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Reinvesting the baseline windfall: Assessing potential baseline surplus from expiring federal operating agreements

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In the 2017 federal budget the federal government stated that the ongoing funding associated with long term federal operating subsidies for social housing would be preserved as baseline funding and be available for reinvestment into new housing initiatives.

Options to repurpose this could include:

1. Retain these funds to reinvest in capital renewal to sustain existing stock in sound state of repair;
2. Use funds to cost share with provinces and territories the ongoing cost of sustaining viable operations and support capital renewal in existing social housing;
3. Use to fund a new Housing Benefit as a way to both extend assistance to additional households and reform the subsidy model in existing social housing.
4. Fully reallocate federal baseline funds to new initiatives (leaving existing stock expenses to provinces and territories)

Before any decision is made, it is appropriate to quantify the level of "savings", the respective share of current subsidy flows and any pre-existing lien on these funds.

This brief presents this financial assessment and considers the options in that context.

About the Center

The Centre for Urban Research and Education (CURE) is a multi-disciplinary network of researchers, primarily from Carleton University, who share an interest and commitment to strengthening municipal and urban affairs. With diverse experience, expertise and perspectives, the CURE network carries out collaborative research in areas including community governance, citizen engagement and local capacity building around planning for infrastructure to sup- port social, economic, and environmental sustainability.

Vision and Goals

We are committed to strengthening governance, policy making, and management in urban areas through collaborative research, community engagement, and education.

Background

This so called baseline funding in 2017 amounts to roughly $1.4B. It declines annually over the next decade with the cumulative reductions totaling almost $5 billion by 2027. This is a significant source of funds for investment over and above the $11 billion announced to support the rollout of a national housing strategy over the next decade, so it has been the subject of much discussion.

CMHC has consulted on the potential use of this “windfall”, including using this to fund preservation and renewal of the existing stock, investing in new development (over and above that already embedded in the NHS funding), and potentially to create a national housing benefit as rental assistance directed to low income households facing affordability problems.

There has been a strong groundswell of advocacy from the social housing sector and from provinces and territories to first direct any such funds to preserve viability of the existing social housing stock created through public investment over the last 50 years. This stock, totaling some 600,000 dwellings and representing 4% of all housing in Canada is a very limited and important resource for very low-income renters. In most cases it is more cost effective to preserve these existing units than to address ongoing housing need through new construction.

The critical issue is that to be viable and be maintained in sound condition this stock requires ongoing funding, not a simply one time investment. So, before any baseline funding can be repurposed, it is necessary to first determine what portion may be required to achieve this preservation objective on an ongoing basis.

It is also important to note that much of this stock is jointly funded under federal and provincial-territorial (PT) cost shared programs, so it is not just a matter of what happens with the baseline federal funds, but also what is happening with PT funding.

Assessing current and projected expenditure requirements

Social housing developed prior to 1995 is primarily funded with ongoing operating subsidies which cover the shortfall between total operating expenses, including debt service costs and rent revenues generated. The rental revenue is low due to the policy of establishing rents at affordable levels, usually on a rent geared to income (rgi) basis.

Many programs were funded under cost-shared arrangements with PTs. And while earlier programs initially involved a higher federal share, the respective contributions have changed over time, and in particular as a consequence of the transfer in administration responsibilities under bilateral Social Housing Agreements (SHAs). These were executed with all but two provinces (Quebec and PEI), although Alberta was a late signee only executing in 2016.

The SHAs effectively froze federal spending at the 1995/96 levels as a block transfer to each PT. The PTs are responsible for any inflationary increase in subsidy costs but are permitted to retain (reinvest) any savings from operating efficiencies or interest savings. Because mortgage rates were on a steady decline from the mid 1990’s, all renewing mortgages were at lower rates, which lowered the P&I portion of expenditures and offset any inflating PT expenditure.

Drawing on previous research

In an analysis of PT social housing expenditures undertaken in 2013, data were collected to assess the overall levels of spending as well as the respective share for the PTs versus federal government. The analysis covered all units funded under programs in the respective SHA agreements, as well as any legacy cost shared programs in Alberta Quebec and PEI. This totaled 498,000 units, representing over 87% of units then under administration in 2012. [1]

Data were collected from each jurisdiction to identify total operating expenses, net of debt service, total P&I payments and rent revenues collected. Together these define the net subsidy required (operating plus debt payments less rental income). [2]

Separately, the total amount of the federal SHA subsidy transfer was identified, alongside the PT contribution (which is a residual, after totaling the net subsidy required and then subtracting the federal transfer). [3]

Data are for the 2012 fiscal year and have not been updated to reflect any inflationary increase in expense, mortgage renewals or expiries since that date. However as a point in time, these provide useful insight into the post expiry situation. This compares subsidy pre and post expiry (assuming all subsidy and P&I ended in 2012).

Figure 1 presents the per unit values for each type of expenditure and revenue, averaged across all units nationally for which sound data was available.[4] For ease of reference, data are shown on a per month basis. The first two columns show the pre expiry situation in 2012; the last two columns illustrate what this would mean if both P&I and Federal subsidy had ended (also in 2012). This is a theoretical presentation as in reality each phases out over time, but it serves to highlight the relative importance and scale of each revenue and cost element.

Highlights of Figure 1:

- An average national unit had a breakeven rent in 2012 of $828;
- This was comprised of operating expenses (including a modest allocation to capital reserves in the non public housing parts) of $612 and debt service costs of $216;
- The average project collected rent revenue of $342 per unit;

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[1] Canadian Housing Statistics 2013, Table 43, identifies the total units under administration at 593,000, but this includes 20,000 RRAP loans. Net units are therefor 573,000.

[2] Data was collected for all jurisdictions, however rental revenues were not available for Ontario (where subsidy has been devolved to the municipal level so there is no single budget) and data on operating expenses in BC were out of line with norms so these too have been set aside and per unit averages determined for remaining data.

[3] In 2012, the total CMHC transfers as reported in the data collecting exercise by the PTs for these 498,000 units was $1.17B; The total CMHC subsidy expenditures, which cover non transferred and on reserve as well as these transfers, total $1.7B.

[4] Prior to adjusting for missing or abnormal values in BC and Ontario, the total P&I cost in 2012 was $1.391 while the total federal transfers to associated units was $1.179B. It appears that the P&I may include some unilateral BC program loans, so BC data removed to generate the national average.

- The average per unit federal transfer subsidy in 2012 was $188;
- The PTs in the aggregate then cover the residual amount required to break-even, which averages at $298. Post expiry this declines marginally to $270.

Note that with the exception of annual allocations to capital reserves in Co-op and NP programs, where such allocations are embedded in operating costs, these costs do not include any spending on capital renewal.

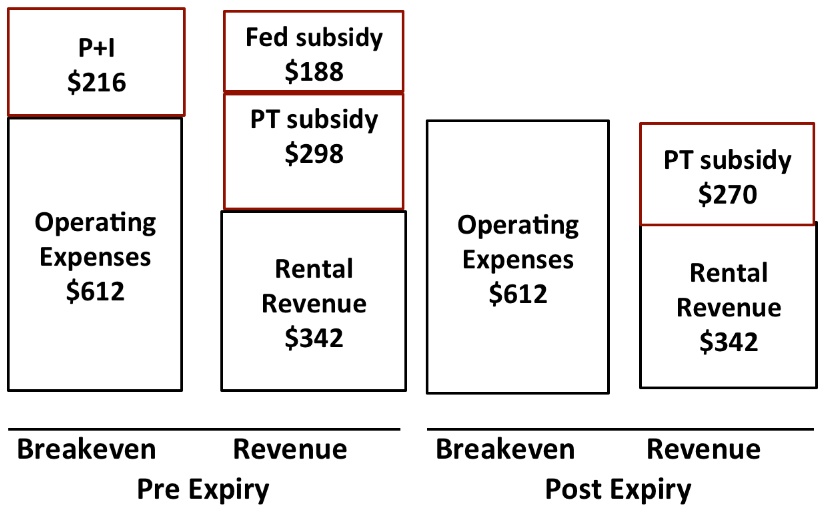

Figure 1: Average per unit costs and revenues, FPT portfolio 2012

There are two critical elements revealed in this figure.

First, because early programs were funded with a higher federal ratio, it is typically assumed that the federal expenditures are larger than those of the PTs, but due to the post SHA PT absorption of any rising operating expense this is no longer the case. ***As Figure 1 shows the average PT per unit subsidy (in 2012 at $298/month) covers two thirds of subsidy while federal subsidy ($188/month) is one-third.*** [5]

The second is the relative amount of federal subsidy ($188) compared to P&I debt service payments ($216). At expiry, both terminate and the breakeven rent falls from $828 to $612. And because the federal subsidy is smaller than the P&I payments (on average) ***the projects, providers and tenants should, on average, NOT be negatively impacted***.

There is however a fundamental assumption in this assessment. That is that PT subsidies (municipalities in Ontario) will continue at roughly their current level (initially a small reduction from $298 to 270, but then inflate over time to absorb any future inflationary increase in operating expenses that exceed any increase in rents).

If indeed PTs did sustain their subsidy commitments, the portfolios would remain viable and the entire federal baseline could be available to reallocate to other federal housing priorities. However this also ignores ongoing requirements to reinvest in capital renewal as projects age.

[5] Note this not the total federal social housing expenditure. It is only that portion associated with SHA and cost shared programs in Quebec and PEI. It excludes some $475 million in other non-transferred programs and on reserve.

Reframing the issues

So the critical issue is not that the legacy stock of almost 500,000 homes would be unviable and no longer affordable. With sustained PT funding it would be quite viable, and rents could remain at affordable levels, with two thirds still operating on an RGI basis.[6] The problem is twofold:

- First there is an issue of unequal fiscal capacity for PTs to sustain their current expenditure levels.
- The second is that to this point there is no consideration of funding for capital renewal of these aging properties.

As shown in the preceding analysis, even with sustained PT subsidy at the current level of $298, there is barely any post expiry surplus (only $28/mo) and thus minimal capacity to leverage debt to fund capital replacement (this requires some surplus cash flow to make any loan repayments – some projects especially with lower RGI to market rent ratio may have some capacity, but others have none).

The 2012 research identified projected gross requirements for capital renewal based on an industry norm of investing 2% of replacement value annually. The PTs estimated the 2012 asset replacement values at $68 billion with a 2% expenditure coming in just under $1.4B. This is a gross estimate and would be reduced by any capital renewal already assisted under the 2009-11 CEAP and budget 2016 retrofit programs, and by drawing on replacement reserves in those portfolios with such reserves. [7]

Coincidentally this gross estimate ($1.4B) is very close the 2012 amount of federal transfers ($1.17B) which are expiring to create the baseline pool for reallocation. Once accounting for recent retrofit funding and replacement reserves, the annual capital expenditure would come very close to matching current spending.

Considering the options

There is a hierarchy of options for the reallocation/repurposing of federal baseline savings. These accumulate gradually as project level agreements expire, so the annual expenditure of $1.4 Billion does not fully become available until after 2036:

1. Retain these funds to reinvest in capital renewal to sustain existing stock in sound state of repair;
2. Use funds to cost share with provinces and territories the ongoing cost of sustaining viable operations and support capital renewal in existing social housing;
3. Use to fund a new Housing Benefit as a way to both extend assistance to additional households and reform the subsidy model in existing social housing;
4. Fully reallocate federal baseline funds to new initiatives (leaving existing stock expenses to provinces and territories).

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[6] In this simplified analysis, the average per unit costs and subsidies are used to account for some missing data. In reality across different programs and at different geographic scales the distribution of costs versus federal subsidy is not an average, it is uneven and therefore it is not necessarily the case that all projects and units would be viable. This analysis looks at the overall system costs and subsidy to provide a more general overview.

[7] The 2% annual spend is also quite generous. It could conceivably be lower to between 1 and 1.5% and still enable properties in sound condition, assuming those in very poor condition are demolished and removed from the capital pool. At 1.5% the annual requirement would be just over $1 billion.

Each of these is reviewed below

1. Reinvest in capital renewal

Given this reframing and identifying the critical issues of fiscal unfairness and unfunded capital renewal, an obvious option would be to allocate responsibility for capital renewal to the federal level and in doing so, match the level of provincial operating subsidy. At an aggregate scale, this would restore roughly even contributions by the federal and PT governments.

It would also retain a separation of responsibilities. Over the past 30 years the PTs have taken on full responsibility for portfolio management, including subsidy administration, new development and in many cases asset renewal. The federal role has become less connected and less involved. On this basis, even with federal funding for capital renewal such funding could flow via PT administration, as part of their ongoing asset renewal roles.

2. Extend and cost share operating subsidies

An alternative option is to preserve some form of cost sharing in both ongoing subsidy requirements and in funding capital renewal. This would achieve the objective of fiscal fairness (although smaller jurisdictions, especially municipalities in Ontario, may still lack fiscal capacity). It could also complicate administration, as it would reinsert a federal presence and impose public accountability and reporting responsibilities.

3. Fund a new Housing Benefit

A third option is to fundamentally reform the rgi subsidy system and gradually transition from project based rental assistance to household assistance.

Potentially this would increase rental revenues with lower income households assisted in sustaining affordable rents via the new rental assistance or housing benefit. These higher rent revenues could then create greater capacity for project owners to lever debt for capital renewal (a more typical market based approach, used in private sector housing).

As per prior comments about fiscal capacity, such a housing benefit approach would require some cost sharing to balance PT capacity. Such a subsidy reform would also overlap with the PT welfare system as many social housing tenants receive their income through welfare programs. As such it would implicate welfare reform (related to the housing components of welfare benefits).

4. Reallocate federal baseline funds to new initiatives

The recent consultation discussions tended to focus on options to reallocate all or some of the baseline savings into new federal initiatives. This could include the aforementioned new Housing Benefit, as well as investment in new affordable rental development.

This analysis suggests that if preservation and enhancement of the legacy stock of 600,000 social housing units is established as a priority, there will be little, if any surplus to reallocate to new initiatives.

Conclusion and suggested option

Based on 2012 data the entire federal transfer is less than aggregate P&I expenditures, so ignoring phasing issues, when debt is retired the entire federal transfer *could* be freed up for reallocation to other federal housing priorities.

This would leave the full funding responsibility to preserve and sustain the existing stock to the provinces and territories. Given constrained fiscal capacity of PTs (and in Ontario the municipalities, to whom the province has devolved the subsidy obligation) this could place the existing limited legacy stock at risk of underfunding and potentially, loss of some stock. Therefore this option is not recommended.

In the short-term, the more practical approach may be for the federal government to either take on responsibility for capital renewal and thereby match ongoing PT operating subsidy, but with a distinct role; or temporarily invest any savings to renew FPT cost sharing to sustain both RGI and capital subsidy at a level necessary to preserve project viability and affordability.

Over the longer term, a revised subsidy approach should be explored, shifting subsidy from project based to person based. This would enable social housing providers to operate on a more realistic disciplined operating basis, with sufficient revenues from quasi-market rents to be viable and to lever finance for capital renewal. Meanwhile a Housing Benefit would provide subsidy to those that could not afford realistic quasi-market rents, sustain affordability and also improve mobility for low-income households.

It is also noted that the data used in this analysis is dated (2012) and incomplete. It is critical that a n updated set of data be assembled from across all jurisdictions to more accurately assess the impacts and potential of repurposing federal “savings”.