

CALGARY HOUSING COMPANY 2016 ANNUAL REPORT

EXECUTIVE SUMMARY

This is the annual report and risk management processes presentation to the City's Audit Committee from the Audit and Risk Management (ARM) Committee of Calhome Properties Ltd. operating as Calgary Housing Company (CHC).

This report, attachments and presentation provide more comprehensive details in response to the letter from the Audit Committee chair dated 2017 March 30 which requested the following items to be provided:

1. Brief summary on governance structure, succession planning and recruitment process, recent financial highlights and key 2017 initiatives/strategy;
2. Report on CHC's key operating and strategic risks including trends and risk management plans and processes;
3. Analysis of the top three risks that in CHC's opinion would impact the City of Calgary and/or be of concern to the City's Audit Committee;
4. Report on internal controls including information technology and systems; and
5. Most recent financial report including management responses as appropriate.

In summary, CHC has established good governance practices including recruitment processes, has demonstrated good financial performance in 2017 and has made good progress on assessing internal controls.

CHC is facing significant risks however, particularly in relation to the provincially-funded social housing portfolios that it manages. The highest identified risks that may affect CHC and therefore the City of Calgary as shareholder are: funding uncertainty, rent revenue, reserve funds and third party owned assets managed by CHC.

RECOMMENDATION:

That the Audit Committee receives this report for information.

PREVIOUS COUNCIL DIRECTION / POLICY

The City of Calgary Audit Committee Bylaw 48M2012 states that Audit Committee is responsible for:

"overseeing its governance responsibility with audit committees of The City's major autonomous civic entities."

Section 4(1)(i)

BACKGROUND

This report responds to the letter dated 2017 March 30, sent to the Chair of Calgary Housing Company's (CHC) Audit and Risk Management Committee. CHC representatives appeared before Audit Committee on 2017 September 14 and presented the company's governance structure, key 2017 priorities, integrated risk management framework and financial highlights. At

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the 2017 September 14 meeting the Audit Committee made the following referral of CHC's Report AC2017-0478:

"That Report AC2017-0478 be referred to the Calgary Housing Company Audit and Finance Committee to return to Audit Committee at the 2017 December 14 meeting with a report providing more comprehensive details as requested by the Chair of Audit in his letter of 2017 March 30."

This report, attachments and presentation provide more comprehensive details in response to the letter from the Audit Committee chair dated 2017 March 30 which requested the following items to be provided:

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2. Report on CHC's key operating and strategic risks including trends and risk management plans and processes;
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5. Most recent financial report including management responses as appropriate.

The annual reporting process is intended to be an ongoing dialogue between The City and CHC. It is anticipated the annual report will assist with developing further understanding of CHC's governance approach.

INVESTIGATION: ALTERNATIVES AND ANALYSIS

This section contains CHC's responses to the five items that are requested to be included in the annual report. Further details are also provided in the attachments noted below.

1. Brief summary on governance structure, succession planning and recruitment process, recent financial highlights and key 2017 initiatives/strategy

1.1. Governance Structure, Succession Planning and Recruitment Process

CHC is a wholly-owned subsidiary of The City of Calgary (The City) and established under the *Business Corporations Act* as a non-profit corporation. CHC is governed by a Board of Directors, appointed by City Council which represents The City as the sole shareholder of the company. CHC's Administration is led by a President who also holds the role of Director of the Calgary Housing Business Unit.

CHC manages properties and programs on behalf of The City, the Province of Alberta, and itself. CHC, in its present incarnation, was formed in 2001 when Calhome Properties Ltd. took on the assets and liabilities of Calgary Housing Authority and assumed the trading name of CHC.

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The Province appoints and authorizes CHC to manage, administer and maintain the social housing portfolio under a Ministerial Order and the Alberta Housing Act. CHC receives its operating funding from provincial government operating subsidies and through rental revenues. CHC does not depend on tax revenue for its funding, drawing only 10% of The City-owned social housing deficit from tax support. This amounted to \$338 thousand in 2016. The surplus contribution returned to The City for City Partnership and Corporate Properties residential portfolios combined was \$2.1 million in 2016.

The properties that CHC manages are owned by the Province, The City and Calhome Properties Ltd. CHC provides homes for approximately 25,000 tenants in CHC managed properties or with private landlords through the rent supplement program. In addition to ownership, properties are divided across one of nine portfolios: e.g. Federal Fixed, City Partnership etc. Depending on the portfolio, CHC may be subject to different legislative or operating agreement requirements, such as the Alberta Housing Act or a specific agreement relating to that portfolio.

As above, CHC reports to a Board of Directors. The Board is supported by four committees, each having a specific mandate and oversight responsibility. They are as follows:

- Audit and Risk Management Committee
- Community and Resident Relations Committee
- Development and Asset Management Committee
- Governance Committee

The Governance Committee is responsible for succession planning and recruitment. These processes are based on Board best practices and identifying appropriate qualifications based on a skills matrix.

For further details on CHC's governance structure, succession planning and recruitment refer to Attachment 2 of this report.

1.2. Recent Financial Highlights

The following section contains recent financial highlights extracted from the 2016 statement of financial position and statement of operations.

Statement of Financial Position

Cash: The cash balance at the end of 2016 has risen from the prior year to \$28.9 million. It is worth noting that \$24.9 million of this balance is restricted for items, such as tenant security deposits, advance government funding, replacement reserve funding and deferred capital contributions.

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Mortgages Payable: CHC had \$15.2 million in outstanding mortgages at December 31, 2015. Over 2016, CHC repaid \$4.5 million in long-term debt and issued \$5.8 million in new debt relating to the acquisition of 163 units in East Village. At December 31, 2016 CHC had \$16.5 million in mortgages payable.

Tangible Capital Assets: Tangible Capital Assets increased to \$102.2 million as at December 31, 2016 from \$92.3 million in 2015. The increase was mostly due to the acquisition of East Village Place.

Statement of Operations

REVENUE

Rent Revenue: Rent revenue was \$48 million for the year ended December 31, 2016, a decrease of \$2.2 million over the previous year. Rent revenue is being affected by lower rent-geared-to income (RGI) rents and increased vacancy rates throughout 2016 in the low end of market segment as it more closely mirrors broader residential vacancy trends.

Rent Supplements: The rent supplement programs provided \$18.8 million in revenues and there is a corresponding expense under rent supplement payments as this is a flow through program and CHC receives funding to offset salary and administration costs to deliver this program.

EXPENSES

Administration: CHC incurred \$6.4 million in administration costs for the year ended December 31, 2016. These costs, excluding the direct charges to certain portfolios, are allocated based on the number of units in each portfolio.

Maintenance: Maintenance expenses were \$16 million for the year ended December 31, 2016. Actual maintenance expenses were higher than budget due to the reallocation of overall budget dollars from savings in utilities and administrative costs towards maintenance needs. The actual maintenance expenses for certain portfolios are dependent on the level of funding provided and do not reflect maintenance requirements. Maintenance is prioritized as follows: life safety; structural integrity; necessary repairs / legislative requirement; energy efficiency; and marketability.

SURPLUS

CHC reported a surplus of \$7.2 million after returning \$2.1 million to The City from the operation of The City's mixed-income portfolios. The CHC surplus was significantly higher than the prior year mostly due to the recognition of restricted funds used from CHC's deferred capital contributions.

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Capital Expenditures

Overall, 2016 actual capital expenditures were \$8.7 million higher than the budget of \$4.2 million mostly due to the acquisition of East Village place offset by delayed spending in the IT section as the Enterprise System Solution (ESS) funding was not fully in place to initiate the project.

1.3. Key 2017 Initiatives / Strategies

CHC is in its second year of the Board approved Strategic Plan 2016 – 2020. A summary of CHC's key priorities and objectives as well as specific 2017 initiatives are identified as follows:

Priority I: Deliver Quality Service to Clients

Objective 1: Take a 'Client-Centric' approach to Service Delivery

Objective 2: Build Positive Working Relationship among Staff and Clients

Objective 3: Foster Opportunities that Contribute to Well-Being and Independence for Individual Clients as well as Community Well-Being

Priority I 2017 Initiatives:

In 2016 CHC's Board approved a Tenant Advisory Group (TAG) pilot project designed as a best practice approach to customer service. In 2017 the group signed terms of reference and is recruiting and orientating members. CHC has signed a contract with Thornhill daycare to lease space in the Lumino South building. Approximately 30% of the 84 child care spots will be used by CHC families. CHC is embarking on a cultural transformation focused on client-centric positive outcomes for tenants and is collaborating with partners towards this goal. After launching the opportunities for homeownership program in 2015, CHC saw 90 families move into affordable homeownership in 2016.

Priority II: Increase Financial Sustainability Including the Optimization of Assets

Objective 1: Develop and Implement an Asset Management Program

Objective 2: Implement Initiatives to Increase Financial Sustainability

Priority II 2017 Initiatives:

The Sustainability Project which is currently in its Phase 3 has developed a program plan, created a development team and started building an analysis tool. CHC has also received a letter of intent from a potential lessor for the East Village Place community space. A vacancy task force was created at CHC in 2017 to address high vacancies particularly in the low end of market segment. In 2016, CHC created a strategic asset management plan and is in the process of implementing an asset management program.

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Priority III: Strengthen Relationships with Key Stakeholders

Objective 1: Work with Government and Stakeholders to Increase Awareness and Support for a More Sustainable Affordable Housing Delivery Model

Objective 2: Enhance Working Relationships with The City and Province to Create Synergies and Clarify CHC's Role & Governance

Priority III 2017 Initiatives:

The Provincial Affordable Housing Strategy was released in 2017 June and showed strong alignment to CHC's positions and requests put forward to the Province. Bridging the Gap is a new initiative underway between CHC, The Calgary Homeless Foundation (CHF) and many other supportive housing agencies. The initiative is designed to integrate and coordinate housing across agencies to prevent future homelessness of individuals and families who have "graduated" from CHF supportive housing programs and are ready to move to more stable and affordable housing.

Priority IV: Strive for Organizational Excellence

Objective 1: Increase Organizational Efficiency and Effectiveness

Objective 2: Develop CHC as a Leading Affordable Housing Provider

Objective 3: Build a Positive Organizational Culture that Engages Employees

Priority IV 2017 Initiatives:

CHC has a number of transformational projects underway. For instance, the Enterprise Software System project that will be replacing CHC's current software and refining its existing processes is expected to contribute significantly to organizational efficiency. In addition, in 2017 CHC launched a newly designed external website and held several celebratory events, such as the Bankview and Mission regenerations.

2. Report on CHC's key operating and strategic risks including trends and risk management plans and processes

On 2011 May 27, The CHC Board of Directors approved the adoption of The City's Integrated Risk Management (IRM) Policy as a model for use by CHC, and directed Administration to annually inform the Board through the ARM Committee regarding CHC's current risk status of the Company. The IRM framework enhances CHC's ability to proactively manage risk and make well informed decisions. Currently CHC is in its sixth year of reporting on IRM. The following section discusses CHC's key operating and strategic risks, recent trends, and risk mitigation strategies.

Funding uncertainty

This risk is currently ranked **high** in both likelihood and impact and has stayed unchanged in ranking from the prior year. This particular risk primarily affects portfolios funded by federal and provincial operating subsidies where funding levels have been

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insufficient to meet inflationary increases and maintenance requirements. CHC's highest priority is the safety, security, and wellbeing of tenants living in the affected buildings. For 2018, CHC has requested \$22 million in operating funding which represents a \$10 million increase over the current \$12 million base funding and covers both the Provincial and City-owned social housing portfolios. This funding is required to meet health and safety standards under the *Residential Tenancies Act*. CHC's mitigation plan if it does not receive this funding includes continued advocacy efforts for increased government funding, the development of operating scenarios and contingency plans should the funding fall short of the stated need, and implementation of the sustainability plan to address the expiry of operating agreements and funding for City-owned properties between 2021 and 2024.

The Government of Alberta has provided over \$10 million in capital grant funding for building maintenance relating to the provincially owned portfolio, the CHC portfolios as well as the City-owned community housing portfolio in the 2016-2017 budget. However, due to a large backlog of maintenance requests, CHC has also requested \$6 million in 2018 capital funding from the Province for provincially-owned social housing to continue addressing deferred maintenance conditions. This request only begins to address the deferred maintenance need for all provincially funded portfolios currently estimated at a total of \$75.1 million for all social housing combined.

The risk within the City-owned social housing portfolio has been mitigated in the short term by The City providing \$3.4 million funding of which \$2.7 million represents emergency funding to maintain acceptable condition of units upon vacancy. Annual capital funding on a long-term basis is required to bring the entire City-owned social housing portfolio to an adequate condition and mitigate this risk, particularly because the assets will eventually return to The City once the funding agreements expire.

Since this report was originally presented in 2017 September, CHC presented its 2018 budget submission to the Province which highlighted emerging issues that have significantly heightened the urgency of this risk. The funding gap for 2018 raises concerns of the viability of operations of the provincially funded portfolios. CHC, The City and the Province are working toward a solution to address this.

Rent Revenue

This risk is rated **high** in both likelihood and impact. With a high likelihood of occurrence this risk is now trending up from the prior year largely due to market conditions. Rent revenue has been adversely affected by higher vacancy rates in the low-end-of-market (LEM) segment and lower rent rates from rent-gear-to-income (RGI) tenants in the social housing portfolios due to falling incomes during the economic downturn. To mitigate this risk, CHC has assembled a vacancy task force, developing a vacancy strategy and exploring opportunities for commercial revenue. These initiatives have proven successful in improving the average vacancy rate in low-end of market units from

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13.3% in January 2017 to 5.9% in September 2017. The affordable segment has had a smaller reduction going from 7.8% in January 2017 to 5.1% in September 2017.

Reserve Funds

This risk is rated **high** in both likelihood and impact. Action is being taken through CHC's Sustainability strategy and optimization of net income initiative to identify reserve requirements. In 2018 CHC will focus on drafting a reserve policy, reserve terms of reference and a plan to start building CHC reserves that would mitigate financial risk during economic downturns or other financial impacts.

Condition of Third Party Owned Assets

This risk is rated **high** in both likelihood and impact. Asset condition risk affects mainly the heavily subsidized portfolios such as social housing. As of 2017 November, nearly 10 per cent (237 units) of the 2,723 provincially-owned social housing units are on hold because there are insufficient operating dollars to upgrade units for occupancy and to ensure that the units meet the minimum housing and health standards. CHC is required to meet these minimum standards under the *Residential Tenancies Act*. The province has verbally committed to providing funding to re-open these units, however an agreement has not yet been signed as of the completion of this report. CHC is optimistic that funding will soon be available to upgrade and occupy units on hold upon signing of the agreement. For the long term, CHC's mitigation strategies include: advocating for the establishment of an asset management program for third party owned assets; and establishing a long-term viable operating model for CHC to continue managing provincially owned properties under the legislative framework.

In 2017, The City committed funding towards implementing a building condition assessment program for City-owned affordable housing as part of a strategic asset management program offered by CHC.

For further details on CHC's operating and strategic risks, refer to Attachment 4 of this report which outlines risks identified and presented to CHC's Board of Directors in 2017 May.

3. Analysis of the top three risks that in CHC's opinion would impact the City of Calgary and/or be of concern to the City's Audit Committee;

Attachment 4 of this report provides an overview of the principal risks that could affect the achievement of CHC strategic priorities and plans. The highest identified risks that may affect CHC and therefore the City of Calgary as shareholder are: funding uncertainty, rent revenue, reserve funds and third party owned assets managed by CHC as noted above.

For further details on the top risks, refer to Attachment 4 of this report.

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4. Report on internal controls including information technology and systems

On September 19, 2016, ARM Committee, approved CHC's adoption of the *Committee of Sponsoring Organizations (COSO) of the Treadway Commission: Integrated Framework* to guide future internal control environment assessment and reporting. This included an implementation process and schedule to conduct a self-assessment of the current internal control environment at the entity level of CHC.

The *COSO Internal Control – Integrated Framework* is the most widely used framework for Sarbanes-Oxley Act (SOX) compliance and is the model of choice in many North American jurisdictions, including Canada. It is also currently used by The City of Calgary and the Calgary Parking Authority.

In 2017, CHC used the COSO 2013 framework to perform an evaluation of existing controls and their effectiveness. CHC division Managers and the President self-assessed whether the internal controls they are accountable for were present and functioning. Based on their best judgement, CHC Administration evaluated internal controls, within each of the 17 principles set by the COSO framework, and determined that the controls were present, functioning and working together among the principles. As part of the detailed assessment, CHC Administration also evaluated specifically whether the organization selects and develops general controls over technology and determined that the controls in this area are present and functioning. CHC Administration's conclusion is that the overall system of internal controls is effective. The conclusion is based on the professional experience and judgement of the Administration.

Some opportunities for improvement were identified at the individual internal control level. These individual opportunities for improvement do not impact the overall effectiveness of the system of internal controls. CHC Management team is committed to ongoing continuous improvement of internal control processes and recommends appropriate resources be assigned as required.

For further details on CHC's internal controls evaluation process, refer to Attachment 5 of this report.

5. Most recent financial report including management responses as appropriate

Deloitte LLP completed the external audit of CHC's 2016 financial statements and issued an unqualified audit opinion. In addition, there were:

- No corrected or uncorrected misstatements in the course of the audit
- No unadjusted disclosure deficiencies
- No significant deficiencies in internal controls were identified

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For further details on CHC's financial report, audit plan and audit report, refer to Attachments 1, 6, 7 and 8 of this report.

Stakeholder Engagement, Research and Communication

This report was drafted with input from ARM Committee and the Board of Directors. The financial statements were audited by Deloitte LLP.

Strategic Alignment

This report aligns with CHC's 2016 – 2020 Strategic Plan by enhancing its relationship with The City and clarifying CHC's role and governance. This report aligns with the City Audit Committee's governance responsibility to receive annual reports on matters of audit governance, including the CHC's most recent annual financial statements.

Social, Environmental, Economic (External)

This report has no social, environmental or economic implications.

Financial Capacity

Current and Future Operating Budget:

This report has no current or future operating budget implications.

Current and Future Capital Budget:

This report has no current or future capital budget implications.

Risk Assessment

CHC uses The City's Integrated Risk Management Policy and Framework as a model to report annual to its Board of Directors. Attachment 4 provides additional detail on CHC's risk reporting.

REASON FOR RECOMMENDATION:

This report responds to the City Audit Committee reporting requirement and is intended for information only.

ATTACHMENTS

1. CHC Annual Report to City Audit Committee presentation from September 14, 2017
2. CHC Summary of Governance Structure, Succession Planning and Recruitment Process
3. CHC Audit & Risk Management Committee Members Qualifications and Experience
4. CHC 2017 Analysis of Key Operating and Strategic Risks Impacting the City of Calgary
5. CHC Internal Controls Assessment
6. Deloitte 2016 Service Audit Plan
7. Deloitte 2016 Year End Communication
8. CHC 2016 Financial Statements