Capital Ideas:

How to Extend the Health and Safety of Social Housing

Prepared by the Social Housing Services Corporation

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Executive Summary

Ontario's social housing is a capital asset which provides for the health and safety of our most vulnerable residents. The Province has mandated that municipalities meet minimum service levels, and maintaining the existing stock is the most cost-effective means of doing so. The problem is that senior levels of government have historically under-funded capital investment and municipalities lack the tax base equal to the job.

Developing solutions to this problem requires a shared understanding of the scope of the capital shortfalls. Provincial estimates have been significantly smaller than those of municipalities. SHSC is coordinating the Asset Management Group, comprised of municipal representatives, housing providers and senior governments, to develop a common methodology so that all pipers are playing the same tune. Only then, can comprehensive strategies be finalized.

Re-investment by the senior levels of government is the fairest option of all. It would address both the hidden debt passed on by devolution, as well as the differing ability to pay. In particular, the running down of the federal transfer threatens the viability of social housing, especially for local housing corporations.

In the absence of reinvestment by the senior levels, municipal governments must look to borrowing options, identify income streams for repayment, and examine other revenue sources or means of cost containment.

Municipalities have general borrowing authority, but it is limited by the Municipal Act. Where the terms of a loan or debenture go beyond the term of the current council, they are limited in the total amount they can borrow - the annual repayment limit set by the Ministry of Municipal Affairs and Housing. Otherwise they must obtain the approval of the Ontario Municipal Board. Given this overall limitation of borrowing levels, municipalities may be reluctant to use debt capacity for other than "traditional" municipal purposes.

A promising alternative is the "cash flow trade", where the housing operator borrows against the strength of its cash flow without impinging on the real estate asset itself. SHSC would bundle these loans and obtain the funds from the capital markets. Operating agreements with housing providers would be extended until the additional capital loan was repaid. This also ensures that the RGI units supplied by providers are available to meet service level requirements.

Infrastructure Ontario, an agency of the Ministry of Public Infrastructure Renewal, provides a bulk borrowing facility for municipalities to access funds for aging capital works. While currently restricted to lending for municipally-owned housing, i.e. local housing corporations, expanding authority to include non-profit housing providers would parallel provisions extended to non-profit long term care

homes. The interest rates possible under Infrastructure Ontario loans would be most attractive to smaller municipalities.

Currently, the Social Housing Reform Act (SHRA) prevents housing providers from adding new debt without provincial approval, as this would affect the provincial liability. Mortgage refinancing is often used by private sector landlords and individual homeowners to access relatively inexpensive funds for major capital work. An increase to the principal amount can be offset by extending the amortization period, meaning that the impact on subsidy requirements and the property tax base is minimized. Service Managers, who are ultimately responsible in the event of mortgage foreclosures, should gain new powers over mortgage refinancing. SHSC has proposed that it assume mortgage administration in order to provide a full range of financial products and services to the sector. Again, refinancing should be matched with an extended requirement to supply RGI units to the Service Manager.

Larger non-profits and local housing corporations are of sufficient size to realize administrative efficiencies. In particular, investment in energy conservation reduces operating costs and the savings can be dedicated to support capital borrowings. Non-profit providers have two other potential income streams to support or repay borrowings. With provincial approval, a portion of the annual capital reserve contribution could be used instead to support capital borrowings. As well, when mortgages are paid off, some providers may find that they have additional financial flexibility. Local housing corporations, lacking access to capital reserves and mortgage financing, also face steady cutbacks to federal transfers. Ultimately, reversing the decline of the federal contribution is necessary to avoid increased municipal costs.

Cost avoidance is another means to increase municipal and housing provider capacity to deal with capital shortfalls. The Co-operative Housing Federation of Canada's Ontario Region has proposed that the Province upload the cost and program control for Ontario's devolved housing co-operatives to the provincial level. There are about 21,300 units of co-operative housing under municipal administration, representing $100 million in municipal costs. Co-operatives operate under different corporate and member requirements, so the proposal, if accepted, would reduce administrative complexity for Service Managers.

Another cost avoidance would be for the province to exempt housing providers from paying property taxes, as are some municipal corporations and other charitable, non-profit corporations providing relief to the poor. The impacts on municipalities would be negligible (effecting mostly lower tier municipalities) as reduced property tax revenues would be offset by smaller subsidies to providers. The major result would be that the educational component of the property tax, now received by the Province, would no longer be reflected in the housing provider's operating budget, freeing up resources.

Energy conservation is an under-utilized source of savings. SHSC's Green Light Initiative (GLI), for example, provides one-window access to a variety of grant and loan programs to improve energy conservation for electricity, gas and water. However, non-profits have made little use of this program, despite SHSC's marketing campaigns and encouragement by Service Managers. Service Managers may need to insist that providers make use of programs like GLI as part of a capital asset strategy.

Finally, municipalities will need to consider other tax and revenue measures to avoid property tax pressures. In some cases, social housing could be redeveloped at higher density. Generally, redevelopment of a site does not result in surplus revenues, as new development is so costly. In a few cases, a project may have surplus land, and the proceeds from its sale could be used for repairs and upgrades.

Tax Increment Financing (TIFs) may be a useful tool where social housing redevelopment is part of a larger neighbourhood renewal. In Ontario, TIFs have been used for brown field redevelopment, where contaminated land is cleaned and redeveloped. TIFs allow municipalities to borrow now against future higher land values once redevelopment is completed.

Sale and lease backs are sometimes used by the private sector where the key business is not the management and maintenance of real estate. The key question is whether the increased lease costs are cheaper than simply borrowing the capital required.

Another means would be adding a municipal portion to the Land Transfer Tax (LTT) to help meet capital shortfalls in social housing. Using a revenue stream from real estate transactions to ensure a related real estate public purpose may be more readily accepted than other uses. Increased income disparities have led to higher property values. By directing LTT to pay for a critical piece of social infrastructure, we maintain the healthy communities required for future wealth creation. With the exception of the City of Toronto, this use of the LTT would require an amendment to the Municipal Act.

Reinvesting in social housing is the most cost-effective means of ensuring we continue to have housing available for all income groups. The senior levels of government have greater capacity than do municipalities to keep the stock in good repair. The federal government, in particular, needs to reverse its declining support for social housing, as local housing corporations (LHCs) face a clear risk. Municipalities have a range of borrowing options, cost containment, and other revenue sources to consider. The effective use of these options depends in federal and provincial willingness to provide the tools required to do the job.

Summary of Options

Option	Cost of Funds	Ease of Access	Comments
REINVESTMENT BY SENIOR LEVELS OF GOVERNMENT			
Invest new capital; stop decline in federal transfer	Depends on how new funds were distributed.	Depends on criteria agreed to by SMs.	Difficulty will be in getting full funds from senior levels.
BORROWING CHOICES			
General Municipal Borrowing	Municipalities can borrow at Government of Canada bonds + 50-55bps[1].	Fairly easy as long as within spending limits.	Municipal willingness will depend on other pressures for capital.
Cash-Flow Trade	Cost would depend on number of factors including time between borrowing and repayment and whether insured.	Difficult for all but the most sophisticated of SMs. May be easier if SHSC has role. Not all providers will have the cash flow to repay principal.	New financing vehicle would have to be marketed to private lenders. May reduce need for provincial approval as cash flow, not real estate, provides security.
Infrastructure Ontario	Current rate is 4.85% which is attractive to smaller municipalities.	Available only to municipally-owned social housing; DSSABs also not eligible.	No take-up yet, by Service Managers. Province is considering SHSC request to extend to non-profits and coops
Refinance Non-Profit Mortgages	Current MAH/OFA rates on provincial mortgage renewals are about 25-30bps above comparable GoC bond rates.	Requires provincial approval; Financial institutions will compete.	Increased debt can be offset by longer amortization period – not available to LHCs
REPAYMENT OPTIONS			
Operating efficiencies	n/a	Larger non-profits and local housing corporations can achieve economies of scale	Operating savings can be used to support debt repayment
Redirect portion of capital reserve contributions	Zero current cost as funds part of subsidy flow	Requires provincial approval	Not available to LHCs
Financial room at mortgage pay down	n/a	Not all non-profits will gain flexibility	n/a for LHCs

[1] Government of Canada 30 year bond rates were 4.258% at time of writing; accounting for the 50bps (basis points) results in an effective municipal borrowing rate of 4.758%.

COST CONTAINMENT MEASURES			
Upload co-op housing	$100 million municipal cost uploaded to province	Requires provincial approval	Not all Service Managers would benefit (if no co-ops)
Exempt social housing from property taxes	Little/no net cost to Service Managers, as tax revenue decrease are offset by subsidy savings; province loses education portion	Requires provincial change to legislation	Province may prefer more targeted measure. Lower-tier levels of government could be affected.
Use of Special Programs (e.g. energy conservation)	Grants and loan interest loans make this an attractive option	Fairly easy for SMs since SHSC facilitates.	Limited to items covered by programs; provider take-up has been low.

OTHER TAX AND REVENUE MEASURES			
Re-Development / Intensification	No borrowing required if sale of land covers cost.	Could be relatively difficult since many SMs not familiar with financial issues in development.	Most effective for sites with surplus land. Demolition and rebuilding would entail a cost
Tax Increment Funding	Cost of TIF depends on tax cut and increase in value.	Fairly easy since municipalities will set own criteria for borrowing	TIFs available for neighbourhood improvement, not project capital
Sale and Leaseback.	No borrowing cost since it would be captured in cost of lease but effective rate would depend on lease rate.	Moderately easy to arrange since model already developed by private sector. SM could require assistance to negotiate lease.	Increased lease costs may be greater than cost of borrowing equivalent capital.
Land Transfer Tax	LTT loads cost on real estate transactions, a related economic activity.	LTT is established and easy to access, however resistance to tax increase is strong.	Only the City of Toronto can use LTT. Requires change to Municipal Act

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1) Introduction

A fundamental objective for social housing is providing safe, healthy accommodation for those who have the fewest opportunities in the housing market. When repairs are put off, nature calls in the debt. When we do not maintain our social housing, the lives of senior citizens, the disabled, and children are put at risk. Be it crumbling foundations, broken elevators, or leaky roofs, the investment we have made to protect the health and safety of our less fortunate may be lost.

The purpose of this backgrounder[2] is to explain why there is a need to invest in the existing stock of social housing, and examine the anticipated shortfall in capital reserves. The various ways through which this investment could be made is examined from the perspective of municipalities – the major funder of social housing.

This paper builds on the work of an earlier discussion paper, *Social Housing and the Provincial-Municipal Fiscal Service and Delivery Review: Sustaining a New Partnership[3],* which set out five key principles towards the sustainability of social housing in Ontario. These principles were developed in consultation with Service Managers and housing providers across Ontario and have been forwarded to the fiscal review 'tables' for their consideration.

These principles, designed to re-balance the social housing equation, include:

1) Well-funded, well-managed social housing is integral to stable, healthy communities.
2) Income redistribution programs should not be financed by property taxes. Municipalities should have access to revenue streams that are appropriate to, and that adequately support the level of funding needed for social housing.
3) Housing is a capital investment and requires flexibility in the tools available to ensure benefits for future generations.
4) Local governments are best placed to respond to and deliver social housing programs.
5) Municipalities need clear authority in critical areas where they bear the financial risk. Providers, who are also funders and owners, must be part of the decision-making process.

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[2] Other backgrounders will focus on the need to better integrate social housing, employment and income-support programs and on the question of who should do what (in terms of roles and responsibilities) to ensure a viable future for social housing in Ontario.

[3] Social Housing Services Corporation. 2007. *Social Housing and the Provincial-Municipal Fiscal Service and Delivery Review: Sustaining a New Partnership*
.http://www.shscorp.ca/(cpd4r145oizna445gaukjte1)/content/Resources/DiscussionResearchPapers/LSRfinalFebruary2007.pdf

All three levels of government share the objective to ensure the health and safety of social housing. Only municipalities face the harsh reality that they must raise their taxes to pay their share. The Province, which regulates the world of social housing, does not contribute to its cost. The federal government pays about $500 million currently, but will steadily decrease its contribution to zero over the next generation. Consequently, municipalities are looking for cost-effective, flexible means to meet their share of the responsibilities in keeping social housing in a good state of repair.

2) Why it is Important to Invest in Existing Social Housing

The good repair of the social housing stock is important to Service Managers (SMs) because the *Social Housing Reform Act* (SHRA) requires each SM to supply a specified number of RGI units in social housing. The over-whelming numbers of RGI units are provided by municipal, non-profit and co-operative housing providers. This service level obligation[4] cannot be avoided without explicit permission of the Minister of Municipal Affairs and Housing. Even when housing providers are mortgage-free and are no longer compelled to make RGI units available, municipalities will be obligated to provide the same number of assisted units as now.

The total number of social housing units in the province is over 260,000 units, of which about 185,000 are subsidized on a rent geared-to-income (RGI) basis.[5] SMs must maintain this number of units in aggregate in their social housing programs.

SMs have three basic choices to meet their service level requirements. They can invest in the present portfolio to keep it in good repair. They can replace the units through new construction, or they can contract with the private sector for rent supplement units.

The cost of new construction is far greater than the cost of maintaining existing units in an adequate condition. At the present time, the average cost of construction for a two bedroom apartment is $150,000. In a similar vein, replacing all social housing with shelter allowances would be very costly and would leave SMs open to future increases in costs outside their control.[6] Consequently, maintaining the physical asset is the most cost-effective means for Service Managers to meet their service level obligation over the long-term.

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[4] the service level for each SM was calculated as the total of the provincial unilateral non-profit units, plus the federal / provincial non-profit units, plus the number of former public housing units

[5] RGI means that households pay no more than 30% of income for rent, heat and water.

[6] A recent study by Marion Steele, et al, indicated that the cost of providing a "shallow" subsidy of $150 monthly to the 350,000 households in need in Ontario would cost approximately $630 million annually. Unlike social housing where the number of subsidies available is restricted to the number of units, shelter allowances are open to all who are eligible. The open ended nature of the subsidies makes the total cost difficult to control. See also Pomeroy, Steve, International Experience with Demand-Side Subsidies, 2005 for the Ministry of Municipal Affairs and Housing, which, based on a review of experience in Australia and Great Britain showed that Housing Benefits paid to the tenant tended to grow faster than the cost of social housing.

More than that, the estimated $40 billion replacement value of the social housing stock is a substantial investment in public infrastructure, no matter which level of government ends up paying for it. Governments at all levels have a fiduciary responsibility to protect and preserve the useful lifetimes of its existing housing stock.

3) The Capital Repair Problem and How it Arose

Like all other buildings, social housing projects require both regular maintenance and, periodically, the replacement of a major capital item such as a furnace or the refurbishment of an underground parking garage. As major building components can last up to 25 or 30 years, the negative impacts of capital under-investments take some time before they are realized – that is why capital needs are so easily neglected.

In developing social housing over time, governments used different methods of addressing the need for capital repairs.

Public housing, built from the 1940s through the 1960s, is facing the second or third cycle of capital renewal. Public housing capital repairs are funded by yearly contributions from the federal government and Service Managers. These funds, perhaps adequate for routine maintenance, cannot deal with additional demands for extensive renewal, let alone redevelopment.

In the case of former public housing; prior to devolution, all 98,000 units were owned by the Ontario Housing Corporation (OHC) and operated by 54 Local Housing Authorities (LHAs). Each year as part of the budget process for the following year, Housing Authority Managers submitted a request for capital. The OHC Board approved the requests for capital spending based on four categories, the most important being the Health and Safety of the tenants and the public.

The amount approved was affected more by the work that could realistically be carried out by the Authority than rigorous building science. This resulted in different levels of spending in different years for each LHA.

The amount received by each LHA in the year prior to devolution became the amount that was allocated to the Local Housing Corporation (LHC) serving the same area after devolution. The $100 million was part of the federal-provincial cost share which for public housing was 52% from the federal government and 48% provincial. The $52 million provided by the federal government was passed through to Service Managers who are accountable for raising the remaining $48 million, formerly paid by the Province.

In the case of non-profit housing, each of the non-profits is required to save for needed capital repairs through a reserve fund (like condominiums). Contributions to the reserve fund are subsidized by the SM as part of the non-profits' overall operating cost. Decisions about what to fix and when, are the responsibility of the non-profit board.

When the first non-profit housing program was created by CMHC in the mid-seventies, sufficient funding for capital was built in as part of the subsidy arrangement. The annual amount to be set aside to address the need for capital over the life of the building was included in the subsidy model, under which the non-profit operating agreements were signed[7]. When the province created the cost-shared and unilateral projects starting in the mid-eighties it increased the amount available for capital. These amounts were then built into the initial program subsidy model.

Two problems have arisen through the life of the non-profit program(s) which have undermined strategies to make projects self-sufficient:

- Capital reserve contributions, when under provincial control, were subject to periodic freezes as part of general spending constraints. Some attempts were made to rectify this by one time capital infusions when additional funding was available. However, the amount invested in capital reserves is less than that originally anticipated when the program was designed.
- Due to early building system failures, inadequate investment strategies and, occasionally, financial mismanagement, some individual non-profit organizations have already expended or soon will expend their reserve funds.

The predicted shortfall has been documented in numerous studies by the province and by the various sector organizations. The lack of funding is attributable to a number of key factors:

- When the social housing programs were devolved to the municipal level, the Province did not address the capital shortfall that it and the federal government had created. In a report made available by the Province in 2002, the IBI group estimated that the contribution rate for provincial and federal/provincial projects would have to increase by 115 per cent to meet the need for capital. Federal projects would need a boost of 223 per cent in their contribution rate to address their capital needs.
- Until the SHSC took over the management of the investment of reserves, non-profit providers were left to get the best return they could on an individual basis. While some attempts were made by the sector organizations, ONPHA and CHF, to increase the returns, control over the funds and the use of the reserve funds was exercised by non-profit boards. Many of the reserves were earning regular bank interest or, at best, GIC interest. Since devolution, improved investment strategies and the requirement in the SHRA that most non-profits invest their reserves through the SHSC have increased the yield from investments of capital reserves, the legacy of years of under-performance have left their mark.

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[7] CMHC determined the amount of capital required of the lifetime of a project based on engineering studies done by engineering firms such as Trow Consulting. This was determined through the practical matter of estimates of when different building systems, i.e., roofs, furnaces, had to be replaced. It did not take into account repairs that had to be done as a result of building system failures such as replacing the reinforcing steel bars in underground parking structures.

- The situation will worsen through withdrawal of the federal transfer, which accelerates over the next 10 years. SMs will then be responsible for all capital replacements in the former public housing portfolio, as well as the non-profit portfolio.
- Service Managers do not have the necessary tools to effectively address the situation on their own behalf. Municipalities are subject to the conditions of the Municipal Act and the SHRA which prevent them from using strategies to raise capital that are available to the private sector.

Over the past seven years, Service Managers have become well acquainted with the problems of insufficient reserves. The prospects are bleak – as the bulk of non-profit housing was built during the 1985 -1995 period, inadequate capital reserves drop more weight upon an already creaky funding structure. The joint municipal-provincial review of services is timely, as municipalities and housing providers face the first phases of a looming liability.

4) How Big is the Problem?

A quick survey of provincial and Service Manager estimates shows significant differences between provincial and municipal estimates of the size of the capital shortfall. SHSC is leading a process focused on developing a shared approach to the problem, as we need to move past aggrievances to forward-looking agreements.

In 2000, when the Ontario government introduced the *Social Housing Reform Act*, the Parliamentary Assistant reported the results of two government studies on the public housing portfolio. The first concluded that the condition of the public housing stock is as good as similar [private] rental stock, if not better in many cases. The second showed that the current budget has sufficient capital dollars to maintain that stock.[8]

KPMG consultants[9] determined that around $100 million was being spent annually on public housing - enough to keep the projects in good shape. However, what was adequate in 1999 may not be in 2007 as buildings age and construction/repair costs increase. Add to that the scheduled withdrawal of $52 million in federal support, and the road ahead for public housing has many potholes.

On the non-profit side a provincial study, prepared by IBI consultants and released in 2002, estimated that the annual shortfall to capital reserve

[8] Ontario Hansard, October 16, 2000

[9] Assessment of Capital Funding Models within the Context of Social Housing Devolution, 2000; Study done by KPMG for the Ontario Housing Corporation. Available on the MMAH website at www.mah.gov.on.ca/userfiles/HTML/nts_1_27769_1.html.

contributions is at least $23 million, with an accumulated shortfall since devolution of $207 million by 2007.[10]

Municipalities, on the other hand, project far larger numbers than does the Province. To take the largest example, Toronto Community Housing Corporation has identified a $300 million requirement for immediate repair to its largely public housing stock. The City of Toronto has estimated that another $34 million annually must be added to non-profits' capital reserves.

Further evidence is provided by those municipalities who set up housing reserves who now report they are emptying them to deal with providers who have run out of capital reserves. Peel Living, with over 7,000 units, used savings from low interest rates to fund its own pool, but will be out of cash in three years. Toronto, likewise, has depleted its reserve.

On the other hand, SHSC's own experience suggests that this problem is not yet widespread. SHSC administers approximately $400 million[11] in accumulated capital reserves held by the SHSCFI on behalf of non-profit projects covered by the provisions of the SHRA. Currently inflows exceed outflows by roughly 2 to 1 since most of the projects are only just reaching the time in their building systems' lifecycle when major repairs are necessary.

What to make of this contradictory information? Some non-profit providers, but not yet most, are at the crisis stage. But developing a full picture requires all the pipers to play the same tune. SHSC offers the following observations in getting to that point.

Building Condition Audits, used by condominiums and non-profit providers to assess future capital needs are highly dependent upon assumptions about useful lifetimes, rates of inflation, interest rates, etc. to determine needed contributions.

- The Ontario IBI report concludes that the "factor having the greatest impact on reserve funds needs, other than the costs of the elements/equipment themselves, is their life span. The impact of funds' return on investment and the size of the initial fund balance are clearly secondary."[12]

- An SHSC study noted that the expected life times of building components were often hidden or varied significantly among Building Condition Audits (BCA), even by the same engineering firm.[13]

- BCAs tend to the safe side (i.e. more costly estimates), as the engineers who write them wish to avoid lawsuits resulting from under-estimates of

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[10] IBI Group, "Replacement Reserves in the Non-Profit Housing Portfolio", Revised Draft, July 30, 2002 (available from Ministry of Municipal Affairs and Housing)

[11] Providers in Toronto, Ottawa and Peel are excluded and invest their funds independently.
[12] IBI provincial report, p. 16
[13] Analysis of Building Condition Audits and a Comparison of Ontario's Non-Profit Portfolio with the Local Housing Corporation Portfolio,

future repair needs. In other words, an astute property manager, with attentive maintenance, can keep building components in good repair for longer than the expected average lifetime.

SHSC, with seed funding provided by MMAH, has organized an Asset Management Group to study ways to improve the estimation of capital needs in social housing. The group comprised of comprised of the major sector groups, Co-operative Housing Federation Ontario (CHFOnt), Ontario Non Profit Housing Association (ONPHA), the Service Managers network, Canadian Mortgage and Housing Corporation (CMHC) and the Ministry of Municipal Affairs and Housing (MMAH), will encourage credible and consistent asset management practices amongst the sector.

The goal of the AMG is to develop a realistic means of assessing future capital costs. Whatever the common standard agreed to, Service Managers and housing providers will likely need to recalibrate their BCA projections of capital needs. Certainly the Province would insist on a standardized approach for any grant or loan program.

5) Ways to Extend the Life of the Capital Reserves Fund

To date, two actions have had a positive impact on the availability of capital. The SHRA required individual non-profit providers to pool their reserves under the auspices of the Social Housing Services Corporation (SHSC) and its subsidiary financial institution (SHSCFI). At the same time, the Province loosened investment restrictions so capital reserves could be invested in funds offering a higher return. The SHSCFI bulk investments have achieved a better than average return of 7% since inception. However, the rate of return cannot compensate for under-funding of the reserve itself.

The second action is a number of Service Managers created social housing reserve funds from the savings generated by lower operating costs, primarily mortgage interest rates. Some of the SMs have already lent money to non-profits for capital repairs. However, as interest rates have stabilized, the ability to add to these reserve funds is quite limited. Moreover, not all SMs were able to establish these reserves and consequently have no buffer for upturns in mortgage rates or capital repairs.

6) Getting the Funds We Need

First, it needs to be acknowledged that social housing tenants can not pay more rent. Unlike the private sector, the bulk of tenants in non-profit housing pay rents as a set percentage of income, as determined by provincial regulations. Moreover, access policies guarantee that social housing is increasingly occupied by persons with the lowest of incomes. The substantial revenue possibilities gained by increasing the percentage of market units in projects would be offset

by the requirement for the SM to meet overall service levels through other means. In practical terms, achieving higher revenues from tenants is not fruitful.

There are four funding sources to maintain the viability of social housing's physical asset:

- additional funds from senior levels of government
- borrowing, through mortgages, debentures, etc.
- cost avoidance measures
- other tax and revenues sources

These funding sources are examined in greater detail below.

7) Re-investment by Senior Levels of Government

SHSC's position is that the provincial and federal governments need to pay their fair share of the cost of social housing. This would addresses both the hidden debt passed on by devolution, as well as address the fiscal imbalance between the senior levels and municipalities.

A lump sum for capital backlogs would help Service Managers deal with "projects in difficulty" at the same time that longer term capital strategies are being developed. The federal government needs to stop its staged withdrawal of its financial transfer which puts the former public housing stock at great risk. This re-investment would allow municipalities to get on with the job of providing safe housing as part of integrated services for the disadvantaged among us.

8) Borrowing Choices

This section describes a variety of borrowing vehicles available to Service Managers. Financing capital works is not a new activity for municipalities, since they already provide funding for construction and maintenance of roads, bridges, municipal buildings, sewers and waterworks, etc. In housing, more borrowing choices are possible, particularly if the provincial and federal governments support municipalities in their Service Manager role.

a) General Municipal Borrowing

As long as a public work is considered a "municipal purpose", municipalities can spend on it and can borrow against the municipal tax base to create and maintain the asset. This authority is, however, restricted. The rules around borrowing are specified in the Municipal Act and are fairly prescriptive. In particular, where the terms of a loan or debenture go beyond the term of the current council, they are limited in the total amount they can borrow - the annual repayment limit set by

the Ministry of Municipal Affairs and Housing. Otherwise they must obtain the approval of the Ontario Municipal Board.

Given this overall limitation of borrowing levels, municipalities may be reluctant to use debt capacity for other than "traditional" municipal purposes.

b) Corporate Borrowing - Cash Flow Trade

The basis of this approach is that a corporate entity, such as a municipal housing corporation or non-profit housing provider, can borrow against the strength of its cash flow without impinging on the real estate asset itself. If housing providers extend the period of time over which RGI units are supplied, Service Managers would extend the period of time in which subsidies could be used to support the cash flow supporting the loan.

SHSC could "bundle" these loans and obtain the funds from a financial institution, either at the point in time the capital work is undertaken, or in advance in the form of a "line of credit" to be drawn down when the work is completed. The financial institution's repayment could be structured as an interest-only payment or delayed until the mortgage is paid down. This option would be enhanced if CMHC provided loan insurance.

The operating agreement would also be extended until the non-profit repays the capital loan to the SM from its revenues, which would mean an extended period of the subsidy from the SM. This keeps the provider's RGI units within the SM's control for a further period of time thus meeting its service level obligations under the SHRA.

This approach avoids the need for the SM and its constituent municipalities to borrow against current revenues, freeing up general municipal borrowing for other capital requirements. It sidesteps the provincial prohibition against mortgaging non-profit assets. It helps address the service level requirement after mortgages are paid down. While it does require a longer period of subsidies to non-profit providers, it is cheaper than using rent supplements in the private market.

c) Bulk Borrowing through Infrastructure Ontario

To lower the cost of borrowing for municipal infrastructure, the Ministry of Finance and the Ministry of Public Infrastructure Renewal have set up a "bulk" borrowing facility under Infrastructure Ontario (IO) to facilitate municipal borrowing for replacing aging capital works. IO is empowered to aggregate a number of infrastructure loans and borrow the money in bulk in the market, using volume to get better rates.

Allowable projects include "hard" municipal facilities such as roads and bridges, as well as other public works such as long term care homes. Municipally-owned social housing rehabilitation is one of the purposes for which funding is available.

However, social housing not owned by the municipality, such as co-operatives and private non-profits (church groups, service clubs, etc) are not eligible.

This is a serious limitation, but not a difficult one. IO was once restricted to lending to municipal long term care facilities; subsequently, eligibility was extended to non-profit long term care homes. IO staff, at SHSC's request, are briefing Minister Caplan, Public Infrastructure Renewal on the need for non-profit and cooperative housing to access low-cost funds for capital renewal.

The current borrowing rate for Infrastructure loans is marginally higher than what a large municipality could obtain for itself, but attractive to smaller municipalities. To date, however, there has been no take-up by municipalities for loans for social housing rehabilitation, likely reflecting municipal unwillingness to accept responsibility for what is seen as an unfair download of financial risk.

d) Refinancing Non-Profit Mortgages

Private sector landlords, as well as individual home owners, use mortgages as a source of relatively inexpensive funds when major repairs are required. Non-profit providers, as a rule, cannot (re)mortgage assets since this would affect the contingent liability held by the province for the original first mortgage. Where this has been allowed it requires consent of the Minister.

Debt refinancing, combining an increase of the principal with an extension of the repayment period of the mortgage, has the potential to realize the capital funds needed without increasing the annual municipal subsidy. As the contingent liability for social housing has decreased by about $1 billion since devolution, there is obvious room to refinance mortgages for capital needs. Subsidy payments, of course, would be stretched out for a longer period of time.

As Service Managers are ultimately responsible for paying any debt arising from mortgage foreclosure, it makes sense that responsibility for approving mortgage re-financing should be transferred from the Minister to the municipalities. SHSC has proposed that it assume mortgage administration so that it can provide a full range of financial products and services to the sector.

The provincial government would likely insist on limiting refinancing to the level it was at devolution, in order to protect its overall level of contingent liability. The federal government, through CMHC, would need to provide mortgage insurance so that the best possible rates would be realized. Allowing the loans to be structured as a line of credit would provide the flexibility required for a multi-stage capital renewal program.

As a condition of re-financing, the current requirement that the non-profit provider supply RGI units to help the municipality meet its service level requirement would be extended for the longer term of the new mortgage.

e) Paying Back the Debt

There are several sources through which to pay back a capital loan, however non-profits have greater flexibility than local housing corporations:

- Operating efficiencies, e.g. through energy conservation and administrative streamlining
- Capital reserve contributions, a portion of which could be re-directed from the annual contribution to an annual interest payment
- Financial flexibility gained at mortgage pay down

Due to economies of scale, the larger non-profits and Local Housing Corporations are better situated to realize operating efficiencies. Toronto Community Housing Corporation was able to float a $250 million bond on the basis of efficiencies gained through energy conservation and other cost-saving measures.

Achieving operating efficiencies is more difficult within the diffuse non-profit sector where it is up to local Boards and staff to find the necessary savings. Service Managers may need to take a more active role. In some cases, encouraging or requiring use of pooled services would reduce the cost of property management and capital renewal. In other cases, small providers may need to consider whether mergers would achieve a right-sized organization for administrative efficiencies.

Service Managers would benefit from these efficiencies as they would receive 50% of any cost savings. But they may wish to waive their share of savings, in order to maximize the loan supported by those savings.

Redirecting a portion of capital reserve contributions for debt service may be an attractive option for non-profits. Currently, the *Social Housing Reform Act* requires that the capital reserve contribution must be made in whole. Allowing providers to re-direct a portion of the annual contribution to support a capital loan would demonstrate provincial willingness to increase the flexibility required to handle the problem.

Many non-profit providers will experience greater financial freedom with the pay down of their mortgage and end of their operating agreements. For some, there is a pot of gold at the end of the rainbow. However, not all providers will be in such a fortunate position. For some, the subsidies that end with the mortgage are greater than the cost of the mortgage. That means that they would have less financial room after the mortgage term. Projects with a high proportion of RGI residents, those in weak or declining markets, may be at greater risk. The post-mortgage position needs to be part of any financial assessment.

Local Housing Corporations, due to the legacy of former public housing units, do not have the same access to capital reserves or mortgage savings. They could

redirect some of the current capital spending to support debt, but in the final analysis, all they have are operating efficiencies to pay it off. In fact, declining federal transfers mean that their financial outlook is far more clouded than for the non-profit stock. Ultimately, reversing the decline of the federal contribution is necessary to avoid increased municipal costs.

9) Cost Avoidance Measures

Another way to increase the capacity of Service Managers and housing providers to deal with capital funding shortfalls is to reduce overall spending levels for social housing.

a) Upload Co-operative Housing

The Co-operative Housing Federation of Canada's Ontario Region has proposed that the Province upload the cost and program control for Ontario's devolved housing co-operatives to the provincial level and that the agency administering the federal co-operatives be tasked with the job for the provincial portfolio.

Co-operative housing comprises 21,300 units or 8% of social housing units under municipal administration. A senior housing official estimates this would represent a $100 million cost saving to municipalities across the Province. Co-operative housing is different from other non-profit housing, as it is resident-controlled, and subject to differing corporate and member requirements.

If accepted, the proposal would reduce some of the complexity faced by Service Managers in administering non-profit housing. The proposal would reduce the current financial load and future uncertainties for funding co-op housing, including any capital shortfalls as they would be assumed by the province.

b) Exempt Non-Profit Projects From Property Taxes

Currently, land "owned, used and occupied by … any charitable, non-profit philanthropic corporation organized for the relief of the poor if the corporation is supported by public funds" is exempt from property taxes (paragraph 12 of s.3(1) of the *Assessment Act*).

The Municipal Property Assessment Corporation (MPAC) has resisted any efforts to expand use of this provision. Broadening the terms of this exemption to non-profit housing providers would provide financial relief that could be used to strengthen the capital reserves of the non-profit provider.

The impact on single-tier municipalities would be neutral or modest, as the reduced properties taxes are offset by the smaller size of municipal subsidies required. In two-tier municipalities and District Social Services Administration Boards, some adjustments would be required to ensure that constituent

municipalities are compensated for lost revenue. The provincial government would realize most of the financial pressure as the educational component of property taxes would no longer be applicable. For that reason, the Province may not endorse such a change to its legislation.

While generally favourable to non-profit providers, the benefit is not targeted to the actual need for additional capital investments. The Province may prefer other measures that more directly reflect the capital shortfall.

c) Energy Conservation Measures

Both the federal and provincial governments provides initiatives, such as energy efficiency, and use grants to support the program. Often the grants are for purposes that fit with the capital requirements of non-profit programs. Wherever possible, these grants should be used to free up capital for other purposes. While such programs are focused on narrow objectives and provide limited funding, their use by non-profit providers reduces the drain on capital reserves.

SHSC coordinates the Green Light Initiative (GLI). GLI provides one-window access to a variety of grant and loan programs to improve energy conservation for electricity, gas and water.[14] Only 20% of available funds have been taken up, most of this by one municipal housing corporation (TCHC). Even worse, some NPs made use of their (scarce) capital reserve funds rather than the cheaper GLI funds. SHSC can market GLI, but it can't mandate it. More is needed to get the full participation of non-profit staff and Boards.

Clearly, SHSC and the sector groups, ONPHA and CHF-Ontario, have an education job to get their membership to think more broadly about such alternatives to capital reserves. Ultimately, however, non-profit providers need to refresh their thinking and outlook about how to best manage the capital requirements of their projects. Service Managers may need to insist that providers maximize use of programs like GLI as part of a capital asset strategy.

10) Other Tax and Revenue Measures

There are a variety of other means through which additional funding can be realized. While none of them, by themselves, would be sufficient to deal with the totality of the capital shortfall, they would alleviate some of the pressure points.

a) Re-development and Intensification

Most social housing projects are sited on land that has increased significantly in value since they were built and often at lower densities than is acceptable today. The increased value in the land could finance the demolition and reconstruction of the projects.

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[14] For more information go to: www.shscorp.ca/shscnew/splash.aspx.

Where projects have become seriously run down, the most cost-effective option may be to demolish and re-build. A recent U.S. report concludes that it is cheaper over the long run to re-develop "seriously-distressed" public housing than it is to rehabilitate.[15] While very little of Ontario's social housing stock has reached that level, there are some examples.

In re-developing Regent Park, Canada's oldest social housing project, a significant investment is being made by the private sector through the purchase of building sites. TCHC reports that land sales to private developers cover only part of the redevelopment costs for the social housing component. There is no surplus available to address capital needs in other parts of the portfolio.

There may be more potential where the provider has "surplus" land that can be sold and the proceeds used for capital. A project in North York is replacing one of their buildings and providing upgrades to another by selling part of the land. SHSC could assist in this process by developing a "how to" handbook for SMs and non-profit organizations contemplating such an undertaking. The Ministry of Municipal Affairs and Housing has a supporting document which focuses on the approvals needed.

Ultimately, redevelopment can reduce the borrowing costs for new construction, rather than providing funds for refurbishing the existing stock. Selling off surplus land offers more potential, but few providers have available space.

b) Tax Increment Financing

The province has given municipalities use of Tax Increment Financing (TIF) for the clean up of "Brownfield" sites where previous land uses created contaminated sites.

The municipality provides an incentive in the form of a reduced property tax rate during the period of rehabilitation and development. Once the land is re-developed, it becomes more valuable and subsequently is re-assessed at its appropriate market value. This is generally significantly higher than its value in its contaminated state and so the property tax revenue from the site increases substantially. Currently, TIFs do not recognize social housing redevelopment as a possible activity.

However, if the rehabilitation of a social housing site was part of an overall neighbourhood renewal initiative, municipalities would realize an increase in property taxes that could be used to finance the rehabilitation/re-development.

One possible drawback is that using TIFs to pay for social housing loads redevelopment costs on the property tax of what may be a lower income community, rather than the broader tax base.

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[15] Urban Institute, Severely Distressed Public Housing: the Cost of Inaction, 2007. http://www.urban.org/publications/411444.html

c) Sale and Lease-Back

This is an option used by the private sector, particularly when their key business activity is not the management and maintenance of real estate. In the initial agreement, the purchaser and vendor agree to a rental rate and periodic escalators in the rents. The new owner becomes responsible for the maintenance of the building, including making the necessary capital investments to keep the building in good condition.

The capital freed up by this transaction could be invested to offset the additional rental cost, or it could be used to fund the rehabilitation of projects not sold. There is no magic to this solution – the costs of rehabilitation and a profit margin are paid over time through increased lease costs. The key question is whether it would be cheaper to simply borrow the capital funds needed and retain ownership of the asset.

d) Land Transfer Tax

Another example would be to add a municipal portion to the Land Transfer Tax (LTT) and dedicated its use for social housing refurbishment. Using a revenue stream from real estate transactions to ensure a related real estate public purpose may be more readily accepted than other uses.

Increasing polarization of income and wealth has resulted in home prices rising well beyond that afforded by most working families. Using the proceeds of the LTT to improve conditions in social housing is a fair and just mechanism to ensure housing adequacy for those disadvantaged by wealth polarization and priced out of the booming real estate market. In creating healthy life conditions for the future labour force, we build the basis for future wealth creation.

This option is most attractive to municipalities with an active housing market; however, with the exception of the City of Toronto, it would require an amendment to the Municipal Act. Recent developments in the City of Toronto demonstrate that increasing taxes is always difficult, particularly if seen as general tax revenues.

11) Hard-Headed Decisions are Required

The Social Housing Reform Act imposes a service level requirement on Service Managers to maintain a minimum number of assisted housing units. The best way of meeting this obligation is by maximizing the period of time in which the existing social housing portfolio can provide safe and healthy accommodation.

Cheaper than new construction or leasing units in the private sector, the existing portfolio offers a guaranteed supply - one whose costs and revenues are under the control of SMs to a greater extent than private sector alternatives.

The continued viability of the portfolio is at threat mostly because of under-funding of capital reserves, and in some cases, by the lack of an asset management strategy. Given the imminent depletion of municipal reserves and some provider capital reserves, Service Managers need to consider what their options are in order to "get ahead" of the problem.

Some housing providers and Service Managers already face serious under-funding issues. The danger is that projects would slide into physical decline, ungovernability, and loss of stock. This risk balloons over the next 3 to 5 years as the bulge of non-profit housing, built in the 1985 to 1995 period, reaches the stage in life cycle requiring structural repairs and replacement. This means that hard decisions are required now to determine which route best meets a municipality's circumstances.

This paper describes a range of financing tools that currently exist as well as other options that would require policy changes at the provincial or federal level. Despite the narrow municipal taxation base and restricted borrowing authority for both municipalities and housing providers, there are a variety of instruments available to realize the funds required to maintain the stock of affordable housing for use by future generations.

Short of the senior levels of government re-establishing their previous financial support for social housing, none of the options presented above, alone or together, will eliminate all of the future financial pressures on municipalities and non-profit housing providers. But the cost of doing nothing is worse.

At the very least, Ontario's municipalities and housing providers need to start considering how to preserve our investment in affordable housing.

For the federal and Ontario governments, the choice is different: how can they best support the legacy of social housing, which has provided healthy and safe communities to so many for so long?

12) Major Conclusions:

- All levels of government and housing providers need to endorse a standardized approach to estimating capital shortfalls so that solutions are based on shared understandings.

- The cash flow trade financing tool shows how effective management of the housing portfolio can realize savings to pay for at least part of the shortfall. However, non-profit and co-operative housing face significant organizational and financial obstacles that limit their capacity to realize operating efficiencies or to deal with capital shortfalls.

- Re-financing non-profit mortgages to cover capital needs, paired with longer amortization periods, could have minimal impacts on property taxes.

- The proposal by the Co-operative Housing Federation (Ontario Region) to upload its housing to the province. A separate agency promises $100 million in immediate relief as well as long-term savings to municipalities.

- Borrowing for capital repairs requires senior government cooperation. Provincial loan guarantees would minimize impacts on municipal borrowing limits, while federal mortgage insurance reduces the cost of borrowing.

- Repayment options also require policy changes. The SHRA needs to permit redirection of some of the capital reserve contributions to debt service.

- The ability of providers to pay back any capital loans depends not just on the match between capital reserves and requirements, but also their financial position at mortgage pay down.

- SHSC's proposal to assume mortgage administration functions would increase its ability to provide a full range of financial products and services to the sector as it enters a period of renewal.

- Of the other revenue tools available, the Land Transfer Tax has the most direct link to social housing, as real estate investment is supported by strong social infrastructure. Other revenues sources, i.e. redevelopment, intensification, sale/lease back, tax increment funding, offer limited or no means of reducing capital needs.

- The situation facing Local Housing Corporations is precarious. They lack the range of financing options available to non-profits; as well, as federal transfers disappear, municipal costs will increase.

- Senior levels of government must get back into the housing business, as assuring the good repair of the existing housing stock is beyond municipal funding tools.