S-3

SCENARIO S-3
SINGLE PROJECT PROVIDER
(CATEGORY 3)

Prepared for BC Non-Profit Housing Association and
BC Housing

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(Users should first read "Introduction to scenarios" document, which describes a range of scenarios and the methodology used to create them.)

SCENARIO S-3 SINGLE PROJECT PROVIDER (CATEGORY 3)

Scenario Highlights:

- Project has negative cash flow but well funded replacement reserves
- Rents are low and operating costs above average

Options:

- Increase rents gradually (facilitated by capacity in seniors benefit income and potential support under SAFER)
- Discuss budget adjustments with BC Housing, including the potential to implement either extended subsidy or rent supplement assistance post expiry

Project/Portfolio Description

This is a small apartment development providing 8 units for low to moderate income seniors in a small coastal community. The town is somewhat isolated and has a weak local economy (and some de-population). This project receives CMHC 2% mortgage write down subsidy. There are few rental options other than this non-profit housing and no other non-profit housing societies. As referenced in Step C of the EOA Planning Guide, the project should be assessed for social sustainability. For instance, there should an assessment of continued need and demand for the housing this project provides (page 12).

Current theoretical viability

To avoid assumptions on inflation of rent and operating costs, the first assessment examines the theoretical outcome that would exist today if all subsidy and all mortgage payments are ignored. The following table summarizes the base line rents, operating costs and capital reserves, as reported in the latest financial statements. For ease of reference these are shown on a per unit basis. The key variable for viability is the net operating income (NOI):

S3 Key Baseline Data (per unit)						
Per unit/month				Annual (per unit)		
Ave rent	Average Operating costs (excl. RR)	Replacement Reserve (RR) Allocation	Net Operating Income after RR	RR alloc per unit	NOI after RR	RR Balance per unit today
$366	$487	$80	-$200	$954	-$2,400	$3,699

The current rents are $360 per month while operating expenses, excluding allocation to capital reserves are almost $490. If subsidy were to end this year the project would have an annual deficit of $200 per unit per month ($2,400 annually).

The current replacement reserve is well funded, with a balance of $3,700 per unit and annual per unit contributions of just under $1,000. As such the project is able to maintain itself in good condition and undertake necessary capital replacements as required.

Expected situation at Expiry of Operating Agreement

As suggested in Step B of the EOA Planning Guide, this scenario uses the simplified Assessment Tool (SAT), which is available on the BCNPHA and BC Housing websites or through link on page 7 of the guide. After inputting base data into the SAT the tool generates a series of outputs based on two viability tests and an assessment of whether capital reserves and ongoing contributions are sufficient to enable the society to continue to maintain the property in sound condition.

As already discussed with the baseline data (situation today if no more mortgage and no more subsidy), the project has negative NOI but sufficient reserves.

Building from the base data, the SAT projects viability and adequacy of capital replacement reserves (using a proxy threshold test) to assess the situation at expiry, which occurs soon, in 2018. The overall result is displayed in the following overall assessment matrix.

With operating expenses assumed to increase faster (2% p.a.) than rents (1% p.a.), the negative net operating income becomes worse. At expiry, in 2018, the development is projected to have an annual operating loss of $23,000 ($2,900 per unit), more than $200 per unit per month.

Figure 1: Results of SAT Analysis

Overall Assessment Matrix		
	Capital reserves	
	Sufficient	Insufficient
Positive NOI	(1) Project is viable, can maintain current RGI market mix and has sufficient capital reserve	(2) Project generates a cash flow surplus, but asset is under-maintained
Negative NOI	(3) The project is not viable but has good reserves	(4) The project is not viable and replacement reserve is insufficient. Project is at risk
	S-3 (2018)	

However a sound capital reserve and ongoing allocations through to the end of the Operating Agreement allow the project to be in sound condition. As shown in Figure 1 this project falls into cell (3) of the assessment matrix: it has negative NOI but sufficient reserves.

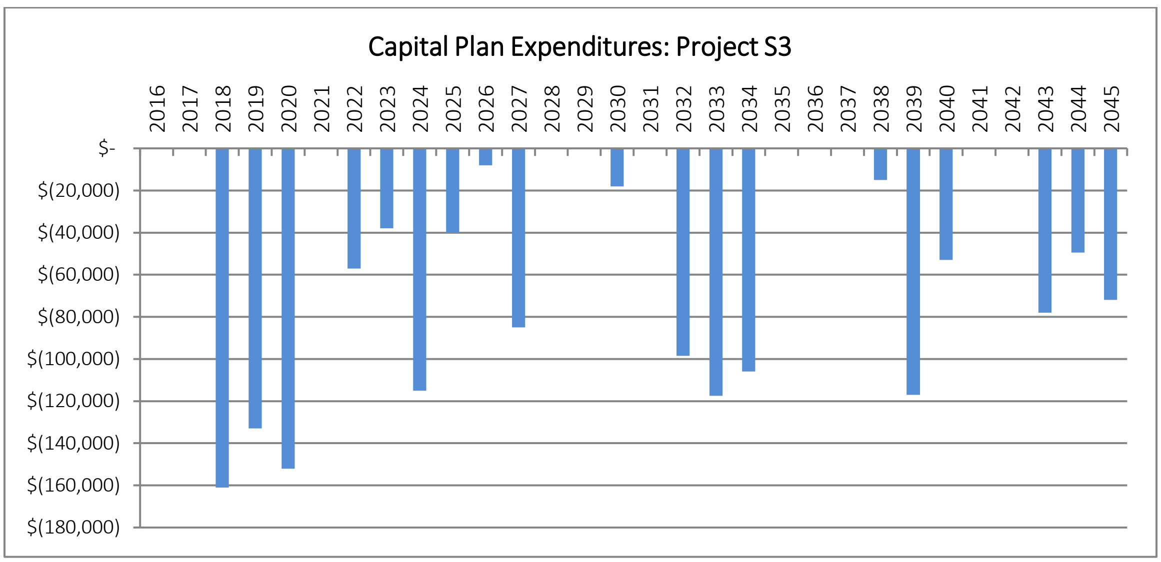
This outcome is not surprising as this was identified at baseline, and over time, this status does not improve, at least not without remedial actions.

Exploring capital adequacy [1]

The SAT uses a proxy value of $1,500 per unit per year as a minimum required availability of cash from reserves and ongoing annual contributions. The SAT analysis indicates availability of $1,700. This can be more accurately examined if the society has completed a building condition assessment (BCA). In this case, a BCA is available.

A BCA was recently completed and confirms that the property is well maintained and in sound condition. All but one lifecycle replacement are categorized as low priority (one medium priority is to replace aged base board heaters with a new more efficient system, but this is not a large cost and is included with others in 2018).

Figure 2: Capital expenditure plan based on BCA



Over the next 30 years of replacement as items such as these reach the end of their useful life, the cost of total one time replacement is estimated at $2.1M. Once adjusting

[1] In this assessment, the planned expenditure is based on 50% of the BCA annualized estimate. BCA's use estimated life of capital items, which may underestimate useful life. Furthermore, BCA's include components that are not practical to replace, and typically remain until the building reaches the end of its useful life (such as structural walls, branch wiring and foundation walls). Deferral, phasing and strategic capital planning based on financial capacity can be strategically used to lower actual spending requirements.

to reflect ongoing useful life, this results in an annual per unit requirement of $2,650. This exceeds the current availability from ongoing contributions and spending from the current reserve. While the identified spending is quite significant in 2018-2020, this is followed by some lower years, and given low priority for most replacements, these can likely be spread out.

Review of challenges and options

The primary issue for this society is its' low rental revenues and consequent negative cash flow. Operating expenses are above the norm, but there is likely limited potential to achieve efficiencies due to the small size of the project.

Some efficiency could be achieved in the area of utility costs – potentially retrofitting units with improved windows and insulation, to lower heating costs (replacing current electric heat with more efficient baseboard heaters), drawing on the healthy capital reserve. However the key cause of negative income is low rental revenue.

Relative to the building condition assessment (BCA) there is a small shortfall in funding for capital renewal, but given sound condition of the building and reasonable reserves, this is not a serious concern.

Exploring potential remedies and options

Step D of the Planning Guide provides options to help improve post-EOA viability, and where necessary address underfunded capital reserves. The discussion presented here draws on those options.

In order that the project is not at risk of bankruptcy at expiry, it is necessary to increase rental revenues. This can be done either through rent increases or by renting some units at market rent (i.e. income mixing).

Options prior to expiry

Option 1: transition some units to market rent.

While this community is not surveyed in the CMHC rental survey, rents in nearby communities for bachelor and one-bed units are $550 to $675, so a market rent might be in the region of $500 per month. As units are vacated the society could seek to rent some of them at a low end of market rent,(rather than RGI) .

Establishing higher rents as units turn over (assume 1 unit per year) such that by expiry (in 2018) 50% of units are rented at $500/month (with remainder at current plus 3% annual increase) significantly improves viability. See page 20-21 of the Planning Guide for a discussion of rent increases post-EOA.

Options 2: Review current RGI rents.

The current rents of $293 appear low relative to a senior's minimum income (OAS/GIS). The Society should review their current RGI calculation and if appropriate adjust RGI rents upward.

Options to take effect after expiry

The SAT assesses the impact after expiry so these options focus on that time frame, and explore remedies that providers can create and implement without BC Housing approval. It is suggested, however, that groups discuss these options with BC Housing, BC Non-Profit Housing Association or a local development consultant prior to expiry, and explore additional opportunities to generate revenue and/or adjust expenditures.

Option 3: Seek new subsidy via rent supplements.

If there are constraints on increasing rents due to a weak local market, the only other option is seek an extension to subsidy, using a rent supplement agreement. This will require approval from BC Housing.

Option 4: Manage increases in operating costs.

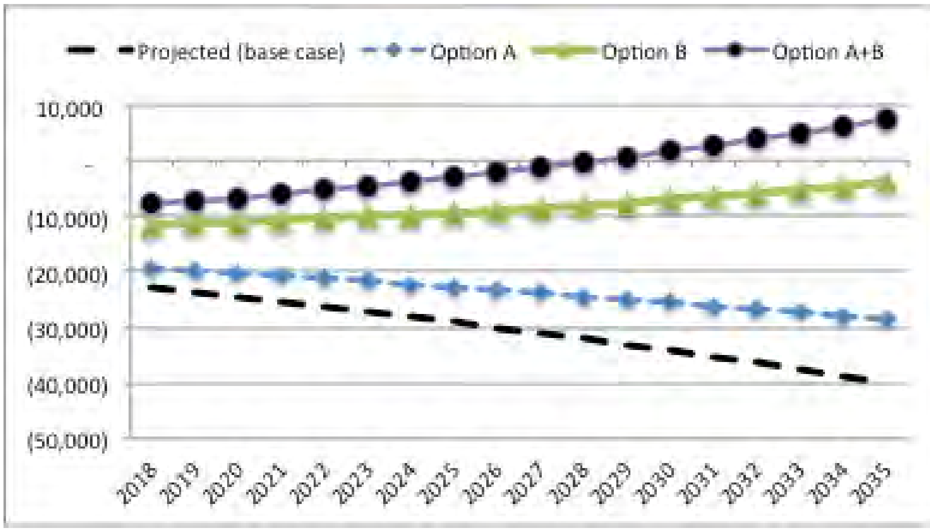
In the SAT it is assumed that operating expenses (and reserve contributions) inflate at 2% p.a. If the society can hold increases down to 1.5% that can slow the gap between revenues and expenses.

Figure 2: examines the option of progressively increasing rents (Option A: such that by expiry in 2018 50% of units are rented at $500/month, with remainder at current plus 3% annual increase) and efforts to hold operating increases down to 1.5% (vs. 2%)

Option A alone still leaves an increasing deficit. However when combined with efforts to manage to rate of increase in operations (Option B), a positive trajectory is achieved and the project gradually becomes more viable, by 2028 (10 years after expiry).

However, it remains in a vulnerable situation. On this basis, in order to preserve some supply of affordable units in this small community, it may be necessary to discuss the potential for some form of rent supplement assistance from BC Housing or other options to adjust the budget.

Figure 3: Projected annual cash flow post expiry, various options



Legal, policy and regulatory considerations

Current low rents relative to OAS/GIS benefits (which yield monthly income in excess of $1,400 suggest that some rent increase is feasible, without negatively impacting seniors (i.e. rents would remain well within 30% of income.

Such rental increases are consistent with the current legislation, which permits vacant units to be re-rented at market rates and allows annual increases at inflation plus 2%. The society should however monitor ongoing rent regulation to ensure they remain compliant (See page 20-21 of the Planning Guide for a discussion of rent increases post-EOA.)

The society will need to initiate discussion with BC Housing to discuss options for some form of subsidy extension or rent supplements at expiry of the Operating Agreement in 2018.

As a cautionary note, recent actions by CRA have placed the "profit-generating" activities of not for profits under greater scrutiny (For more information, see page 11 of the EOA Planning guide). In this case, the options contemplate generating a profit on one project, to cross subsidize another. Rents remain far below market, so should not raise concerns, but it may be appropriate to secure legal advice as part of the implementation plan.

Summary comments

This society and project may not be viable without ongoing public assistance, a rental increase or other approaches to generate revenue and/or adjust expenditures. In this regard, it is recommended that the society meet with BC Housing, BC Non-Profit Housing Association or a local development consultant to review and discuss potential options.