and the UK as a way to finance housing. There is little in the way of having other large housing providers in Canada issuing bonds either publicly or privately. The bond market will always be out of reach for smaller housing providers in Canada, due to lack of scale, capacity and revenue.

All of the models in this report can bring money into the housing sector if the deals are structured in an attractive manner for investors. However, none of these models should be viewed as a cure-all for bringing money into the housing sector.

[1] Housing Services Corporation, "*Closing the Gap*", Retrieved from: http://www.hscorp.ca/wp-content/uploads/2011/12/Closing_the_Gap.pdf

1.

Introduction

As part of a complete housing system, provincial/territorial and municipal service manager governments have an interest in sustaining social and affordable housing in their respective service areas. While this helps support the concept of inclusive and healthy communities, there are also legislative and financial obligations that governments must address in order to support their goals.

Underfunding and capital shortfalls have been one of the critical issues affecting the financial viability and health of social housing in Canada. There are no consistent long-term, predictable or sustainable funding agreements or models in place across Canada. There has also been limited funding for new social and affordable housing development and the operating funding/ rent-geared-to-income subsidies associated with it over the past 10-15 years. The need for this funding is nevertheless growing and other (non-traditional) sources of capital need to be explored as ways to bring money into the sector. This research project aims to provide insight on alternative sources of capital for social and affordable housing in the Canadian context.

1.1 Scope

This research study has been conducted by the Housing Services Corporation (HSC) in a partnership with BC Housing. The primary purpose is to provide a review and analysis of selected models supported by case studies of raising capital for the social and affordable housing sector. The case studies are examples of financial vehicles that exist in other countries or provinces and have been used to raise capital in those jurisdictions. Four models have been selected, and nine case studies have been conducted, under the following broad categories:

- Hybrid Legal Structures
- Social/ Affordable Housing Real Estate Investment Trusts (REITs)
- Capital Raising and Lending Facilities
- Housing bonds.

The case studies were chosen based on a review of relevant literature widely available on the Internet and from interviews with organizations.

2.

Housing Finance in Canada

The housing sector is broad and diverse in Canada. About 69% of Canadians are homeowners; 25% live in private rental housing[2]. The social and affordable housing sector comprises about 4-5% of the total. It is growing smaller by the day as operating agreements expire and in regions where the cost for new housing spirals even higher. Under these circumstances, the available limited federal and provincial funding makes no dent in the financial need for affordable housing. There are three major needs facing the sector:

a) Reinvesting in existing housing stock to ensure decent places to live and buildings in a good state of repair;
b) Building new housing for low- and moderate-income households in an era of government withdrawal from capital and operating funding; and
c) Accessing a range of financing options to ensure the long term sustainability of the housing system.

The Canadian housing sector is heavily regulated, subject to provincial and municipal oversight with over five decades of government investment in a solid asset base. Unlocking the capital within those assets has proven to be a challenge. Further, the social and affordable housing sector is diverse in its technical, financial and professional capacity. Any solution to the problem must acknowledge and respond to this diversity and it must be available at an affordable cost. There are three key factors in bringing additional capital into the Canadian social and affordable housing sector:

1. Readiness and capacity of the social and affordable housing sector to meet the tests established by investors and financiers;
2. Readiness and capacity of the investor industry to invest in the social and affordable housing sector; and
3. Building the capacity and resources of both sectors to bring additional capital into the social and affordable housing sector.

These are interrelated factors that must be understood from all sides. It is also necessary to answer the most important question, “What problem are you trying to solve?” The possible investment vehicles work better in certain situations and in response to certain problems. In that regard, there is no one “silver bullet” that will solve the need to bring additional capital into the social and affordable housing sector.

The issue of capacity is also critical for housing providers and investors/lenders alike. Canadian housing providers typically lack the knowledge and scale necessary to carry out complex financial transactions and few lenders are able to navigate the complexity of the sector to offer a large-scale financial solution. While there are number of sources of capital available to providers who meet specific criteria, few sources are positioned to address the needs of the sector as a whole. The sector is highly fragmented, and the nature of the need is complex. Differences in location, regional jurisdiction, size and ownership structure

[2] http://www.statcan.gc.ca/daily-quotidien/130911/dq130911b-eng.htm

amongst housing providers make the need hard to quantify. Any effective capital funding program needs significant scale in order to provide investors with liquidity and address otherwise prohibitive transaction costs. In addition to scale, a capital funding program that is targeted to addressing the specific needs of the social and affordable housing sector must recognize the support needed by housing providers to navigate and manage these complex financial transactions.

3.

Models and Case Studies

Important lessons can be learned from strategies and financial vehicles that exist in other countries or provinces. Although there are many models that can be explored, this next section provides background on four selected models and the case studies under each of the models:

1. Hybrid Legal Structures
2. Social/Affordable Housing Real Estate Investment Trusts (REITs)
3. Capital Raising and Lending Facilities
4. Housing Bonds

3.1 Hybrid Legal Structures

Over the past decade, there has been a huge growth in social enterprises. A social enterprise is an organization that applies commercial strategies to maximize improvements in human and environmental well-being, rather than maximizing profits for external shareholders[3].

At issue recently has been the perception of the restrictive nature of the existing types of corporate legislation. Typically corporations can be businesses or charities – businesses being split into those that seek profit and those that don't. The purpose of a legal structure is to facilitate the conduct of an organization's activities[4]. In the housing sector, the key purpose of a housing provider is to own and manage property and to house low to moderate-income households. Most Canadian housing providers are non-profit corporations. Non-profits or "civil society" associations are intended to use surplus revenues to support the goals of its organization rather than to distribute earnings to shareholders. In addition, registered charities and non-profit organizations may only undertake activities (and expend funds) that advance the purpose stated in their Constating Documents.[5]

Recently, new corporate legislation has been introduced in several countries which blend the power of for-profit companies with the social and community benefits of charities and non-profits. The hope is that these new hybrid legal structures will make it easier for organizations to raise money from impact investors that will be used for social good.

3.1.1 Strengths, Weaknesses, Opportunities and Threats

The following table presents an overview of the strengths, weaknesses, opportunities and threats (SWOT) with Hybrid Legal Structures.

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[3] http://en.wikipedia.org/wiki/Social_enterprise

[4] Joseph Rowntree Foundation, "Using the Community Interest Company model in the housing sector", 2007.

[5] A housing provider must be aware of the purposes set out is in its Articles or Letters Patent. These are fundamental "constating documents" of the Corporation.

Table 1: Hybrid Legal Structures - SWOT Analysis

Strengths
• Offers advantages to entities working locally and seeking to support existing non-profits and charities; • They can be used to generate revenue which can be invested in a related but separate non-profit or charity; • Local democratic control helps ensure that funds are directed towards community needs.
Weaknesses
• Work well for new businesses but do not offer sufficient financial attractiveness for existing housing businesses to move from an existing non-profit structure into the new one. This is primarily due to the fact that charitable or non-profit housing corporations may rely on their preferential tax treatment which is not available as a C3 (Community Contribution Company) or CIC (Community Interest Company); • Lenders typically invest in housing as there is a physical asset or a solid income stream. The asset lock might make housing a less attractive investment since, in the event of a default, a lender cannot seize the assets; • Currently, BC is the only province with a hybrid legal structure. This limits any organization trying to work at a national level; • The hybrid legal structure represents a new and untested legal and taxation environment; • Canada already has a non-profit corporate structure which functions well for established social enterprises; • Like their business counterparts, social enterprises have difficulty attracting debt and equity investments in their activities. A different corporate structure does nothing to solve this issue; • As an emerging vehicle, these forms may be relatively unrecognised to local investors and may require additional efforts to overcome a 'trust' gap; • The Community Contribution Company (C3) structure is new in the BC context and an assessment of their success has not yetoccurred. In the UK, the CIC model is not any more appropriate than existing legal forms for the provision of social housing by housing associations.
Opportunities
• Any housing provider seeking to make a powerful political statement about its intentions to provide a community benefit could consider this structure.
Threats
• The regulatory and legal environment poses challenges as well as potential future threats. • There may be potential legal and tax issues which could jeopardize a non-profit housing organization's tax-exempt status.

3.1.2 Typical Roles

Government: In BC, the Community Contribution Company (C3) structure will not be regulated except through filing an annual public report. In the UK, government chose an oversight role with CICs. If a housing association is a CIC, there is dual regulation from the Homes and Community Agency (HCA) that focuses on governance, financial viability and value for money. The CIC regulator reviews annual reports and has certain powers to conduct investigations and audits where required, but generally speaking, the CIC Regulator uses a "light touch." All CIC annual reports are available on the internet at the Companies House.

Housing providers: Housing providers can choose to establish themselves as a C3 or to establish a subsidiary company as a C3.

Banks/Investors: Banks and investors can choose to invest in a C3/CIC.

3.1.3 How Hybrid Legal Structures Work: A Cross-Jurisdictional Review

Community Investment Company (CIC): United Kingdom

In the United Kingdom, the "Community Interest Company" (CIC) legal structure was established in 2004 to support social enterprises. The UK also established a government CIC regulator to monitor, approve and review annually each CICs structure and proposed social benefits. There are two key features of a CIC: a community interest test; and an asset lock.

A CIC must meet the community interest test as determined by the Regulator. As a legal structure, the CIC model is based on a conventional company model, either limited by shares or by guarantee with a requirement to submit a community interest statement to the Regulator upon formation. Whether a CIC registers as a share or a guarantee company depends on how it is financed and how it wants to apply its surplus funds. The articles of incorporation must include "CIC" as part of its name, describe the CICs social purpose and must provide and make public an annual report to the Regulator.[6]

CICs are also subject to an "asset lock". This means that a CIC is not allowed to transfer its assets unless it transfers them to another asset-locked CIC or to a charity. The purpose of doing so is to ensure that the benefits would remain in the community. CICs can issue shares in order to raise capital but, unlike traditional business corporations, the dividends that can be paid by CICs on these shares are controlled by a cap on returns set by the regulator. CICs have no favourable taxation treatment, unlike charities. Furthermore, CICs were not designed with housing associations or registered social landlords in mind.[7]

Housing associations access finance by borrowing against assets or income streams. The CIC form doesn't prevent either of these from happening but it doesn't provide any enabling features either. The asset lock may mean that lenders would be less likely to lend money against assets since assets could not be seized in the event of a default. Assets can only pass to another asset-locked body which would be of no use to a lender.

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[6] Robert Coffey, Judith Smyth and Max Hogg, "*Using the Community Interest Company model in the Housing Sector: A Marriage in the making?*", Retrieved from: http://www.jrf.org.uk/sites/files/jrf/2054-cic-housing-sector.pdf

[7] Joseph Rowntree Foundation "Using the Community Interest Company model in the housing sector", 2007. Retrieved from: http://www.jrf.org.uk/sites/files/jrf/2054-cic-housing-sector.pdf

There has been a huge growth in the number of CIC's in the UK since the legislation's introduction 10 years ago. As of December 2013, there were 7,670 CIC's in England[8]. In comparison, there are over 160,000 charities in the UK which. as a legal structure, has existed in one form or another for about 500 years. Inclusion Housing, a UK Housing Association that is also a Community Interest Company, is discussed below.

Case Study #1 - Inclusion Housing CIC

Inclusion Housing is a community interest company, a social enterprise, and a Registered Provider as of June 2011 based in the north of England. Inclusion Housing is a not-for-profit, voluntary housing organization that works with, and on behalf of, vulnerable people. They provide a range of properties to suit the care package and person-centred plans such as supported living, registered and respite care and so on. As a Community Interest Company (CIC), Inclusion Housing seeks to use allocated reserves to work in partnership with like-minded organizations for the benefit of the local community on programs such as employment and training initiatives.[9]

Inclusion Housing works primarily in Yorkshire. CICs in general are typically driven by a mission and suggests there are no geographic or market limitations to establishing one. CICs can pay board members unlike social landlords, which are charities.

Inclusion Housing enters into partnership with local councils, housing associations or other entities to bring the supported housing mix into larger housing developments. For example, Inclusion Housing recently entered into a 20-year agreement with the clinical commissioning group (CCG) for Northeast Lincolnshire Council for 60 extra care units. The CCG purchases healthcare services on behalf of citizens in the area (about 165,000). In this particular arrangement, Inclusion Housing is the landlord and provides rental housing and services to residents that need extra care (mainly the elderly). Inclusion Housing worked with a private developer who arranges the financing. Residents are charged based on their financial means, in keeping with housing benefit coverage for the area. They pay rent service charges for running the property and for extra care as needed.

Inclusion Housing has a good outlook but still depends on grants from various sources to makes its operations viable. As a supported housing provider, it receives grants mainly from government.

Low-Profit Limited Liability Company (L3C): United States

In the United States, a low-profit limited liability company (L3C) legal form was created to bridge the gap between non-profit and for-profit investing by providing a structure that facilitates investments in socially beneficial, for-profit ventures while simplifying compliance with Internal Revenue Service (IRS) rules for program-related investments, a type of investment that private foundations are allowed to make.[10] By law, foundations have to direct 5% of their assets every year for charitable purposes to keep their tax-exempt status. This can be accomplished using grants and investments, if the investments are primarily aimed at a charitable or educational purpose and making a profit is not a significant goal.Those

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[8] Regulator of CICs, "*Annual Report: 2012/13*". Retrieved from: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/243869/13-p117-community-interest-companies-annual-report-2012-2013.pdf

[9] http://www.inclusionhousingcic.org.uk/html_docs/faq.html

[10] http://en.wikipedia.org/wiki/Low-profit_limited_liability_company

investments are called program-related investments or PRIs.[11]. The L3C was specifically created to attract wider investment sources.

The L3C is currently enacted in about 10 states and 2 First Nations territories. There are about 600 L3C's in the US and this is expected to grow over time as other states have pending L3C legislation. Canada does not have the same access to philanthropic contributions as exists in the US but the ability to combine foundation capital and private capital for community-based projects is very attractive and potentially powerful. [12]

These structures are relatively new in the American context and no examples of housing-related L3C's could be found. With the exception of a few localized housing development companies, the L3C form does not appear to be used by existing social and affordable housing.

Community Contribution Company (C3): Canada (British Columbia)

Canada has been discussing the need to establish a national corporate legal structure to support social enterprises for several years. While concerns have delayed the enactment of legislation, including concerns that the new legal structures available in the UK and the US are too complicated for the Canadian context, many social enterprise organizations are functioning well in spite of no specific legislation.

In light of this debate, British Columbia established its own new corporate structure in 2013 called a "Community Contribution Company" (C3), a subtype of for-profit corporate structure under the *BC Business Corporations Act*. The C3 is modelled after the CIC legal structure. It is a for-profit company that must have a minimum of three directors and must have a community purpose set out in the articles of incorporation. The community purpose can refer to providing health, social, environmental, cultural, educational or other services to society at large or to a segment of society. C3s must also publish an annual report documenting how community purpose has been met. Like the CIC, there is an "asset lock" and a cap on dividends to shareholders. They are designed to attract socially conscious investments. C3's are not non-profits and are therefore not tax exempt under the *Income Tax Act*.

Nova Scotia introduced CIC-type legislation in December 2012. Likewise, Ontario made changes to its existing *Non-Profit Corporations Act* to encourage social enterprise-like behaviour (e.g., revenue generation). Neither Ontario nor BC has been particularly interested in over-governing social enterprises, instead allowing existing government offices to monitor incorporation, dissolution and public reporting. Regulations have not yet been enacted in Nova Scotia so it is not known if a government regulator function will be adopted.

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[11] Anne Field, "*IRS Rule Could Help the Fledgling L3 Corporate Form*", Forbes. Retrieved from: http://www.forbes.com/sites/annefield/2012/05/04/irs-rules-could-help-the-fledgling-l3c/

[12] Richard Bridge and Stacey Corriveau, "*Legislative Innovations and Social Enterprise: Structural Lessons for Canada*". Retrieved from: http://www.centreforsocialenterprise.com/f/Legislative_Innovations_and_Social_Enterprise_Structural_Lessons_for_Canada_Feb_2009.pdf

3.2 Social/Affordable Housing Real Estate Investment Trust

A social or affordable housing Real Estate Investment Trust (REIT) is a tax efficient mechanism for investment in social or affordable housing properties. REITs can either be a publicly listed trust that allows investors to purchase units of income-producing real estate assets or privately held for members of the trust.

REITs allow the average investor to receive a return for their investment due to the growth potential in rental housing. REITs typically generate returns for investors by driving cost efficiencies through the use of professional management, by making property improvements which generate higher rents, and with property sales in high growth markets. These methods make REITs successful in the private market but may make them ill-suited for affordable housing purposes because affordable housing will generate a lower return for investors. This has been an untested assumption until recently as organizations in the US, Canada and the UK have been exploring different REIT models for investment in affordable housing. REITs are not in use in Australia.

3.2.1 Strengths, Weaknesses, Opportunities and Threats

The following table presents an overview of the strengths, weaknesses, opportunities and threats (SWOT) with Social/Affordable housing REIT's.

Table 2: Social/Affordable housing REITs - SWOT Analysis

Strengths
• Professional staff with strong track records in the affordable housing sector; • Mission-oriented towards preserving housing affordability; • For small or very small housing associations, it offers a vehicle to access professional property management within a larger structure committed to providing a return to investors – hence property attractiveness and revenue flows are critical; • Provides a vehicle to access low-cost capital for property upgrades.
Weaknesses
• Requires access to rental housing buildings for sale at the right price or the willingness of a local authority or housing provider to give up full or partial ownership for a limited period of time; • Lease arrangements between the REIT and housing provider may include an inflationary factor and may cost higher than other finance in the long run; • Availability of properties that will provide the right return for investors; • Competing with other investment vehicles. For example, local authorities and housing providers can choose to seek alternate finance to address their issues (e.g. bond finance, government grant, etc.); • Difficult to raise additional funds from other investors without a track record; • Requires significant incubation and investment of capital upfront to get the REIT working effectively and building up to scale.

Opportunities
• Capacity to expand; • Can assist participating non-profits to diversify their portfolios into non-subsidized properties; • May be an attractive vehicle for smaller associations struggling with managing the day-to-day operation of a real estate business without access to professional staff.
Threats
• Availability of properties that meet the criteria; • Upswings in target markets from a moderate to "hot" may result in difficult-to-source real estate deals; • Small number of staff with specialized knowledge creates staff turnover risk; • Difficult to raise additional funds from investors without a track record; • Competing with other impact investing vehicles who are also looking for investors; • Changes to housing policies by government or local authorities; • Inability to achieve the required scale needed by institutional investors; • Inability to arrange a pipeline of projects for the REIT.

3.2.2 Typical Roles

Government: Little direct relationship with government although reliant on well-developed relationships with government or similar entities. This model does not need additional government intervention. It is a non-government-based solution to address the need to preserve existing affordable housing projects in multiple markets.

Housing providers: In a typical REIT transaction, the non-profit member is transferring full or partial ownership of its property to the REIT for a period of time.

Banks/Investors: The investor's main role is to provide funding for the fund manager to acquire properties.

3.2.3 How Affordable Housing REITs Work: A Cross-Jurisdictional Review

United States

REITs were initially created by the United States Congress in the 1960s as a vehicle through which small investors could gain access to large-scale income-producing real estate properties. [13] REITs have grown in popularity and there are now over 200 publicly traded REITs in the United States, of which 21% are residential in nature.

Until recently, social and affordable housing REITs were virtually unknown in the US. In 2012 however, the Housing Partnership Equity Trust (HPET) was established as a private REIT for use by members belonging to the Housing Partnership Network (HPN). HPET is included as Case Study #2.

[13] "REIT Guide: 8th Edition", Deloitte, 2004.

Case Study #2 – Housing Partnership Equity Trust - US

Housing Partnership Equity Trust (HPET) is a multiparty trust that invests in its members' acquisitions that are multi-family properties for low- and moderate-income residents. HPET is a partnership of 12 non-profit members that operate about 53,000 affordable housing units across multiple states. It focuses on unsubsidized affordable rental housing properties that are cash flow positive and in good physical condition. Participation in the REIT enables members to compete in a fast-moving marketplace with for-profit developers by providing timely access to financing. As start-up funding, HPET received a $100 million initial investment from investors.

HPET is incorporated as a Limited Liability Company (LLC) and has 4 real estate finance professionals as staff. HPN, as sponsor, provides business and HR services. A nine-member Board of Directors governs HPET.

HPET has closed 3 transactions in 3 different housing markets and has preserved 557 units of affordable rental housing since April 2013. In September 2013, HPN was awarded the NEXT Award worth $2.5 million that will allow for the fivefold expansion of the REIT over the next two years.[14]

How it works

The Housing Partnership Equity Trust (HPET) invests strategically in medium- to large-sized multifamily properties, including non-core, secondary real estate markets that are currently at or below market rents and are typically unsubsidized, unrestricted rental properties. HPET is set up as a two-tier structure where the trust acts as the upper tier and the non-profit members are the lower tier. HPET makes joint venture investments with its lower tier members who acquire and operate the acquired properties.

The future outlook is very good. HPN/HPET is closely in tune with government and real estate developments that may create additional sources of properties to acquire and preserve. Based on performance data and benchmarking, HPN believes it is possible to grow the venture to over $2 billion. HPET is in Phase 1 of a three phase strategy.

Canada

Canadian residential REITs have been in wide use in the real estate sector since the early 1990's. They predominantly invest and hold properties in large multi-story rental buildings in multiple cities. Currently, social housing REITs are almost non-existent in Canada, though there has been speculation that a REIT would be established for Toronto Community Housing Corporation (TCHC) as a way to bring needed capital into the system.[15] In late 2013, the City of Toronto released its market sounding report on this topic.[16] While the report notes that there are potentially viable opportunities to explore setting up a REIT, a significant amount of due diligence and analysis would be required before the REIT could actually be established.

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[14] Retrieved from: http://hpequitytrust.com/wp-content/uploads/2013/09/HPN-Wins-2013-NEXT-Award_9.18.2013.pdf

[15] See Jacqueline Nelson, "*Toronto Community Housing REIT coming soon*?" http://www.theglobeandmail.com/report-on-business/streetwise/toronto-community-housing-reit-coming-soon/article4551667/

[16] City of Toronto Housing Partnership: Market Sounding Report, 2013. Retrieved from: http://www1.toronto.ca/City%20Of%20Toronto/Affordable%20Housing%20Office/Shared%20Content/pdf/City%20of%20Toronto%20-%20HPMS%20Report%20vFINAL%20Oct%207-2013.pdf

Canada also has three independent organizations pursuing the establishment of an affordable housing REIT: Responsible Residential Investment I (Quebec); Trillium Housing (Ontario); and Affordable Rental Fund I (BC). The formative private Responsible Residential Investment (RRI) is included as Case Study #3.

Case Study #3 – Responsible Residential Investment – Canada

Responsible Residential Investment (RRI) is a standard limited partnership. RRI is currently seeking investors as limited partners that are expected to be principally pension funds, but may also include foundations and high net-worth individuals.

The purpose of RRI is to acquire mid-size (i.e., 75+ unit) multi-family rental properties in Quebec that need capital improvements. RRI Inc., as general partner, will contract with GIRR Inc. as fund manager and enter into a master lease agreement with non-profit owners who will manage the properties on an ongoing basis. The purpose of the partnership is to acquire and maintain the properties for the long term, thus retaining them as affordable rental housing. RRI will set aside 5% of its fee to fund Environment, Society and Governance (ESG) activities with residents. The board is composed of 7 directors who have been chosen for their complementary skills and expertise.

How it Works

RRI is looking for capital investment which will enable the partnership to acquire unsubsidized affordable rental housing properties in certain markets in the province of Québec. RRI is targeting smaller rental apartment buildings, which often share equipment or facilities, are often not professionally managed, and suffer from deferred maintenance and poor leasing policies. RRI sees an opportunity to introduce professional management, address maintenance issues and introduce ESG principles to residents, thereby improving their quality of life.

At this point all three Canadian organizations trying to establish an entity to preserve or acquire affordable housing have been only marginally successful in obtaining investment in their concepts.

United Kingdom

REITs were largely unknown in the UK until 2007. REITs in the UK are subject to stiff competition from other investor options in the social housing sector – including bonds that provide a return of 5-6% and equity investment that provide returns of about 7%. In 2012, the government introduced significant changes to the law which simplified the process for companies entering into a REIT. The first UK social housing REIT, Houses for Homes, was established in 2013 and is identified as case study #4

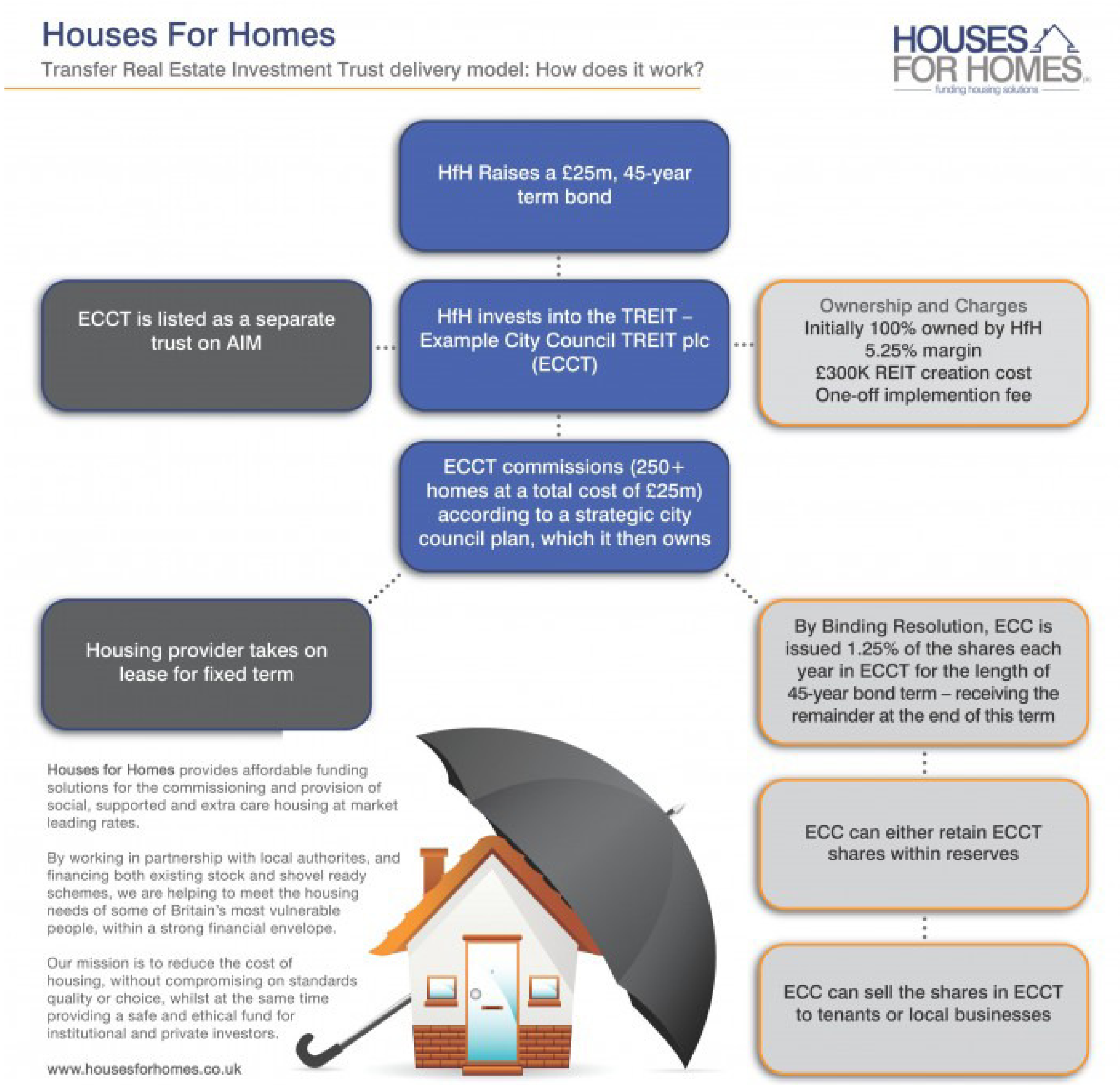
Case Study #4 – Houses for Homes – UK

Houses for Homes (HFH)is the first REIT of its kind in England. It provides an off balance sheet solution to fund the development and provision of housing stock, enabling the continued supply of social, extra care and specialist homes (i.e., supportive housing) via registered social landlords (RSLs) and local authorities.

HFH has been working steadily for almost three years to source investors and real estate holdings. HFH recently closed a £130 million deal with a local authority to construct homes over an 18-month period. The REIT will soon be listed on the Alternative Investment Market of the London Stock Exchange.

How it Works

Houses for Homes raises capital from institutional investors (pension funds and insurance companies), buys housing stock (either freehold or leasehold), and then holds that housing stock in trust. HFH then leases the stock to registered housing providers on full repairing leases. The housing provider pays the lease charge for the bricks and mortar to HFH. The housing provider then leases the property to its tenants. The housing provider adds on management charges to the cost of the building lease. Below is an illustration of the process.[17]



The outlook for HFH is good as they are slowly building the REIT and they have recently arranged for a banking facility to continue to grow the business.

[17] http://www.housesforhomes.co.uk/treit-how-it-works/

3.3 Capital Raising and Lending Facilities

A capital raising and lending facility is a financial intermediary that borrows funds in the capital markets and lends that money to social and affordable housing providers. Typically, these facilities offer specialized or aggregating services to providers that cannot access the markets on their own due to scale or capacity issues.

Canada's social housing system has traditionally relied on Canada Mortgage and Housing Corporation (CMHC) mortgage insurance with mortgages being held by banks and supported by insurance agreements between governments which protect the banks and hold CMHC harmless.

In the vacuum of no substantial grant funding for housing, there has been no influx of private money for building new or renovating existing social housing. Instead, provincial government agencies have picked up the slack. Both Infrastructure Ontario and BC Housing are now providing low-interest loans for eligible housing providers in their jurisdictions.

3.3.1 Strengths, Weaknesses, Opportunities and Threats

The following table presents an overview of the strengths, weaknesses, opportunities and threats (SWOT) with Capital Raising and Lending Facilities.

Table 3: Capital Raising and Lending Facilities - SWOT Analysis

Strengths
• Efficient means of introducing large investments to housing providers; • Allows small to medium-sized housing associations the ability to access cheap capital to continue with their business initiatives; • The "soft" features are key selling points and difference from other market players. This includes the trust built over time with housing providers, the marketplace, investors and government; • Backed by government guarantees which allows the lowest possible rates to affordable housing projects; • Low transaction costs.
Weaknesses
• Small but experienced team can leave entity vulnerable to turnover and key personnel risk; • Reliance on housing providers to identify capital needs which means that the entity is always "herding cats"; • Requires institutional investors in advanced capital markets with a ready supply of investing institutions; • Larger housing associations are able to raise their own bond finance without the entity's assistance.
Opportunities
• Potential to expand its offerings to other small and medium-sized housing associations which have not yet accessed their services;

• Deal structures which offer even tighter pricing than in the past; • High demand for social/affordable housing so will continue to have clients over the long term.
Threats
• Land sourcing and planning restrictions which prevent or delay housing providers from accessing capital when they need it; • Requirement to continuously monitor changes in government policies related to housing and finance which impact lending to housing providers;

3.3.2 Typical Roles

Government: Capital facilities are typically regulated by legislation governing financial vehicles. In the UK, the Housing Finance Corporation (THFC) operates under rules registered and approved by the Registrar for Friendly Societies, which is part of the Financial Conduct Authority (FCA). In the case of both BC Housing and Infrastructure Ontario, they are both provincial crown corporations, entities in which oversight occurs through a board appointed by government. They also are approved lenders under the *National Housing Act*.

Housing providers: They access loans from a lending entity that requires them to know how much money they need, for what purpose, and when they need to use the money. In the case of BC Housing, the housing providers work with the lending and development services departments in order to receive both grant and financing to build new affordable rental housing.

Banks/Investors: THFC raises money directly on the markets. In the case of both BC Housing and Infrastructure Ontario, a central provincial government department performs the capital raising function. In the case of BC Housing, once a new building is complete, a pool of mortgages is competitively tendered to lending institutions who bid on the pools. The successful winner of the pool then sells the bundled mortgages to investors as mortgage-backed securities.

3.3.3 How Capital Facilities Work: A Cross-Jurisdictional Review

United Kingdom

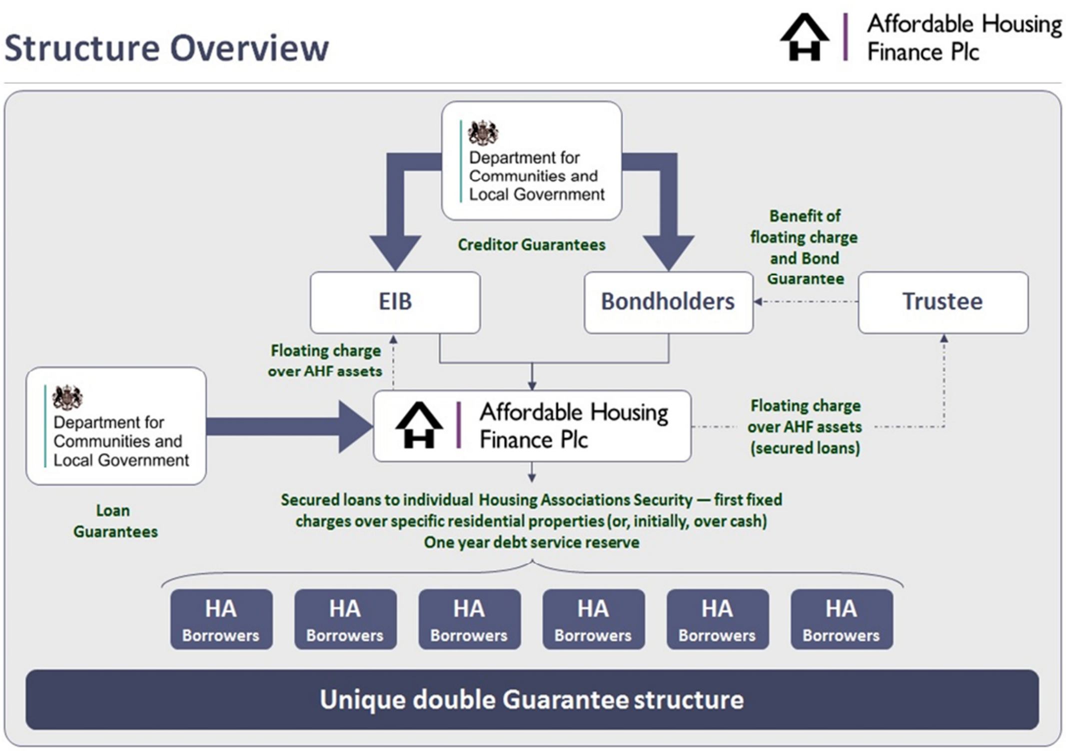
Despite government retreat, as a special purpose lending facility, the Housing Finance Corporation (THFC) has been flourishing in the UK. THFC was established in 1988 to provide a source of private capital for not-for-profit housing associations. It directly raises longer-term bond finance and lends that money on a secured basis for long fixed terms. It operates without direct government control or subsidy. Currently rated as A+/stable/A-1 by ratings agencies, THFC's loan book stood at £3,12m in 2013 and has a 100% repayment rate on the part of its borrowers. Whereas a bank intermediates between savers and borrowers by entering into separate transactions with each, with all the risk that entails, THFC acts as credit principal and borrows/lends on similar terms (for example, if THFC borrows for a 30 year term in the market, it lends at the same term to a housing association).

THFC's success relies on several key factors such as the size of housing sector which provides a large pool of potential clients, sophisticated borrowers (housing providers) who can manage complex loans, the housing provider's loan repayment capacity based on the government-funded housing benefit program, and a stable regulatory regime which gives comfort to investors. THFC is identified as case study #5.

Case Study #5 - The Housing Finance Corporation – UK

THFC is a financial intermediary, diversifying the risk to those investors wanting to lend to registered housing associations and allowing access to the capital markets for housing association borrowers that would ordinarily not be able to do so, typically owing to their size.[18] THFC creates cost efficiencies for small- to medium-sized (as per UK definitions of size) housing associations through economies of scale and standardizes loan terms across those that participate in their arrangements.

THFC works in a group structure, with subsidiaries being established as needed to manage particular bond issues. The structure of its most recent subsidiary, Affordable Housing Finance, is highlighted below:



THFC is a not-for-profit Industrial and Provident Society (I&PS) with the English statutory housing regulator as a shareholder and board appointee. THFC is an unregulated finance company although it does talk to the systematic part of the banking regulator (the Prudential Regulation Authority) about the regulatory perimeter. THFC operates in a highly competitive financial market with the primarily goal of aggregating capital from institutional investors to meet the needs of UK housing associations.
THFC has a 9-member board with 2 nominees each coming from their founders, the Homes and Communities Agency (HCA) and the National Housing Federation (NHF). THFC has a small operational team of sixteen professionals, with backgrounds in social housing, banking, accounting and corporate treasury.

[18] Standard and Poors, "The Housing Finance Corporation Ltd", 2008.

How it Works

THFC sources long-term capital on the markets from institutional investors. THFC acts as principal and borrows in its own name and immediately on-lends only to registered housing providers. THFC secures all of its loans, which are ranked pari passu alongside other loans, thereby adding to THFC's status on title.

THFC makes and maintains its own independent credit assessment of its borrowers, using its own credit rating system, and approves applications for funding only after a careful review by the Group's credit committee.[18] THFC also monitors the financial position of its borrowers on an ongoing basis.

The outlook for THFC is very good. Its net profits jumped to 44% in 2013 compared to an average of 39% between 2008 and 2012, thanks to fees from bonds.

Canada

Canada has a long history in accessing debt financing from third party institutions by way of mortgages,the predominant mechanism used to build and finance housing in Canada since the 1970's. Canada's major banks offered competitive interest rates on the construction costs for social housing projects that are backed by CMHC's Mortgage Insurance Fund so long as they have an operating agreement. CMHC's role, while supportive of social and affordable rental housing, is primarily about protecting Canada's banks because of the guarantee in place to protect them in the event of a mortgage default.

There is currently no active structure like the THFC in Canada where the housing sector is significantly smaller than the UK sector and without a housing benefit program which provides guaranteed revenue into the system. However, both Infrastructure Ontario and BC Housing provide loans for new non-profits and co-ops in their respective jurisdictions and both are NHA-approved lenders. Because both institutions are backed by their respective provincial governments, they are able to achieve very low interest rates. Canada is taking a bold step to explore the feasibility of developing a Canadian Housing Bank similar in structure to THFC.

In the case of BC Housing, new loans are then added to their ongoing competitive financing renewal program for renewing mortgages. This does not occur in Ontario as Infrastructure Ontario continues to hold the loans. BC Housing tenders out loans for newly constructed projects to the big banks and reimburses the provincial treasury for the money lent during construction. Ontario does have a competitive financing renewal program for existing social housing mortgages which is managed by another government department. The same program is not in place for affordable housing loans in Ontario whereas in BC it is.

BC Housing is case study #6. Infrastructure Ontario is case study #7.

Case Study #6 - BC Housing – Canada

BC Housing is the provincial Crown agency that develops, manages and administers a wide range of subsidized housing options for those most in need across the province. BC Housing has acted as the construction lender for new homes and secured long-term financing from private sector banks, trust companies and insurance companies. All projects are built using public/private partnerships. In most

[18] Retrieved from: http://www.thfcorp.com/accounts/2013/2013-annual-accounts.pdf

cases, non-profit societies are the project owners. Private sector architects and contractors design and build the homes. BC Housing usually enters into long-term operating agreements and may provide ongoing subsidies if required.[19]

The key elements of BC Housing's financing model are that:
- BC Housing borrows from the Provincial Treasury to obtain the funds necessary to fund the construction of the new housing project;
- The construction financing is secured by a mortgage registered against the land title for the project;
- At project completion, BC Housing solicits bids from private sector financial institutions for long term (take-out) financing which is used to repay the construction loan.[20]
- As an arm of the provincial government, it is able to achieve rates based on the AAA credit rating of the province.

Case Study #7 - Infrastructure Ontario – Canada

Infrastructure Ontario (IO) is a Crown agency of the Ontario government. It is focussed on modernizing and financing the renewal of public infrastructure, maximizing the value of public real estate and managing government facilities. IO has $7.1 billion loans approved as of 2014. Housing comprises $712 million of those loans.

The key elements of Infrastructure Ontario's financing model are that:
- Infrastructure Ontario borrows from the Ontario Financing Authority (OFA) and on-lends that money to eligible affordable housing proponents with grant funding from the local service manager under the affordable housing programs or for existing social housing proponents with agreements in place with the local service manager;
- Financing is secured by a mortgage registered against the land title for the project;
- It has concentration limits to which it must adhere. This means that it must limit its exposure to certain industries or borrowers. It has not yet reached its concentration limits in the social or affordable housing sector;
- It offers attractive interest rates over long periods of time based on the credit rating of the Ontario provincial government. Its only competition at this point is from service managers (local government) who sometimes choose to direct lend/issue debentures to fund affordable housing projects in their areas.

3.4 Housing Bonds

Bonds are, in essence, a debt that the issuer promises to repay, and are issued for a specified period of time (anywhere from one year to several decades).[21] Bond issues are an efficient means of raising money for housing and can raise more money than mortgages. Funds can be freely used, including for redevelopment or new construction. They are often non-renewing and have long repayment terms (e.g., 25-30 years). Interest rates for bonds are comparable to equivalent-term mortgages. Unsecured bonds

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[19] This section relies on information from an unpublished paper by BC Housing called "Affordable Housing Financing in British Columbia"

[20] See further for BC Housing's lending criteria: http://www.bchousing.org/resources/Partner_Resources/Developing_Housing_Opportunities/CPI-Lending_Criteria_Guide.pdf

[21] Retrieved from: http://www.ahuri.edu.au/housing_information/review/evrev056

are based on the financial health of the organization itself. In contrast, mortgages and secured bonds are limited by the asset value of the subject property.

Bonds can also be arranged via a public bond offering or through a private placement with one investor. Public bonds can take 6 to 12 months to arrange and require expensive specialized financial advisory services. Private placements, on the other hand, can be arranged relatively quickly without needing specialized services. Public bond offerings are rated by a credit rating agency such as Standard and Poor's. The rating attests to the credit worthiness of the issuer and is the key factor in determining the interest rate.

The market conditions that drive bonds are highly related to what is happening in the broader financial markets. Bonds can be alternative source of financing when traditional banks have restricted ability to lend. Bonds are generally perceived by the investing community to be low-risk investments. When investors are looking for safe, long-term placements for their money, bonds are appealing. Affordable housing bonds are also appealing – not because they are affordable housing per se but because they are considered to be stable, investments can be made for the long term, and the assets are generally considered to be secure investments. Despite turmoil in the debt market from time to time, highly rated issues (AAA and AA class) are always in demand.

3.4.1 Strengths, Weaknesses, Opportunities and Threats

The following table presents an overview of the strengths, weaknesses, opportunities and threats (SWOT) with Housing Bonds.

Table 4: Housing Bonds - SWOT Analysis

Strengths
• Demonstrated investor market interest in investing in housing particularly where there is a high credit rating, a funding agreement with government which reduced risk as perceived by investors and there is sufficient scale (ie it is easier to borrow $250 million than $25 million); • Bonds allow access to cheaper money – interest rate on 30-year bonds can be less than for comparable mortgages with mortgage insurance; • Annual financing costs are much lower for debentures as interest-only payments are the norm; • Asset security is not mandatory; • Flexibility in determining repayment of capital debt – can use sinking fund to build up payment or simply refinance at end of term; • Higher levels of financing are available, as of creditworthiness is based on security of income flows, rather than asset value or net operating income; • Funds can be freely used for a variety of purposes without impeding security of underlying asset; • Provides stability to the housing association over a long period of time and encourages portfolio growth.
Weaknesses
• Organization must have scale. Bond issues require a critical mass to interest pension

funds, insurance companies and the banks that look for big long-term deals; • The process requires time, money and management attention. Support of stakeholders is critical; • Significant public disclosure requirements for public bond offerings; • Fees (overhead) are significant and relatively fixed: participating in capital markets requires substantial legal resources, paying for the services of a rating agency, underwriting fees, and the costs for a financial advisor; • With private placements, there is a limited secondary market (unlike public bonds which benefit from a large and robust secondary market) which means that the investor must be willing to hold the investment until maturity.
Opportunities
• Municipal housing corporations may be a preferred risk by virtue of their structural links to the municipal government. Private placements would work very well for medium-sized companies; • Remainder of sector would only benefit from bond aggregating as they are too small; • Bonds can be highly attractive to housing providers looking for long-term cost-effective financing when banks are only willing to lend for short terms (e 3 to 5 years).
Threats
• Canadian bond issues in Ontario for service-manager owned organizations can only be approved if Shareholder has debt-carrying capacity due to changes to Public Sector accounting rules.

3.4.2 Typical Roles

Government: Approves any loans, debentures or bonds that are registered on title. If a bond offering is based on credit-worthiness of the entity and not registered on title, municipal government approval will still likely be required in Ontario.

Housing providers: In any bond offering, a significant investment of time and money is needed on the part of senior management to oversee the process. The housing provider typically has a long-term business or asset management strategy in place and is seeking access to low-cost, easy-to-arrange, long-term stable financing. The choice to pursue a private placement over a public bond offering comes down to timing and the ability of the provider to service the debt.

Banks/Investors: Investor's role is to purchase the debt over the required length of time.

3.4.3 How Capital Facilities Work: A Cross-Jurisdictional Review

United Kingdom

The UK housing sector has been accessing the public bond market since 1987 when North Housing Association (NHA) raised £65 million. About 35 housing associations have issued public bonds since that time and have ratings from ratings agencies. In 2012, UK housing associations raised almost £4 billion in the capital markets, four times the previous annual record. At the same time, investors are increasingly interested in social housing as a form of investment, attracted by the higher yields when compared to the current low yields of inflation-linked gilts[22] (gilts are UK bonds). Over £1.2 billion has been raised to date by housing associations through private placements.[23] In the UK, social housing is seen as a viable, reasonable and solid low-risk investment for institutional investors.

Derwentside Homes, a medium-sized UK housing association, placed a private bond in 2013. This is included as case study #8.

Case Study #8 – Derwentside Homes – UK

A private placement bond is an established method of raising long-term committed debt capital. They are not substantially different than a public bond offering except that there is usually a one-on-one relationship between the issuer and the investor. The private placement approach can also be significantly less complicated than a public bond offering since a ratings agency is not involved in the process. They are usually arranged quickly which necessitates having quick regulatory approval. They are also not subject to the same level of scrutiny that exists during a public bond offering.

In December 2013, Derwentside Homes agreed to a £40 million private placement deal with Canada Life Investments.[24] Derwentside Homes is a Registered Social Landlord, which owns and manages approximately 6,800 homes across North Durham. The private placement took 2 months to arrange.

There are advantages to private placements compared to public bond offerings. For example, legal documents are more flexible than those used for publicly listed bonds, they operate in a private market which is less volatile than the public market, arranging the bond occurs within a short time frame, there are minimal public disclosure as no public ratings are required and the flexible issue size can be substantially smaller than public bond offerings. The simplicity of the process can give smaller and medium-sized housing associations confidence to do more bond placements.

Canada

In Ontario, social housing is the last MUSH sector (Municipalities, Universities, Schools and Hospitals) to go to the capital debt market for financing. Toronto Community Housing Corporation (TCHC) broke new ground when it raised $450 million from two 30-year bond issues to deal with its capital repair backlog. Both issues, in 2007 and 2010, had more potential buyers than bonds. TCHC is the only rated social housing provider in Canada. The Toronto Community Housing Corporation public bond offerings are included as case study #9.

Case Study #9 – Toronto Community Housing Corporation – Canada

TCHC issued two bonds for a total of $450 million:

- Series A May 2007 - $250 million, 4.877% debentures, 30-year term
- Series B February 2010 - $200 million, 5.395% debentures, 30-year term

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[22] http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~/media/Policy/Documents/0302-Investment-Insight-Social-Housing%20b.pdf

[23] Retrieved from: http://www.socialhousing.co.uk/private-placements-exceed-12bn-as-smaller-deals-flow/7001218.article

[24] Retrieved from: http://www.housingexcellence.co.uk/news/derwentside-homes-agrees-%C2%A340-million-private-placement-deal-canada-life-investments

TCHC's debentures were issued through a third party trust – TCHC Issuer Trust. The Trust is a pass-through vehicle with TCHC being fully behind these debentures. Repayments are semi-annual interest-payment-only with the principle repayment occurring at the end of the 30-year term.

TCHC obtained a Standard and Poor's issuer credit rating of "AA- stable" for both Series A & B debentures. In its ratings update in November 2012, Standard and Poor's re-affirmed TCHC's 'AA-' rating.[25] The credit rating is for TCHC as a standalone entity without direct backing from the City of Toronto. TCHC's credit rating at AA- is one notch below the AA rating of the City of Toronto, the sole shareholder of TCHC.

The debentures are corporate debt. They are unsecured obligation of TCHC, i.e., bondholders are unsecured creditors. As such, there is no pledging of TCHC asset and cash flow. The debentures are not guaranteed by the City of Toronto.

More than 40 investors bought the bond including provincial pension funds, fund managers, insurance companies, etc. The interest rates for Series A and Series B were 0.64% and 1.29% over the interest rates on the equivalent Government of Canada 30-year bonds respectively.

For TCHC, which is a subsidiary of the City of Toronto, the final spread was also impacted by the interest rate on the City's bond and other factors such as provincial support as funding of housing is governed by provincial legislation. The market perceived an "implied" support from the province and hence "improved" the spread.

The TCHC bond issue demonstrated that there is investor interest in the social/affordable housing sector in Canada.

[25] Retrieve from: http://www.torontohousing.ca/webfm_send/9042

4.

Discussion and Comparison

In examining the four models to bring alternative capital into the affordable housing sector, it is important to understand that the direct replacement of public with private capital is impossible without an increase in the economic cost of social housing. Private capital is motivated by the return that can be achieved on an investment and in a manner that reduces its own risk.

All of the models in this report can bring money into the housing sector, if the deals are structured in an attractive manner for investors. There is no question that the private sector will invest money into the social housing sector, but it must be understood that investors are driven by risk reduction and investment return rather than social goals. While the social goals may have certain appeal, the decision to invest is based on trust in the product and due diligence rather than social motivation. Yet the housing sector is one based on physical assets which have received significant financial investments over time. The assets themselves, if properly positioned, can be an attractive investment to the private sector in Canada, as they are in other countries such as the United Kingdom.

All of these models have certain advantages and disadvantages and flourish/fail under different conditions. The most critical factors are:

- Are investors ready?
- Are housing providers ready?
- If they are not, how do we get there?

4.1 Hybrid Legal Structures

Hybrid legal structures are meant to bridge the gap between charities or non-profits and for-profits. The hope is that the relatively new impact investing field will make investments in these structures, thereby enhancing their social benefits. They have uses, which can be summarized as follows. Hybrid Legal structures;

- work well for new businesses but do not offer sufficient financial attractiveness for existing housing businesses to move from a non-profit to hybrid structure . Charitable or non-profit housing corporations may rely on their preferential tax treatment which is not available to hybrid forms.
- work when a lender is willing to overlook the asset lock provisions.
- are not available nationally in Canada which limits any organization trying to work at a national level.
- offer advantages to entities working locally and seeking to support existing businesses (i.e., can be used to generate revenue which can be invested in the existing business).
- have difficulty attracting debt and equity investments in their activities. A different corporate structure does nothing to solve this issue.

Investor readiness: In BC, the C3 legal structure is very new. As a potential new asset class, institutional or other lending institutions have no lending policies in place to assess lending options. The possible new entities are unknown to the investing community, as are the possible risks to investors. While trailblazing will eventually occur, there are too many unknowns from the investor community to attract attention from most of them (e.g., lack of scale, lack of liquidity, operational/staff/personnel risks, asset condition risks and policy risks).

Provider readiness: The biggest consideration for a housing provider to want to change its existing corporate structure is if there is a business driver to do so. There does not appear to any great advantage from a UK housing association perspective to change from the current form (largely Industrial and Provident Societies). In Canada, the non-profit corporate structure has performed well overall despite the challenges faced in recent years due to interpretations on the part of Canada Revenue Agency.

How to get there? Housing providers could consider changing corporate structure to a C3 or creating a new corporation immediately only in BC. These forms are not available elsewhere in Canada. New national legislation would have to be passed to allow them to flourish across the country. The biggest disadvantage at this stage is that a new corporate structure does not guarantee any additional investment from private investors.

4.2 Social and Affordable Housing REIT

The REIT model is intended to minimize government support and involvement. It is a private sector approach to a mission-oriented affordable housing product. A REIT will not, in and of itself, enhance the attractiveness of social housing as an investment proposition but it is an extremely useful tool in the following circumstances:

- Desire to preserve affordability of existing assets
- Lack of access to other sources of capital
- If debt carrying capacity is tapped out
- In a partnership model which is member-driven
- Has a well-developed pipeline of potential buildings
- Not composed of properties where all residents are subsidized
- Where there is access to cheap, efficient and professional property management
- Where properties are geographically concentrated
- Where properties are not already secured or subject to other debt obligations
- Where transferring full or partial ownership of assets forever or for a time-limit is not in question
- A successful publicly-listed Canadian REIT requires significant upfront investment of capital and time in order to achieve scale and profitability.

Investor readiness: In the UK, US and Canada, the residential REIT structure is a tried and tested structure in the private sector. REITs are excellent investments and are attractive to investors if they can be structured to provide a good rate of return.

Provider readiness: Existing housing providers are not ready or interested in transferring ownership to a trust. It is possible to structure a Canadian REIT, as RRI is doing, so that it is not acquiring existing social housing. By focussing on naturally affordable rental housing, like HPET does, a Canadian REIT may be a viable entity.

How do we get there? Depending on how the REIT is structured in Canada, it may or may not need government approval. From the concept phase until an initial public offering, a timeframe of 6 months to 1 year is typical. Fees, however, would be substantial – i.e., in excess of $1-2 million to pay for legal fees, underwriters, audits, accountants, legal fees for underwriter's counsel, appraisals and other administrative costs. A Canadian REIT will need to rely on the economics of the model – i.e. the pipeline, the property managers and the investments from investors.

4.3 Capital Raising and Lending Facilities

If the Canadian housing sector is to become more self-reliant, then establishing a capital raising and lending facility for social and affordable housing purposes is necessary. But the facility must meet the unique needs of the Canadian housing sector, which is composed of a handful of larger government-owned entities and thousands of small community-based housing organizations. The sector is credit worthy; what must be addressed are the issues of scale and capacity of housing providers, their debt carrying capacity and the variability of regulation in different provinces.

An appropriately structured nationwide housing capital raising and lending facility could be an extremely effective tool in the following circumstances:

- For housing providers who are ready and able to access funding
- If housing providers have cash flow
- If housing providers have solid business plans in place for new or existing housing purposes
- If access to capital is offered at an attractive interest rate
- In an environment where the investor community understands the nature of the housing in which it is investing
- Are willing to pool with other housing providers that seeking similar lending terms (long-term, attractive repayment terms)

Investor readiness: As demonstrated by TCHC's publicly offered bonds, the investor community has substantial funding available and is willing to lend to the social housing sector. It is likely that investors would be equally interested in an aggregated bond offering of a Canadian sector bank similar to THFC. Any stable, long-term investment with a government guarantee and backstop will automatically attract institutional investors.

Provider readiness: Most Canadian housing providers are not ready. Only about 25 to 30 larger ones have business plans and asset management strategies in place across the country, t. Each one of these organizations would need to have sufficient cash flow, indemnities from their subsidy funders, and solid, reasonable, achievable business plans along with internal staff with capacity to manage large scale transactions. In addition, significant effort would be required to build the capacity amongst the smaller housing providers who may have sufficient cash flow and business plans but may not have the capacity to manage the complexities of investing with in the capital markets.

How do we get there? The creation of a Canadian financing entity requires resources and commitment. Prrime key human resources will be required in the areas of finance/corporate treasury, underwriting, credit analysis and law. There will also be a need for stakeholder consultation and communication, an oversight committee to help make decisions about the legal and governance structure, legislative requirements/modifications/research, financial expertise (to identify private sector interest and support), and good relationship management with government.

It is recommended that a more in-depth feasibility study be undertaken to investigate whether there is indeed a viable opportunity to establish a Canadian THFC. As a course of action, the sector is currently investigating the feasibility of a dedicated social housing lender (Canadian Housing Bank). The goal of the feasibility study is to identify the merits and marketplace for the establishment of a Canadian Housing Bank.

The creation of a Canadian Housing Bank specifically designed to meet the needs of the sector could represent an effective solution. A dedicated lending institution focused on pooling capital requirements through the private capital markets could promote efficiency and cost-effectiveness for a diverse group of borrowers. Properly executed, the Canadian Housing Bank could provide a sustainable, long term source of funding specifically tailored to the needs of the sector.

4.4 Housing Bonds

Bonds are viable method of raising capital from the private sector and have been extensively used in the UK for about 30 years. They work well in the following circumstances:

- Large to very large housing organizations who are ready and able to access substantial funding (upwards of $100 million) through public bond offerings
- Medium-sized organizations who are ready and able to access funding of $50-100 million through private placements
- If housing providers have cash flow, liquidity and low debt levels
- If housing providers have solid business plans in place
- If access to capital is at an attractive interest rate
- In an environment where the investor community understands the business
- If the housing provider's senior management are professional with experience and skill in housing and/or finance
- When the organization can bear public, external and ongoing scrutiny of its finance and governance by ratings agencies (for public bond offerings only)

Investor readiness: Investors are ready.

Provider readiness: At this point, most large housing providers are ready but they have chosen to access other financing. There are also limited numbers of very large housing providers (i.e., in excess of 5,000 units) in Canada that have the scale, money and capacity necessary to access the bond market alone. Any organization that chooses to do so will need access to substantial internal funds for the bond issuing process.

How do we get there? There is no reason why a housing provider with scale, capacity, a solid business plan and any needed approvals could not issue a housing bond at this point in time.

5.

Conclusion

There are many challenges and opportunities associated with raising capital for social and affordable housing but they are not evenly distributed across Canada. This is primarily a factor of the size of the housing sector, the scale of the organizations that own and manage assets, the capacity of those organizations to use that funding and the vision those organizations have of their own future. This paper has provided a review of four models that could bring additional capital into the housing sector in Canada.

Housing CICs are already operating in the UK and the new legislation will allow for the emergence of housing C3s in BC. These hybrid legal structures can be used as a political statement by housing organizations as a way to generate revenues for social purpose business and to access impact investment funds.

Affordable housing REITs are under development in Canada and already operating in the US and the UK. Canadian investors are familiar with residential REITs so if the deal can be structured properly, it is just a matter of time before Canada has an operational one for social housing. REITs can be used to ensure ongoing affordability in certain housing markets with funding from private investors.

Capital raising and lending facilities can be used to aggregate the needs of smaller housing providers via the capital markets. A Canadian Housing Finance Corporation, modelled after the one in the UK, is a real possibility and the next steps are to fully explore the economic and market feasibility of such an approach.

Housing bonds have been used to finance housing in the UK for 30 years and housing providers in both Canada and the US have issued them too. Housing bonds are a promising prospect in Canada for larger housing providers. Since most housing providers in Canada are smaller, an aggregating bond function is needed in order to reach a broader segment of the market.

In closing, all of these models can coexist in Canada and be used to address funding gaps in the social and affordable housing sector.

About BC Housing

BC Housing develops, manages, and administers a wide range of subsidized housing options across the province of British Columbia in Canada. We partner with private and non-profit housing providers, other levels of government, health authorities, and community groups to increase affordable housing options for British Columbians in greatest need. BC Housing also helps bring about improvements in the quality of residential construction in B.C. and helps strengthen consumer protection for buyers of new homes.

For more information, visit www.bchousing.org.

About HSC

The Housing Services Corporation (HSC) is a non-profit organization that is committed to ensuring that Ontario residents have access to safe and affordable housing that improves their quality of life. We support this by focusing on the long-term health and sustainability of Ontario's social housing asset.

For more information, visit www.hscorp.ca

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