Augmenting the National Housing Strategy with an affordable housing acquisition program

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Every year more existing "naturally occurring affordable housing" (NOAH) units are lost through market processes than were created annual under the 2001-18 affordable housing programs or are proposed to be created annually under the National Housing Strategy

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Executive summary

The challenge: Canada is losing affordable housing faster than we can create it

This erosion of "naturally occurring affordable housing" (NOAH) units is the most serious threat to Canada's supply of affordable housing. Between 2011 and 2016 the number of private rental units affordable to households earning less than $30,000 per year (rents below $750) declined by 322,600 units -- a trend that appears to be continuing. The subsidy cost to build and replace the 300,000 lost units with rents at or below $750 per month would exceed $60 Billion – more than the current total 10-year budget of the National Housing Strategy ($55 Billion).

Over the same period, the F/P Investments in Affordable Housing program together with unilateral provincial initiatives, mainly in BC and Quebec, added fewer than 20,000 new affordable units – ***so for every (1) one new affordable unit created, at considerable public cost, fifteen (15) existing private affordable units (rents below $750) were lost!***[1]

These losses are driven chiefly by the financialization of rental housing – an asset class attracting investment from both large capital funds, as well as smaller investors, both seeking to capitalize on dramatically rising rents. A further contributor is the intensification and redevelopment of sites with older low-moderate rent properties.

These annual losses far outstrip the 150,000 new affordable units planned under the 10-year National Housing Strategy (NHS). This $40 Billion national initiative establishes a number of new funding envelopes (and has subsequently been increased to $55 billion). But missing from this array is an initiative to preserve Canada's rapidly eroding privately owned affordable rental stock.

The solution: preserve Canada's affordable housing stock through a non-market community-based acquisitions funding strategy

While it has been suggested that there should be some regulation to constrain the financialization of moderately priced rental housing, a complementary approach is to intervene to acquire these affordable properties. This suggests an approach that would enable community-based non-profit providers to acquire rental buildings with rents at or below the median market rent.

Such non-market acquisition can shift these assets out of the speculative market, preserve affordability in perpetuity, and expand the scale of the non-market sector.

By reducing the loss of critically important moderate rent homes, this approach can help to prevent homelessness – especially family homelessness. In the immediate post-Covid recovery period, this can also help to manage the risk that speculative capital funds will scoop up

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[1] Malatest Associations (2019) *Sponsorship and Funding of Investment in Affordable Housing Construction, prepared for CMHC enumerated 9,.839 IAH . This excluded any unilateral provincial units, and during this period both BC and Quebec were constructing on average over 2,100 units annually (so together likely contributed a further 10,000 units in addition to the 9,839 reported in Malatest (2019).*

affordable rental facing financial difficulty. And if implemented immediately it could enable acquisition of properties suitable within Housing First as supportive housing, such as motels and student rooming house properties.

Funding and Financing

It is proposed that CMHC establish a new funding stream specifically designed to facilitate non-profit community-based entities to acquire existing moderate rent assets. These would continue to be operated as “affordable market” properties, and as such will reduce the above noted issue of erosion.

Delivery models

The intent is to create a funding mechanism to enable acquisition, including some combination of loans and grants, but with the flexibility to be adapted to different contexts. It will require technical assistance in the form of capable intermediaries with competencies and capacity to complete searches for acquisition targets, undertake due diligence and facilitating the purchase. Canada’s multi-unit purpose-built rental stock exists mainly in larger cities, so acquisition would be more focused in these centres (where there are potential acquisition properties), but may also be used in smaller markets.

The approach can vary to include participation of provincial housing agencies, municipalities and community-based providers, community land trusts and intermediaries, where these already exist. In other locales it may be necessary to create capacity through new entities.

What is the impact and what will it cost?

It is estimated that a targeted affordable housing acquisition fund could preserve potentially 7,500 affordable rental units annually – augmenting by one-half the annual NHS target of 15,000 new affordable units. Because these are market rent properties and have capacity to carry financing, the required subsidy is much lower than that required to build new housing.

This would not create truly affordable very low rent housing, but it would help to offset and reduce speculative purchases by investors (large and small) that are pushing rents above affordable levels, effectively withdrawing these existing (NOAH) assets from the affordable universe, while expanding the stock of non-market housing. [2]

It is also anticipated that this would be a program of selective acquisition. It would avoid purchasing properties in poor state of repair that would need excessively expensive retrofits. It could however be linked to programs to facilitate energy retrofit to both improve energy efficiency and environmental impacts, as well as being a way to reduce high utility cost burdens that also contribute to affordability challenges.

The annual cost to implement such an acquisition fund is estimated at $1.35 Billion: with roughly 1.0 Billion) in loans, with the remaining $330 Million in a forgivable loan contribution. This balance could shift to a larger loan component if CMHC favourable financing is secured.

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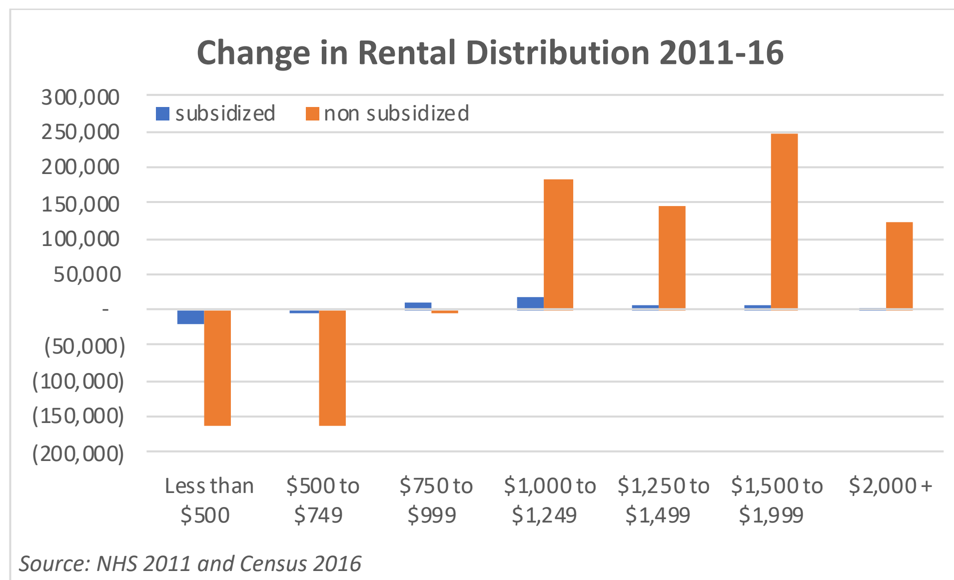
[2] The term “non-profit” is used throughout this brief to encompass any housing corporation, society or co-operative that would own and operate or facilitate the proposed acquisitions on a non-speculative basis.

1. Quantifying the problem

Between 2011 and 2016 the number of existing private rental units with rents below $750/month (affordable up to incomes of $30,000) declined by 322,600 units [3]. By comparison the F/P IAH program , augmented by unilateral initiatives, mainly in BC and Quebec created fewer than 20,000 new affordable units – so for every new affordable unit created, 15 were lost.[4]

Alongside other initiatives, over ten years the National Housing Strategy (NHS) is designed to create 100,000 units on new sites plus a further 50,000 via infill and redevelopment of existing social housing. Despite billions of dollars of planned investment under the NHS, Canada's affordable housing stock is eroding faster than new initiatives are planned to respond. It is therefore critical that the NHS be augmented with a specific program and funding to enable non-profit providers to acquire and preserve existing NOAH properties.



Source: NHS 2011 and Census 2016

Naturally occurring affordable housing (NOAH) is a legacy of past private investment, often stimulated by incentive programs such as the Limited Dividend program, Assisted Rental program and MURB tax measures. These programs created a large rental supply at historic cost, especially through the mid- 1960's through 1980s. Many of these units continue to provide housing at below median market rents (which is the benchmark for new affordable development).

A federal acquisition program could also address the need for alternatives to congregate living for homeless people. The Covid pandemic has revealed fault lines in Canada homeless-serving emergency system, and heighted concerns that homeless people have nowhere to "go home

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[3] Based on the 2011 NHS and 2016 Census rental distribution.

[4] New affordable production data based on units reported to CMHC and funded with assistance via IAH. This excludes additional unilateral provincial units, primarily in BC and Quebec.

and stay home." While temporary accommodation has been secured via motel and hotel accommodations, those temporarily assisted will have few options beyond the streets or returning to the emergency shelter when these arrangements end.

To prepare for and avoid the spread of disease in a future pandemic we must accelerate and expand the housing options available to those exiting the shelter system. One promising approach is the modular housing initiative piloted in Vancouver and now being adopted in Toronto to quickly create self-contained housing for those leaving homelessness. Another approach is to purchase and convert motels, small hotels and other self-contained rooms now being used as temporary accommodation into permanent supportive housing.

An acquisition program can support the acquisition of existing motels or small hotels alongside acquisition of multi-unit rental properties.

2. Why is the NOAH Stock Declining?

There are a number of factors contributing to the erosion of naturally occurring affordable housing, including both the absolute loss of affordable homes and particularly the increase of rents above the affordable rent range. A recent increase in demand, long-term low supply and the emergence of residential rental property as an attractive investment class have all contributed to what is now identified as the commodification and financialization of rental housing.

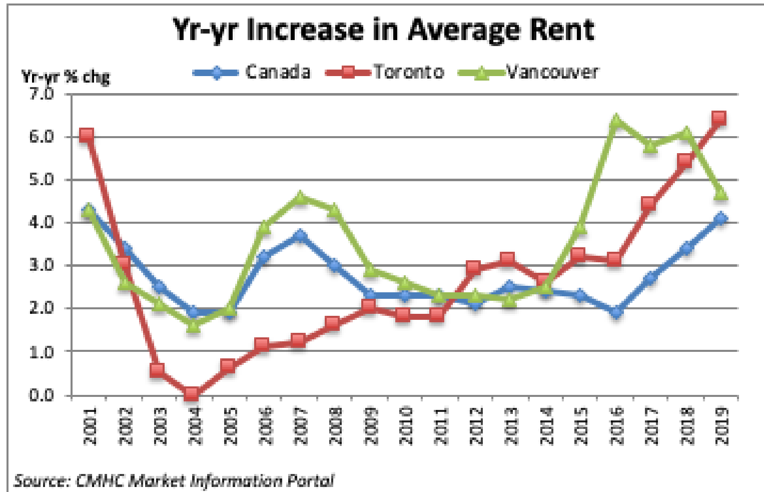
1. The data identify a shift in the rent distribution rather than an absolute loss of units. In fact non-subsidized renter occupied dwellings increased from 3.50 million to 3.88 million units between 2011-2016. So many units may still exist, but rents have increased above affordable levels. The 2019 CMHC rent survey reveal rents increasing three-four times faster than the rate of inflation; and more so for vacated units where increases often exceed 15% above the prior year.
2. For the many units that still exist, but with rents moving up above affordable levels, the critical issue is financialization and commodification. Capital funds and Real Estate Investment Trusts (REITs) target these NOAH properties as "underperforming assets" ripe for the picking, as illustrated in the Globe and Mail quote:

> "Starlight, the company to which Q recently sold its large apartment portfolio, just raised $216 million to deploy into rental properties in the United States, telling investors ***there is the potential for 'significant increases in rental rates' by making minor fixes to the properties and then hiking rents".***
>
> Globe and Mail Feb 3, 2020 [Bay Street Targets Toronto Rental Apartments]

3. Although operating at a smaller property scale, the emergence of short-term rental companies such as Airbnb has enabled both small investors and some large corporations to generate much higher revenues than those generated through long-term tenancies. Short-term rentals have particularly affected smaller rental properties. For example, in Ottawa since 2015, where each year there have been on average 60 transactions,

involving around 2,000 units, almost half of all multi-residential property transactions have been in properties of eight units or fewer. Many of these units have been purchased by individuals or corporations for the purpose of operating short-term rentals, removing as many as 850 units each year from a rental stock of 68,000 units.

4. The expansion of financialized housing has been significantly abetted by low vacancy rates, increasing rental demand and opportunities to raise rents. Since 2014 the year-to-year rent increase has exceeded the rate of inflation by two to three times, especially in the largest metro areas.



Under these conditions, residential rental property has become a strongly favoured asset class (notably distinct from a basic need and a home). Funds like Starlight and Blackstone, as well as the expansion of Real Estate Investment Trusts (REITs), are having a significant impact in pushing rents above affordable levels. The number of REITs in Canada has increased from a half dozen in 1995 to over 40 today (although not all invest in the residential sector). Their sole purpose is to purchase property and increase rental income for their investors. The existing NOAH properties are the collateral damage.

That said, it is not just the Capital funds and REITs that are driving these rent increases. While the loss is quantified above as over 300,000 units in just 5 years, REITs remain a small part of the rental sector. In a 2017 analysis of ownership, REITs were identified as owning only 7.9% of the purpose build rental universe. [5] This totals 2.1 million, units so REIT account for only 160,000 units. They may be a significant contributing factor in high rent increases, but are not the only driver of this trend – new investors and owners of the remaining 1.8 million units are equally culpable.

5. Increasing demand, and thus the increased attraction of this asset class, is also a consequence of federal macro-prudential policies such as stress tests, implemented to address concerns about growing household debt. By constraining access to homeownership for potential first-time buyers, these policies have increased residual rental demand. This is very different from the late 1990s and 2000s, when, on average

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[5] CMHC (2017*). Rental Ownership Structure in Canada*

over 80,000 renters per year transitioned from renting to owning, and the national ownership rate increased from 63% to 69% (between 1996 and 2011). During these years, rental demand weakened. While vacancy rates were still low in some markets and there was some rent pressure, this was far less extensive and significant than it is now- no longer assisted by the vacancies created by renters transitioning out to ownership.

6. Between 2011 and 2016, for the first time in Canada's history, the national rate of homeownership declined, and has likely continued to decline after 2016. There are now more renters applying demand in a constrained market. For the 20 years between 1995 and 2015, new rental construction accounted for less than 10% of all new construction – even though over 30% of households are renters. The cumulative effect of low supply and now substantially expanding demand creates an environment that encourages and enables the substantial yr-to yr rent increases charted above and thus supports rampant financialization.
7. And there is also evidence of absolute loss. Using the more narrowly defined CMHC universe of private purpose-built rental housing (totalling 1.9 million units in 2016), we can examine the change in this stock with more precision than the broader census universe (3.88 million private non-subsidized units). The purpose-built rental universe should increase as recent rental completions come into use. In 2000 the CMHC universe was 1.84 million units. Based on the addition of 420,000 purpose-built rental completions since 2000 the universe should now be 2.22 million units in 2019. However, the 2019 CMHC universe remains at only 2.10 million units – 116,000 fewer units than anticipated. ***This implies an absolute loss of 116,000 rental units (11,000 units per year)*** – most likely older lower-rent properties. [6]
8. Much of this absolute loss is caused by intensification policies and associated redevelopment. With such policies focused on older inner-city areas, the collateral damage is often three- and four-storey walk-up rental building created in the 1960s, usually with still moderate rents. For example, in Toronto's Mimico neighbourhood there are 3,000 such properties with average rents at 83% of the City median rent. The demand for, and pricing of, new condominium units frequently displace these older affordable units (although some cities have adopted replacement bylaws).

[6] Going back further to 1990, in that decade a further 157,000 purpose-built units were lost. At that time, the main cause was conversion from rentals into condominiums, although some of these main have been investor purchased, and thus remain in the secondary rental market.

3. How to respond to the problem of erosion and financialization

Just as there is an array of contributing factors leading to the loss of Canada's affordable rental housing, there is also an array of potential responses. These are of two forms:

- Efforts to prevent (or reduce) the practice of financialization; and
- Options to offset financialization by encouraging and enabling non-profit acquisition (focusing on small- and mid-sized properties with existing rents at or below the market median – essentially the NOAH stock).

A hybrid option would be to enable non-profit acquisition by creating incentives for owners of existing rental assets to sell to a non-profit purchaser. A separate analysis completed for BCNPHA has explored the option of a vendor tax credit as an incentive to encourage existing asset owners to sell to non-profit providers.

3.1 Slowing or preventing financialization (acquisition by private capital funds)

The idea of prohibiting private transactions has been proposed by poverty and tenant advocates and by the former UN Rapporteur, Leilani Farha. They advocate for legislation and regulation to prevent the sale of existing properties (and their purchase by Capital Funds and REITS) as well as reform to rent regulation such as adjusting vacancy decontrol.

One approach to slow the impacts of financialization is the City of Montreal's initiative to establish a right of first refusal on multi-unit property sales to enable a public entity (in this case the City) to purchase ahead of a private purchaser. This approach is rooted in an extensive practice of acquisition facilitated by both the City and social investment funds, and supported by a strong renter culture, strong rent regulation and strong tenant associations across Quebec. The bylaw creating a Right of First Refusal in Montreal has only recently been adopted and has not yet been tested.

The context in the rest of Canada is much different. There are also practical challenges, including an issue of moral hazard. Vendors may deliberately price properties above their true value to either circumvent or game the regulation. If the City intends to purchase only lower rent properties, for example, owners contemplating selling properties with rents below median rents may accelerate rent increases via vacancy decontrol to exceed that threshold, leading to the very outcomes that acquisition was designed to prevent.

A second approach is to review and reconsider rent regulation. It is the policy and practice of vacancy decontrol that has been the primary contributor to rent inflation double and triple the rate of inflation (increase in the CPI). Removing decontrol and reverting to a guideline increase, even for vacated units would stall the excessive increases on unit turnover. Such regulatory reform, would however face opposition from the industry, which has long argued that past more restrictive regulation discouraged rental construction. The volume of new rental construction has recently increased, and reflects the stronger yields created by the decontrol mechanism.

Another option may be to examine regulations on mortgage lending to investors. Most rental investment properties are highly leveraged, so restricting the loan to value ratio, or in the case of smaller property investors restricting use of individual home-equity lines of credit to acquire investment properties might have some effect.

Such regulatory proposals will likely meet some push back and may be challenging to achieve but can be pursued in parallel with an acquisition approach.

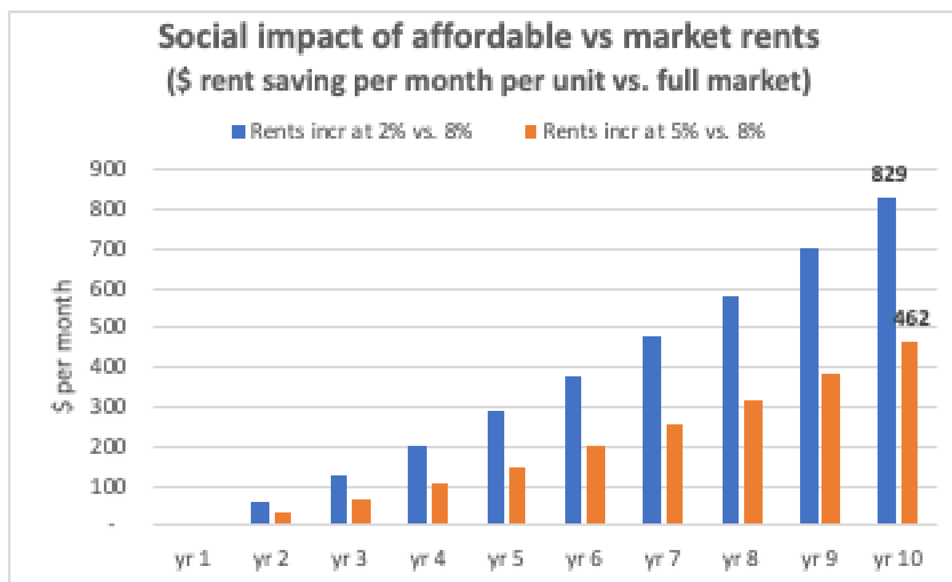
3.2 Encouraging and facilitating acquisition

An approach, which can either complement or be pursued independent of regulatory initiatives would be to encourage and explicitly support non-profit acquisition of rental properties as a way to permanently remove assets from the speculative market.

In a sense, this means emulating the approach of REITs, but in a more benign way. While the REIT seeks to maximize revenue and return to the investors, the non-profit seems to maximize affordability and is not motivated to generate a surplus beyond that required to ensure viable operation and some reserves for capital renewal as the asset ages.

The intent is not to acquire and seek to reduce rents to very low affordable levels. Rather it is simply to preserve existing moderate rents and to slow the future rate of increase in these rent levels. For example properties with rents currently at 90%, would continue to have modest (rent index based) annual increases, but as the market median moves, would remain at or below 90%.

Modelling of longer-term yields and associated rent levels under a current conditions, where the average rents may rise annually at 5%-8% vs. an affordable market scenario were rents would still inflate, but only at the rate of inflation (here assumed at 2% p.a.) reveals the type of social impact such a NOAH acquisition could have.



Using an Ottawa case study project where the current blended one- and two-bed rent is 1,031 we can compare a 2% rent guideline increase to the recent rate of increases of 5% or 8%

annually. After 10 years the base rent would have increased to $1,238; meanwhile a market rent increasing at the recent 5% would be $1,600 and at 8% p.a. at $2,031. Thus the difference is $462 and $829 less per month respectively. This represents a substantial social impact rate of return.

3.3. Need for financial support

Unlike a REIT or a capital fund, non-profits do not hold a nest-egg of investor capital to deploy into the acquisition market. In order for non-profit providers to pursue acquisitions there are a number of pre-requisite considerations:

- Existing assets have ongoing rent cash flow (and are valued based on the capitalization of that cashflow) and can carry debt. Depending on mortgage rates and terms, this may be in the order of 80% of the cost. Consequently it is necessary to have access to cash reserves or equity to cover 20% (or more) of the cost. Few existing non-profit housing providers have this minimal cash or reserve.
- To pursue acquisitions, a purchaser must be ready and nimble. In the absence of equity and pre-approved financing, the non-profit is dependent on securing funding under a public program. Even in the best programs the application and approval process takes time. Under the NHS, approvals have been extremely slow and do not fit well with an acquisition model. To acquire properties, potential purchasers must be able to act quickly with few or no conditions on the offer. Without this assurance, they cannot compete with unconditional private offers.
- While a potential acquisition may appear affordable, not all properties are appropriate or in sound condition. The purchasing non-profit must have the expertise and capacity to quickly complete due diligence and assess value for money before submitting a bid.

Some useful lessons are available from Quebec, where acquisition has long been a key part of the social-affordable housing eco-system. At different times the City has funded acquisition programs, and a private social impact fund (Fond D'Investment de Montreal - FIM) has also been created to support this approach. Municipal housing agencies and community based technical assistance groups (Groupe Resource Technique, GRT) have acted as intermediaries in identifying potential purchase opportunities, undertaking due diligence, arranging financing and facilitating the purchase.

Mid- to large-size non-profit providers often have the capacity and expertise to pursue acquisitions, but this capacity does not exist across the social/affordable sector. Montreal addresses this pre-requisite by having either the municipal housing corporation (SHDM) or one of the city's GRTs complete the acquisition and any necessary renovations. Properties are then transferred to smaller community-based providers (including supportive housing organizations) to own and operate.

In BC, the provincial housing agency acted through blind third-party facilitators in 2007 to purchase a portfolio of SRO properties to improve living conditions and install supportive operators. In this case, a capable provincial housing corporation, the serendipitous availability of funding, a pre-approved budget and the authority to act quickly enabled a unique acquisition

approach. And the relatively new Vancouver Community Land Trust also have the capacity to act as the purchasing intermediary or entity.

3.4 Incenting vendors to sell to the community non-profit sector

While investment properties come onto the market regularly, Capital Funds and REITs are pro-active in seeking out potential asset vendors. In order to be effective the non-profit sector must do the same thing. This can include creating or utilizing an existing intermediary organization that specifically pursues options, as well as building relationships with commercial realtors that specialize in this area.

In addition to identifying potential vendors, it would be beneficial to also incent them to sell to non-profits, rather than into the open market. Vendors, especially those that have held the property for many years, or decades, will face substantial tax liabilities due to capital gains tax and recapture of accelerated depreciation.

A recent research report for BC Non-Profit Housing Association found that these tax liability can reduce net proceeds on sale by 20-25%.[7] That same report suggested an option to create a vendor tax credit that would offset this impact and improve after tax proceeds, premised on a sale to a non-profit that committed to preserve affordability.

[7] Pomeroy, Steve, Greg Lampert and Margaret Eberle (2020, forthcoming) *Facilitating Non-Profit Acquisition of Purpose-Built Rental Housing*, prepared for BCNPHA.

4. How would an acquisition fund work?

There are two aspects to the proposal, how the funding mechanism is structured; and how it is delivered. The primary requirement of any acquisition initiative is a funding program that actively and explicitly supports acquisition by non-profits. The second requirement is the capacity to effectively pursue acquisition, Including the expertise to quickly complete due diligence and assess appropriate price and bid amounts and the financial capacity to undertake the acquisition.

4.1 The funding mechanism

Step 1 is the creation of the funding program. This could be a new stream within the existing National Housing Co-investment Fund (NHCF). However, the NHCF's current requirements for energy efficiency and accessibility are prohibitive in an acquisition model, at least at the outset. Downstream, retrofits to address some level of accessibility and energy efficiency could be added, drawing, for example, on the recently announced FCM $300 million Sustainable Housing Fund.

Alternatively, a new Acquisitions Fund could be established outside the NHCF. Such an approach would eliminate the need to negotiate the NHCF's energy efficiency and accessibility targets, and thus might be the faster route.

Existing rental assets are typically valued based on the capitalized net income and this rent revenue is used to support debt financing. Recognizing the limited cash reserves of existing non-profit providers, ideally the fund would permit financing up to 100% of cost, subject to meeting a minimum debt coverage ratio (1.1 may be appropriate).

Most NOAH target properties (rents below the median level) cannot support financing 100% of cost.

Accordingly some level of equity (likely 20-30% of price) is required, alongside financing. If a low rate financing, with favourable terms as available under the NHCF and RCFI were available, a higher amount of financing (and less equity, potentially as low at 10%) would be required.

While the NHCF seeks to lever partnerships and partner contributions, and therefore limits the level of grant and loan, in this instance such constraints are not appropriate. The intent is to maximize the capacity of non-profits to intervene in the acquisition market. Imposing requirements for partner contributions will severely limit participation and undermine the objective of reducing predatory private fund acquisition and erosion.

In addition to a sufficient combination of loan and grant, the efficiency of the funding delivery mechanism is critical.

4.2 The delivery mechanism

Property acquisition requires local knowledge and insight, expertise and capacity, along with regional or local conduits to the fund.

This implies only larger capable organizations can effectively undertake acquisition. But as the Quebec and BC experience shows, an intermediary entity can assume these functions and then transfer the assets to smaller providers including, in the case of rooming houses or special

needs housing, to a supportive housing provider. This transfer can take the form of a sale or a leasehold interest with the fund retaining ownership of the asset (e.g. this model may apply where the intermediary is a competent land trust). [8]

The following cascading options are suggested. These start with a basic federal funding mechanism while subsequent options explore how to expand capacity and enable locally based pro-active acquisition. The subsequent options and capacity can evolve over time.[9]

Option 1. Create the funding program with no additional local institutional infrastructure

Under this approach, the Federal Government would establish and manage a new acquisition fund under the NHS and managed by CMHC.

It is anticipated that only larger, capable providers, resource groups, as exist in Quebec, established community land trusts, as in Vancouver or entities like municipalities would be able to actively pursue acquisitions. However, these providers could still function as a form of intermediary, subsequently passing on assets to small local providers (as historically done in Montreal).

Ideally a system should be created to pre-approve acquisition intermediaries (with some accreditation assessment of competencies and capacity to complete searches for acquisition targets, undertake due diligence and facilitate the purchase). This should also include pre-approval of a credit facility that effectively guarantees the flow of funds, and minimizes the need for conditional offers to purchase.

Option 2. Expand local acquisition capacity

In locations where there is no existing competent intermediary, and a municipality is not willing or able to retain this role over the longer term, it may be desirable to create new intermediaries.

These might be created as collaborations across a network of existing housing providers, assisted by technical resource consultants or organizations (which were the mechanism to build non-profit and co-ops when the community housing model was initiated in the 1970s). They could also be in the form of provincial housing associations or community land trusts.

[8] Subsequent transfers may trigger land transfer tax. These would be avoided under a leasehold arrangement. Alternatively the program could seek provincial collaboration to waive the transfer tax in these specific circumstances.

[9] A much more aggressive approach, involving acquisition of entire REIT portfolios is discussed later, in section 7.

5. What is potential scope for an acquisition program

Data assembled in 2016 examined rental investment property sales for Vancouver, Toronto and Calgary. From 2011 to 2016, the average annual number of units sold among properties with 80 or fewer units was: 8,300 units per year in Toronto, 2,000 units per year in Vancouver and 460 per year in Calgary.

A more recent 2019 analysis in Vancouver confirms that, in the last four years, approximately 5,000 units per year were sold in the Lower Mainland. In Ottawa from 2015 through 2019 an average 60 rental properties and 2,200 units were sold each year.

Assuming that an acquisitions program would target only those properties at or below the median market level and requiring only minor repairs and capital replacements, we can project an acquisition target of 7,500 units per year.

Potential annual acquisition target
Based on recent transactions in Toronto, Calgary, Vancouver and Ottawa

	Total units transacting/year	Potential acquisition units	Maximum per year per city	Aggregate units/year
Largest 6 CMA's	2,000 to 5,000	200-500	500	3,000
Next 10 mid-sized CMA's	up to 1,500	100-150	150	1,500
Next 20 smaller CMA's	up to 500	50-100	100	2,000
Non-CMA	Up to 2,000	150-200	n/a	1,000
Totals	**35,000-55,000**			**7,500**

By precluding the loss of these 7,500 units to capital funds seeking to push rents above affordable levels, **an acquisitions program would have the same effect as building 7,500 new affordable units each year** -- equivalent to one-half of the NHS annual target of 15,000 new affordable units (including a 10-year target of 100,000 new units plus 50,000 new units added on existing social housing sites through intensification and redevelopment).

6. What would a Canada-wide acquisitions program cost?

We estimate that the acquisition of 7,500 units, distributed across large and mid-sized Canadian cities, would involve aggregate capital costs of $1.35 Billion per year.

Of this $1.35 Billion, assuming financing on the basis of 75% loan-cost ratio, three-quarters of this ($1.0 billion) would be in loans, with the remaining $336 million in forgivable loan contributions, for which some downstream return on equity may be generated).

This estimate is based on the following assumptions:

Property acquisition costs would range from an average $145,000 per unit in smaller markets up to $225,000 per unit in large CMAs

- Projects operating at market rents will continue to generate sufficient rental revenue to support debt service at 75% of cost. Note that this program is designed to preserve moderate rents already at or below local median rents rather than reduce rents to deeply affordable levels. Over time these rents can either generate cash flow reserves to cross-subsidize affordable initiatives or enable rents to gradually fall further below the inflating market median rent. In some cases a non-profit operator could selectively lower rents upon unit turnover where tenant income levels qualify for reduced rent.
- At the outset, the non-profit partner will not contribute equity. The acquisition cost will be covered at 100% of costs with a 75% loan and 25% equity contribution.[10] Options to relax this assumption are discussed below.

Acquisition Program: Gross capital requirements ($ Millions)

	Gross capital need	**Loan funds at 75% price**	**Equity at 25% price**
Largest 6 cma's	675.0	506.3	168.8
Next 10 mid sized CMA's	255.0	191.3	63.8
Next 20 smaller CMA's	290.0	217.5	72.5
Non-CMA	125.0	93.75	15.6
Totals	**1,345.0**	**1,008**	**336.25**
Average/unit	179,300	134,500	45,800

Note that even with no non-profit contribution, the cost to government for each affordable (below median rent) unit preserved is less than $50,000 -- **less than one-third the grant required to build a new unit at the same affordability level.**

This is an estimate of the maximum annual budget. For simplicity, we have assumed that non-profits do not have sufficient reserves to purchase properties, or would prefer to direct any

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[10] Were CMHC to provide financing on the same favourable terms provided under the NHCF and RCFI (10-year bond rate plus 50 basis points) with an up to 35-year amortization period, the loan to cost ratio could potentially be increased as high as 85%. For acquisition, a 50-year amortization period used for new construction would not be appropriate.

reserves to new affordable housing construction (even though investing in existing properties is an effective way to lever their capital reserves and generate accumulating cash flow.)

7. An audacious extension of the acquisition approach – a NOAH-REIT

In setting out the rationale for an acquisition approach, the ongoing erosion of the existing naturally occurring affordable housing (NOAH) stock was highlighted -- over 300,000 units were lost between 2011 and 2016 (on average 64,000 units each year).

In proposing a new funding mechanism to enable non-profit acquisition, and premised on the volume of annual investment property sales combined with the desire to avoid those in need of major retrofit and those with rents above the median rent level, it has been suggested that a realistic target may be in the order of 5,000 to 10,000 units annually.

The juxtaposition of this acquisition target level with the scale of erosion (64,000 units per year) suggests that such an acquisition approach, while perhaps significant against the modest targets of the NHS (to add 15,000 affordable units annually), is dwarfed by the scale of erosion. Accordingly a much larger and more aggressive approach may be warranted.

How can an acquisition model be scaled up to a level that has significant impact – one that quickly gets to a scale of 50,000 units and potentially grows to 100,000 units? The only practical way to achieve this scale is to expand beyond purchasing individual properties to purchasing entire portfolios.

This suggests the option of creating a NOAH-REIT with a mandate to aggressively acquire properties – not just from those coming on market, but by seeking to purchase portfolios from existing REITs (who frequently trade properties as a way to capitalize value gains, and enhance the fund yield. A variant and potentially more effective approach is to purchase all or portions of existing REITs – both the portfolio and the existing management structure.

Table 1 reveals the current size of the largest publicly traded REITs active in residential real estate in Canada (other private equity funds are also active, but because these are not publicly traded, no information is readily available of the size of their holdings. A purchase-takeover of two or three existing REITs could assemble a portfolio of close to 50,000 and could be used to quickly create a NOAH-REIT. This could be augmented by a proactive acquisition strategy to acquire privately held portfolios of rental properties.

7.1 Instant capacity

A strategy to acquire existing REITs could help overcome the issue of limited expertise and capacity in the Non-profit sector. If the existing management structure were part of the acquisition, the acquired REIT would already have in-house expertise. These existing REITs are to varying degrees already active across a range of provinces and markets, so provide access to the larger more active markets.

Unlike a non-profit owner operator, which may have an inclination to shift the business model from one that generates revenue to one that seeks to maximize affordability, retaining existing

private sector management would ensure that the NOAH-REIT continues to operate on an entrepreneurial basis. However its mandate would be revised to align as a social impact investor.

Table 1. The top 25 largest Canadian landlords, 2017[a]

Rank	Landlord	Type of Company ("shaded if financialized")	Suites
1	CAPREIT	REIT	43,080
2	Boardwalk REIT	REIT	33,187
3	Realstar Properties Ltd.	Real Estate Investment and Asset Manager for pensions (e.g. bcIMC)	30,200
4	Homestead Landholdings Ltd.	Private, family-run company	25,790
5	Starlight Investments Ltd.	Real Estate Investment and Asset Management Company	26,221
6	Northview REIT	REIT	25,188
7	Timbercreek Asset Management	Real Estate Investment and Asset Management Company	18,429
8	Skyline REIT	REIT (private)	16,654
9	Killam REIT	REIT	14,983
10	Minto Properties Inc.	Private integrated real estate company and fund manager (REIT as of 2019)	11,755
11	Quadreal (bcIMC)	Institutional Investor (Pension fund)	11,258
12	Mainstreet Equity Corporation	Publicly-traded real estate company (TSX: MEQ)	10,181
13	Drewlo Holdings Inc.	Private, family-run company	8,558
14	Park Property Management	Private real estate company	8,418
15	InterRent REIT	REIT	8,660
16	Morguard Corporation (includes North American Residential REIT)	REIT and publicly-traded company (TSX: MRG.UN, TSX: MRC)	9,364
17	Q Residential (Conundrum Capital)	Private Equity firm	7,418
18	Akelius Canada Ltd.	Foreign private real estate company	5,500
19	Oxford Properties Group	Institutional Investor, on behalf of OMERS, large Canadian pension plan	6,403
20	Globe General Agencies	Private real estate company	6,720
21	Centurion REIT	REIT (private)	5,511
22	Osgoode Properties	Private real estate company	5,624
23	Hollyburn Properties Ltd.	Private, family-run company	5,143
24	M&R Holdings	Private, family-run company	4,810
25	Pinedale Properties	Private, family-run company	3,855
	Total ownership by financialized landlords in Top 25, 2017 (ie. shaded entries)		**290,712**
	Total ownership by all landlords in Top 25, 2017 (ie. all entries on this list)		**352,910**

[a]CAPREIT (2017, p. 4), Boardwalk REIT (2017, p. 3), Northview (Northview REIT, 2017), Killam (2017), Akelius (2017, p. 3); InterRent REIT (2017), Morguard (2017), Q Residential's 2017 totals estimated by combining suites held by their two operable funds (http://conundrumcapital.com/funds/). Canada Apartment Magazine's 2017 "Who's Who" in Canadian apartment ownership data was used for the remaining companies not cited above.

Source: Martine August (2020): The financialization of Canadian multi-family rental housing: From trailer to tower, Journal of Urban Affairs, DOI: 10.1080/07352166.2019.1705846

Inflationary increases in rent would be acceptable; but the NOAH REIT would not seek to maximize return via pursuing rent increases above the annual rent guidelines legislated in provincial rent regulations. i.e. it would not seek to maximize rents on vacancy decontrol.

This revised mandate would be pursued under a new trustee governance model, wherein the public sector equity investors (CMHC and potentially Provincial government housing agencies).[11]

[11] It may also be possible to collaborate with other social impact investors – including Community Foundations.

As noted earlier, when operated with the objective of balancing viability with preserving affordability, such a fund has a substantial social impact. Compared to increases of 5% or 8% annually, in a pure market profit maximizing model, after 10 years the NOAH REIT average rent would have increased by $462 and $829 less per month respectively.

7.2 **Funding the acquisitions**

As suggested acquiring existing REITs with a target of 50,000 units would require an investment of $10 billion. This can be funded by leveraging the net rental income to cover potentially 80% of the cost, it will also require an equity investment of $2 Billion. While this seems significant, it represents less than 4% of the funding committed to the National Housing Strategy. Moreover, as an equity investment, over time it generates a return, distinct from a subsidy expenditure.

And it is much lower than other initiatives pursued in the current covid pandemic. For example, the federal government has authorized CMHC to invest $150 Billion to implement a revised Insured Mortgage Purchase Program (IMPP). Under this program, the government stands ready to purchase up to $150 billion of insured mortgage pools through CMHC. Here the policy objective is to ensure liquidity in Canada's mortgage market.

The federal government has invested $4 billion to purchase the TransCanada Pipeline, and will require much more to build it out. Here the policy objective is to protect jobs and ensure that Canada's economy is strengthened by helping to move Alberta Oil to international markets.

By the same token, purchasing existing REITs can serve a critical public policy objective of slowing the drastic impact of financialization, and its impact in eroding the existing affordable stock (loss of NOAHs). By investing to preserve NOAH properties, the impact of the NHS investments are strengthened (vs. negated under current conditions).

Because the REITs generate healthy dividends, similar to the individual assets generating operating income, the acquisition can be supported by a leveraged purchase, and does not require a large cash outlay by the federal government. This would not be a subsidy expenditure; it would represent an equity investment by the federal government (and any potential co-investors).

Potentially, an equity investment of $1-$2B may be required, with the remainder of the purchase price managed via financing, ideally utilizing CMHC''s access to low rate financing through the crown borrowing facility, as used to finance NHS lending under RCFI and NHCF.

7.3 Rebalancing the NOAH-REIT

If acquiring the entire portfolio of existing REITs, there will be a mix of property asset, some which do not meet the policy intent to acquire and preserve NOAH properties with rents below the median level. The NOAHREIT would gradually dispose of these assets and use the proceeds to gradually expand the more targeted portfolio.

Overtime, the NOAH REIT would continue to seek out and acquire additional NOAH properties, and seek to grow to over 100,000.These properties could be help in a single REIT, or it could be restructured to create more regionally focused NOAH REITs (e.g. BC, Prairies, Ontario, Quebec and Maritimes).

8. Other acquisition opportunities

Acquisition of motels/hotels

Separate from the acquisition of existing rental apartment properties, there may be opportunities to acquire non-residential properties such as motels or small commercial buildings that can be readily converted into residential.

This is especially true of motels, where small self-contained units with a full bath and kitchenette can be easily converted to small-suite supportive housing. For example the Yellowknife Women's Society is now acquiring an existing 42-unit motel and converting into permanent supportive housing). [12] In Victoria the provincial government recently purchased a The B.C. government has purchased a Comfort Inn Hotel to provide temporary shelter with supports for 65 people living in homeless camps at Topaz Park and Pandora Avenue. They plan to subsequently convert into long term permanent supportive housing. Advocates in Ottawa have initiated a campaign (Hotels2Homes) to encourage the City to similarly purchase motels.

During the Covid pandemic, many homeless persons have been temporarily housed in motels. As we transition to a "new normal" these individuals should not be forced back onto the streets or back into emergency shelters. The acquisition of small apartments, hotels or motels is a way to create healthier self-contained accommodation for homeless people much faster than new construction.

It should however be highlighted that when the acquisition is targeting more vulnerable populations the funding requirement is very different. Unlike the previously discussed apartment acquisitions, which have market based rental cash flow to support financing, properties targeting former homeless and other vulnerable populations with little or no income will not have this rental revenue, and accordingly will require a funding mechanism premised almost entirely on grant.

Properties with potential for redevelopment

Financialization is one contributor to the erosion of the NOAH stock. The other major contributor is the purchase of properties for redevelopment or intensification. In the absence of rental replacement bylaws, the existing NOAH properties are at risk.

An acquisition fund could facilitate the purchase of these at-risk buildings to be operated "as is" as affordable market rental housing. Redevelopment and intensification could still be pursued at some point, but under the control of a non-profit developer motivated to expand the number of affordable units, possibly within a mixed affordable and market approach.

Thus the acquisition program can help to establish a foothold in a redevelopment area that may be gentrifying and ensure an ongoing income mix and availability of affordable housing.

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[12] Notably, while extremely cost effective, the attempt to secure funding under NHCF was initially rejected – in part due to inability to meet the accessibility and energy retrofit requirements of the new construction stream of NHCF (which the acquisition did not fit). It was only the urgency of the Covid crisis that highlighted the need for temporary emergency housing that enabled this project to proceed with financial assistance under the NHCF. Under a return to "business as usual," this project would not have been possible.

9. Conclusions

There is a compelling need to address the rapid erosion of the naturally occurring affordable housing (NOAH) stock.

The pace at which properties and thus units are being lost is alarming – between 2011-16 over 300,000 rental units below $750, and thus affordable up to annual incomes of $30,000 were lost. This was either in absolute terms in the case of intensification related redevelopment – or due to raising rents, often purposefully increased as a way to enhance yields to investors.

The erosion of this affordable supply has been directly linked to increasing levels of homelessness. And as low rent stock disappears there are no affordable options to facilitate Housing First for individuals seeking to exit homelessness.

To offset this erosion by new construction would require quadrupling the planned targets of the NHS and substantially expanding the NHS funding (to in excess of $200 billion).

So an acquisition strategy is preventative both fiscally and in terms of preventing growth in the number of homeless persons and families.

This brief has detailed the rational and lays out a number of potential paths forward framing at a conceptual level both a proposed new funding program combining grants (or forgiveable loans) and financing, as well as suggestions for a delivery mechanism, as well a much more aggressive larger scale approach that envisions acquisition of existing REITs for a far more significant impact- scaling up quickly to 50,000 or more units.

Two parallel tracks are identified – efforts to regulate against speculative purchase, especially as smaller landlords fall into financial difficulty during the current pandemic as well as the proposed acquisition funding mechanism. And an acquisition strategy.

It is noted that the proposed acquisition approach is premised on acquiring existing rental assets and continuing to operate these as a going concern. This approach is insufficient to facilitate acquisition of properties that are targeted to the most vulnerable, including those dependent on income assistance and those exiting the homeless system. Their rent paying capacity is very low and requires deep capital subsidy as well as potentially ongoing rental assistance. Options to address this need, and higher levels of capital funding should be developed separately.

However acquiring and preserving NOAH properties, even with ongoing modest inflationary increases can over time achieve rents that decline relative to a percentage of the market median.