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EXAMINATION OF THE HOUSING SERVICES ACT OF ONTARIO FUNDING MODEL AND ITS EFFECTS UPON HOUSING CO-OPERATIVES IN ONTARIO INTO THE FUTURE

Prepared for

CO-OPERATIVE HOUSING FEDERATION OF CANADA
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OBJECTIVES OF THE STUDY

This study is an attempt to establish how the subsidy regime for social housing projects under the Housing Services Act (HSA) in Ontario affects individual co-operative housing projects financially. The study attempts to establish what variables such as location and size make a significant difference to funding for each project.

The housing subsidy program may not be treating all housing co-operatives equally or fairly. The program has undergone several significant legislative changes. There is concern that the original funding objectives may have been lost along the way.

CONCLUSIONS

The analysis of the data suggests three possible conclusions:

1) Financial success for a housing co-operative funded under the HSA depends, in part, upon the original benchmarks. If the original bench marks are too low the subsidy formula serves to exaggerate the weakness and make a difficult situation worse.

2) After EOM in the absence of any change to the program or use of options as in # 3 below, most housing co-operatives funded under the HSA will encounter negative cash flow problems and not be sustainable into the future. When EOM is reached and negative subsidy increases significantly covering the bulk of property tax subsidy and RGI subsidy, the housing co-ops can afford to cover the RGI subsidy program or cover all necessary capital expenditures. They lack the financial capacity to be able to do both on their own without assistance.

3) Given the nature of the funding calculation, if the Service Manager were to increase the annual CRF to accommodate the necessary capital work to be done at a project, the negative effects demonstrated by the charts below would be at least partially mitigated. The SM has the ability to allow a group to make such an increase under the HSA in section 98(4) of Ont Regulation 367/11.

This second conclusion is consistent with the experience of the section 95 co-ops as they reach the end of their mortgages and agreements with CMHC.

The caveat to accompany these conclusions is that the sample size is small and one is reluctant to draw definitive conclusions without further review and study. However, because the results are so consistent between co-ops sampled the results should be a fair indication of what is happening and will happen with all projects funded under the HSA.

The data trend lines are so consistent among the sample co-ops that there appear to be definitive patterns. To support this is the observation that the formulae for subsidy are fixed, the assumptions are fixed and applied equally to all the data. The only variables are drawn from the input data. These are base year revenues, base year expenditures, opening cash and investment levels, mortgage rates and payments and end of mortgage dates for each co-op. These data are all drawn exclusively from the audited financial statements provided and are assumed to be reasonably accurate and a fair presentation of normal operational activities of each co-op. One can reasonably conclude that comparison of the forecast results between co-ops although not necessarily accurate in an absolute sense will still provide a reasonably accurate comparison between co-ops.

The analysis of results supports this observation.

ACRONYMS

HSA	Housing Services Act and its regulations
MMAH	Ministry of Municipal Affairs and Housing

SM	Service manager (municipal)
EOM	End of mortgage
AIR	Annual Information Return
BCA	Building condition assessment
CRF	Capital reserve fund
U	Urban location co-op (# units)
SC	Small centre co-op (#units)
SU	Suburban co-op (#units)

METHODOLOGY

The intent was to keep the sample size small and cover as many variables between co-ops as possible. Selections were targeted, not random.

Hamilton, Ottawa and Toronto were categorized as urban, other GTA as suburban. All other locations were categorized as small centre.

Style of construction largely lined up with location and size. Urban co-ops are generally larger and concrete slab buildings. Small centre co-ops are generally wood frame construction and are mostly townhouses.

Letters went out to a number of co-ops considered to be representative of these categories. Eleven co-ops agreed to provide data and participate in the study.

A financial model was designed. The focus was entirely upon cash flow. The model consisted of a cash flow statement from 2015 to 2045. Two key support schedules feeding into the cash flow were an income statement and a statement of subsidy calculation.

Inputs were largely based on the most recent audited financial statement. In all cases the 2015/2016 numbers are actuals drawn from the audited statements. In addition the 2015/2016 subsidy numbers were drawn from the 2015/2016 Annual Information Return. The subsidy treatment in the audited financial statements was checked to ensure it was consistent with the data in the AIR. This was the case for all sample items.

All numbers past 2015/2016 are derived from the base 2015/2016 year or are driven by the subsidy funding formula. The exception is the debt service payments. They end at the end of the mortgage.

Capital expenditures are based on whatever the co-op had available in the form of a capital budget.

SAMPLE SIZE AND SELECTION

Sample size was 11 co-ops. To get as much coverage as possible from such a small sample co-ops were targeted with a request to participate in the study.

RELEVANT DATA COLLECTED

Each co-op supplied audited statements and annual information returns and a BCA where available or a capital budget. All projections are based on these three items from each co-op.

ASSUMPTIONS

INFLATION

Inflation is split between revenue inflation and expenditure inflation. All projections are based on 2% revenue inflation and 2% expenditure inflation.

INTEREST RATES

Interest rates used for mortgages are based on the rates in effect with each mortgage. Mortgage terms were ignored and each mortgage was allowed to run out at its current interest rate, payment level and amortization period. Any interest rate changes will simply call for amended mortgage payments and amended bench marks. The effects upon the subsidy formula would be to increase or decrease the numbers but the net effect would be the same and the EOM effect would be the same. The trends would be identical.

Any residual cash balances were increased annually by a 1% allowance for investment income.

RGI USAGE RATES

RGI usage rates were assumed to remain unchanged throughout the study period. The only change to RGI subsidy was an allowance for inflation.

FUTURE CAPITAL EXPENDITURES

This was the weakest area for the data collected. Not all co-ops in the sample had BCA's. Several co-ops had 5 or 10 year capital budgets. Where a co-op had nothing available, estimates were used more as place holders than anything. There is certainty that there will need to be capital expenditures. The levels per unit per year are a matter for each individual co-op. Because of the marked effect even modest capital expenditures have upon the co-op it was necessary to use estimates as they would serve to make the point that these expenditures would be there regardless of level of expenditure.

AVAILABLE CASH FLOW

The analysis performed for future cash flow levels is based on the assumption that all cash and investments that are not directly needed for day to day operations are used for capital expenditures. That is, all surplus is automatically allocated to reserves. Any surplus retained is that necessary only for maintaining efficient daily operations.

ANALYSIS

HOUSING SERVICES ACT

The initial part of this study was to review the HSA and its regulations. Specifically the subsidy calculation sections were reviewed for an indication of what happened to subsidy after the mortgages were repaid. In addition several conversations with key service manager personnel and CHFC staff and CHFC's legal advisor supported the conclusion that the subsidy formulae would remain in place regardless of the status of the mortgage. It was also confirmed that any additional debt acquired by the co-op outside the original first mortgage would not be included in the subsidy formulae, under the current legislation.

The lawyer for CHFC was consulted about the status of the HSA and the funding formulae. There do not appear to be any funding formulae changes anticipated in the HSA when a project reaches EOM. However, it was established that section 98(4) of Regulation 367/11 provided SM's with authorization to allow the individual housing co-operatives to request that they contribute additional amounts to the CRF. This increase is taken into account in the subsidy calculation and serves to reduce negative subsidy. This regulation could be of great use to a SM wishing to provide additional funds to a group under the program and stay within the requirements of the program.

Any changes to mitigate the effects of the formulae will have to be negotiated either with the provincial MMAH or with each service manager in cases such as mentioned above. Further search of the HSA regulations may yield additional clauses that may be of use.

As a result of legal action in the past, the subject of negative subsidy may not be entirely clear. Currently SM's expect that any net negative subsidy (negative operating subsidy in excess of RGI and Property tax subsidy) will be repaid to the SM annually in cash. Discussions with CHFC's lawyer suggest that there is reason to believe this could in fact be challenged successfully in court. To date it has not been challenged and there are likely a small number of projects presently in this position throughout Ontario. As the charts below indicate, there will be many more once EOM is achieved.

SERVICE MANAGERS

The HSA offers the s 98(4) tool to use to fund capital work post EOM. Some service managers will make use of that tool and some will not.

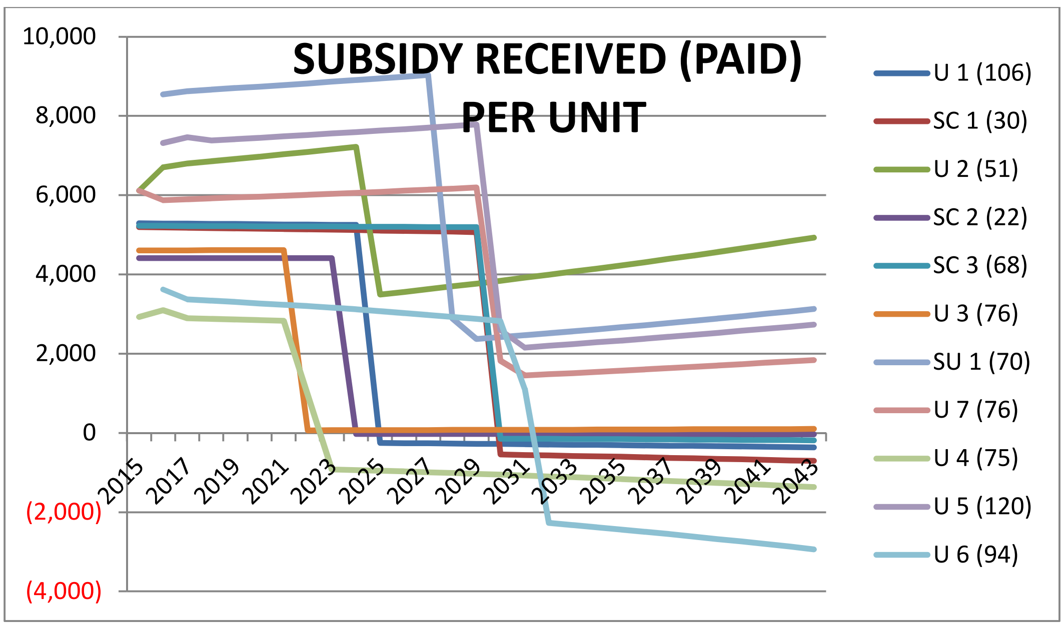
It is important that all service managers are aware both of the existence of the section and its potential effects upon municipal funding of capital sending in their social housing inventory. It represents a method of providing for capital spending in its social housing projects without any additional funding adjustments to the rest of it municipal budget. The ability arises from the freed up cash flow in projects once past EOM.

CHFC may want to do further work on specific pro forma case study examples of how a SM can lever funds through the use of s98(4) and illustrate how much and how effective this spending can be.

Without this or some other method of support, most housing co-operative projects funded under the HSA will not be sustainable after EOM.

DATA

Total subsidy received from Service Manager

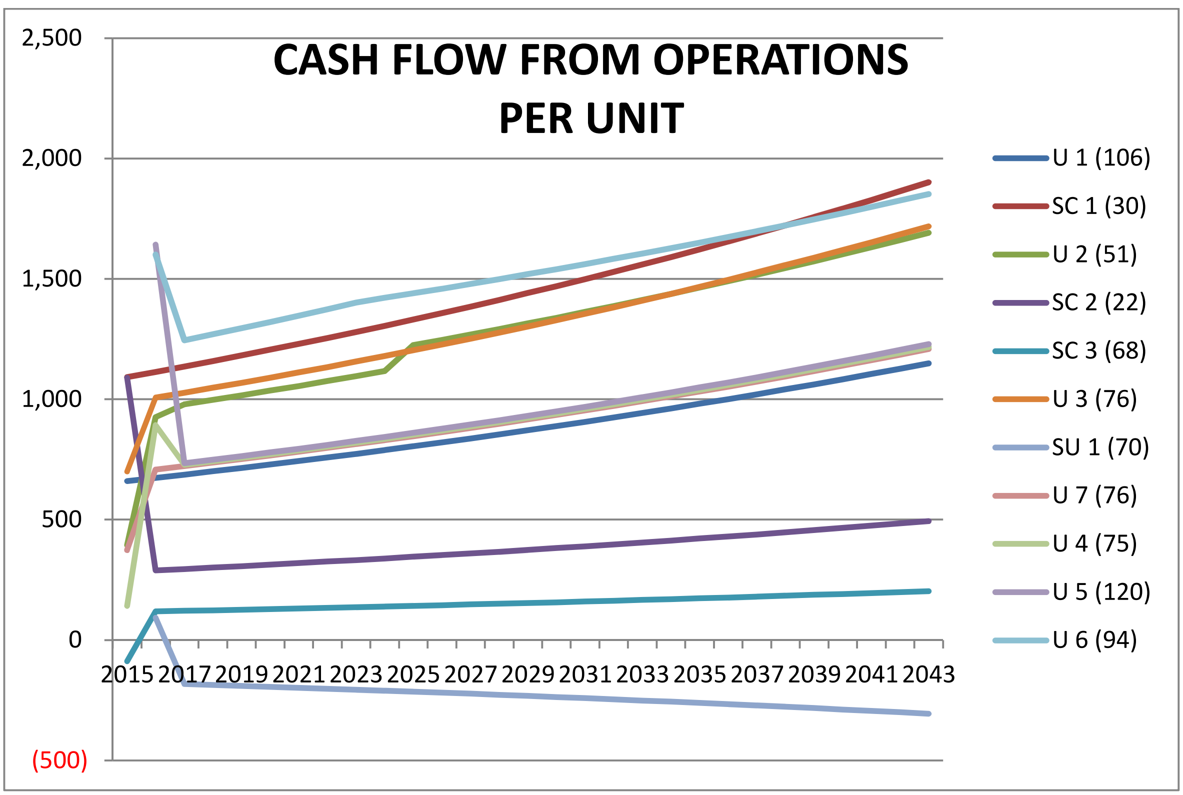


The graph of total subsidy per unit received in total from the service manager over time indicates several trends. The most obvious trend is at end of mortgage. With several exceptions subsidy for all other sample items drops to zero or less and stays at that level on an ongoing basis. In most cases the co-op is repaying the service manager and in some the service manager is paying the co-op at a much reduced level. The exceptions to this trend although they do show the EOM drop, the negative subsidy is so much lower that the RGI level that inflation increases the overall level of subsidy on an annual basis. The starting subsidy level for this co-op is high per unit compared to the other co-ops and may be an anomaly. The high subsidy is largely because of the level of RGI subsidy provided per unit.

The implication here is that the co-op's operations are covering all or most of the RGI and property tax subsidy after EOM. After EOM the service manager financial involvement is reduced to a minor financial effect. For many this will involve annual payment of funds from the operating budget to the service manager and will become an annual operating expense that will rise with inflation.

Whether this interpretation of the HSA (negative subsidy) will stand a legal challenge remains an open question.

Cash flow from operations



The graph representing the annual cash flow per unit from operations shows all sample items trending up slightly. This trend is entirely due to inflation. The levels however, are different. Two of the three small centre co-ops, while they have the same trend, have a much reduced level of cash flow per unit. The third has the same trend but at a higher per unit level. This has to do with their original bench marks, the effects of inflation upon those benchmarks and the expenditure profile with the smaller co-ops.

This cash flow increase is the only internal source to fund capital expenditures.

The smaller co-ops in smaller centres generally are all townhouse complexes. The utilities for these co-ops are paid directly by the members. They also lack full time staff because of their reduced size. With this reduced expenditure profile and small size it is crucially important that the original benchmarks allow for the fixed costs of running a co-op regardless of size. The two co-ops at the lower levels of cash flow per unit appear to have very low overhead allowances. As such they trend up with inflation but at much lower levels and their trends lines are not as pronounced as the larger co-ops.

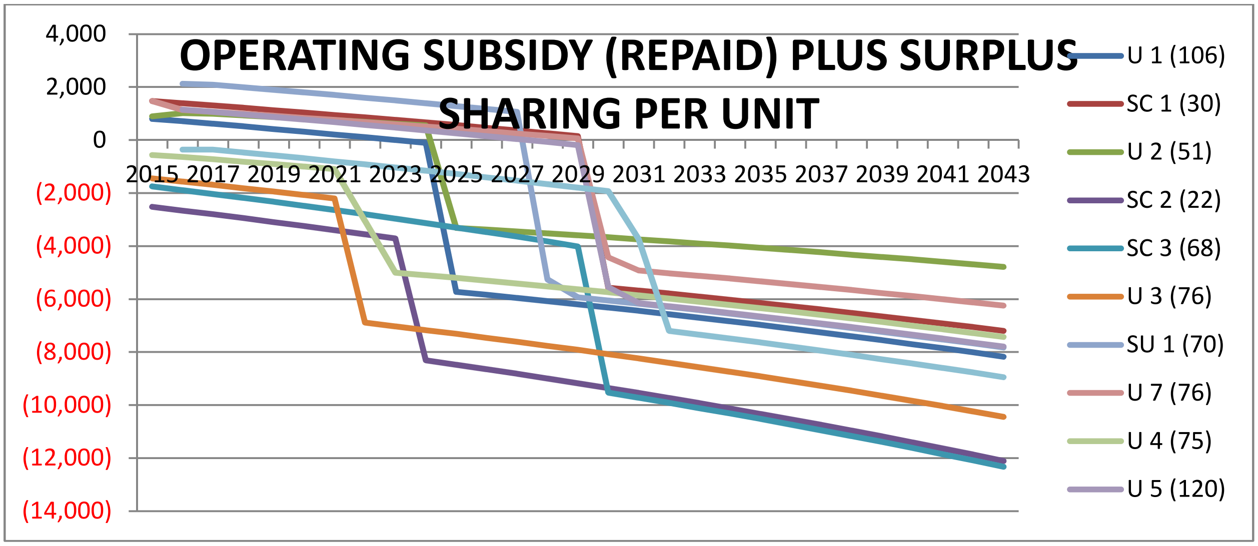
Both these co-ops are from the same service manager.

However, one of the small centre co-ops has higher per unit cash flow from operations and has a trend line consistent with the urban co-ops. This trend started high and went higher ie. higher benchmarks.

There is one co-op which is already in trouble and it's annual operational cash flow deficiency is projected to get only worse with inflation. EOM will have no effect on this process.

The data suggest that the effects of the original bench marks has a more pronounced financial effect upon the co-op than size or expenditure profile.

Operating surplus plus surplus sharing repaid to the service manager. (Negative subsidy)

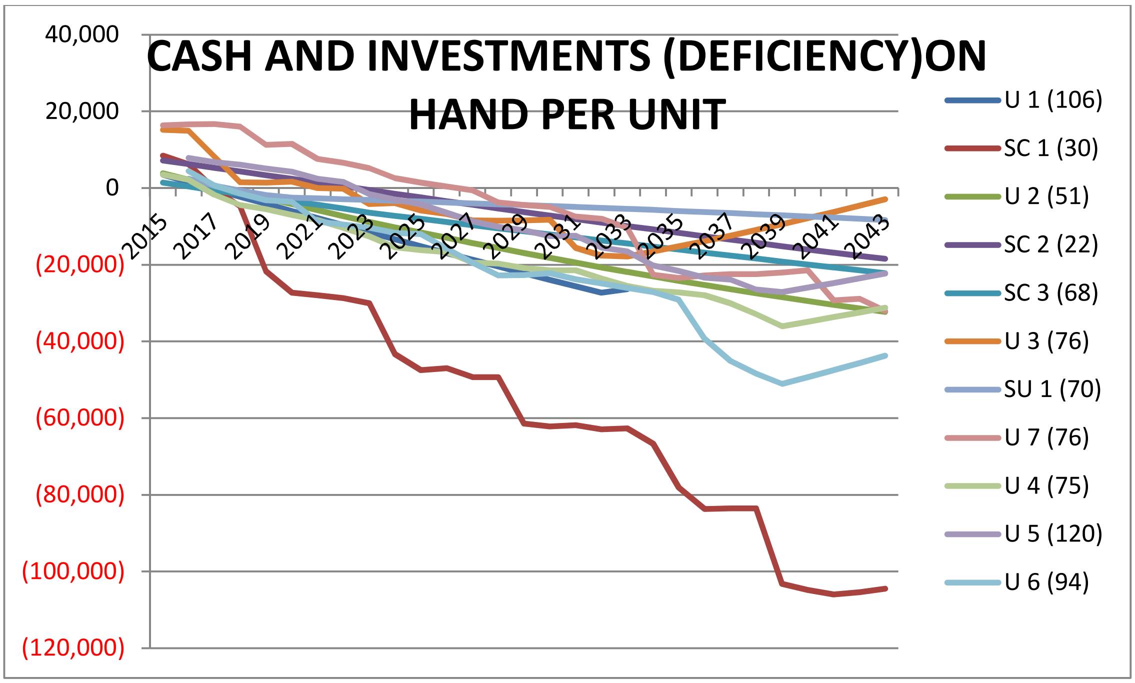


All sample co-ops have reducing operating subsidy. Each year the formula reduces the amount of operating subsidy available from the service manager. The formula includes one large fixed cost – debt service. This remains unchanged during the term of the mortgage. With housing charges rising by the rent control guideline and all other expenditures increasing with inflation the inescapable effect of the funding formula for operating subsidy is to reduce the amount of funds available for operations by reducing the level of operating subsidy to the co-op by that amount.

The graph illustrating this also shows the same trends of decreasing levels of operating subsidy. All sample items are close to or below zero before end of mortgage. At EOM all levels drop to negative subsidy. All trend lines are on the same slope. However the 2 of the 3 smaller co-ops, because of their original low bench marks, repay a much increased level of subsidy per unit.

All negative subsidy trends continue down with inflation indefinitely into the future.

Cash on hand (Deficiency)



The cash graphs all show the same story. Given levels of cash flow from operations and levels of subsidy moving according to formula and given projected capital expenditures over time, all sample co-ops will have a cash deficiency. The cash deficiency in one case is severe. In one other case the level is decreasing toward positive cash flow but only far into the future.

The major caveat related to these observations is that not all co-ops had BCA's. One had a 10 year capital budget which was then extrapolated. The others had estimates used. To the extent the estimates are inaccurate the data may be misleading. The tight grouping of the trend lines may simply be due to similar assumptions about estimated capital expenditures. The fact that they are all showing negative cash indicates that regardless of the amount of the capital expenditure estimated there will be an inability to fund all necessary capital expenditures which will result in inevitable building deficiencies.

This same trend has existed with some previous funding programs for social housing and this trend continues with this program.