

Coping with the end of income-tested assistance:

Can we continue to help
low-income households?



The
CO-OPERATIVE
HOUSING
FEDERATION
of Canada

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Introduction

More and more, our Section 95 members are asking how they can help low-income households with their housing charges when the CMHC income-tested assistance ends. Specifically, they are asking how to create a sustainable “internal subsidy” scheme. This guideline will explain how such a scheme could be put in place, but first, two big notes of caution.

1. “Internal subsidy” may not be sustainable

Co-ops should begin by taking stock of how much CMHC income-tested assistance they are currently using to reduce the housing charges of low-income households, based on their incomes. Because that’s the amount co-ops are going to have to somehow make up for internally, if they want to continue to offer those same reduced housing charges after the CMHC assistance comes to an end. And that may not be sustainable, as we shall see.

Co-ops may be able in the short term to continue to offer reduced housing charges to low-income households. But that will of course have the effect of reducing the co-op’s revenue. Meanwhile, co-ops are going to be faced with significant capital investment decisions as their properties continue to age. It may well be that the reduced revenues that result from income-based housing charges won’t be enough to cover all operating expenses and the costs of capital reinvestment, which will be some combination of a new mortgage payment and increased capital reserve contributions.

So co-ops are going to have to make some hard decisions about their capacity to continue with income-based housing charges. Do they continue with them and underfund their capital requirements, with predictably bad results? Or do they make the right decisions on capital investment and become unable to offer income-based housing charges? This dilemma highlights the uncertainty of an “internal subsidy” scheme, which is why CHF Canada’s members rightly believe that the only reliable way to assist low-income co-op households with their housing charges is with government support.

2. Some internal subsidy facts

First, there is really no such thing as internal subsidy. What is actually happening is this: co-ops are simply reducing the housing charges of income-tested members. Either that works within the framework of a balanced budget or it doesn’t.

Some co-ops have created a so-called internal subsidy reserve. This can only happen if a co-op generates a surplus, having met all other cost requirements, including the provision for an adequate capital reserve. Money set aside in a subsidy reserve in one year can be transferred to operations in another year to offset a deficit resulting from reducing the housing charges of low-income households.

If your intention is to offer reduced, income-based housing charges to low-income households, here’s how to do it.

How to provide income-based housing charges without subsidy

Setting the rules

Before all else, decide what your *intentions* are for offering reduced housing charges on the basis of household income. Note the use of the word *intentions*. What reduction you will actually be able to offer to your low-income households will depend on the co-op's overall financial picture. More on this shortly. Meanwhile, here are some of the questions that will have to be decided.

- **Which households will be entitled to apply for reduced housing charges? Is it just the households that were previously assisted when the CMHC agreement was in place? What about other households that would also qualify on the basis of income? What about households that move from employment income to fixed income due to retirement or health issues? What about households that take a voluntary reduction in income, moving from full- to part-time work, for example?**
- **How will income be defined? Is it income from all sources? Will the income of minors be included? Will any deductions be allowed?**
- **How will income be verified?**
- **What are the requirements for reporting changes to income?**
- **What are the rules for households that are over-housed? Broadly speaking, over-housing refers to households that have more bedrooms than occupants¹. Will over-housed households be required to pay a surcharge on top of their income-based housing charge? Many housing co-ops already do this.**

Co-ops that try to make up a custom set of rules to answer these questions are asking for trouble, because rules that some might think are justified and reasonable could seem unfair or discriminatory to others. The simplest way to create a set of rules for setting reduced housing charges is to base them on rules that already exist: rules based on the Section 95 operating agreement, or the rent supplement rules used for ILM co-ops.

Using rent supplement rules may be the best bet as they are very specific and detailed, unlike the Section 95 agreement rules. The rent supplement rules are set out in provincial handbooks or guides, typically in the form of a binder or on-line guide. They would work fine in a former Section 95 co-op, and will apply anyway if provincial rent supplements become available after the Section 95 agreements end. Here is a link to a sample set of rules from BC Housing's *Rent Calculation Guide*.

http://www.bchousing.org/Partners/H_S_Op/RCG

¹ Some co-ops may define over-housing as housing with more bedrooms than the minimums set out in the National Occupancy Standards. In some housing programs this is the mandated standard, though not in the Section 95 program. Here is a link to the National Occupancy Standards on the BC Housing website: <http://www.bchousing.org/Find/FAQ/Housing#size>

We offer this example because it is detailed yet plainly written and logically ordered. Section 2 of the guide will give you a set of rules and a rent/housing charge calculation method that will cover virtually every possible situation. That's the only part of the guide you need to look at.

Whatever rules a co-op does choose to use, they should be formally adopted as a policy or by-law. Using rules that are already on-line offers an added benefit here. They can be referred to in a by-law rather than reproduced in it. A scan of Section 2 of the BC Housing rules will show why that is an advantage!

Rent supplement rules will still leave some questions that the co-op will have to decide for itself. One of them we've noted already: the number of households that will be offered housing charges based on their incomes. Here are two others: the percentage of income that will be charged and the minimum housing charges that will apply.

In fact neither of these two questions can be settled at this point. As we noted earlier, the actual reduced housing charges you assess, and therefore the percentage of income and minimum charges, will depend on the co-op's overall finances—how much housing charge revenue can you afford to go without?

Here are the steps to walk through in order to answer that question—we'll list them in summary, then go through them in detail, using sample numbers.

The steps to offering income-based housing charges—in summary

- 1. Create a realistic expense budget** for operating expenses, reserve allocations and debt service (mortgage payments). For the sake of simplicity we'll call this your total expenses.
- 2. Set a revenue budget** for non-housing charge revenues.
- 3. Income-test the households** that you have decided are eligible for income-based housing charges.
- 4. Make preliminary assumptions** for the percentage of income you will charge your income-tested households, and what the minimum housing charges will be.
- 5. Based on steps 1–4, set housing charges** for the households that are paying according to income. Add these housing charges to your revenue budget.
- 6. Set the housing charges** for the households paying the full housing charge. The total amount of these housing charges will have to bridge the gap between your revenue from steps 2 and 5 above, and your total expenses from step 1.
- 7. Decide whether the full housing charges are reasonable** for the non-income-tested households and within the range of local market rents. If you think they are, confirm the percentage of income and minimum housing charges for the income-tested households. If not, go back to step 4 and adjust one or both of these factors.

And now here's what each of these steps looks like in more detail, using sample numbers and assumptions where necessary.

The 7 steps in detail

1. Begin by creating a realistic budget for operating expenses, reserve allocations and debt service.

Here is some sample data for a 60-unit housing co-op. Note that the numbers we use here are for the sake of example only and are not meant to suggest what the budget for a 60-unit co-op would look like.

TABLE 1

Expenses	
Operating expenses	\$ 360,000
Allocation to capital reserve	\$ 75,000
Mortgage payment	\$ 123,000
Total expenses	\$ 558,000

As simple as our summary sample looks, a great deal of preparation must go into developing the total expense picture. A co-op cannot arrive at accurate numbers for reserve allocations and borrowing requirements without developing a full asset management plan. And don't think your co-op won't need to borrow after the present mortgage has been paid out. It's just a question of when, not if. In testing whether you will be able to offer income-based housing charges you should always assume that you are going to have a new mortgage payment to make. Because if you plan without that and then find you need a new mortgage, your plan can fall apart in a hurry.

Now to the revenue side.

2. Set a budget for non-housing charge revenues.

For the sake of simplicity we'll combine all sources of non-housing charge revenues in one line. A co-op will of course want to budget for each revenue source separately.

TABLE 2

Revenues	
Non-housing charge revenue	\$ 20,000

3. Income-test the households that you have decided are eligible for income-based housing.

Here you will be applying the rules you have adopted for the definition of income and income verification (see *Setting the rules*, above). The rules you have chosen may already offer a set of alternatives for verifying income for different household circumstances. The BC Housing rules do that. A default verification method in most cases is to ask for the Canada Revenue Agency notice of assessment for each member of a household who has income.

4. Make preliminary assumptions for the percentage of income you will charge your income-tested households, and what the minimum housing charges will be.

Let's assume the following facts for our example.

TABLE 3

Total units	60
Total income-tested units	20
Percentage of income charged to income tested households	30%
Minimum housing charge for income tested households	\$ 400

5. Based on steps 1–4, set housing charges for the households that are paying according to income. Add these housing charges to your revenue budget.

In a real-world example, the co-op would, of course, calculate the reduced housing charge separately for each household. For the sake of simplicity in our example we are going to use an average for the monthly housing charge paid by the income-tested households.

So, let’s assume that each income-tested household pays an average housing charge of \$450. Here is the housing charge revenue picture from those 20 units:

TABLE 4 – INCOME-TESTED HOUSEHOLDS

Unit type	# of units	Monthly charge	Total annual revenue
1-bedroom apartment	6	\$ 450	\$ 32,400
2-bedroom apartment	6	\$ 450	\$ 32,400
3-bedroom apartment	5	\$ 450	\$ 27,000
3-bedroom townhouse	3	\$ 450	\$ 16,200
Total	20		\$ 108,000

Let’s recap. The co-op has annual costs of \$558,000 to cover (see Table 1). It expects to earn \$20,000 from non-housing charge revenue and it will charge the income-tested members \$108,000 if it applies the percentage of income and minimum housing charges set out above. So up to this point the financial picture looks like this:

TABLE 5

Revenue:	
Full housing charges	?
Income-tested housing charges	\$ 108,000
Non-housing charge revenue	\$ 20,000
Total revenue	\$ 128,000
Expenses:	
Operating expenses	\$ 360,000
Allocation to capital reserve	\$ 75,000
Mortgage payment	\$ 123,000
Total expenses	\$ 558,000
Net deficit	\$(430,000)

6. Set the housing charges for the households paying the full housing charge.

Note that in Table 5, above, the housing charges for the households paying the full rate have not yet been decided. The co-op needs to set those charges for the 40 non-income-tested households at a level that will at least erase the \$430,000 deficit. This work is best carried out using a spreadsheet, where different scenarios can be tested for housing charges for different sizes and configurations of units. You can start with your existing full housing charges and then adjust them to cover all your expenses and eliminate the net deficit.

Here's a scenario for full housing charges for our sample co-op that meets the required revenue target with a little room to spare.

TABLE 6 – FULL HOUSING CHARGE UNITS

Unit type	# of units	Monthly charge	Total annual revenue
1-bedroom apartment	12	\$ 800	\$ 115,200
2-bedroom apartment	16	\$ 900	\$ 172,800
3-bedroom apartment	11	\$ 1,000	\$ 132,000
3-bedroom townhouse	1	\$ 1,100	\$ 13,200
Total	40		\$ 433,200

So now we can add the full housing charges to the revenue and expense numbers from Table 5.

TABLE 7

Revenue:

Full housing charges	\$ 433,200
Income-tested housing charges	\$ 108,000
Non-housing charge revenue	\$ 20,000
Total revenue	\$ 561,200

Expenses:

Operating expenses	\$ 360,000
Allocation to capital reserve	\$ 75,000
Mortgage payment	\$ 123,000
Total expenses	\$ 558,000
Net surplus	\$ 3,200

7. Decide whether the full housing charges are reasonable.

Bear in mind that, in order to reduce some housing charges below the break-even point, the other housing charges will have to be set above break-even to make up the difference. To illustrate this, let's look at what the real break-even housing charges would be, again with a little room to spare, if all 60 households were to pay the break-even rate. As you can see from Table 8, the housing charges would look quite a bit different from those in Table 6:

TABLE 8

Unit type	# of units	Monthly charge	Total annual revenue
1-bedroom apartment	18	\$ 661	\$ 142,734
2-bedroom apartment	22	\$ 743	\$ 196,259
3-bedroom apartment	16	\$ 826	\$ 158,593
3-bedroom townhouse	4	\$ 909	\$ 43,613
Total	60		\$ 541,200

This gives us the same housing charge revenue as in Table 7, but with the full housing charges 17% lower. As we said, in order to offer income-based housing charges to some households, the other households will have to pay more than the break-even rate.

So before you recommend housing charges that are above break-even, consider these two questions:

- Are these housing charges competitive in the local market? (if not, the co-op is at risk of losing money in due to vacancies that can't be filled)
- If the full housing charges are significantly above break-even, can you count on the members supporting them?

If the answer to either of these questions is no, then as we noted earlier, you will need to return to step 4, where you made assumptions for the percentage of income you will charge your income-tested households and for minimum housing charges regardless of income.

Conclusion

If your co-op follows the steps set out here you will be able to decide whether offering income-based housing charges is possible for your co-op in the context of your expenditure requirements, and if so, how to implement a workable system. However, it must be understood that having the capacity to offer income-based housing charges in one year does not mean they can be offered in the following year. If the result in any year would be full housing charges that are not competitive, income-based housing charges become impracticable. The only sure, sustainable way to provide security for low-income members is through a government sponsored program.

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Coping with the end of income-tested assistance is a 2020 Vision publication made possible through the dues paid by CHF Canada's members.

Printed on Rolland
Enviro 100 Smooth
100% P.C.
100% C.F.P.A.
Archival/Acid Free
88 Brightness

