Brief: An acquisition program to preserve affordable rental

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Summary

The Canadian Housing Policy Roundtable (the Roundtable) recently released "Three Policies Needed for a Healthy Housing System" — a set of three policy proposals highlighting how the federal government can take immediate action to strengthen key areas of Canada's housing system where the pandemic is hurting the most vulnerable. This brief provides a more detailed model for the first of these three policies: Creating an acquisition program to enable rapid non-profit acquisition of existing affordable rental buildings.[1]

P R O P O S A L

This model for an acquisition program would create and expand a network of qualified non-profits to undertake acquisition of affordable private rental buildings by accessing National Housing Strategy (NHS) funding. This model is centered on enabling the non-profit sector to move quickly to seize market opportunities, by providing a small, Canada-wide network of trusted local entities with pre-approved access to funding. In communities across Canada, a few local entities are already acting in this intermediary role to acquire and preserve affordable rental properties. This model would scale the work that these experienced, reliable partners are already carrying out on the ground.

This model proposes creating a specific acquisition funding stream within the NHS, that would be used by this network of acquisition specialist intermediaries to facilitate purchase of existing moderate rent properties. This will include revising eligibility criteria and creating a funding pre-approval process for existing NHS funding, to equip accredited, local intermediaries to respond to the speed and competitiveness of real estate transactions. Designating a portion of existing NHS funding for acquisition enable the creation of a series of local revolving funds to facilitate acquisitions on an ongoing basis in communities across Canada. With $1.1 billion in financing and $300 million in grants, this program could enable acquisition and preservation of up to 7,500 affordable rental units annually.

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[1] An acquisition program has been proposed and endorsed and proposed by a range of national and provincial associations, including the Federation of Canadian Municipalities, Canadian Housing and Renewal Association, the Canadian Alliance to End Homelessness, Ontario Non-Profit Housing Association, and BC Non-Profit Housing Association. An in-depth look at an acquisition model is offered in "Augmenting the National Housing Strategy with an Affordable Housing Acquisition Program" (Steve Pomeroy, 2020, [https://bit.ly/3sXoWd2].

Why Canada needs an acquisition program

The number of existing affordable rental properties in the private rental market is declining at an alarming rate. From 2010-2020, an estimated 60,000 affordable[2] units with monthly rents were lost *every year*, while the NHS aims to create an average of 16,000 affordable units annually. This means that for every unit of affordable housing created through the NHS, four are lost.

A key driver of this erosion of Canada's affordable rental stock is the acquisition of affordable rental buildings by profit-seeking landlords and real estate investment trusts (REITs), who in turn raise rents above affordable levels as existing tenants leave and through building rehabilitation and improvements and rental unit upgrades.[3]

While new build affordable housing is a critical component of Canada's housing strategy, without an acquisition program to offset this erosion of existing affordable stock, new development is like pouring water into a leaky bucket. Additionally, acquisitions of affordable rental stock can help to preserve affordability in this stock, require less investment, and meet both the immediate and future housing needs of Canadians.

Over the next 10 years, an acquisition program would help to preserve up to 75,000 existing affordable rental units currently held in the private market. Under non-profit ownership, existing tenants would remain in their affordable units, while individuals from affordable housing waitlists would be moved in as natural vacancies occur. An acquisition program would thereby address housing challenges for Canadians now and into the future and ensure that investments made through the NHS are not being undermined by the erosion of existing affordable rental stock.

The key benefits of this approach are:

- With selective acquisition, the cost to acquire is typically much lower than new construction. Because properties already exist and operate, acquisition is typically much faster than building new.
- Many existing tenants are low-moderate income – preserving their current housing reduces challenge to find similarly affordable housing if they are evicted to renovate the building.
- The existing rental income and net income after operating costs creates capacity to lever loan financing, and reduces the amount of grant (forgivable loan) compared to new affordable development seeking to serve a similar income group.
- Shifting ownership from private sector to community non-profit ownership preserves affordability in perpetuity.

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[2] With rents under $750 a month, affordable at incomes under $30,000 per year.

[3] Martine August, "[The financialization of Canadian Multi-Family Rental Housing: From Trailer to Tower](https://)," *Journal of Urban Affairs* (February 2020).

In order to address the erosion of existing affordable rental stock, non-profit organizations need to be able to compete with the investors and REITs driving much of this erosion. An acquisition program would address three key challenges non-profits face in competing against the private sector for acquisitions:

1. **Access to funding on a revolving basis:** Some communities across Canada are already working strategically to acquire existing affordable rental stock on behalf of the non-profit sector. Examples include the Parkdale Community Land Trust, which secured a pre-commitment of City funding in Toronto; Horizon Housing in Calgary, which had or has access to funds from a local capital campaign; and the City of Montreal, which has set aside municipal funds to support its right of first purchase bylaw.[4] In Ottawa, a local fund is being created through the Ottawa Community Foundation, attracting social impact investors, and through its own capital pool.

   While these entities have the necessary expertise and experience for strategic acquisition of existing affordable rental buildings, funding is extremely limited. Once used to purchase a property, their equity is tied up and there is no further capacity to pursue additional acquisitions.

   With a pre-approved funding facility to backstop their activities, once these intermediaries have completed an acquisition they would secure funds from the acquisition fund to replenish their resources, thus positioning and enabling them to pursue additional acquisitions. This model effectively creates a revolving local fund that can recycle funding to sustain ongoing additional acquisitions.

2. **Ability to scale the model :** In order to scale this practice at a level that meaningfully addresses affordable housing need, it is necessary to expand the network of accredited intermediaries as well as ensure sufficient funding across the network to enable ongoing acquisitions of existing affordable rental buildings as they become available.
3. **Ability to move quickly:** Non-profits and trusted intermediaries not only need access to funding to support the future purchase of a building, but also must be able to move quickly to make offers and execute transactions as market opportunities arise. In most cases when an investment property is listed for sale the sales process moves quickly — especially if the property has potential for rent lift or redevelopment. Existing funding mechanisms supporting Canada's non-profit housing sector are not set up to enable non-profits to move at this pace. They involve a number of pre-requisite criteria and a lengthy review and approval process. To be successful in acquiring existing buildings, a more nimble, flexible and swift mechanism is required.

[4] The City of Montreal has passed a bylaw giving the City of Montreal right of first refusal for rental assets in designated affordable areas where the current owner seeks to sell. However, the budget is limited and depleted once used to purchase a small number of buildings.

What it would entail

An effective acquisition program would include the following core features:

Repurposing and allocating a portion of existing NHS funding towards acquisition: With $1.4 billion in NHS financing/funding each year, an acquisition fund could support the preservation of up to 7,500 affordable units annually. This represents 10-15% of annual rental property transactions and reflects a strategic and selective approach that would focus on properties in sound condition, with average rents currently at or below median rent levels.

This proposed funding would include $1.1 billion in loans and the remaining $300 million in a forgivable loan contribution. Drawing on the low rate financing available in the NHS, results in a larger loan component (and less grant/forgivable loan) compared to using market rate financing.[5]

Giving a small network of select entities pre-approval to access funding: An acquisition program would equip accredited local intermediaries with streamlined access to designated NHS funding to acquire existing affordable rental buildings either for their own portfolio or on behalf of the non-profit sector.

Pre-approved access to funding would enable these entities to move quickly to seize market opportunities. This pre-approval could include criteria to ensure that the non-profit has appropriate expertise, and ideally the ability to contribute some of its own resources for the deposit and equity component of the purchase, at least on an interim basis.

This network of intermediaries could consist of non-profit housing providers, land trusts, and technical assistance resource groups. The purchasing entity could operate the property or turn it over to an existing non-profit housing provider.

Across Canada, this would create a network of local revolving acquisition funds — with the proposed acquisition funding replenishing their capital to pursue additional acquisitions on an ongoing basis. It is this type of technical assistance intermediary network that enabled the development of much of the non-profit and coop housing in starting in the 1970s, so this is a proven mechanism.

Ensuring equitable program design: Implementation of the proposal should include measures to ensure an equitable approach to acquisition of rental properties in areas that are heavily populated by Black and other racialized persons in particular, and ensuring organizations led by and working on behalf of Black, other racialized persons, women, and persons with disabilities are included in program delivery.

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[5] Details are presented in "Augmenting the National Housing Strategy with an Affordable Housing Acquisition Program" (Steve Pomeroy, 2020, [https://bit.ly/3sXoWd2). This assumes acquisitions across a range of CMAs at average purchase price of 180,000, with each property financed with loan at 80% of cost and forgivable loan (grant) at 20% of cost.

The fund in action

With an acquisition fund, an established non-profit housing provider or other local intermediary could apply to CMHC for accreditation as an acquisition agent and be pre-approved for some quantum of funding or line of credit (e.g. up to $X million in forgiveable loan, and a further $Y million in loan capacity). **Knowing that they are backstopped by the CMHC acquisition facility, they can make an offer to purchase. At closing, the necessary funding/financing would be advanced by CMHC.**

If the proposed acquisition fund includes access to the low-rate financing provided under the Rental Construction Financing Initiative (RCFI) and the National Housing Co-Investment Fund (NHCF), it is possible to increase the loan amount and reduce the amount of equity (grant) required.

This is illustrated below, based on a real acquisition opportunity in Ottawa. Here, it is feasible to finance $6.337 million (97% of the acquisition cost), provided the proposed program permitted such a high loan-to-cost ratio. With this level of financing, an equity contribution of only $153,000 ($4,657 per unit) is required. This highlights the added benefit of access to low-rate financing.

Example 2: CMHC Low rate financing		
(A 35 unit building rents at 87% AMR)	**Project***	**Per unit**
Net Revenues (rent, parking less vacancy)	430,000	12,286
Total operating expenses	170,000	4,857
NOI	260,000	7,429
Debt Coverage Ratio (DCR)	1.1	
Available to service debt (NOI/DCR)	236,000	6,743
Max loan at 1.6% (CMHC RCFI rate, 30 years)	6,337,000	181,057
Purchase price	6,500,000	185,714
Equity required	**163,000**	**4,657**
* Project amounts rounded to nearest 1000		

Conclusion

While the federal government has demonstrated a strong commitment to growing Canada's supply of affordable housing, these efforts are being undermined by the erosion of Canada's existing supply of affordable rental stock. Every time the government takes one step forward, the market leaps four steps back, as 60,000 affordable units are lost every year.

COVID-19 has demonstrated that safe and affordable housing is a critical social safety net. When Canadians are unable to access housing they can afford, not only are they at increased risk of homelessness, but ripple effects are also felt throughout our communities. The pandemic has also opened up new opportunity for Canada's non-profit sector to acquire affordable rental stock.

The Roundtable urges the federal government to act quickly to implement an acquisition program to seize this unique opportunity, even as further details or refinements to this program may take shape over time.

An acquisition program would have a significant impact on achieving the NHS goals by saving up to 10,000 units every year from becoming unaffordable. Targeting investments to facilitate non-profit ownership over existing rental buildings would build long-term capacity in Canada's non-profit housing sector — a critical element to sustaining permanent affordable housing.

This program will allow the government to demonstrate nimbleness, efficacy, and clear insight into the housing sector, while maintaining robust protections and multiple accountabilities for funding, including the involvement of reliable civil society partners and CMHC's trusted financial oversight. Finally, by preserving affordability for existing tenants and those waiting for affordable housing, an acquisition program would address housing challenges for Canadians now and into the future.