
Subject: Partnership Housing Program

Report to: Corporate Services Committee

Report date: Wednesday, June 12, 2019

Recommendations

1. That financing in the amount of \$1,750,000 gross and net **BE INITIATED** from the approved 2018 capital budget for the Social Housing Alternative Service Delivery Capital Requirements project and that the project **BE FUNDED** as follows:
 - Reserves – Capital Levy - \$175,000
 - Development Charges – Social Housing - \$1,575,000
2. That Council **APPROVE** the general terms and conditions of the Partnership Housing Program as outlined in Appendix 1 as a pilot project to encourage co-investment in the development of new purpose-built rental stock; and
3. That Council **APPROVE** the Negotiated RFP procurement strategy identified herein including Appendix 2 for the Partnership Housing Program in accordance with Section 16 (c) of Procurement By-law No. 02-2016, as amended on February 28, 2019.

Key Facts

- The purpose of this report is to initiate capital funding for the project and seek council support of the procurement process.
- In March of 2018 Regional Council approved CSD 14-2018 which authorized staff to enter into negotiations with the private sector and community partners for the purpose of developing new affordable housing supply under joint partnership arrangements with final approval of the arrangements subject to Council approval.
- Staff developed the Partnership Housing Program (PHP), to encourage the not-for-profit and private sector to develop new purpose-built rental buildings. This new approach would have no or nominal impact on existing tax levy payers due to the funding approach developed. The funding approach was a layered approach that required two significant previous approvals:
 - Capital Funding - The 2017 Development Charge By-law (2017-98) included social housing as a municipal wide service for which Development Charges would be levied.

- Operating Funding - In March of 2018, Council approved the use of increment tax financing as a tool for new affordable housing subsidy (CSD 14-2018).
- The pilot project would have Niagara Region partner in the development of new purpose-built rental units. Niagara Region would be a minority equity participant in the development, this equity/capital would be substantially funded by utilizing the funds raised from the development charges (\$1.575 million) as well as funding from the capital levy reserve (\$0.175 million). The current amount of development charges raised for Social Housing is approximately \$2.5 million.
- For the units to be utilized by Niagara Region in their Social Housing programs, the cost difference between the rental amount and what the client can afford would be subsidized by the incremental property tax generated by the building.
- The Procurement By-law allows for Council review of a Negotiated Request for Proposal (NRFP) prior to issuance where the Goods and/or Services being acquired meet one or more of the following: (i) there is Significant value, (ii) Significant public importance; and (iii) the project is significant in terms complexity or specialization.

Financial Considerations

The Financial considerations for this program are as follows:

- The initial funds to be made available for the pilot program is \$1.75 million. This was approved in the 2018 capital budget with funding of \$175,000 from reserves and \$1.575 million from DC.
- The exact quantum of the directed tax increment revenue available to fund unit subsidies is not known at this time but would be capped at the Regional Portion of the increased taxes created by the development. The example provided below for a 25% equity share purchased with \$1.75 million investment would result in approximately \$78,000 in available funding through assessment growth. Due to this there would not be an impact to the taxpayer, however Council would effectively be dedicating the tax levy growth from this development to the affordable housing initiative. The total financial commitment for the use of incremental tax financing would be at a minimum 10 years but could be potentially 25 years or longer.
- Development Charges for Social Housing have been collected since September 2017 in accordance with the 2017 Development Charges By-law. To December 31, 2018 \$2.5 million in DCs have been collected for this purpose with the annual amount for 2018 being \$2.2 million and expected to grow annually with indexing in the by-law as well as growth in the Regional permit activity. At this time these funds have been committed to the project described herein and to the Hawkins Street Project (\$675,000 in 2019 capital budget for initial design).
- Though it is not anticipated to be a material amount, there is the potential for Niagara Region to receive income from the developments.

- There are financial risks to the project similar to any other housing project; however as noted in the section below the risk profile of this project would be lower as the risks are shared and diversified.
- Niagara Region could also utilize profit distributions from the joint venture (JV) investments to support rental subsidies, additional Regional capital investment or administrative costs related to managing the investment which will vary depending on the nature of the proposals. This being said the time frame for material profit distributions would not be immediate.

Analysis

Background

Description of the Partnership Housing Program

The PHP is proposed to work in the following manner:

- Niagara Region would seek development opportunities and partners via an open procurement process as outlined in this report.
- Niagara Region would look at development opportunities in which it would co-invest with partner and obtain an ownership interest up to 35%. This equity for this Joint Venture (JV) as noted would be funded in part with DC funds. Taking a minority position in the developments helps leverage Niagara Region's limited resources into more projects and reduces investment risk.
- Niagara Region would also enter into a commitment with the JV to secure via a longer-term lease for a number of rental units which would be used by the Region for social housing purposes. By entering into effectively a long-term blanket lease for a number of units, Niagara Region should be able to obtain preferential pricing.
- By Niagara Region investing equity and by guaranteeing a portion of the rental roll of the development creates a lower risk investment for the development partner. It is anticipated that this "de-risking" of the investment will be sufficient to motivate investment in purpose built rental properties.
- The rental rates for the development would be set by the Joint Venture in line with the marketing plan and its planned rate of return for the development. Depending on the type of building the rents could differ significantly for from one project to another. For example, one project could be a Joint Venture with a not-for-profit targeting young families and a second project could be for a higher end development targeting retirees. Due to the difference in the projects the average cost per unit, average rental rates, anticipated rate of return on equity and assessed property taxes would differ significantly between the projects.

- Allowing developments to be more aligned with market forces provides for greater sustainability and by allowing for a diversity of projects allows for greater market diversification.
- Niagara Region's portion of the incremental property taxes generated from the new developments would be used to subsidize the rental amounts in the building for the units under lease by the Niagara Region and would be administered by the regional entity responsible for housing subsidy programs
- Niagara Region could also utilize profit distributions from the JV investments to support rental subsidies and or additional capital investment. This being said the time frame for material profit distributions would not be immediate.

The following is a brief example, the amounts provided are for illustrative purposes only: Niagara Region and a private sector developer enter into a joint venture to develop and operate a 100 unit building in St. Catharines. The total cost of the development is \$17.5 million. The JV would seek bank financing at 60% loan to value and Niagara would contribute \$1.75 million in equity and the development partner would contribute \$5.45 million. The Region would have a 25% equity interest in the JV. The average rent for the units is \$1,400 per month, the total revenue per year would be approximately \$1.7 million and debt servicing obligations would be conservatively estimated at \$840,000, total property taxes would be estimated to be \$197,000 (assumed a tax value at 80% of development costs). The Niagara Region portion of the property taxes for the property would be \$78,000 which would be used to subsidize units in the building.

It is assumed in this example that the Niagara Region would enter into a lease for a block of units at a rental amount of \$1,300 per month on a long-term basis (a small discount to be included in the proposal is provided for the block rental arrangement). If we assume the average subsidy required is \$600 per month, then the property taxes created by the building would be able to subsidize the 11 units.

Key Considerations for the PHP

The pilot project was developed after reviewing existing programs, market conditions and consultations with stakeholders. The following is a summary of some the critical considerations that impacted the PHP.

Key Financial Factors

1) **Capital Funding** – The cost to construct new units is significant. The latest construction cost for NRH's Carleton Street Project was \$15,770,877 (this is the budgeted amount of the project – to date we have spent \$15,170,434.28 which included the open PO's but the project is not yet done so staff anticipate the full amount will be utilized) for 85 units or \$185,540 per unit (does not include DC's). Based on this in order to add 100 units of supply the Niagara Region would have to commit to a capital contribution of \$18.5 M with no leveraging of private investment.

Depending on the particulars of the joint venture the project may be structured as a Government Business Partnership which would be recorded by the Region on a modified equity basis. This would not require the consolidation or recording of debt of the joint venture therefore not impact the region's debt annual repayment level.

2) **Rental Subsidy** – After the building is constructed there is a requirement to subsidize the rental amount in the building to reduce the gap between the rent amount and the client's ability to fund the rent using a combination of Rent Geared to Income (RGI) and Housing Allowance (H/A). The RGI sets the amount paid for rent to be 30% of the household's gross income. The gap between this amount and the rent level would represent the maximum amount of the level of support required.

3) **"Market Rent" and development economics** – The Canada Mortgage and Housing Corporation (CMHC) publishes average market rates for Niagara (currently \$870 for a 1 bedroom and \$1,035 for a 2 bedroom per month). The challenge with the market rate is it is based on the current inventory in the Region which on average is old stock. As such a new building constructed under new building code requirements would not be able to economically support the average rent. For example, if a new unit cost \$200,000 and the average annual rent was \$12,000 (\$1,000 per month) the simple payback period would be more than 16 years, assuming 100% occupancy and this would not factor in any operating costs or any investment returns or sustainable capital replacement allowances.

The average market rate impacts a number of items, for example an affordable housing unit is defined as being a unit that is charging rent at 80% of the CMHC market rent. This makes it very difficult or not possible for new construction to meet this guideline without additional supports.

Current Housing Status

The following are some very brief notes on the supply of rental housing:

- Niagara Region through Niagara Regional Housing (NRH) previously owned 2758 units in 68 buildings. Currently, the Niagara Region owns and manages 2852 units within 64 properties including the newly built, Roach Ave and the recent purchase (January 2019) in Thorold. The current housing portfolio is a mix of building types and was substantially acquired via a download in 2001 and 2002. During this time Niagara Region obtained 2,600 units in 66 properties. The average age of NRH's portfolio is 45 years. In 2017 NRH undertook a third-party building condition assessment study and the results indicated that the portfolio was in fair to good condition. Though there are no pressing issues in the portfolio, the mix of properties and the design of the properties are not optimal and the overall age of the portfolio will create challenges in the longer term, which the Region needs to pro-actively plan for. The long term maintenance and optimization of the portfolio will require also require additional capital funding.

- According to October 2018 CMHC data for the St. Catharines-Niagara CMA there were a total of 16,138 apartment units in the Region and the regional vacancy rate was 2.5%.

The Rational for the PHP program

The program was designed based on the following observations:

- Overall there has not been significant development in purpose-built rental stock in the Region over the last number of decades. There are a number of reasons for this lack of development, however it is clear that the market conditions and incentives have not been sufficient to induce investment. The impact of the lack of supply means that rental rates increase and the demand and cost for affordable housing increases. Increasing the supply of rental properties has a significant impact on the overall market.
- Niagara Region cannot afford to solve this problem alone, the cost to increase the affordable housing portfolio in a material manner is very significant. Additionally, there will be a cost to Niagara Region just to maintain and modernize its existing portfolio of units or in other words maintain our existing stock.
- NRH has added some new units to its portfolio, however this has only occurred when there was funding available from upper level governments. The Provincial and Federal governments both are currently experiencing annual deficits as such basing a strategy solely on receiving upper level support would carry significant risk. The fact that NRH generally only adds to its portfolio when there is upper level funding also underscores the economic reality of developing affordable housing.

Program Details

It is anticipated that the PHP will be able to induce the development of more rental stock in the market by providing at risk equity and income certainty around a portion of the rental income. The goals of the program would be to:

- Increase supply of purpose-built rental units in the market. To be clear this does not mean that the units deployed would be affordable or even at CMHC market level rates. The intent is to increase overall supply of rental units, as more rental options become available the acute supply and demand pressures are reduced.
- Leverage Niagara Region's limited funds in a manner that puts more units into the market place.
- Have minimal tax levy impact.
- Reduce the overall risk profile to Niagara Region with its housing portfolio on a number of levels:

- By participating as a minority partner, the Niagara Region would reduce its exposure to (i) Construction Risk and (ii) Operational Risk.
- By participating with a variety of developers in a mix of different types of buildings (buildings that Niagara Region would traditionally not build), Niagara Region will increase the diversification of its portfolio which will decrease market risks related to the changes in property valuations in the long term.
- Niagara Region will also diversify its counter-party risk. Currently all of Niagara Region's housing stock is managed by NRH. By engaging with additional managers, the Region will diversify its management risk and potentially be able to gain additional insights into different construction or management strategies.

Other Potential Enhancements to the Program

- **Local Municipality Participation**
The PHP could be enhanced in a few areas. The biggest enhancement would be to allow local municipalities to also participate in the program. To avoid complexity in the transaction the most efficient way would be to allow the Local Municipalities to only participate in the incremental property tax financing component of the transaction. A local municipality could contribute all or a portion of the incremental tax revenue and provide for more units in the development to be utilized for affordable housing use. The municipality would be a party to the lease agreement with the Joint Venture, but in this case not be a part of the Joint Venture.

If there was a project of significance and the local municipality wanted to participate in the equity portion of the transaction, this could be considered by Niagara Region, additional focus on the Governance structure of the transaction would be required.

- **Other Enhancements**
There are other potential enhancements to the program that could be used as part of the negotiation process with a development party. The potential enhancements would not have a material impact to the budget or to the current levy payers. Due to the nature of these items and the impact it might have on Niagara Region's negotiation position, these items should be disclosed as part of an in-camera session.

The Procurement Approach

Staff are proposing the Negotiated Request for Proposal strategy inclusive of proposed evaluation criteria for each of the two phases identified herein (Appendix 2) be presented to Council for their approval in accordance with Section 16 (c) of Procurement By-law No. 02-2016, as amended on February 28, 2019.

Section 16 (c) allows for Council review of the process prior to issuance where at the discretion of the CAO and/or the Department Commissioner, the Goods and/or Services being acquired meet one or more of the following: (i) there is Significant value, (ii) Significant public importance; and (iii) the project is significant in terms complexity or specialization.

Generally, a Negotiated Request for Proposal (NRFP) non-binding procurement process is employed in instances where a more flexible strategy is needed to offset a higher level of complexity and risk associated with a procurement project. Staff are recommending employing the NRFP process for the PHP program as it provides a non-binding process with lower risk legal framework and that coupled with increased flexibility in the process presents a greater opportunity for market engagement with Proponents / Developers and is expected to yield improved bid response culminating in maximizing outcomes.

The NRFP process employs multiple stages whereby Niagara Region will conduct the evaluation of all proposals deemed to have met the mandatory submission requirements in two sub-stages. The bidders will be generally required to provide two proposals for the Region.

The first proposal is designed to solicit responses from potential development partners without placing undo burden on the proponents. While the Proposal at this stage will be at a higher level, they need to provide sufficient detail to enable the Niagara Region to assess whether the proposal has met the requirements as outlined in the Bid document. Within this stage there are two evaluation components. The first being adherence to mandatory requirements (for example the development must create new units, be of a certain size and have requirements that fit into the guidelines of the program). Proposal deemed to have met these mandatory requirements would be evaluated in accordance with the Step II Evaluation Criteria (Appendix 2) including their partner experience, financial plan, governance plan and the development opportunity.

Bidders achieving the requisite benchmark score will advance to Stage III where they will be provided with the same deadline to put more investment into their proposal and create a new or more detailed business plan which would then be evaluated by the staff at the Niagara Region in accordance with the Step III evaluation criteria outlined in Step III within Appendix 2. After completion of Stage III where Niagara Region would invite the top “x” Proponents to enter into concurrent negotiations at which time each would be provided any additional information and Niagara Region would seek clarification and discussion concerning alternatives to methods for providing the deliverables identified in each proponents bid.

After the expiration of the concurrent negotiation period, Niagara Region would issue a further request for a best and final offer (BAFO) to each proponent which would include

such options and alternatives which Niagara Region has identified through concurrent negotiations as of value. Each Proponent would be invited to revise its initial proposal (or specific parts thereof) as identified in the BAFO request issued by Niagara Region, including but not restricted to price and specific features of the Deliverables and submit its BAFO to Niagara Region.

Niagara Region staff would then evaluate and rank these submissions and put forth a recommendation which would be presented to Council which would make the final and binding decision to enter into a contract with the name Proponent / Developer.

Alternatives Reviewed

Other alternatives to support investment in housing were reviewed and were outlined in report CSD 14-2018. It should be noted that the PHP is not mutually exclusive and should not be considered as the only method for increasing affordable housing developments. Niagara Region can include additional approaches in addition to the PHP.

Relationship to Council Strategic Priorities

Alternative Service Delivery in affordable housing was a specific Council priority in its previous strategic plan.

Other Pertinent Reports

- CAO 5-2015 - Update on Alternative Service Delivery Review March 26, 2015
- CAO 1-2016 - Update on Social Housing ASD Review February 4, 2016
- CAO 18–2016 - Update on Social Housing Alternative Service Delivery Review November 17, 2016
- CSD 14-2018 - Alternative Service Delivery Social Housing March 7, 2018

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Appendices

Appendix 1	Partnership Housing Program – General Guidelines
Appendix 2	Negotiated Request for Proposal: Evaluation Criteria