Recommendations for Maximizing Effectiveness of and Synergy Among Federal Investments in Supply

National Housing Collaborative

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Context

CMHC estimates that announced investments to date through the National Housing Strategy (NHS) would produce 80,000-120,000 new units over ten years, 30 to 40 per cent (24,000-48,000) of which could be considered "affordable" by those in core housing need.

While significant and welcome, 24,000-48,000 new affordable units may have only limited long-term impact in addressing core housing need in Canada. With strategic modifications to the mix of policy and program instruments, opportunities exist for system-wide interventions to mobilize the wider housing capabilities available in Canada. These could leverage and multiply the impacts of this initial federal investment as anticipated in Budget 2017.

To be effective, and to maximize the historic opportunity of the NHS, additional housing supply interventions beyond those announced can significantly increase housing affordability, rental and affordable ownership supply, and maximize the utility of investments made in the housing system over the past decades. None of the initiatives proposed here call for funding beyond what was announced in Budget 2017. Rather they look mainly to modest legislative and regulatory changes, and shifts in organizational arrangements for supply, with limited federal equity and risk-sharing participation.

The following proposals aim to achieve a balanced housing delivery system that includes market and non-market housing, and varied tenure forms, including not-for-profit, institutional, mixed-tenure and private ownership options. They build upon an analysis of the initiatives announced in Budget 2017 and previous investments now being delivered through CMHC programs and initiatives. They also enhance and extend policy proposals made previously by the National Housing Collaborative.

Proposal

Refocus and expand the current toolkit of supply mechanisms to include a broader array of tools to promote affordability across the spectrum of housing types and tenures. These tools would be neutral regarding the form of ownership by providers, and could be used to achieve a range of housing outcomes.

Objectives

- Support and grow all parts of the housing system that contribute to affordability outcomes, across housing type and tenure.
- Increase the capacity of housing providers across the continuum to contribute to housing affordability solutions, and as much as possible, to mixed-income formats.
- Maximize the leveraging of existing housing and housing systems to achieve affordability outcomes in a financially sustainable manner.

From targeted programs to investing in outcomes

Past federal policy in housing supply has largely been anchored in specific programs with varying designs and objectives, e.g. successive generations of social housing construction, project grants, and tax measures, among others. Many of these initiatives have achieved their intended objectives, but most have been designed so that each addresses only a narrow band of the entire housing continuum.

The National Housing Strategy presents an opportunity to shift from a more fragmented network of provider-specific programs to an outcomes-focused set of tools that any housing system participant can employ to achieve desired outcomes. The tools are "neutral" in that they allow for a diversity of housing products. Similarly, the mechanisms are market facing, but blind to the type of provider. As such, they encourage all participants across the continuum of housing to pursue both financial viability and affordability in order to access the tools.

In certain instances, targeted programs are useful and even urgently required. Programs aimed at specific housing types are most effective when either a) a discrete part of the overall housing inventory requires significant attention for a limited period of time, as is the case with tower renewal for Canada's aging apartment towers; or b) a discrete part of the housing inventory cannot reasonably be expected to achieve the same underwriting conditions as the rest of the system, as is the case with northern housing. Housing type-specific programs can be added to the toolkit approach, rather than its core. This will reorient government intervention in the housing system, and in so doing will also refocus housing-system actors to achieve specific defined outcomes.

A balanced toolkit of outcome-oriented mechanisms available to any provider who meets basic conditions will enable federal actions via the toolkit to be more effective and consistent over time. This approach will build capacity across the housing system. The mechanism through which investment is delivered into the overall housing system results in increased capacity as providers gain proficiency in accessing and employing funds through the mechanism. In short, ongoing practice creates capacity. This contrasts with the "stop-go" nature of many previous program initiatives.

Continuity of the mechanisms in the toolkit over time will develop capacities through practice, and the recycling of funds will produce a 'pipeline' effect where providers plan on returns to be reinvested in further development. Consistency of available mechanisms, and the recycling of funds facilitate forward planning and an entrepreneurial approach among providers, whether for-profit or not-for-profit.

An outcomes-focused toolkit

The National Housing Strategy is already taking a toolkit approach, making a variety of mechanisms available and allowing 'stacking', i.e., enabling providers to employ multiple mechanisms on a single eligible project. Announced tools to support housing supply include: grants, forgivable loans, low-interest loans, subsidy extensions, and lands.

These mechanisms can be situated in a reoriented toolkit, expanded to focus on overall housing system vitality and improved outcomes. The following outline some vital outcomes the NHS should seek to achieve, and details how re-profiled or new mechanisms in the toolkit can enable the housing system to maximize investment towards those outcomes.

Outcome 1: Leverage non-government capital into the system

Federal investment through the NHS should privilege mechanisms that serve to de-risk projects and attract capital from other sources, including other governments, philanthropists, developers and private investors. Expanding the toolkit to include significant funds for seed capital or start-up equity can provide simple and flexible mechanisms to bring diverse forms of capital and operating assistance together in housing projects. The National Housing Collaborative first made these proposals for the NHS in its submission of 2016.

- **Mechanism in the toolkit: Equity funds**

Equity support promotes the use of more conventional project financial structures, and separates the development economics of rental housing from the provision of funds to support affordability for very low-income households. (This support can be provided by rent supplements and other income support measures, outlined below in 'Supporting Actions'.)

Equity participation mechanisms can respond to the variable rental housing markets across Canada, and allow for variation in rental targets to be achieved. Deploying federal investment in the form of equity funding can serve to both enhance credit and reduce the cost of equity, attracting private and institutional investors to augment government capital. As equity contributions to a project increase, the expectations of rental affordability and duration should increase as well.

Shifting the balance of investment from grants to equity would serve to simplify applications and reporting by applying market criteria to recipient projects. It is also a major step in the direction of inter-personal and inter-generational fairness, given the overall demographic trend in Canada: there will be increasing reliance on a shrinking proportion of working-age people to support both themselves and an increasing number of dependents.

There is precedent for an equity participation approach to government investment in development: Section 92 of the *National Housing Act* has deployed federal equity that resulted, for example, in highly-regarded projects such as the development of Granville Island. It is also consistent with current practice of government taking an equity position in industries that it seeks to grow, such as Indigenous finance authorities or high-technology companies.

Outcome 2: Recycle investment through the system over time

Government investment in housing, with some notable exceptions such as northern housing, should favour mechanisms that produce some returns over time to be reinvested in the system. This can be achieved by shifting the balance of mechanisms in the toolkit towards equity and loans. Grant funding for targeted purposes can be effective, but is generally less efficient and equitable in contributing to overall system health because funds can only be spent once, and attract no additional funds towards a project (unless matched by other orders of government, or by housing providers on a one-time basis).

- **Mechanism in the toolkit: Equity funds**

Equity can work on a shorter or long time horizon, as detailed in the National Housing Collaborative's 2016 submission to the National Housing Strategy. Equity funds have the benefit of returning funds over time for reinvestment, and have a clear exit strategy for government funding from a project integrated into the initial investment. Investing in established intermediaries and managed funds would ensure government capital is deployed to achieve maximum benefit to both the housing system and government. This type of intervention would also enable not-for-profits without access to land to become more entrepreneurial in the development of new housing.

- **Mechanism in the toolkit: Loans**

Expanding long-term low cost financing to any provider meeting affordability criteria set by the federal government could enable a variety of projects contributing to affordability, including affordable home ownership. Refinancing over time presents a significant operating risk for rental housing providers during periods where rental rate increases trail inflation, or in periods of interest rate increases. Fixing long-term debt to 30 or 40-year terms would mitigate the risks related to project refinancing. This type of financing also enables developers to reduce their return expectations as a critical operating risk has been removed from projects.

This approach has already been proposed by Housing Partnerships Canada in the form of a Canadian Housing Finance Authority (CHFA). Investing through the NHS in this new intermediary would ensure a qualified underwriting team could oversee placement of debt into projects. Federal investment or a loan-loss guarantee would also leverage low-cost investment from non-government sources. The CHFA model can be extended in scale and targeted to a wider array of affordable housing projects, for both private and non-profit developers across tenure types. The model should also be open to projects that mix affordable housing with market-rent housing.

Outcome 3: Increase the effectiveness and diversity of the current inventory

Taking a systems approach to the overall inventory of housing supply will help encourage fluidity across the continuum, and will maximize the effectiveness of various types of housing in alleviating core housing need, across the lifespan of the stock.

- **Mechanism in the toolkit: Tax incentives to encourage small landlords to sell to not-for-profit providers**

This is potentially the largest inventory in the existing stock that is already affordable without ongoing federal subsidies. There are approximately 400,000-500,000 units of existing affordable rental inventory in the private market available for potential sale. Much of this inventory is owned by families or individuals who do not have effective exit mechanisms for their asset, nor the incentive to continue to re-capitalize these assets, putting the affordability at risk. Purchasing this inventory and moving it into non-market ownership is one of the most economical approaches to increasing this inventory and maintaining it as long term affordable rental housing. Creating incentives for private landlords to sell this stock to providers with a mission to maintain affordability will ensure this segment of supply is preserved in the system. The present federal tax system essentially requires recapture of value appreciation, regardless of the nature of the purchaser. This tax policy virtually guarantees loss of much of this stock from the “affordable private rental” category, especially in high-growth markets and close to transit systems.

- **Mechanism in the toolkit: Patient equity and financing to support the acquisition of existing rental housing by non-profit organizations**

Equity and financing equipping not-for-profits to purchase existing stock would develop the capacity of the sector to open up new opportunities to grow the inventory of social housing stock. Both equity and financing for acquisition would be subject to underwriting criteria for the viability of projects.

- **Mechanism in the toolkit: Restored and expanded rental RRAP program**

The former rental RRAP program leveraged the investment of private landlords by providing favourable loan terms (including forgivable loans) in exchange for assured affordability to tenants. This program should be renewed and expanded to incent the preservation of existing affordable housing stock; RRAP programs could also be expanded to be applicable to affordable home ownership.

- **Mechanism in the toolkit: Equalized tax treatment for all forms of secondary or accessory suites**

Current GST rules in the context of secondary or accessory suites strongly favour some forms of accessory dwellings, namely suites in part of or attached to the principal dwelling, while discouraging others, such as garage or garden suites not physically connected to the principal dwelling. They also favour personal relationships between the homeowner and prospective occupant of the accessory suite, effectively removing it from the category of generally available rental housing. Making a more favourable tax treatment comparable regardless of the physical location of the accessory suite and the personal connection between owners and renters would stimulate building of unattached forms of accessory suites. That will encourage intensification while improving the adequacy of these alternative forms of housing and encouraging a broader array of individuals to engage in the production of well-located affordable rental options.

Outcome 4: Increase affordability in all tenure forms

Affordability is not the purview of any single part of the housing system. Ensuring the toolkit contains mechanisms that incent affordability through all parts of the continuum would contribute to choice and flexibility for households, and encourage fluidity across the continuum.

- **Mechanism in the toolkit: Monitor and extend the CMHC Rental Construction Financing Initiative (RCFI)**

The overall response of both industry commentators and participating firms and non-profit corporations to the introduction of the RCFI program has been very positive, although much remains to be done on the ground. The program should be monitored and iterated, beginning in 2018-19 to reflect learning from the experience from 2017-18, and extended to become an ongoing tool of federal rental housing support, rather than perpetuating the stop-start nature of previous initiatives in this field.

Ongoing monitoring should be conducted in collaboration with both actual and potential participants, as well as experts in the rental-housing field. Specific elements for ongoing monitoring and evaluation include: 1) How well the program as designed is working for different applicants, whether for-profit or non-profit; 2) What rental affordability outcomes are being achieved; 3) Whether co-financing of mixed-income projects is facilitated or inhibited; 4) Whether the RCFI is responding to local market conditions and encouraging the creation of affordable stock where it is most needed; 5) Whether current restrictions on commercial uses are achieving desirable outcomes, especially in relation to public transit; 6) Whether RCFI as designed is readily able to link with other affordability measures available for provincial, territorial and municipal governments so that effective capital stacking can increase affordability and the impact of new housing; 7) The efficiency and impact of the application-review process and point-scoring system. For instance, a too-rigorous application system may inadvertently reduce potential affordability outcomes if it results in delays in land acquisition, construction and/or reduced competition among providers.

- **Mechanism in the toolkit: Equity funds for affordable home ownership**

Ensuring the range of equity mechanisms apply to the creation of affordable home ownership will improve access to home ownership for low- and moderate-income households. An estimated 240,000 units of rental supply each year are generated by moves from rental into first-time home ownership. This is the largest single short-term contribution to rental supply, dwarfing all other sources. Some affordable home ownership providers, such as Habitat for Humanity, transition households from social housing into affordable homeownership, and thereby contribute directly to the reduction of social housing waiting lists and the number of households in core housing need.

Equity funding would also allow affordable homeownership providers to scale up production. Affordable homeownership providers have self-sufficient models that do not rely on long-term public subsidies, would leverage government equity with other funds or support and generate equity to fund future supply.

- **Mechanism in the toolkit: CMHC loan insurance**

Broaden access to low-cost mortgage insurance for all levels of affordable housing, by extending the availability of CMHC loan insurance to developers achieving shallower overall project affordability. This will encourage developers to offer below market rents on a selected number of units. This mechanism will be useful to both profit and not-for-profit developers, encouraging mixed-income communities.

- **Mechanism in the toolkit: Federal lands and infrastructure policy**

In addition to making federal lands available for the production of affordable housing, the federal government should build a policy connection between its infrastructure spending (in particular for expanded urban transit systems) and the use of funds and lands acquire for this infrastructure, and set as a condition of funding that local policies be in place to support the development of mixed uses in transit corridors including meetings particular targets for affordable housing.

Implementing measures in housing supply

The following guidelines frame the shift from programmatic to systemic intervention. They can shape the detailed design and implementation of the recommendations listed above.

Keep a full, balanced toolkit – Equity, financing, grants, lands and tax mechanisms all have a specific role to play to promote and enable a healthy housing system.

Organize around outcomes, not process – To encourage entrepreneurialism and responses tailored to the local market situation.

Tie eligibility to viability and outcomes, not provider type – Making tools accessible to non-profit, social and co-operative housing developers, provinces/territories and municipalities, as well as to private developers who may work in concert with not-for-profit organizations or independently, will encourage the whole continuum to contribute to the overall affordability of housing stock. Applying underwriting conditions on accessing funding will ensure applicants develop viable projects.

Shift policy focus from new supply to the life cycle of inventory – Buildings are most expensive when they are new. Intervention in supply should not be limited to the creation of new supply but should assist the market to make its own adjustments and circulate stock across the affordability continuum.

Apply a sliding scale of favourability for affordability – Mechanisms should be flexible to ensure the level of assistance offered can be tied to the level of affordability achieved, promoting mixed-rent and mixed-income projects. This can be within a development or across multiple developments and supports the intent of creating mixed income and diverse communities. There is welcome and increasing resort to public-private partnerships and joint ventures between non-profit and for-profit providers to build such communities.

Government investments should be financially sustainable – Government investment in housing should privilege mechanisms that are patient, but that return funds over time to amplify investment through recycling of funds back into the system.

Supporting actions

Interventions in housing supply will be significantly influenced by complementary actions that can be taken by the federal government, within and beyond the National Housing Strategy. The following actions will amplify the impact of successful supply measures:

Implement a portable housing benefit – A portable housing benefit paid directly to tenants will enable adoption of conventional project financial structures across the housing continuum, by separating the development economics of housing from the provision of funds to support affordability for low-income households.

Encourage vertically aligned multi-level strategies – Federal/provincial/ territorial efforts are aligned through Investments in Affordable Housing to leverage investment on affordability and homelessness. The Homelessness Partnering Strategy model is also designed to align the efforts of multiple orders of government towards shared, locally flexible and nationally directed outcomes. Expanding this partnership model will facilitate overall housing system health by directing federal funding towards defined outcomes. For example, federal tax measures facilitating the acquisition of affordable rental stock by not-for-profit providers will be amplified by municipal incentives in waiving of the land transfer tax on said purchases. Consider imposing conditions on federal funding accessible to municipalities or provinces around policy outcomes, realized through a community-based framework. Aligning federal-provincial/territorial-municipal strategies is the only way to realize nationally coherent policies.

Build on provincial models for success – Take full advantage of the benefit of the confederated model by expanding and recreating successful provincial programs, such as the B.C. construction financing model. The federal government could facilitate expansion of this program to interested provinces.

Apply a housing lens to all federal land-related transactions and infrastructure investments – Land is the largest variable cost affecting housing construction. Incorporating a housing lens into all relevant federal and associated provincial and municipal infrastructure investments could vastly expand the impact of the announced $202M for federal lands for affordable housing, and could be achieved through procurement requirements or through title.