

Introduction

KPMG LLP (“**KPMG**”) has been retained by the City of Peterborough (the “**City**”) to assist with the development of a business case relating to the establishment of a municipal services corporation (“**MSC**”) pursuant to the provisions on Ontario Regulation 599/06 (the “**Regulation**”).

Background to the Business Case

The City is a single-tier municipality located in Central Ontario that provides a range of services to more than 85,000 residents. During the 2021 fiscal year, the City budgeted a total of \$292 million in operating expenditures, with an additional \$70 million in budgeted capital expenditures.

Under the Housing Services Act (“**HSA**”), the City is designated as the service manager for housing services for the City and the County of Peterborough, the responsibilities of which include, but are not limited to:

- The development of housing plans, strategies and analysis for all aspects of housing continuum;
- The administration of various programs intended to incentivize the construction of affordable housing;
- 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**”).

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). 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.

As noted above, 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, the City has proposed the establishment of an MSC that would be responsible for the construction, financing and operation of approximately 1,100 new affordable and market housing units, as well as the management of the existing affordable housing portfolio currently held by PHC (287 units). In addition, the MSC would coordinate with the City and PHC on the redevelopment of six existing social housing sites (311 units).

This document represents the formal business case for the establishment of the MSC.

About Municipal Service Corporations

A MSC is defined under the Regulation as a corporation, all of whose shares are owned by a municipality or by a municipality and one or more other public sector entities, where the shareholders have an entitlement to all the voting shares allocated to the members of the corporation, and which provides a system, service or thing that the municipality itself could provide. As noted in the definition, MSCs are not required to be wholly-owned by a single municipality but rather can be used to structure the governance of shared service initiatives between municipalities.

Pursuant to Section 11(1) of the Regulation, MSCs are not permitted to provide services that are mandated by the following acts:

- *Ambulance Act.*
- *Child and Family Services Act.*
- *Fire Protection and Prevention Act, 1997.*
- *Health Protection and Promotion Act.*
- *Long-Term Care Homes Act, 2007* in respect of long-term care homes under Part VIII of that Act.
- *Police Services Act.*
- *Provincial Offences Act.*
- *Public Libraries Act.*
- *Ontario Works Act, 1997.*

In addition to delivering the services of an individual municipality, an MSC can also facilitate the creation of shared service agreements between multiple municipalities by providing a corporate structure that allows for the joint ownership and operation of assets.

Prior to establishing an MSC, the Regulation requires municipalities to undertake the following activities:

- Develop a business case study for the proposed MSC;
- Adopt and maintain policies with respect to the transfer of assets; and
- Consult with the public concerning the establishment of the MSC.

This document represents the business case study for the proposed MSCs.

Restrictions

This report is based on information and documentation that was made available to KPMG at the date of this report. KPMG has not audited nor otherwise attempted to independently verify the information provided unless otherwise indicated. Should additional information be provided to KPMG after the issuance of this report, KPMG reserves the right (but is under no obligation) to review such information and adjust its comments accordingly.

Pursuant to the terms of our engagement, it is understood and agreed that all decisions in connection with the implementation of advice and recommendations as provided by KPMG during the course of this engagement shall be the responsibility of, and made by, the City.

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.

The Proposed Municipal Corporation

Services Provided

The City is proposing to utilize an MSC structure to facilitate a significant investment in housing in the community. Specifically, the MSC would initially be responsible for:

- Managing the development of approximately 1,100 new market and affordable housing units, located on property to be transferred by PHC to the MSC. The development of the new housing units is expected to involve a combination of units directly owned and managed by the MSC as well as new units involving private sector participation, potentially through the use of joint ventures, limited partnerships or land leases.
- Managing the existing affordable housing units (287) currently owned by PHC, which will be transferred by PHC to an MSC upon the establishment of the latter.
- In conjunction with the City and PHC, managing the redevelopment of six social housing facilities that have approached end of useful life.

After these initial steps, the MSC could lead the redevelopment of additional properties and/or the construction of additional affordable housing units, which could include properties located in the City and County.

Upon completion of the transfer of affordable housing units from PHC to the MSC and the finalization of land transfers to facilitate the construction of new affordable housing units, the MSC will have sole responsibility for the management of City-owned affordable housing units, with PHC being the sole agency responsible for the management of City-owned social housing.

Capital financing for the construction and redevelopment of housing units is expected to be a combination of equity, grants and debt financing provided under the National Co-Investment Fund (the “Co-Investment Fund”) administered by the Canada Mortgage and Housing Corporation. It is expected that the associated debt will be held by the entities with title to the housing units:

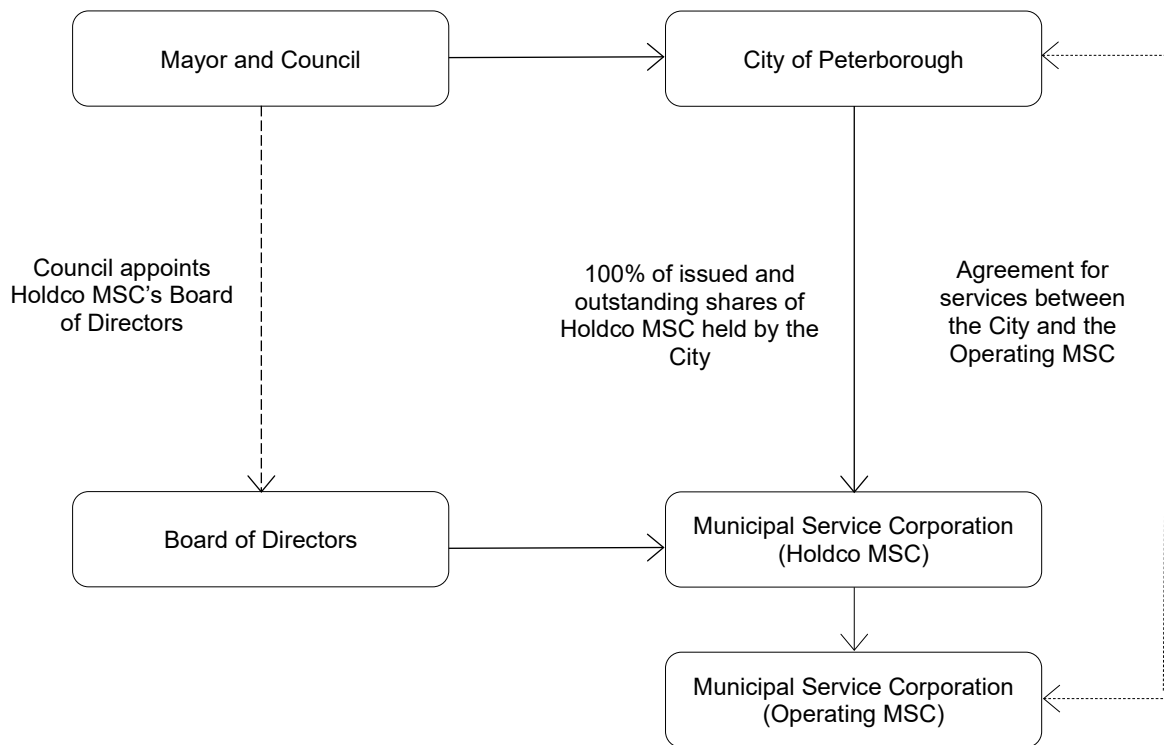
- Debt associated with the redevelopment of existing social housing units will be held by PHC; and
- Debt associated with the construction of MSC-owned market and affordable housing units will be held by the MSC.

In addition to the construction of new market and affordable housing units, the MSC will also be responsible for ongoing maintenance and property management of its units, which is expected to be accomplished through a shared-service arrangement with PHC and/or the use of third party service providers. Corporate support services, such as finance and information technology, are also expected to be provided through shared service arrangements, either with PHC or the City.

Corporate Structure

As depicted below, the proposed structure would involve the establishment of two MSCs:

- One MSC to act as a holding company (“**Holdco MSC**”) to hold the City’s equity ownership interest in Operating MSC (as hereinafter defined). The issued and outstanding shares of Holdco MSC would be owned by the City. The use of a Holdco MSC as holding company is intended to:
 - a) Allow the City to establish additional MSCs in the future while providing for a common governance structure; and
 - b) Provide a means for the City to participate in MSC arrangements with other municipalities or public sector bodies, with the Holdco MSC owning the City’s equity interest in other MSCs; and
- Another MSC to act as an operating company (the “**Operating MSC**”) for delivery of affordable housing, which includes newly constructed units as well as the properties transferred from PHC. The issued and outstanding shares of Operating MSC would be owned by the Holdco MSC.

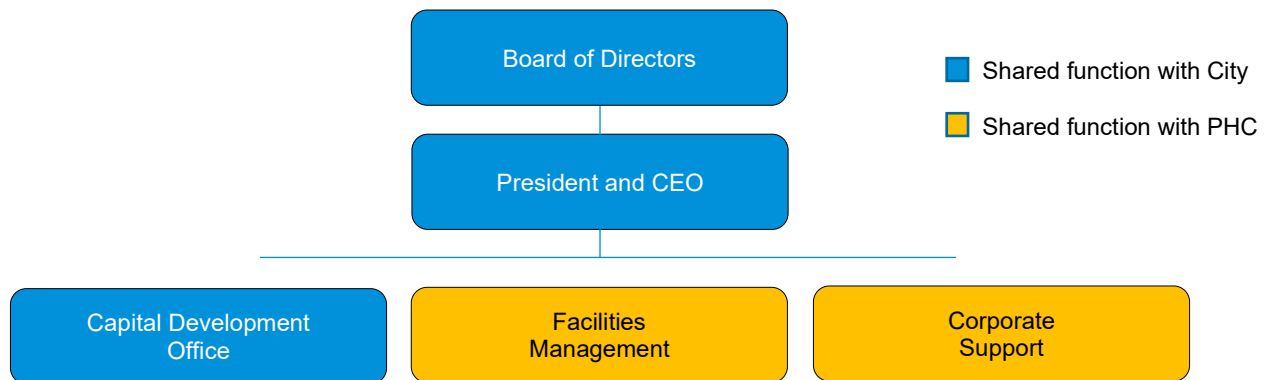


The City is proposing the use of a common board membership for both MSCs, whereby directors of the Holdco MSC would also serve as the directors of the Operating MSC. While the structure and composition of the board may evolve over time, the initial board of directors will be comprised of five members of City Council (Mayor, Deputy Mayor, Housing Committee Chair, Housing Committee Co-Chair, Finance Committee Chair).

Management and Personnel Structure

As a means of ensuring coordination of the MSC's activities with the City and PHC, as well as reduce overall administrative costs, the MSC's are not anticipated to have any employees; rather, resources will be provided through shared staffing arrangements with the City and PHC with third party advisors retained by the MSC's to assist with specific matters.

The proposed organizational chart of the Operating MSC is provided below.



Day-to-day operations of the Operating MSC would be the responsibility of its President and CEO. For the initial start-up period of the Operating MSC, the City's Commissioner of Community Services would be appointed as President and CEO. The use of a shared position (as opposed to a newly hired MSC employee) reflects the following considerations:

- The overall size of Holdco MSC's and the Operating MSC's operations are not expected to be sufficient to justify a full-time President and CEO; and
- The appointment of the Commissioner of Community Services will ensure coordination between the City, Holdco MSC, Operating MSC and PHC during and following the transfer of properties from PHC to the Operating MSC, as well as the negotiation of shared services arrangements involving the parties. .

The President and CEO would be assisted by a Capital Development Office comprised to two to three individuals that will be responsible for the planning and management of the capital program for affordable housing in the community. In order to maximize coordination with the City and address labour management issues, these individuals would be hired by the City and seconded to the Operating MSC for the duration of the affordable housing development project (as opposed to be hired directly by the Operating MSC) and would be responsible for:

- Working with external advisors and the PHC to complete architectural designs, space planning and other planning for the planned construction activities;
- Working with external advisors and the City to identify potential opportunities for private sector involvement in the development of affordable housing and negotiating final agreements with selected partners;
- Working with external advisors, the City and PHC to secure project funding from the Canada Mortgage and Housing Corporation and other sources;
- Coordinating with the City's procurement function and other departments on the development and issuance of procurement documents for construction services; and
- Providing ongoing project management for construction activities, including periodic reporting to the Board of Directors.

CSSS21-010 - Appendix A

With respect to property management, corporate support services (e.g. financial transaction processing) and other activities relating to the maintenance of affordable housing units and associated tenant relations activities, the Operating MSC will utilize the services of the PHC on a cost-recovery basis. The use of a contractual arrangement with the PHC, as opposed to the hiring of new employees by the Operating MSC, is intended to:

- Maximize economies of scale and efficiencies by delivering property management, corporate support services and other functions on a combined basis for both social and affordable housing; and
- Minimize staffing and other operating impacts on PHC that would otherwise result from the transfer of affordable housing units from PHC to the Operating MSC.

The Case for Support

The City's Housing Strategy has identified a clear need for affordable housing in the community:

- The Housing Strategy identified a rental vacancy rate of 1.5%, which is significantly lower than the recommended range of 3% to 5% and is indicative of a lack of supply for rental accommodations;
- Average rents have increased by 7.1% between 2017 and 2018, resulting in increasing pressures from the standpoint of affordability. Overall, an estimated 50% of renters spend more than 30% of their household income on housing costs; and
- Average resale home prices have increased by almost \$150,000 from 2014 to 2019, making private home ownership increasingly unaffordable and resulting in more people remaining in rental units, which in turn reduces the overall vacancy rate and increases market rents. This, in turn, makes it more difficult for individuals to obtain affordable rental housing.

Since the completion of the City's Housing Strategy, the community has continued to experience pressures with respect to housing affordability:

- The reported vacancy rate continues to remain below the recommended range, with the CMHC reporting an overall vacancy rate of 2.6% at October 2020, with the vacancy rate ranging from 0.6% for bachelor apartments to 2.9% for 3 bedroom and larger units.
- Private apartment rents increased by 2.6% from 2018 to 2019 and a further 4.9% from 2019 to 2020.

Through the construction of additional affordable and market units, the MSC will provide relief for housing pressures across various segments of the population. For example, the increased availability of affordable housing may allow individuals to transition from social housing, freeing up space for individuals currently on the wait list and contributing towards a reduction in homelessness.

The establishment of a separate organizational structure for affordable housing in the form of an MSC has been identified as the preferred model for the development of new units, based on a range of benefits to the City and its residents:

- *The use of an MSC results in a specific focus on affordable housing development* – As noted earlier in the business case, the MSC is intended to be the sole agency responsible for the development and ongoing management of affordable housing in the community. This specificity of purpose and mandate avoids the potential for competing priorities that would shift resources and focus away from the key goal of developing more affordable housing in Peterborough.
- *The use of an MSC means no draw on the City's debt financing capacity* – The City has established a limit on the amount of debt financing that can be incurred, with a maximum of 16.5% of own-source revenues available for principal and interest payments. Debt incurred by PHC is included in this determination as PHC is a wholly-owned corporation and is consolidated for financial reporting purposes. The anticipated level of investment in affordable housing proposed by the City is expected to result in a significant level of debt financing through the Co-Investment Fund, which would significantly reduce, if not fully exhaust, the City's debt financing capacity if it were issued by PHC or the City directly. As a result, the City could be faced with a situation whereby it is required to reduce capital investments in other services (e.g. recreation) in order to accommodate the level of debt associated with the investment in affordable housing or reduce the level of investment in affordable housing in order to preserve debt servicing capacity for other projects.

CSSS21-010 - Appendix A

The proposed MSC structure would qualify as a so-called “government business enterprise” for financial reporting purposes, which does not require the inclusion of debt incurred by the MSC in the City’s financial statements. As a result, the use of the MSC structure will allow the City to fully pursue the proposed level of investment in new affordable and market housing units without reducing its debt servicing capacity.

- *The use of an MSC provides a streamlined yet effective governance structure* – The proposed board structure of the MSC, ensures that the City has both direct control over the activities of the MSCs and a clear line of reporting between the MSC’s and City Council.
- *The MSC structure seeks to minimize resources through shared service arrangements* – To the extent possible, the MSC involves the use of shared resources (executive management, capital development processes, property management, corporate support) between itself, PHC and the City, avoiding the potential for duplication and increased administrative and other operating costs.
- *The establishment of a Holdco MSC structure can support future initiatives* – To the extent that the City wishes to pursue other initiatives, the proposed structure provides the ability to position these as new Operating MSCs held by the Holdco MSC
- *The use of the MSC allows PHC to focus on its original mandate of social housing* – As proposed, affordable housing units currently held by PHC will be transferred to the Operating MSC, which returns PHC’s mandate and operations to its original focus on social housing.

Implementation Strategy

In connection with the implementation of a MSC for affordable housing, the City will consider the following worksteps:

1. **Completion of public consultation** with respect to the proposed MSC model as required under Ontario Regulation 599/06, which we suggest include the following components:
 - a. Information materials included on the City's website and social media channels, including an overview of the proposed MSC structure, the case for support and frequently asked questions.
 - b. The use of an online survey to solicit input from the City's residents.

With respect to the consultation and communication process, we suggest that the key themes include the following:

- The proposed MSC model allows the City to address a key priority (the need for affordable housing and social housing renewal) without potential constraints resulting from debt servicing limitations.
 - The proposed MSC model is not expected to result in significant incremental costs for residents as affordable housing has traditionally operated at a surplus and is expected to continue to do so in the future.
 - The proposed MSC model is intended to enhance governance and operational efficiencies, particularly through the use of shared service arrangements that avoid the duplication of efforts.
2. **Incorporation of the Holdco MSC and Operating MSC** as legal entities. In doing so, the City should:
 - a. Obtain support from legal counsel with appropriate experience with the establishment of MSC's under the Regulation.
 - b. Ensure that the articles of incorporation of the MSC's are structured so as to meet the definition of a Government Business Enterprise ("**GBE**") for financial reporting purposes. Under Generally Accepted Accounting Standards for Public Sector organizations, GBE's are not consolidated for financial reporting purposes but rather are accounted for using the modified equity basis of accounting. As such, long-term debt held by a GBE is not reflected in the financial statements of the municipality and as such, is not considered in the determination of the allowable debt servicing limit. In order to qualify for GBE status, the MSC must meet the following criteria:
 - it is a separate legal 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.
 - c. Ensure that the articles of incorporation are structured so as to meet the requirements for tax exempt status under Section 148.1(c) of the Income Tax Act.
 3. **Adoption of an asset transfer policy** as required under Ontario Regulation 599/06 that would establish the framework for the transfer of assets from PHC to the MSC, specifically existing affordable housing units and properties to be developed for market and affordable units.

4. **Development of appropriate governance and operating policies** for the MSC's, including terms of reference for the Board of Directors of the MSC's, a shareholder's agreement and operating framework.
5. **Establish a Master Services Contract** between the MSC and PHC the purpose of which will be to define the roles and responsibilities of PHC with respect to the services being provided to the MSC's, which should include, but not be limited to:
 - a. Maintenance of affordable housing units
 - b. Financial services, including tenant billing and collection
 - c. Information technology
 - d. Tenant services
6. **Establish an Administrative Services Contract** between the City and the MSC's for the corporate management (i.e. President and CEO) and capital development services.
7. **Procure necessary third party advisors** for key activities, including architectural planning, financial negotiations, legal and private sector partnering arrangements.
8. **Complete the initial planning phase of the affordable housing development initiative**, the purpose of which is to finalize site plans for the affordable and social housing units under development, allocate development responsibilities and ownership between the MSC and potential private sector partners and determine the strategy for ongoing ownership, including the nature of asset transfers between PHC and the MSC's (e.g. ownership transfers, lease arrangements).
9. **Assess potential strategies for social housing needs**, including a potential transition to rent supplement arrangements as opposed to the direct provision of social housing.
10. **Conduct consultations with the County of Peterborough (through the PRLC) and lower tier municipalities (as required)** to ensure a comprehensive understanding of the affordable housing redevelopment and secure required consents for the transfer of title for affordable housing units from the PHC to MSC.

Financial Analysis

Included as Appendix A is an analysis of the projected financial performance of the MSC, which considers the proposed scope of development and the assumption of existing affordable housing units from PHC. As noted in the projections, the MSC's are expected to be financially self-sufficient and do not require an ongoing subsidy or other financial support from the City.

In order to demonstrate the potential impact of changes in key assumptions (capital costs, level of debt, rental revenues), we have outlined below the forecasted impact on annual cash flows based on a 10% change in these considerations. As noted below, the MSC's are expected to generate sufficient cash flows to accommodate this level of variation in key assumptions.

Projected Annual Cash Flows (in thousands)

