Financing Affordable Housing

Presentation to the OMSSA Housing Forum

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March 8, 2018

Overview of Presentation

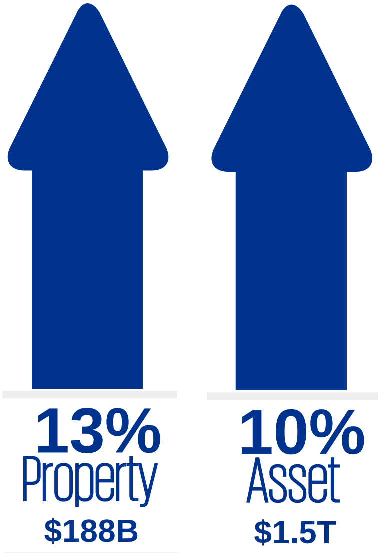
- Institutional investors
- Deal Structure
- Financial analysis
- Emerging trends
- Case studies

"There has never been a more exciting time to be…".

In Affordable Housing!

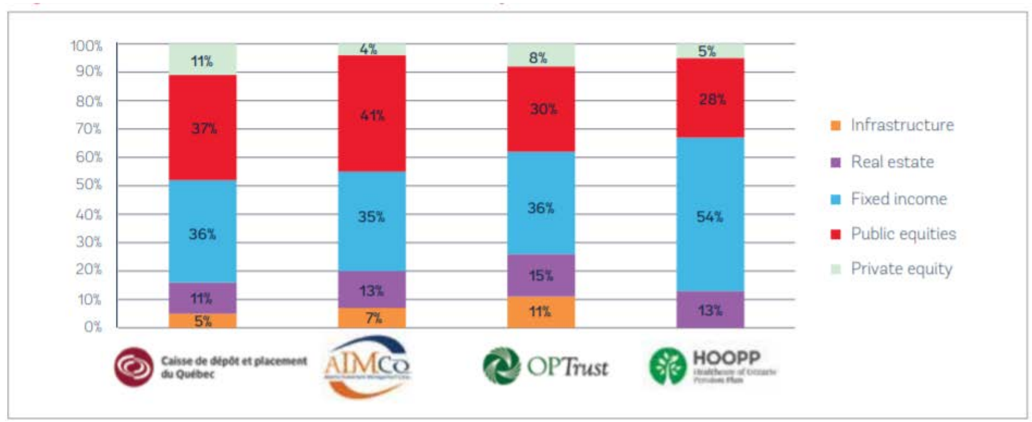
Institutional investors

Institutional Investors - Pension Funds



- At the end of 2016, the country's top 24 pension plans had 13 per cent (or $188 billion) of their $1.5 trillion of assets invested in property, according to RBC analysts Neil Downey and Michael Smith.
- Pension funds are turning to real estate. During the same period real property investments jumped from $32 billion in 2004 to $188 billion in 2016, equating to a compound annual growth rate of about 16 per cent.

- Canadian pension funds are increasing their asset mix to include real estate assets. The asset mix below is from a recent report by Common Wealth, *The Evolution of the Canadian Pension Model*



Spotlight - OPTrust

- The majority of OPTrust members are current and former employees of the Ontario public service, including several government agencies.
- OPTrust views itself as a long-term investor, and this is reflected in its asset allocation. It diversifies across asset classes and different geographies to achieve its objectives. This approach aims to generate the funding target return over a long-term horizon, while avoiding substantial negative returns in the short term.
- Among Canadian pension plans, OPTrust has distinguished itself as an active participant in public policy debates and broader industry issues, advocating on matters such as retirement security policy, responsible investing, and climate change.

Overview:

- Established in 1995
- Administers the Ontario Public Sector Employee Union Pension Plan
- ~90,000 members

Assets: $19 billion

10-year return: 6.2%

Source: Common Wealth, The Evolution of the Canadian Pension Model

Institutional Investors

- Factors that may attract investment include:

Right product: An affordable housing – rental housing – is most likely to succeed if the investment product is characterized as an 'infrastructure-style' offering with steady, predictable cash flow from rental revenue.

Sufficient scale: Institutional players are attracted by opportunities that range between $50 million to $250 million. If offering an aggregated set of assets, the scale shifts to at least $500 million.

Mix development: Offering the investors to develop a mix of market and affordable housing on the site will assist in enhancing the rate of return and the scale.

Facilitate intermediaries: To help deliver scale and liquidity for institutional investors (and overcome fragmentation), specialist intermediaries could pool together larger portfolios of different types of rental investment opportunities in a range of locations and managed by a variety of providers.

Source: Australian Housing and Urban Research Institute

Deal Structure

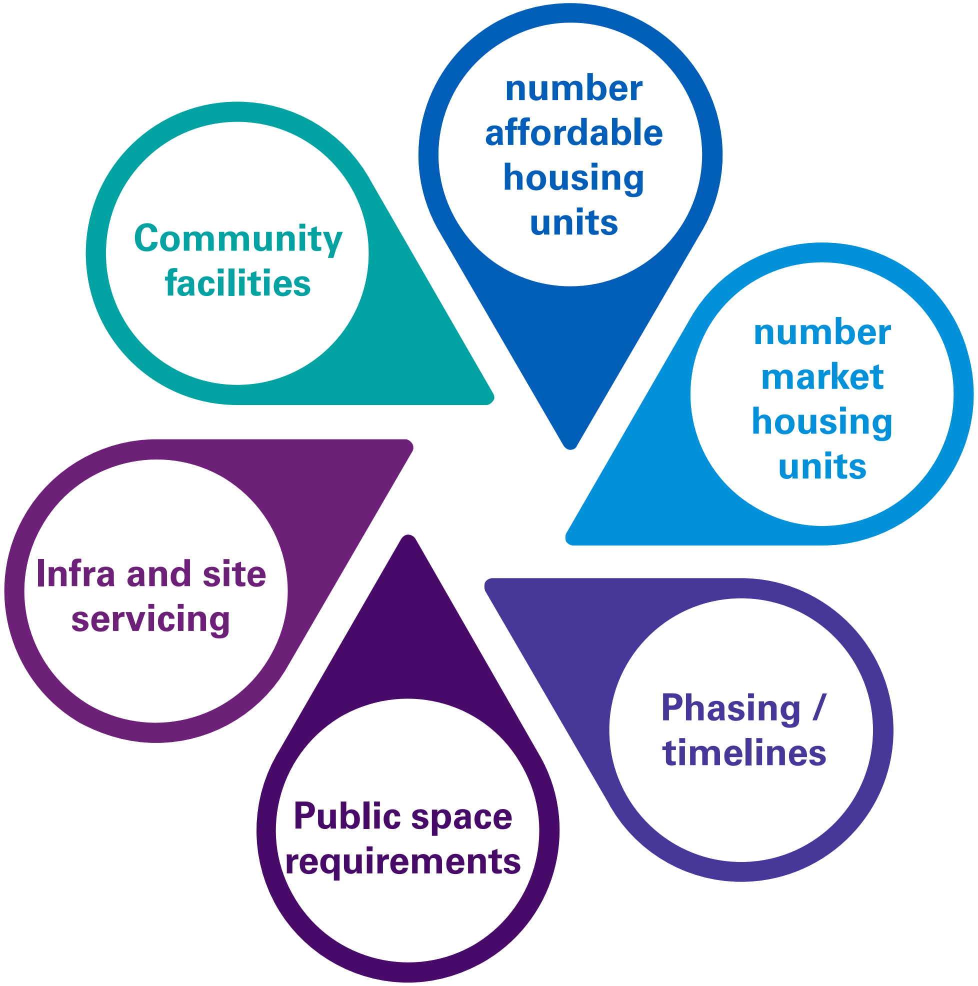
Deal Structure Objectives

Transfer risks to the party best suited to mitigate that risk

Leverage up limited public sector resources

Encourages innovation in project design and delivery

Deal Structure Components



Deal Structure

Special Purpose Vehicle (Standalone Entity) as developer / asset owner

Graphic removed due to proprietary information, please contact Martin Joyce (martinjoyce1@kpmg.ca) for additional information.

Key questions

- How to market the opportunity to potential partner so as to help ensure investment?
- Is there a reliable income stream for the investor to leverage?
- Any pre-conditions that would need to be addressed in advance, or in parallel with the development?
- Is the deal structure optimized for risk-adjusted returns?
- What is the phasing and timing for the overall development and procurement milestones?
- Is there a flexibility for innovation in the development of the project?

Financial Analysis

Financial Analysis Overview

- Prior to engaging in the financial analysis of an affordable housing development, it is essential to determine the preliminary development concept and delivery model for the project.
- This elements are often included in the business case for the project that is often adopted by the Board of Directors or executive decision-makers.
- The business case should include a high-level financial analysis that:

- It is important to identify the assumptions and dependent results as they may change as the project progresses and the analysis may need to be updated

Financial Scenarios

- In conducting the financial analysis, scenarios of possible implications or changes should be reviewed and understood.
- Common elements for modeling the scenarios include:
  1. Change in the assumed number of affordable housing units on the site
  2. Addition or removal of government services on the site
  3. Purchase of additional land
  4. Reduction in land for market housing
  5. Delay in development

Institution Investors - Areas of focus

- In exploring housing opportunities elements that institutional investors, such as pension funds, are focused on the following:

  1. **Risk adjustment**: Poor risk-adjusted rate of return on investment is the biggest issue for institutional investors.
  2. **Long-term horizon**: Institutional investors are interested in assets with 25+ horizons, however there is limited data on asset performance of residential assets and uneven knowledge of the operational cash flows of affordable housing.
  3. **Certainty**: Greater certainty in the broader housing market and government policy enable greater investment by institutional investors in affordable housing.
  4. **Scale and scope**: Opportunities in affordable housing with scope and scale through either aggregation or consolidating a site are critical for institutional investment.
  5. **Impact**: Institutional investors are looking to participate and invest in assets that will result in positive outcomes for the community and are focused on impacts beyond financial returns.

Emerging trends

The Canadian Rockies

Common Tools | Housing Policy

1

Housing allowances

Funding provided by public entity to resident for rent in the form of cash or voucher.

2

Homeownership subsidies

Government provides grants or financial assistance for access to homeownership. Tax relief and subsidy for energy efficiency are also common instruments.

3

Rent support and regulation

Governments provides construction subsidy and taxation relief for rental housing. Common instruments also include tax relief for renters and rent controls in market rent units.

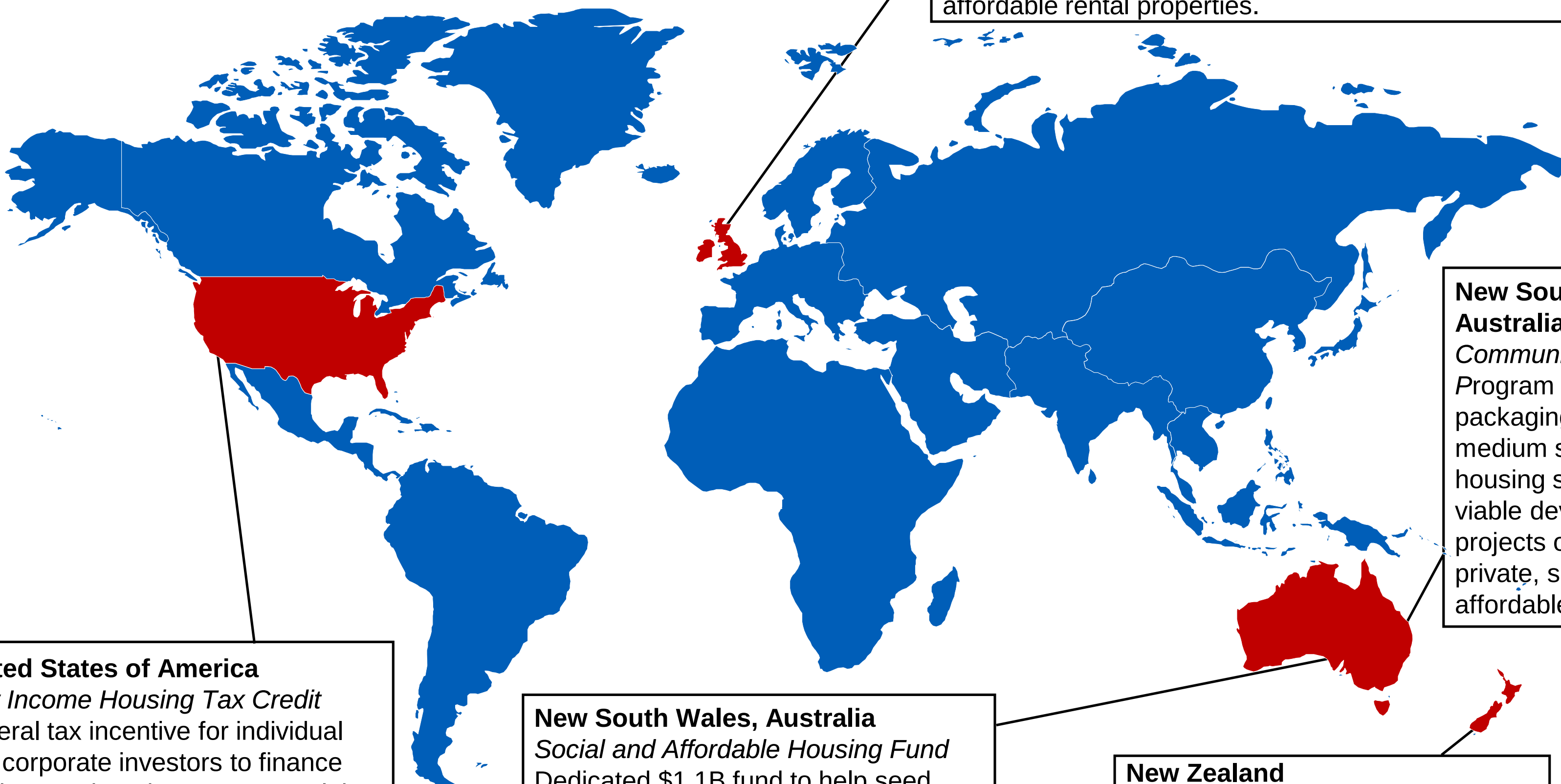
4

Social rental housing

Stimulus funding for social rental housing construction including taxation relief.

Source: *Policies to promote access to good-quality affordable housing in OECD countries,* OECD Social, Employment, and Migration Working Paper No. 176 (2016)

Global Trends | Housing Stimulus Programs



United Kingdom
Housing Finance Corporation
Leading affordable housing aggregator, which lends long-term debt to over 170 housing associations who manage affordable rental properties.

New South Wales, Australia
*Communities Plus P*rogram assists in packaging small to medium sized social housing sites into viable development projects of mixed private, social and affordable housing.

United States of America
Low Income Housing Tax Credit
Federal tax incentive for individual and corporate investors to finance low-income housing. Investors claim tax credit for a percentage of incurred costs over a 10-year period.

New South Wales, Australia
Social and Affordable Housing Fund
Dedicated $1.1B fund to help seed social housing developments in order to develop 2,200 additional units.

New Zealand
Tauranga Housing Development
Government transfers 1,140 properties to Accessible Properties to foster innovation and seamless support for tenants.

Case studies

Case Study | Australia

The **Social and Affordable Housing Fund** (SAHF) is a $1.1 billion New South Wales Government initiative funding the provision of social housing - and related services - from private or non-profit consortia through an availability-type payment stream.

The Government's investment arm, TCorp, is investing the money to provide a stable income stream for up to 25 years to boost social and affordable housing, with homes to be built over four years.

The SAHF was established in early 2015, which saw an initial endowment of $1.1 billion of asset recycling proceeds invested in the Social and Affordable Housing Fund to fund the trial of the concepts developed in the paper *From housing assets, to housing people: Fixing Australia's social housing system*.

The SAHF will increase the capacity of the NSW social housing system by 2,200 new dwellings. The first phase of the SAHF aims to establish service agreements for social and affordable housing accommodation, comprising the delivery of housing along with tenancy and asset management, as well as coordinating access to social support programs and services where appropriate.

The majority of the 2,200 homes will be built on land contributed to the State by five non-government organisations.

In September 2017, the NSW Government announced that the second phase would provide 1,200 dwellings in addition to the 2,200 from phase 1.

The Government will begin market sounding to engage with community housing providers, not for profit and commercial organisations in October 2017. It is expected that some changes will be made to simplify the procurement process, compared to phase one.

Source: Australia & New Zealand Infrastructure Pipeline

Case Study | Australia

HESTA committed $30 million — the largest single commitment to the local impact investment market made by an Australian superannuation fund — to create a dedicated fund managed by **Social Ventures Australia** (SVA).

HESTA has a specific focus on impact investments in the health and community services sectors, which represent the core of our membership base, and allows us to leverage our organisation's extensive knowledge of the sector.

SVA and HESTA have designed a dedicated fund, the Social Impact Investment Trust, to allow HESTA to make direct and indirect investments in a range of businesses, housing projects and social impact bonds that deliver both financial returns and identifiable and quantifiable social impact.

SVA and HESTA will seek to make investments in organisations and enterprises established in Australia that include the following:

- senior and/or subordinated debt
- equity capital (including ordinary shares, convertible and/or redeemable preference shares, convertible notes and/or warrants); and
- Social Impact Bonds

The target minimum investment size is $1 million, with the actual amount of individual investments to be determined on a case-by-case basis by SVA.

Source: KPMG Research

Case Study | USA

The **Low-Income Housing Tax Credit** (LIHTC) is an indirect federal subsidy that finances low-income housing and allows investors to claim tax credits on their federal income tax returns. The tax credit is calculated as a percentage of costs incurred in developing the affordable housing property, and is claimed annually over a 10-year period.

Created by the Tax Reform Act of 1986, the LIHTC program gives State and local LIHTC-allocating agencies the equivalent of nearly $8 billion in annual budget authority to issue tax credits for the acquisition, rehabilitation, or new construction of rental housing targeted to lower-income households.

Unlike a tax deduction, which only reduces taxable income, the LIHTC credits offset dollar-for-dollar a party's tax liability.

Developers sell the right to use these credits to investors who want to reduce their federal taxes. The investor's payment for such right, its "capital contribution" to the project, reduces the developer's need to use other financing. This credit then reduces the developer's debt-service costs, allowing the development to be financially appealing even with below-market rental income.

Source: Office of the Comptroller of the Currency Insights

Sample scenario

Factor	Amount
Eligible basis[a]	$12,803,265
Applicable fraction (percentage of affordable units)	100%
Qualified basis	$12,803,265
Applicable percentage[b]	3.20%
Annual housing tax credits	409,704
Total housing tax credits (Annual housing tax credits x 10 years)	4,097,040
Net equity (Total housing tax credits x $0.90 (price per tax dollar))	$ 3,687,336

[a] The eligible basis refers to the construction costs that can be included in the LIHTC calculations. The eligible basis includes most hard costs, such as construction costs, and most depreciable soft costs. Excluded are land, commercial space, and any portion of professional fees (such as consultant or developer fees) that are above state-determined limits.

[b] For buildings that are placed in service after 1987, the 4 percent credit is recalculated on a monthly basis to yield a present value of 30 percent of the costs that qualify for the credit. The IRS publishes these rates at http://apps.irs.gov/app/picklist/list/federalRates.html.

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