



City of Peterborough

# Governance Alternatives for Community Housing Development

Final Report

February 5, 2021



# Executive Summary

## A. Introduction

Established in December 2000 as part of the devolution of social housing from the Province of Ontario to municipalities, the Peterborough Housing Corporation (“PHC”) is a leading organization for the administration and management of community housing (encompassing social and affordable housing) and other housing-related programs for households of low to moderate income in the City of Peterborough (the “City”) and the County of Peterborough (the “County”). Currently included within PHC’s portfolio of community housing are 910 rent-geared-to-income units and approximately 287 affordable housing units, with a further 85 units in development.

As the designated consolidated municipal service manager (the “Service Manager”) under the Housing Services Act (the “HSA”), the City is responsible for the development of an overall strategy for housing and homelessness, with its most recent strategy (the “Housing Plan”) covering the period from 2019 to 2029. In addition to other priorities, the Housing Plan identifies the need for 1,918 new affordable rental housing units in the City, with a further 762 affordable rental housing units elsewhere in the County, in order to meet all housing needs by 2029. While this level of new construction is arguably aspirational, it does identify the need for a significant increase in affordable housing in the City and County.

In recognition of the need for a significant investment in both new affordable housing units as well as the replacement of existing social housing units that are reaching the end of useful life and are in need of redevelopment, PHC has advanced a proposal intended to support the anticipated level of new construction activity. Specifically, PHC’s proposal calls for the establishment of a new not-for-profit corporation (“Newco”) that would be responsible for the construction, financing and operation of:

- Redeveloped social housing units (six sites representing a total of 311 units);
- The existing portfolio of affordable housing units currently owned by PHC (287 units); and
- Newly constructed market and affordable housing units (1,093 units).

If undertaken as proposed, Newco would ultimately own and manage just over 1,400 market and community housing units, with the total cost of construction estimated to be in the order of \$468 million.

Financing for the planned construction program envisioned under PHC’s proposal is expected to come from the National Housing Co-Investment Fund (the “Co-Investment Fund”), a component of the National Housing Strategy administered by the Canada Mortgage and Housing Corporation (“CMHC”). As the proposal involves a significant degree of debt financing (as much as 70% of construction costs or \$327 million), PHC recognizes the potential limitations on the proposed capital program arising from the City’s limitations to issue this quantum of debt (either directly or through the PHC) given its internal and external limits on borrowings. As a means of resolving this issue, PHC has proposed that Newco be structured and operate independently from the City, precluding the need for its debt to be factored into the City’s borrowing limitations.

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## B. KPMG Findings and Observations

In order to assess the potential benefits and risks associated with PHC's proposal, as well as evaluate the extent to which other alternative strategies may be available to the City, the City has retained KPMG to undertake an analysis of PHC's proposal. This report summarizes the results of our review, which are predicated on the assumption that the City will proceed with a community housing investment program of the magnitude proposed by PHC. To the extent that the City chooses to proceed with a lower level of capital investment, our findings will necessarily require revision.

Based on our review, we make the following comments and observations concerning PHC's proposal:

- We understand that the City's current efforts with respect to the Housing Plan are focused on the construction of rent-geared-to-income supportive housing, with a target of 580 units identified in the Housing Plan. As the construction of affordable housing appears to represent, at least in the short-term, a secondary priority for the City based on the limited level of resources available, the capital program proposed by PHC is considered to be consistent with the Housing Plan.
- PHC's proposal intends to rely on financing through the Co-Investment Fund, which provides favourable financial terms (50-year amortization period, below market interest rates for the first two ten-year terms, no municipal loan guarantees) and is being used by other municipalities and not-for-profits to support similar capital investment programs. In addition, PHC's proposal is based on densification of existing social housing sites, which is considered to be a best practice for community housing providers in Canada and internationally.
- In order to avoid the need for the City to consolidate long-term debt associated with existing and new community housing, PHC's proposal requires the City to significantly relinquish control over Newco and by extension, housing decisions. Currently, the City has control over a number of corporate decisions by virtue of its role as sole shareholder of PHC and the associated shareholder declaration, including but not limited to PHC's ability to purchase or sell land, PHC's ability to issue debt and the composition of the Board of Directors. Under PHC's proposal, the City's control over Newco would be limited to its authority as Service Manager with respect to Newco's social housing operations, with little to no control over Newco's much larger affordable housing activities.

From our perspective, the requirement for the City to significantly reduce its control over social and affordable housing is most significant element of risk associated with PHC's proposal and, while ultimately a political decision for Council, may preclude the adoption of PHC's proposed course of action. In addition, our analysis of the City's current and projected debt obligations and associated debt servicing costs indicates that it can likely issue the level of debt forecasted under PHC's proposal and still remain within its internal and external borrowing limits, which negates the need for Newco in the first place. Notwithstanding this ability, however, there is a benefit to reducing the City's reported outstanding debt by avoiding the need to include Newco's indebtedness.

# Executive Summary

## C. Potential Courses of Action

While the results of our analysis have identified a number of benefits associated with PHC's proposal, there are other alternatives can also be considered by the City with respect to its approach to redeveloping existing social housing and creating new affordable housing. Based on our evaluation of these alternatives, we suggest that the City consider a modification of the PHC proposal that would see affordable housing (including the management of PHC's existing affordable housing units and newly constructed units) reside within Newco, with all social housing remaining within PHC. Under this approach, Newco would qualify as a so-called government business enterprise under the City's financial reporting framework, which would allow the City to control Newco while at the same time exclude its debt from the determination of the City's borrowing limits. While debt related to social housing redevelopment would continue to be considered as part of the City's borrowing limits, the quantum of the debt and the favourable terms provided by the Co-Investment Fund are expected to allow the City to accommodate the additional debt without exceeding its internal or external limitations on borrowings.

If the City chooses to proceed with this course of action, we suggest that implementation activities include:

- Establishing a municipal services corporation pursuant to the requirements of Ontario Regulation 599/06, which includes the appointment of the Newco board and the development of the required business case, asset transfer policy and service agreements between Newco, PHC and the City;
- Continuing the strategies outlined in the Housing Plan for affordable housing construction that can consider (i) direct construction by Newco; (ii) third-party development models (i.e. reliance on the private sector); and (iii) joint venture, limited partnership arrangements and other joint approaches to development;
- Assessing the current capacity for project management in support of affordable housing development and social housing redevelopment, with additional resources secured as required; and
- Commencing the application process for financing from the Co-Investment Fund.

# Introduction to the Review

## A. Overview of the City's Mandate for Community Housing

The City's involvement in the delivery of housing services is mandated by the HSA, which designates the City as the Service Manager for the City and County. Pursuant to Section 6(1) of the HSA, the Service Manager is required to have a plan to address housing and homelessness, which must include:

- An assessment of the current and future housing needs within the Service Manager's service area;
- Objectives and targets relating to housing needs;
- A description of how progress towards meeting the objectives and targets will be measured; and
- Other matters as prescribed by the Ministry.

The HSA further requires that the housing plan, which must cover a minimum planning horizon of ten years, address both (i) matters of Provincial interest which are defined in Section 4 of the Act; and (ii) policy statements issued by the Province with respect to housing.

In keeping with the requirements of the HSA, the City as Service Manager completed the Housing Plan, which outlines the City's priorities over the ten year planning period (2019-2029). The Housing Plan identifies two key priorities – ending homeless and staying housed and building housing – with the construction of 580 supportive housing units, 2,680 new rental units and 796 new homeownership units identified as being required to meet all housing needs in the City and County. With respect to the construction of new housing, the Housing Plan identifies nine key actions that are expected to contribute towards the targeted number of new housing units, which encompass financial incentives, planning and other legislative changes to encourage and facilitate new construction, partnerships with private and not-for-profit organizations and other strategies.

At the present time, the City's dedicated resources for housing and homeless are limited and primarily focused on the construction of new supportive housing.

## B. Organizational Structure

While the City is the Service Manager for housing services, a number of different organizations are involved in the actual delivery of programming, most notably the City's Social Services Division and PHC.

## Introduction to the Review

- **Housing Program (Social Services Division)** – The City’s Housing Program is a functional unit within the Social Services Division and is tasked with a range of housing services, including:
  - The development of housing plans, strategies and analysis for all aspects of housing continuum;
  - The administration of the Investment in Affordable Housing (“IAH”) and other special programs;
  - Since July 2020, the administration of the wait list for social housing (Housing Access Program), which was previously administered by PHC; and
  - The administration of financial subsidies to third party social housing providers, including Peterborough Housing Corporation (“PHC”).
- **Peterborough Housing Corporation** – PHC was established in December 2000 in response to the passing of the Social Housing Reform Act (“SHRA”), the enabling legislation for the transfer of social housing from the Province to the 47 service managers (comprising of 37 upper or single tier municipalities and 10 district social services administration boards [“DSSAB”]). Pursuant to the SHRA, approximately 84,000 public housing units were devolved to Ontario municipalities effective January 1, 2001, including more than 700 units that were transferred to PHC.

In order to manage the relationship between the City (as Service Manager), PHC (as owner and operator of the actual social housing units) and the Province (as the ultimate funder of Service Managers), a shareholder declaration was executed, the purpose of which is to prescribe the nature of the relationship between PHC and the City (in its capacity as both shareholder and Service Manager), including stipulating provisions with respect to decision-making, financial management and reporting.

The scope of PHC’s activities and responsibilities include, but are not limited to, the following:

- The ownership and management of social housing units;
- The ownership and management of affordable housing units;
- The ownership and management of other housing initiatives, including supportive housing, assumed by PHC over time;
- The administration of the Service Manager’s commercial rent supplement program, which provides payments to third party landlords on behalf of clients in need of housing;
- Administrative functions associated with PHC’s client-facing activities; and
- Capital redevelopment activities, including capital planning, procurement and project management of construction projects.

# Introduction to the Review

Financial information relating to PHC's activities for the 2019 fiscal year is summarized below.

(in thousands of dollars)	Social Housing	Affordable Housing	Other Housing	Rent Supplement	Capital	Housing Access Program	Total
<b>Revenues:</b>							
• City subsidy	2,886	–	814	1,673	2,439	146	7,958
• Rent and other sources	5,365	2,251	840	32	134	–	8,622
<b>Total revenue</b>	<b>8,251</b>	<b>2,251</b>	<b>1,654</b>	<b>1,705</b>	<b>2,573</b>	<b>146</b>	<b>16,580</b>
<b>Expenses:</b>							
• Operating expenses	7,114	1,069	705	–	–	146	2,669
• Major repairs	–	46	21	–	662	–	729
• Interest on long-term debt	–	535	51	–	–	–	586
• Rent supplements	–	–	–	1,588	–	–	1,588
<b>Total expenses</b>	<b>7,114</b>	<b>1,650</b>	<b>777</b>	<b>1,588</b>	<b>662</b>	<b>146</b>	<b>11,967</b>
<b>Excess (deficiency) from operations</b>	<b>1,107</b>	<b>601</b>	<b>877</b>	<b>117</b>	<b>1,911</b>		<b>4,613</b>
Capital expenditures/transfers	(1,096)	–	–	–	1,113	–	17
Debt financing	–	–	–	–	4,373	–	4,373
Contributions to reserves	(2)	(35)	(330)	–	(8,364)	–	(8,731)
Debt principal repayments	(7)	(584)	(479)	–	–	–	(1,070)
Other adjustments	8	–	–	–	–	–	8
<b>Net change in surplus</b>	<b>10</b>	<b>(18)</b>	<b>68</b>	<b>117</b>	<b>(967)</b>		<b>(790)</b>

# Introduction to the Review

## C. Overview of the PHC Proposal

PHC has submitted a proposal to the City that outlined an alternative approach to governance of community housing that would support both the redevelopment of PHC's social housing stock as well as the construction of new affordable housing. Specifically, PHC proposed the establishment of Newco, a not-for-profit corporation controlled by the City that would be responsible for the management of PHC's existing affordable housing units, the construction of new affordable housing units and the redevelopment of social housing units that have reached the end of their useful lives. In support of its activities, Newco would retain a CEO and would also hire managers for finance and redevelopment functions.

The key benefit of the proposed governance structure was cited as the ability to incur debt in Newco without the need to consolidate this debt with the City's, thereby avoiding any constraints imposed by the City's debt servicing limits. However, initial due diligence indicated that this would not be possible if the City retained control of Newco due to the financial reporting requirements established by the Public Sector Accounting Board ("PSAB"). In response, PHC revised its proposal to reflect the fact that the City would not retain control of Newco; rather, it would be established as a not-for-profit corporation without share capital.

The initial proposal submitted by PHC focused primarily on the governance aspects of the new corporation, with limited information concerning the scope of activities to be undertaken by Newco (although the proposal did refer to PHC's Capital Finance and Community Revitalization Plan). However, during the course of our review, we were provided with additional information concerning the proposal, which anticipates the following:

- The redevelopment of 311 social housing units and the construction of 1,093 market and affordable units (assumed to be 15% market and 85% affordable) over a ten-year period, conducted in three separate phases. Each phase is expected to require two years to complete.
- The construction of market and affordable units would occur on the same properties as the existing social housing units, providing for greater densification of the properties.
- The estimated cost per unit would be in the range of \$323,000 to \$347,000, depending on the timing of the construction. We were advised that this cost is based on PHC's most recent experience with the construction of housing units and includes construction costs, soft costs, demolition and site preparation.
- PHC has assumed that 70% of capital costs will be funded through the Co-Investment Fund, with the remaining 30% funded through grants, City contributions towards construction in the form of waivers of building permit fees and development charges, and other sources.

As summarized on the following page, the proposed capital program for Newco has an anticipated capital cost of \$467.7 million over the ten-year planning period, of which \$327.3 million will be financed through debt.



# Introduction to the Review

Phase	Number of Units				Cost per Unit	Total Cost (in millions)	Debt Financing (in millions)
	Social	Affordable	Market	Total			
Phase 1	78	374	66	518	\$323,000	\$167.3	\$117.1
Phase 1(a)	–	90	16	106	\$323,000	\$34.2	\$23.9
Phase 2	138	199	35	372	\$335,000	\$124.6	\$87.2
Phase 3	95	266	47	408	\$347,000	\$141.6	\$99.1
<b>Total</b>	<b>311</b>	<b>929</b>	<b>164</b>	<b>1,404</b>		<b>\$467.7</b>	<b>\$327.3</b>

# Option Analysis

## A. Evaluation Considerations

For the purposes of our review, and consistent with the terms of reference for our engagement, we have evaluated PHC's proposal, along with other potential strategies that could be considered by the City, based on the following considerations:

### 1. Control

Given the significance of housing and homelessness to the City, as well as the City's overall responsibility for as Service Manager, we have considered the extent to which potential strategies affect the City's control over housing initiatives and services. While the HSA does provide the Service Manager with authority over housing strategy and some control over the activities of not-for-profit housing providers, the degree of control is not as extensive as that provided by the City's role as sole shareholder of PHC, which is defined in the Shareholder's Declaration and Ontario Business Corporations Act. We further understand that the City's authority as Service Manager under the HSA only applies to social housing (i.e. rent-g geared-to-income) and does not extend to affordable housing activities. As a result, potential governance models that result in the City exercising control as shareholder are viewed more favourably than options where direct shareholder control is not present, limiting the City solely to the authority granted to it as Service Manager under the HSA.

### 2. Consolidation of Debt

Pursuant to Ontario Regulation 403/02: Debt and Financial Obligation Limits (the "Regulation"), all Ontario municipalities are subject to a limitation on the amount of debt financing incurred, with annual debt servicing costs (principal and interest) limited to a maximum of 25% of the municipality's own-source revenues. The City's debt servicing limitations under the Regulation are calculated annually as part of its Financial Information Return (Schedule 81), with the most recent Financial Information Return (2019) indicating that the City had a total of \$19 million in annual debt servicing costs as compared to \$57 million in available debt servicing capacity, resulting in a total of \$38 million in available debt servicing capacity.

In addition to the debt limit established under the Regulation, the City has also implemented its own limit on borrowings which considers a lower level of allowable debt servicing costs as well as additional financial commitments that are excluded from considered under the Regulation. Specifically, the City's internal limit caps tax-supported debt (which is funded through the taxation levy as opposed to user fees) at 8% of its own-source revenues, while rate supported debt (which is funded through user fees and other non-taxation sources) is capped at 7% of its own source revenues. In addition to providing a lower limit than the Regulation (15% vs. 25% under the Regulation), the separation of debt capacity between tax supported and non-tax supported debt can provide an additional limitation as unused debt capacity in one category cannot offset exceedances in the other.

At the end of the 2019 fiscal year, the City's internal debt servicing calculations indicated \$3.9 million in tax-supported debt servicing capacity, with \$2.0 million in available debt servicing capacity for tax-supported debt.

## Option Analysis

The determination of the City's debt servicing payments are based on the formula outlined in the Regulation, which considers the amount of reported debt servicing payments (i.e. debt included in its financial statements) as well as debt commitments approved by Council but not yet finalized. As noted earlier in our report, PHC has identified the ability to not include Newco debt in the City's financial statements – and by extension the determination of its borrowing capacity – as a key benefit of its proposal. The determination of whether debt is included or excluded from the City's financial statements is based on two considerations:

- The nature of the relationship between the City and the entity incurring the debt; and
- The nature of the entity incurring the debt.

Generally speaking, not-for-profit entities that are controlled by a municipality are considered to be part of the so-called government reporting entity and are consolidated, with the assets, liabilities, revenues and expenses combined with the municipality's for the purposes of financial reporting. Not-for-profit entities that are not controlled are generally not consolidated with the municipality. However, some entities may qualify for treatment as a government business enterprise, which are not required to be consolidated even if municipal control exists. In order to qualify as a government business enterprise, the entity must have all of the following characteristics as defined by PSAB:

- It is a separate entity with the power to contract in its own name and that can sue and be sued;
- It has been delegated the financial and operational authority to carry on a business;
- It sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity; and
- It can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

As government business enterprises are not consolidated, their debt is not consolidated with the controlling municipality's financial statements and as such, does not impact on borrowing limits. The City's investment in City of Peterborough Holdings Inc. ("Holdings") is classified as a government business enterprise, with Holdings long-term debt of approximately \$123 million not consolidated with the City's financial statements and as such, excluded from its debt capacity calculations.

For the purposes of our review, potential governance models that alleviate pressure on the City's borrowing capacity are viewed more favourably than options that result in an increase in reported debt servicing costs.

# Option Analysis

## 3. Other Considerations

In addition to the key evaluation considerations of control and debt consolidation, our evaluation of PHC's proposal and other potential strategies available to the City considers the following secondary considerations:

- *Consistency with best practices* – Is the governance model aligned with best practices for community housing providers?
- *Consistency with available resources* – Is the governance model feasible given the resources and capabilities of the entities involved?
- *Impact on operating costs* – Will the governance model result in a significant increase in operating costs, potentially diverting resources from client-facing activities?

## B. Evaluation of PHC Proposal and Other Alternatives

Based on our review, we make the following comments and observations concerning PHC's proposal:

- While the proposal achieves the objective of excluding any debt incurred in connection with the redevelopment of existing social housing units and the construction of new affordable housing, this would be accomplished through the relinquishment of City control over Newco, rather than its establishment as a government business enterprise. As noted in the summary of PHC's financial results provided earlier in our report, PHC's social housing operations require financial support from the City in order to meet its operating costs and as a result, the inclusion of social housing operations in Newco would preclude it from qualifying as a government business enterprise.
- While contingent on the position adopted by Council, we suggest that the relinquishment of control by the City is not without risk as the absence of control would preclude the City from directly or indirectly controlling the construction of affordable housing. As a result, the City would not be able to control the pace at which affordable housing is constructed nor could it influence the level of associated debt, either by limiting affordable housing construction or requiring alternative approaches, most notably third party development arrangements where the private sector is involved in affordable housing construction. Notwithstanding the absence of control, we additional risk likely exists in the event of a failure of Newco, which may require the City to assume its operations in some form, including the potential for the City to assume responsibility for any outstanding debt
- In addition to issues surrounding control, we suggest that the use of a separate corporation that is not controlled by either the City or PHC can increase the overall cost of administering affordable and social housing by establishing duplicate functions, including separate governance boards, senior management positions (CEO) and finance functions at the onset of Newco's operations. The potential may also exist for Newco to further add staffing and internal capacity as opposed to relying on shared service arrangements with PHC or the City, resulting in further duplication of resources and cost increases.

## Option Analysis

While PHC's proposal outlines one potential governance model for the City's consideration, we have identified the following alternative structures that could be considered by the City:

- **Modified Newco structure** – This alternative, representing a modification of PHC's proposed governance structure, would see Newco assume responsibility for the existing affordable housing portfolio managed by PHC, as well as future affordable housing to be constructed. Social housing, including newly developed units, would remain within PHC. As affordable housing generates sufficient revenues from third parties (i.e. rental revenue from tenants) to fund its operating costs and debt servicing requirements, we believe Newco may qualify as a government business enterprise under this option. As a result, the City could continue to control Newco while at the same time avoiding the need to incorporate its debt into the consideration of its borrowing capacity. In addition, the City's control over Newco would allow it to achieve operating efficiencies through the sharing of personnel and support functions with the City of PHC.
- **Full Separation of PHC** – This alternative would see PHC restructured as a separate not-for-profit corporation that would not be controlled by the City but rather have full autonomy for its operations. This option would have the same associated benefits and risks as PHC's proposal but rather would encompass the full extent of PHC's operations and not just the social housing units slated for redevelopment and affordable housing units.
- **Full Integration with the City** – Under this alternative, all responsibility for community housing would be assumed by the City's Housing Program within the Social Services Division, with PHC either dissolved or repurposed as a property holding company. While this provides for the fullest extent of direct control by the City and also reflects best practice for housing providers (we understand that 37 of 47 service managers have adopted this approach), it would require the City to directly issue debt for social housing redevelopment and the construction of new affordable housing, significantly impacting its borrowing capacity. At the same time, the City has limited resources with respect to the management and delivery of community housing services and as such, may not have the resources or capabilities necessary to support this option.
- **Status Quo** – The City may, at its discretion, continue with the current governance structure, with any debt associated with the redevelopment of social housing units and the construction of new affordable housing units issued by the PHC. While this would require the City to continue the consolidation of PHC's debt and include it in its debt capacity determination, our analysis indicates that the City may have the available debt capacity to support the issuance of new debt under its current limitations and if not, could revise its internal threshold to accommodate a higher level of debt. At the same time, this option continues to provide for City control over housing decisions by virtue of its role as the sole shareholder as well as service manager while avoiding significant change to staffing and other aspects of service delivery.

Our overall evaluation of these options is summarized on the following page.

# KPMG Comments and Observations

Evaluation Consideration	Option					Notes
	PHC Proposal	Modified Newco Structure	Full Separation of PHC	Full Integration With City	Status Quo	
Does the option provide City control over housing decisions, including the scope of construction activity and debt issuance?	◐	●	○	●	●	The options involving the Modified Newco Structure, Full Integration with the City and Status Quo provide direct City control over housing and as such, have been rated the highest. The PHC proposal, while providing the City with control over the PHC, does not provide for City control over Newco and as such is seen as partially effective. The Full Separation of PHC would relinquish any City control other than that afforded it by its role as Service Manager and have been rated least effective.
Does the option allow the City to avoid the consolidation of debt and as such, reduce pressure on its borrowing capacity?	●	◐	●	○	○	PHC's proposal would see all debt assumed by Newco which, as a non-controlled entity, would not be consolidated with the City. Similarly, Full Separation of PHC would result in a relinquishment of City control and precluding consolidation as well. The Modified Newco Structure would result in debt related to affordable housing construction (\$254 million) to be excluded from consolidation (as Newco is expected to qualify as a government business enterprise), while debt associated with social housing redevelopment (\$73 million) would remain in PHC and as such, be consolidated with the City. Under Full Integration with the City and Status Quo, all debt

● Fully effective in meeting consideration    ◐ Partially effective in meeting consideration    ○ Least effective in meeting consideration



# KPMG Comments and Observations

Evaluation Consideration	Option					Notes
	PHC Proposal	Modified Newco Structure	Full Separation of PHC	Full Integration With City	Status Quo	
Could the option contribute to an overall increase in administrative costs for housing services?	○	◐	●	●	●	The PHC proposal anticipates that Newco will retain a CEO and finance function, resulting in duplication of efforts with PHC. While the Modified Newco Structure results in some duplication (e.g. separate corporation requiring audit), we suggest that administrative functions can be undertaken on a shared service basis with either the City or PHC, limiting the potential for duplication of effort. Under the remaining three strategies, all activities would be undertaken by a single organization (either PHC or the City), reducing the likelihood of duplication of work efforts.

The results of our evaluation have identified the Modified Newco Structure, representing a modification of PHC’s proposal, to be the highest rated strategy based on the following considerations:

- The City is able to retain control over Newco by virtue of being the sole shareholder;
- As Newco is expected to qualify as a government business enterprise, any debt incurred by Newco is not expected to be considered as part of the City’s debt capacity limitations. While debt related to social housing redevelopment is not expected to be included within Newco, and as such would be included in the determination of the City’s debt servicing capacity, it is not expected to result in an exceedance of the City’s current limits; and
- Shared service arrangements (as discussed in more detail in the next chapter) provide the potential to reduce administrative costs associated with Newco.

● Fully effective in meeting consideration      ◐ Partially effective in meeting consideration      ○ Least effective in meeting consideration



## Potential Courses of Action for Consideration

In the event that the City chooses to proceed with the establishment of Newco as a government business enterprise responsible for the management and construction of affordable housing, we suggest that the following courses of action be considered.

**1. Pre-establishment activities.** We understand that the establishment of Newco is permitted under Ontario Regulation 599/60: Municipal Services Corporations (“O.Reg 599”), which requires the City to:

- Develop a business case for Newco;
- Consult with the community about the plan to create Newco; and
- Adopt and maintain policies with respect to the transfer of assets.

The requirement for an asset transfer policy establishes the framework for the transfer of land on which future affordable housing units will be constructed, as well as the ownership of existing affordable housing units owned by PHC. In determining the asset transfer policy, consideration will need to be given to (1) the valuation of assets transferred by PHC to Newco, which will likely require property appraisals; and (2) the consideration to be received by PHC from Newco (e.g. note receivable). As part of the asset transfer policy, the City may wish to evaluate alternative approaches to land title, including (1) severing properties into separate parcels for social and affordable housing; and/or (2) having PHC lease property to Newco (e.g. 99-year master leases) that avoids the need for title transfer.

In addition to the requirements associated with establishing Newco as a corporate entity, we also suggest that the City consider finalizing a more detailed strategy with respect to affordable housing development. We understand that the goals established in the Housing Plan are intended to address all housing needs in the City and County and as such, can arguably be viewed as aspirational. At the same time, the PHC proposal and Modified Newco Structure both anticipate direct involvement by Newco in the construction and operation of affordable housing, which may not necessarily represent the preferred approach to affordable housing development. While the approach proposed by PHC is reflective of common/best practices for community housing providers through its focus on densification of social housing sites, it does not consider the potential for third party development models, examples of which are included on the following page.



## Potential Courses of Action for Consideration

- *Direct private sector ownership*, which would see the Newco sell or lease the subject parcels of land to third party developers for the construction of affordable and market units. The use of a direct private sector ownership model is intended to result in risk transfer from Newco, with the private sector party responsible for cost overruns, interest rate increases, lower than expected vacancy and other potential adverse financial conditions associated with the construction and operation of the affordable housing units. In exchange for this risk transfer, however, Newco would forgo future income or equity appreciate in the affordable housing units and would also not be involve in operational decision making for the affordable housing units.
- *Joint venture arrangements*, which would involve the Newco enter into a business arrangement with a private sector third party. In connection with the joint venture, Newco would contribute value in the form of the land for redevelopment which would determine Newco's pro-rated interest in the joint venture. The joint venture would be the corporate vehicle for the construction and operation of the affordable housing units, with profits and risks divided between Newco and the private sector operator based on their proportionate contributions to the joint venture. Potential liabilities would also be shared based on the proportionate interest in the joint venture, providing a measure of risk-sharing with the private sector in the event of a business failure or other adverse event.
- *Limited partnership arrangements*. A limited partnership structure would have Newco acting as a limited partner, with a private sector developer operating as a general (or operating) partner. As a limited partner, Newco would be required to make a contribution towards the affordable housing projects (presumably the value of the land for redevelopment), with the general partner responsible for the overall management of the construction and operation of the affordable housing units. While similar to a joint venture agreement, the use of a limited partnership caps Newco's potential exposure to liability to the amount of its initial contribution in the event of a business failure (although limited partnership agreements often include provisions for ongoing cash calls), and also defines the income distribution to limited partners.
- *Partnership arrangements*. The use of a partnership arrangement is similar to a joint venture in terms of the proportionate sharing of risks and return with the private sector, although using a different corporate vehicle.

In determining what, if any, private sector development model to adopt, we suggest that sufficient due diligence be undertaken to ensure a comprehensive understanding of the respective risks and benefits associated with each model.

During the course of our review, we were advised by representatives of PHC that they would be open to alternative models of developing affordable housing and we suggest that a formal strategy be developed as an immediate objective.

As part of the development of a more detailed strategy for housing development, the City may also wish to commence the process for obtaining financing through the Co-Investment Fund and other sources, which we understand may take between eight months to a year to complete. Additionally, we understand that the Co-Investment Fund requires projects to be completed by 2028, which suggests that time is of the essence if the City wishes to access funding under the program.

## Potential Courses of Action for Consideration

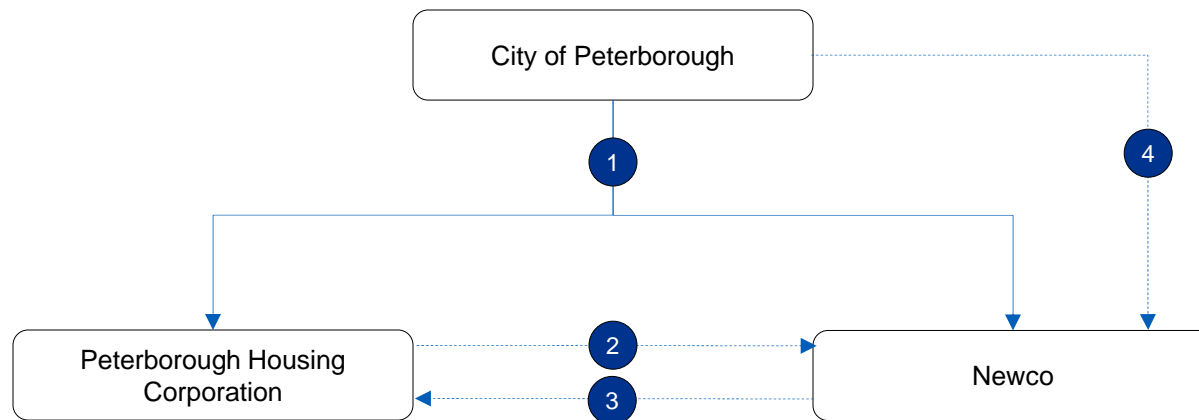
- 2. Incorporate Newco.** While subject to the wishes of the City and contingent upon the results of the pre-establishment activities noted earlier in our report, the City may wish to consider establishing a holding company structure for Newco that would involve the following:
- The incorporation of one corporation to act as a holding company (“Holdco MSC”) to hold the City’s equity ownership interest in the Operating MSC (as hereinafter defined). The issued and outstanding shares of Holdco MSC would be owned by the City. The establishment of Holdco MSC is intended to facilitate potential initiatives involving other municipalities or the private sector and/or the establishment of additional municipal service corporations for housing initiatives.
  - The incorporation of a second corporation to act as an operating company (the “Operating MSC”) for the management and construction of new affordable housing.

From a governance perspective, consideration could be given to having Council act as the board of directors for Newco/Holdco MSC/Operating MSC. This would ensure alignment between the City’s priorities for housing and the activities of Newco. Additionally, the City could consider including board members with applicable skills (finance, construction, legal, project management) to provide added skills from a governance perspective. While we appreciate that a board of directors is in place for PHC, our experience demonstrates that local housing corporation boards act in more of an advisory capacity, which we believe may not necessarily be consistent with the significant level of construction activity and financing anticipated for Newco over the next ten years.

- 3. Enact policies for governance and operations.** Upon the establishment of Newco, we suggest that the City consider the development of policies relating to the governance and operation of Newco, including the following:
- A *Shareholder’s Declaration*, which define the roles and responsibilities of Newco with respect to its involvement in housing services and the City’s role in its governance as sole shareholder. We suggest that the shareholder’s declaration include, but not be limited to, Newco’s reporting requirements and decisions that require consent of the City as shareholder (property acquisition and disposition, capital programs, debt issuances, etc.).
  - An *Administrative Services Contract* between the City, PHC and Newco for the delivery of certain functions under a shared service arrangement, including finance, information technology, human resources and project management for new construction activities (which can be provided by Newco to PHC). Additionally, we suggest that the Administrative Services Contract address the role of Newco’s CEO, which could be a member of the City’s senior management team as opposed to a newly created position.
  - A *Property Management Services Contract* between the PHC and Newco for property management of the existing affordable housing stock that is expected to be transferred from PHC to Newco. This will avoid the need to either transfer staff from PHC to Newco or for Newco to hire personnel to manage its stock of affordable housing.

# Potential Courses of Action for Consideration

Based on the potential courses of action outlined on the previous pages, the proposed organizational structure for social and affordable housing is outlined below.



- Ownership and management of social housing units, including units slated for redevelopment
- Financial results are consolidated with the City
- Debt servicing costs are included in the determination of the City's borrowing limits

- Ownership and management of affordable housing units
- Qualifies as a government business enterprise and as such, financial results are not consolidated with the City
- Debt servicing costs are excluded from the determination of the City's borrowing limits

1. The City is the sole shareholder of PHC and Newco and controls the organizations pursuant to the provisions of the Shareholder's Declaration and Ontario Business Corporations Act.
2. PHC provides administrative support services to Newco under an administrative services contract, with property management services for Newco's affordable housing units under a separate project management services contract.
3. Newco retains project management resources for all development activities (social housing and affordable housing) and provides them to PHC on a fee-for-service basis. Alternatively, project management resources could be retained within PHC or the City and provided to Newco on a fee for service basis.
4. The City provides senior management (CEO) oversight and additional administrative support to Newco under an administrative services contract.

# Implementation Timeframe

We have presented below a suggested implementation timeframe for the development of Newco and associated activities.

Action Item	2021												2022									
	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	
Council approval of suggested course of action			█																			
Newco pre-establishment activities (business case, consultation, asset transfer policy)			█	█	█	█	█	█	█	█	█											
Review and selection of development model (direct, private sector)			█	█	█	█	█	█	█	█												
CMHC application and negotiations for funding			█	█	█	█	█	█	█													
Incorporation of Newco												█										
Development of Newco policies and agreements								█	█	█	█	█	█									
Solicit private sector involvement (if required)													█	█	█	█	█	█	█	█	█	
Commencement of construction																					█	

## Risk Considerations

While the PHC proposal, modified to reflect only the transfer of affordable housing units to Newco (as opposed to affordable and social housing units), is expected to allow the City and PHC to proceed with the development of additional affordable housing units while avoiding the constraint of the City's allowable debt servicing, there are potential risks that are associated with the strategy.

### **A. Newco does not qualify as a GBE, resulting in the inclusion of affordable housing debt in the City's determination of its borrowing limits**

In the event that Newco does not qualify as a GBE, either at inception or in subsequent financial periods, its status would revert to a government not-for-profit entity that would need to be consolidated with the City's financial statements. As such, Newco debt would be included in the determination of the City's borrowing limit, potentially constraining borrowing for other municipal purposes.

The results of our analysis indicate that Newco should qualify as a GBE upon inception, based on the following considerations:

- The designation as a GBE for new entities is often determined based on financial projections as opposed to the requirement for historical operating results. In addition, general practice allows for newly established GBE's to incur operating losses during their start-up phase without losing their designation.
- PHC's financial statements indicate that its affordable housing activities generate sufficient revenues to cover operational requirements, with no financial support provided by the City.
- Financial modeling associated with the proposed development of additional affordable housing units indicates that Newco is expected to continue to generate positive operating cash flows, negating the need for financial support from the City. Specifically, the favourable terms associated with financing from the Co-Investment Fund (below market interest rate, extended amortization period) are expected to reduce debt servicing costs.

We understand that the City has consulted with its external auditors, who have indicated their concurrence that Newco would qualify as a GBE.

With respect to the ongoing designation of Newco as a GBE, guidance provided by the Public Sector Accounting Board Discussion Group indicates that the designation of a GBE is not determined based on short-term considerations but rather longer-term factors relating to the financial sustainability of the entity.

## Risk Considerations

**B. The transfer of affordable housing out of PHC adversely impacts PHC's financial position and performance, resulting in increased financial support required from the City**

While affordable housing activities represent a significant component of PHC's operations, the results of our analysis indicate that the transfer of affordable housing to Newco is not expected to result in a significant adverse impact to PHC based on the following considerations:

- Surpluses generated by affordable housing are not used to finance PHC's other activities but rather are designated to a specific reserve fund.
- The business case analysis for Newco is based on the assumption that Newco would purchase certain services from PHC, specifically property management, project management and finance, which would provide a revenue source to PHC.

**C. The City would be required to guarantee the debt of Newco, resulting in the inclusion of the debt servicing costs for affordable housing in the determination of the City's borrowing limits**

The level of equity to be contributed by Newco in the form of land and other contributions and the projected debt servicing coverage for Newco is expected to avoid the need for a guarantee by the City of the Newco debt. In addition, the use of a private sector development model, as opposed to direct ownership by Newco, would further reduce the potential for significant loan guarantees by the City.

## Risk Considerations

### **D. The City would be required to provide additional financing to Newco, either at the time of construction or during the ongoing operating period**

As with any business venture, there is the potential for additional financial requirements from the City in relation to the construction and operation of new affordable housing units. However, these risks need to be assessed based on the projected operating results for Newco, which reflect the following:

- Based on the level of equity inherent in the land and other contributions to be provided by the City, PHC and Newco, the preliminary financial model indicates that Newco could support a higher level of debt financing that anticipated in PHC's proposal. Accordingly, Newco may be able to fund cash flow requirements through debt as opposed to a financial contribution from the City.
- The historical operating results for PHC's affordable housing units indicate that they have operated without a subsidy from the City or PHC, with the expectation that future affordable housing developments would have similar financial results.
- The proposed financing from the Co-Investment Fund is expected to have favourable repayment terms, including below-market interest rates for the first 20 years of financing and an amortization period of up to 50 years. This reduces the cost of debt servicing from historical levels, and as such, the potential for financial support from the City.
- To the extent that additional financing is required, Newco has the ability to refinance the affordable housing stock transferred from PHC, potentially limiting the need for additional financial support from the City.
- The proposed organizational and management structure for Newco is intended to provide the City with direct insight into Newco's operations, allowing for early intervention if required.
- The risk of future financing from the City can be further reduced through the adoption of a private sector development model(s), which provide a degree of risk transfer (including the potential for future financial contributions) from Newco and the City to the private sector.

## Restrictions

This report is based on information and documentation that was made available to KPMG at the date of this report. We had access to information up to January 12, 2021 in order to arrive at our observations but, should additional documentation or other information become available which impacts upon the observations reached in our report, we will reserve the right, if we consider it necessary, to amend our report accordingly. This report and the observations and recommendations expressed herein are valid only in the context of the whole report. Selected observations and recommendations should not be examined outside of the context of the report in its entirety.

Our review was limited to, and our recommendations are based on, the procedures conducted. The scope of our engagement was, by design, limited and therefore the observations and recommendations should be in the context of the procedures performed. In this capacity, we are not acting as external auditors and, accordingly, our work does not constitute an audit, examination, attestation, or specified procedures engagement in the nature of that conducted by external auditors on financial statements or other information and does not result in the expression of an opinion.

Pursuant to the terms of our engagement, it is understood and agreed that all decisions in connection with the implementation of advice and opportunities as provided by KPMG during the course of this engagement shall be the responsibility of, and made by, the City. Accordingly, KPMG will assume no responsibility for any losses or expenses incurred by any party as a result of the reliance on our report.

This report includes or makes reference to future oriented financial information. Readers are cautioned that since these financial projections are based on assumptions regarding future events, actual results will vary from the information presented even if the hypotheses occur, and the variations may be material.

Comments in this report are not intended, nor should they be interpreted, to be legal advice or opinion.

KPMG has no present or contemplated interest in the City nor are we an insider or associate of the City or its management team. Our fees for this engagement are not contingent upon our findings or any other event. Accordingly, we believe we are independent of the City and are acting objectively.





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