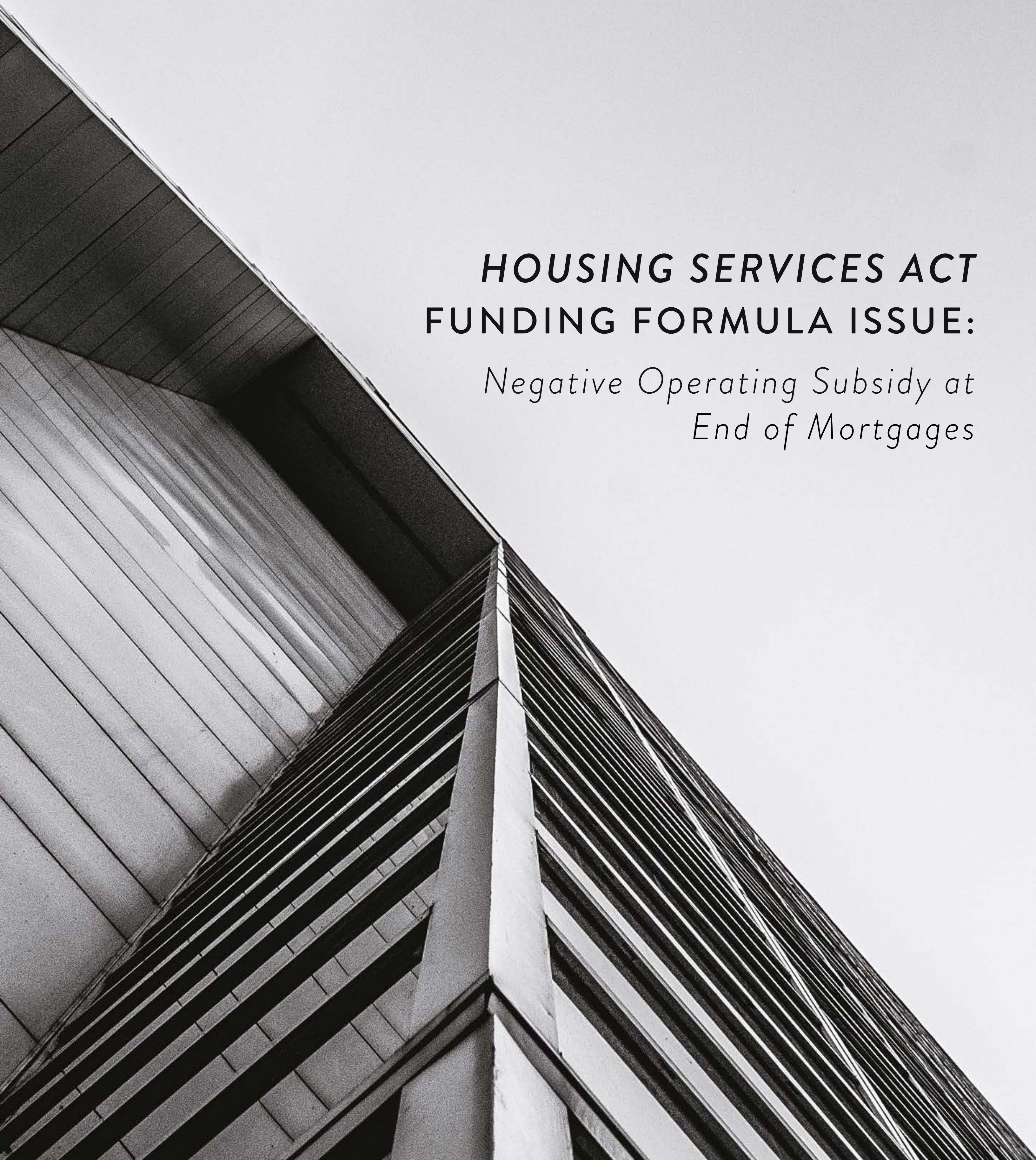
ONPhA

ONTARIO NON-PROFIT
HOUSING ASSOCIATION

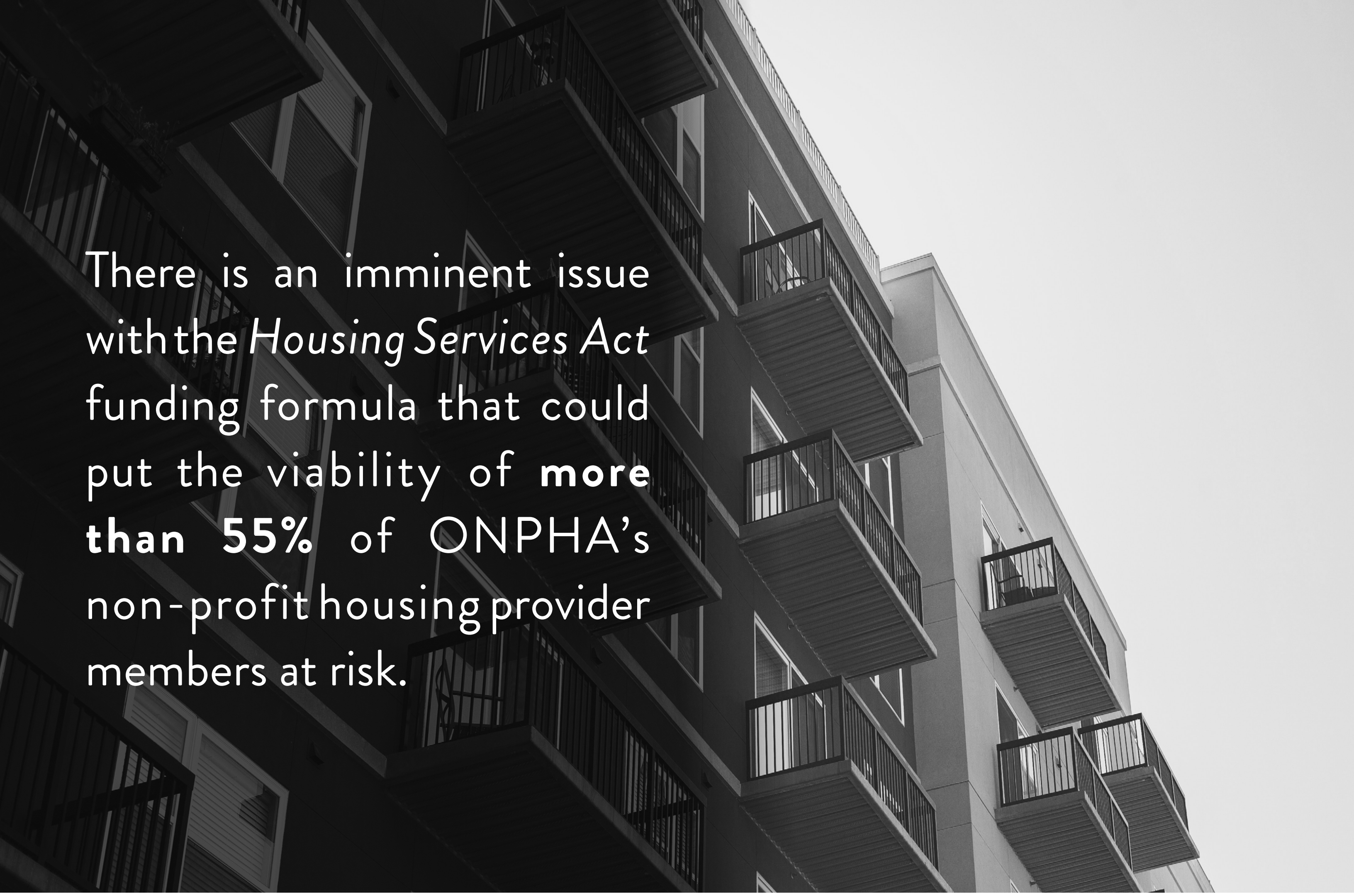
BRIEFING NOTE
JULY 2019

# *HOUSING SERVICES ACT* FUNDING FORMULA ISSUE:

## *Negative Operating Subsidy at End of Mortgages*



# contents



There is an imminent issue with the *Housing Services Act* funding formula that could put the viability of **more than 55%** of ONPHA's non-profit housing provider members at risk.

# *the problem*

## The current *Housing Services Act (HSA), 2011* funding formula allows for a negative operating subsidy.

As providers reach the end of mortgages (EOM), they will not see the benefits of being mortgage-free, either for ongoing operations or renewal of their capital assets.

Coupled with aging buildings and decades of underinvestment in capital reserves, **many providers will not be sustainable into the future unless we take action.**

This technical briefing note explains the negative operating subsidy issue, identifies the likely outcomes for Ontario's non-profit housing sector if no action is taken, and introduces the advocacy approach ONPHA is taking to promote the long-term sustainability of the sector.

# *setting the context:* A BRIEF OVERVIEW OF ONTARIO'S NON-PROFIT HOUSING PROVIDERS

Ontario's social housing sector has evolved significantly over the past several decades. This section provides a brief overview and explains how the current provincial legislation and its accompanying funding model came to be.

**From the 1970s to the early 1990s**, Canada Mortgage and Housing Corporation (CMHC) supported non-profit housing development through a variety of ways, including unilateral federal funding and lending programs and cost-shared federal/provincial programs. In the early 1990s, Ontario also funded a large number of projects through unilateral provincial funding.

**During this time,** every housing project developed had its own Operating Agreement, either with CMHC or the provincial government. These Operating Agreements defined funding and lending arrangements and provider requirements around rent and subsidized units. The agreements were usually linked to a provider's mortgage, which was typically 35 years.

**Since then,** there have been several changes and stages of devolution that have impacted Ontario's housing system. Significantly, most of non-profit housing programs are now funded and/or administered through consolidated municipal service managers[1] and provincial operating agreements have been replaced by legislation (first the *Social Housing Reform Act, 2000,* followed by the *HSA, 2011)*. Unlike the original operating agreements, the legislation has no end dates.

[1] A service manager is a level of government in Ontario responsible for carrying out the funding and responsibilities of the provincial *HSA*. This could be a regional government, a county or a separated city depending on the local services. The provincial government created District Social Services Administration Boards (DSSABs) in northern regions of Ontario where there was no existing municipal government with the legal jurisdiction to act as a service manager. DSSABs have the same funding and administrative responsibilities as services managers.

# THE DEVOLUTION OF HOUSING IN ONTARIO HAS CREATED SEVERAL TYPES OF NON-PROFIT HOUSING PROVIDERS:

## 1. THOSE OPERATING PROVINCIAL REFORM PROJECTS

These are projects where the province was involved in providing funding, either unilaterally or through cost-sharing with the federal government. They no longer have an Operating Agreement. These agreements were replaced by an operating framework and funding model set out in provincial legislation – first the *Social Housing Reform Act, 2000*, followed by the *Housing Services Act, 2011*.

When these providers were overseen by Operating Agreements there were clear and defined end dates for the obligations for both housing providers and the funder. However, the current provincial legislation does not include an end date. This means that, unless legislation changes, the current obligations and requirements for both housing provider and funder will continue indefinitely.

**IMPACT:** If nothing changes with the current funding model, this group of providers will be directly and negatively impacted at the end of mortgage (EOM). Please read on to learn more about this issue.

## 2. THOSE OPERATING FORMER FEDERAL PROJECTS

These are projects that were created through unilateral federal funding. As of today, they still have their original Operating Agreements. Even though the agreements are now administered through service managers, the original terms and conditions are still intact, including the funding arrangements and the eventual end date.

**IMPACT:** Former federal projects are not directly impacted by this funding model issue (although, if left unaddressed, it will have negative impacts on the sector broadly).

However, there are other issues for you to consider with the End of Operating Agreements (EOA). Please refer to ONPHA's EOA resources or reach out to us if you have questions.

## 3. THOSE OPERATING OTHER TYPES OF PROJECTS

There are also many other types of non-profit housing projects in Ontario that are not subject to the funding model set out under the *HSA*.

These include: *public housing projects operated by Local Housing Corporations that have different funding models; supportive and alternative housing that is administered by the Ministry of Health and Long-Term Care or Ministry of Community and Social Services; any affordable housing projects that were developed through the Affordable Housing Program or the Investment in Affordable Housing; and any projects that are operating outside of government programs.*

**IMPACT:** While these projects face their own challenges, they will not be directly impacted by this specific issue. However, if left unaddressed, the issue will have negative impacts on the sector broadly.

## 4. THOSE OPERATING PROVINCIAL REFORM PROJECTS AND OTHER TYPES OF PROJECTS

Some housing providers have both provincial reform projects and other types of projects (i.e. former federal projects or other types of projects) within their portfolios.

**IMPACT:** The provincial reform projects will be impacted by this funding formula issue even though the other projects are not.

### IT IS ABSOLUTELY CRITICAL NON-PROFIT HOUSING PROVIDERS KNOW:

Which types of housing projects you have in your portfolio and the end-date of your mortgages or agreements. If you aren't sure where to look for this, contact ONPHA at 1-800-297-6660 or member.support@onpha.org.

# *defining the issue:* THE *HSA* FUNDING FORMULA AND NEGATIVE OPERATING SUBSIDY

Over 400 ONPHA members own and operate non-profit housing projects that fall under the operating framework of the *HSA*. These housing providers receive **three types of subsidies** from service managers:

1. **Rent-geared-to-income (RGI)**
2. **Property Tax**
3. **Operating**

The basic funding formula for these subsidies is displayed in Figure 1.

*Figure 1: HSA Funding Formula*[2]

**OPERATING SUBSIDY**
[(benchmarked operating + mortgage costs) - benchmarked revenues]

**+ RGI SUBSIDY + PROPERTY TAX SUBSIDY - SURPLUS**
**=**
***TOTAL SUBSIDY RECEIVED FROM SERVICE MANAGER***

To understand the issue, we first have to examine the operating subsidy which is meant to bridge the gap between benchmarked revenues (rents and other revenue streams) and the actual costs (mortgage and operations).

As it currently stands, the funding formula allows for a negative operating subsidy. This occurs when the benchmarked revenues are greater than the project's total costs and the formula returns a negative number.

While this can occur before EOM, the impact becomes much more dramatic when the mortgage cost is removed. This is displayed in Figure 2 (page 6).

[2] With some conditions, the *HSA* gives service managers to ability to collect up to 50 per cent of a provider's annual operating surplus. Some service managers do this and others do not.

*Figure 2: Example of Non-Profit Project Operating Subsidy Calculation: Before & After EOM*

| Total costs (benchmarked operating + mortgage costs) – benchmarked revenues = OPERATING SUBSIDY | |
|---|---|
| **OPERATING SUBSIDY WITH MORTGAGE** | **OPERATING SUBSIDY AFTER EOM** |
| ($350,000 + $332,000) – $600,000 | ($350,000 + 0) – $600,000 |
| = **$82,000** | = **-$250,000** |

Next, we have to examine the impact of negative operating subsidy on the overall funding formula. As shown in the full *HSA* funding formula (Figure 1), the RGI and property tax subsidies are included in the same formula as the operating subsidy.

What this means is that, when negative operating subsidy starts to occur, providers will begin covering portions of the RGI and property tax costs through their own revenues and mortgage savings instead of receiving full subsidies from the service manager. Using the same operating subsidy numbers as the previous example (Figure 2), this is displayed in Figure 3.

*Figure 3: Example of total non-profit subsidy before and after EOM*[3]

| Operating subsidy + RGI Subsidy + property tax property = TOTAL SUBSIDY | |
|---|---|
| **TOTAL SUBSIDY WITH MORTGAGE** | **TOTAL SUBSIDY AFTER EOM** |
| $82,000 + $325,000 + $150,000 | - **$250,000** + $325,000 + $150,000 |
| = **$557,000** | = **$225,000** |

[3] For simplicity, this example assumes the service manager is not collecting any surplus from the housing project.

# *assessing the impact:* END OF MORTGAGE STUDY

In 2018, ONPHA commissioned a study to examine effects of the *HSA* funding formula on non-profit housing corporations in Ontario into the future.

The study examined a representative sample (small, large, urban and rural) of 12 housing providers. These providers supplied the consultant with audited statements, annual information returns and a building condition audit (BCA) or capital budget for analysis.

The study identified trends and reached several possible conclusions.

**Most significantly:**

### AT EOM, MOST HOUSING PROVIDERS WILL SEE **NEGATIVE OPERATING SUBSIDY INCREASE** SIGNIFICANTLY.

With negative operating subsidy increasing, housing providers will be covering the bulk of property tax and RGI subsidies from their rental revenues and mortgage savings; service manager financial contributions will be reduced drastically.

### IF NOTHING IS DONE, MOST *HSA* HOUSING PROVIDERS WILL ENCOUNTER NEGATIVE CASH FLOW PROBLEMS AT EOM AND WILL NOT BE SUSTAINABLE INTO THE FUTURE.

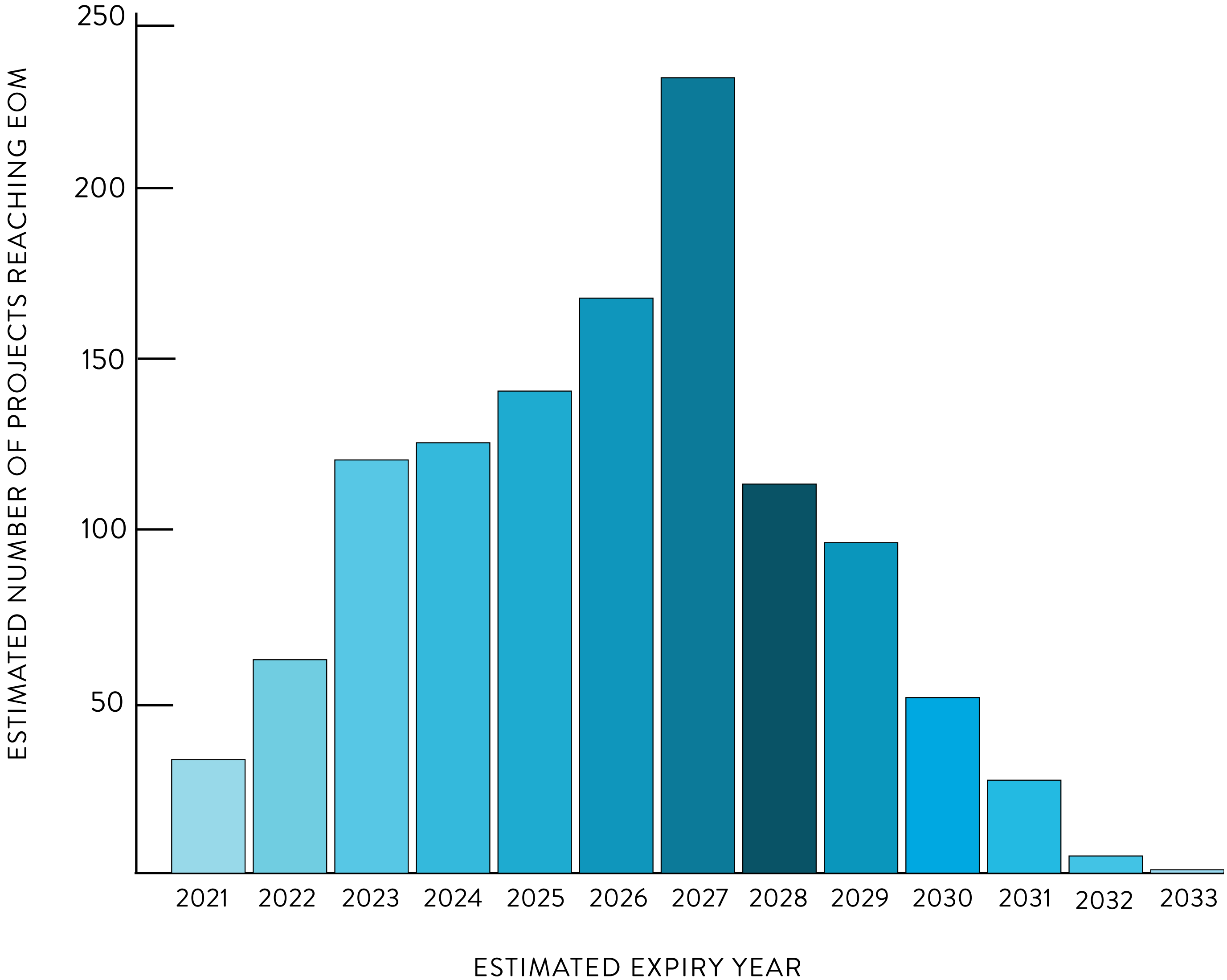
The study found that many providers will have the resources to either maintain subsidized rents or cover needed capital repairs. They will not have the ability to do both without assistance.

# *quantifying the impact:* EOM DATES FOR ONTARIO'S NON-PROFIT HOUSING SECTOR

As of today, there are approximately **1,200** non-profit housing projects that are subject to the *HSA* funding formula. Based on legacy data, we know the approximate schedule of when mortgages for these projects will end (see Figure 6).

*Figure 6*

**ESTIMATED EOM DATES IN ONTARIO BY NON-PROFIT PROJECT**



Drawing on our study, ONPHA projects that the vast majority – if not all – of these housing projects will *not* be in a financial position to maintain subsidized rents (despite a legislative requirement to do so) and to undertake necessary capital repairs at EOM.

They simply will not have the resources on hand.

Further, due to negative or low cash flow, providers will have limited or no ability to service debt through private lending institutions or even through current National Housing Strategy initiatives. This will prevent them from leveraging assets to undertake vital capital repair work, let alone to expand their portfolios to increase affordable housing options for Ontario.

Because of these factors, we project that the majority of non-profit units operating under the *HSA* will eventually be lost or fall into disrepair if the issue with the funding formula is left unaddressed.

## THIS WOULD MEAN THE LOSS OF AT LEAST 60,000 SUBSIDIZED UNITS.

As it stands, there are already more than 185,000 households on waiting lists for affordable housing in Ontario and we know that at least 235,000 Canadians experience homelessness annually. The loss of any community housing stock will only make this worse.

**185,000**

HOUSEHOLDS WAITING FOR AFFORDABLE HOUSING

**235,000**

CANADIANS EXPERIENCING HOMELESSNESS ANNUALLY

# *number one advocacy priority:* ONPHA'S ACTION AND RECOMMENDATIONS

While there may be some actions housing providers can take to mitigate and prepare for the impacts of this issue, this is fundamentally a structural policy issue that will require a policy solution. More than **55%** of ONPHA's membership will be impacted. With the majority of provincial projects reaching the end of their mortgages over the next decade, this is currently our number one advocacy priority.

ONPHA is calling for **two options** for housing providers after the end of mortgages.

| END OF MORTGAGES: TWO OPTIONS FOR HOUSING PROVIDERS | |
|---|---|
| **1**<br>**LEGISLATIVE STREAM**<br>This would maintain the current *HSA* operating framework (or something similar) but alter the funding formula to prevent against negative operating subsidy.<br><br>With this, ONPHA will also be advocating for the re-evaluation of current benchmarks to align more closely with today's realities and targeted initiatives to address outstanding capital repair and deferred maintenance costs. | **2**<br>**RENT SUPPLEMENT STREAM**<br>This would give housing providers that are financially and operationally equipped the ability to "opt-out" of the legislative framework and enter into individual rent supplement agreements with their service manager. |

## *THREE KEY BENEFITS* OF ONPHA'S RECOMMENDATION

### 1. HOUSING PROVIDERS STAY IN BUSINESS.

Our recommended solutions will ensure that housing providers are sustainable to continue providing affordable housing to Ontarians in need.

### 2. HOUSING PROVIDERS CAN ADDRESS MUCH-NEEDED REPAIRS.

Our recommended solutions will give housing providers access to resources and leveraging capacity to address much-needed repairs and renewals. Addressing growing capital repair needs is a goal shared by the community housing sector and all levels of government.

### 3. HOUSING PROVIDERS CAN BUILD TO INCREASE HOUSING SUPPLY.

Our recommended solutions will also give many providers the ability to leverage their assets and mortgage savings to expand their portfolios. This would help increase affordable housing supply across the province and serve to reduce current waiting lists.

# *what's next?*

## FROM ONPHA:

Over the coming weeks and months ONPHA will share more detailed information about our recommendations with our membership.

We recognize that this is an issue that will have both direct and indirect impacts across all parts of Ontario's housing system. ONPHA is committed to working closely with all stakeholders to achieve the long-term sustainability of community housing providers and to ensure a healthy and vibrant Ontario where everyone has a safe and affordable place to call home.

We will continue to keep ONPHA members appraised of our progress.

## FOR HOUSING PROVIDERS:

If you are unsure about whether you will be impacted by this issue or when your mortgage ends, we strongly encourage you to look into this.

If you aren't sure where to look for this information, please contact ONPHA for assistance at 1-800-297-6660 or member.support@onpha.org.

ONPHA

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