CHC Audit Committee Report to
City Audit Committee
2018 September 18

Calgary Housing Company – 2018 Analysis of Key Operating and Strategic Risks Impacting the City of Calgary

BACKGROUND

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 CHC administration to annually inform the Board through the Audit and Risk Management (ARM) Committee regarding the current risk status of the company.

Since the approval by the Board of Directors and implementation of the City's IRM Model, CHC administration has taken the necessary steps to implement and sustain the IRM Model. Administration has provided annual risk reports in each year following the original adoption of The City's IRM model.

PURPOSE AND METHODOLOGY

Administration is committed to the ongoing improvement of the IRM framework and process, thus it continues to actively:

Increase staff awareness and understanding of risks and the IRM model.
Engage all senior managers in the review and in-depth analysis of identified risks (see attachments for detailed analysis).
Develop detailed mitigation/action plans with timelines in addition to an overall mitigation plan for all risks determined to be highest (in terms of both likelihood and impact).

In preparation of this report, Administration's Corporate Management Team (CMT) met on several occasions and evaluated all current identified risks to achieving the business plan goals as part of the CHC Strategic Plan. Based on the professional experience and judgement of Administration, risks to the corporation were discussed and rated in terms of likelihood of occurrence in year 2018 and the significance of their impact on the operational status of CHC. The highest likelihood and highest impact rated risks are continually being monitored and have detailed risk mitigation action plans in place.

The principal risks to CHC and details of the mitigation strategies carried out by Administration to prepare for their impact and likelihood of occurrence are outlined in the explained in CHC Risk Analysis. The highest identified risks relate to vacancy rates and rent revenue, reserve funds, uncertainty of funding sources and third party owned assets managed by CHC.

STAKEHOLDER ENGAGEMENT AND STRATEGIC ALIGNMENT

Administration continues to engage senior management staff on the IRM model and regularly monitors its risks. Administration supports a corporate philosophy and culture that encourages all staff to manage risks proactively and communicate openly about risk. All CHC staff actively report and manage operational risk in their work plans. The Integrated Risk Management report is presented annually to the Board for information.

Annual reporting of the CHC Integrated Risk Management report to the CHC Board of Directors is in alignment with CHC's Strategic Priority to Strive for Organizational Excellence, through the review and evaluation of integrated risks in supporting decision making to meet the company's objective of increasing organizational efficiency and effectiveness. This report is also in alignment with both the City of Calgary and CHC's IRM policies through the consistent identification, analysis and communication of integrated risks within the existing business environment at CHC. The following heat map and trend analysis summarize and analyze CHC's key operating and strategic risks which are also the risks that may impact the City of Calgary. Management's mitigation strategies are also part of the analysis.

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Likelihood

Low	Medium	High	Impact
Operating Agreements		Vacancy Rates and Rent Revenue Reserve Funds Funding Uncertainty Third Party Owned Assets Managed by CHC	High
Emergency Response Plan Occupational Exposure to Hazards Tenant Security Damage to Brand Data & Information Security	Cost of Externally Sourced Services Continuity of Business Operations CHC Owned Assets Condition Internal Fraud		Medium
Talent Management Enterprise System Solution			Low

Level of Risk	Definition
	The organization is willing to accept and monitor some risks since they have low likelihood of occurrence however with minor consequences.
	The organization recognizes these risks will probably occur and will have moderate consequences. Management will monitor and manage risks by implementing contingency plans to reduce the likelihood and impact of their occurrence.
	The organization recognizes that these risks are top priorities of critical importance to the organization. Management is spending more effort to manage and monitor these risks by implementing risk mitigation strategies to reduce the likelihood and impact of their occurrence.

ISC: UNRESTRICTED
AC2018-0597
Attachment 4

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Analysis of CHC's top 4 Risks

Risk Category	2016 Risk Map	Change	2017 Risk Map	Change	2018 Risk Map	Trend Explanation and Risk Mitigation Summary
Vacancy Risk and Rent Revenue	Likelihood: High Impact: Medium	↑	Likelihood: High Impact: High	→	Likelihood: High Impact: High	• Economic downturn and high unemployment leading to higher vacancy rate in the LEM portfolio. • Current high vacancy rate in Calgary has affected the corporation`s revenue and will likely continue to do so. • The Portfolio Review Committee (PRC) will prioritize a review of operating and financial performance of all buildings. • Development of a leasing strategy and operating model that will identify tools and tactics for mitigating the risk of revenue loss through proactive marketing and leasing, market analysis, operational tactics, processes and performance measures. • Issues, such as break ins, squatters as well as damages going unreported in vacant units affecting other units continue to keep the vacancy risk level steady.
Reserve Funds	Likelihood: Medium Impact: Medium	↑	Likelihood: High Impact: High	→	Likelihood: High Impact: High	• Insufficient operating and capital reserves to support lifecycle needs, replacement of assets or meet emergencies. • Economic situation limiting availability of funding for operating and capital reserves.

Funding Uncertainty	Likelihood: High Impact: High	→	Likelihood: High Impact: High	→	Likelihood: High Impact: High	• CHC does not receive sufficient funding to operate social housing. A funding gap exists between the rent paid by social housing tenants, which is provincially regulated, the current amount off subsidy which CHC receives from the Province, and the actual cost to operate housing to a minimum standard. Significant advocacy efforts for the current period have resulted in increased funding in 2018. However, CHC predicts a shortfall in 2019 and requires sufficient and predictable funding to ensure that the units it manages on behalf of the Government of Alberta.
3rd Party Owned Assets Managed by CHC	Not Applicable	Not Applicable	Likelihood: High Impact: High	→	Likelihood: High Impact: High:	• Current operating agreements do not identify asset management within the scope of CHC contracted services. • Asset condition assessments and capital investment prioritization for third party owned portfolios are not currently in place.

Risk 1

CHC relies on rent revenue from the various properties across its portfolios to support its operational and financial viability. The current economic conditions in the Calgary region have resulted in higher vacancy rates for near-market residential rental properties. The increase of available rental stock, and the reduction in prices has increased choice and shifted the market to a buyer's market. This has increased the risk of revenue loss, primarily in CHC's Low End of Market (LEM) programs. LEM units are marketed to Calgarians who are close to being able to afford current private market rent levels. There is direct loss of revenue as a result of higher vacancies, holding/turnover costs and reduced rents. This has created an increased level of competition within the market for renters.

There are also indirect causes of vacancy that contribute to overall revenue loss, such as:

- Increased costs associated with inspecting vacant units
- Damages that go unreported in vacant units
- Vandalism/theft due to break-ins, squatters, etc.

As of April 9, 2018, the current vacancy rate for LEM units is 4.5% and the vacancy rate for Affordable (AFF) units is 3.5 %. The AFF program is designed for Calgarians able to afford slightly more for rent but who still require rental assistance. These vacancy rates are in line with the rates used for the 2018 budget. However, a significant or prolonged revenue loss would impact CHC's ability to maintain its assets, meet its financial obligations, and continue day-to-day services. CHC is monitoring and reporting on revenue as it relates to these two programs. Although overall economic and market conditions are outside of CHC's control, there are certain mechanisms that remain within CHC's control to respond in order to mitigate revenue loss. A few of these include but are not limited to:

- Assess competitiveness and financial sustainability of buildings within each portfolio (including CHC owned) to inform future decisions on the asset.
- Conduct ongoing market analysis to ensure competitiveness within the market (price, incentives, marketing, etc.).
- Evaluate operating costs to identify opportunities for improvement in the short and long term. These include building maintenance and operating costs as well as costs of operational processes such as unit turnaround times.
- Identify opportunities for partnerships with like-minded agencies that may contribute to sustained revenue through supplements and grants which contribute to revenue but also help to serve people within our mandate.
- Develop a formal, approved leasing and marketing strategy for the LEM program.

Effective January 1, 2018, changes to the Provincial Social Housing Act Regulations came into effect. These changes impacted the prioritization of applicants on the social housing waitlist. The result is that the new point scoring changes for eligibility and prioritization favour a higher proportion of individuals who are on social assistance. Since the rent calculation for social housing is based on a rent geared to income model, this effectively reduces the average rent revenue received by CHC. The impact to revenue has not yet been quantified within 2018, however 2019-2021 budget submissions to the province take into account the projected changes and impact to revenue based on historical turnover and the forecasted rent revenue of new tenants into social housing. Overall, this presents a net reduction in revenue at an anticipated turnover of approximately 20% of social housing clientele annually.

Risk 2

CHC currently has insufficient operating and capital reserves to support projected life cycle maintenance, redevelopment and emergency needs.

A reserve fund is a separate fund or account set up by a company to meet any future expenditures or financial obligations such as repairs and improvements that are both planned and/or unplanned in nature. It is important to have these reserves to meet these expenditures and possibly shield the company from large unmanageable payments that could impact the company's financial viability. The creation, use and management of reserve funds in a formalized financial reserve policy is considered good financial management. It is best practice for companies in Canada and the U.S. and a key component to a corporation's credit rating.

Management Mitigation Strategy

- Through the completion of Phase 1 and 2 of the Sustainability Project, CHC has become more aware of actual reserve requirements. Phase 3 of the project is currently underway.
- Action is being taken through optimization of net income initiatives to increase revenue and reduce operating expenditures in order to have surpluses that could be contributed to reserves.
- CHC is implementing an Asset Management Program to define what is required in order to correlate with the sources and availability of capital to fund these requirements.
- For the Calhome owned portfolios the Infrastructure & Asset Management group initiated a Building Conditions Assessment (BCA) program. This program assessed building conditions and the anticipated capital and non-recurring funding requirements for individual building components. The completion of the BCAs is anticipated in year 2019. These funding requirements define the required lifecycle reserve. For 2017 and 2018 these lifecycle requirements have been funded by provincial grants, capital funding and City of Calgary capital allocations. A written services offer has been presented to The City and Province for the services of CHC Asset Management division to assist with sustainability plans for respective properties.
- A reserve strategy is in the CHC 2018 work plan with expected reserve policy and reserve terms of reference to be developed in 2019. This strategy will set up a structure and priority model which will guide and establish reserves at CHC.

Risk 3

CHC does not receive sufficient funding to operate social housing. A funding gap exists between the rent paid by social housing tenants, which is provincially regulated, the current amount of subsidy which CHC receives from the Province, and the actual cost to operate housing to a minimum standard. Years of flat-lined funding came to a head in 2017, when CHC closed approximately 250 provincially-owned units due to insufficient maintenance funding.

After significant efforts to build awareness around the issue, CHC received a 2018 budget that will ensure operating viability for the year ahead. A portion of the funding received for 2018 is one-time, and in its entirety, does not address the need for long-term funding certainty. CHC has advised the Province, that in spite of the increase in base operating funding (from $12M to $18M) and the one-time grants, CHC forecasts a shortfall of up to $1.5M for 2019, which could result in the closure of up to 150 provincially-owned units.

CHC requires sufficient and predictable funding to ensure that the units it manages on behalf of the Government of Alberta meet Minimum Housing and Health Standards. Furthermore, the upcoming expiry of operating agreements (where properties will no longer receive any government subsidy), means that CHC requires investment to address the maintenance backlog and to ensure a viable transition to a more financially sustainable operating model.

Management Mitigation Strategy

- CHC will continue the dialogue with stakeholders to build awareness on the issue of obtaining sufficient funding and funding certainty.

- CHC will continue to prepare for the eventuality that the 2019 budget request is unmet. Preparations include:
  - Assessing the legal obligations of all parties within the existing agreements.
  - Attempting to reach a new agreement.
  - Continuing to narrow the gap on the estimated investment backlog through the completion of building condition assessments.
- Providing clear and concise budget requirements for 2019 and beyond.
- Working with the Province to obtain flexibility over regulations that govern rent calculation to pilot a more financially sustainable, mixed income operating model.

CHC is continuing work on the sustainability project which assesses the financial requirements related to operating social housing once the provincial operating agreements expire. The aim is to transition properties to a self-sustaining model.

Risk 4

As the CHC-managed portfolios age, life cycle maintenance needs to be appropriately identified, funded and implemented or there will be an increased risk of service levels not being met or the lifespan of the housing stock being reduced. As well, construction methods and materials incorporated in older housing stock can represent an environmental safety or health risk if inappropriately managed. This can also result in increased financial risk due to energy inefficiency.

Management Mitigation Strategy for Calgary Housing Company Owned Assets

CHC continues to establish an Asset Management Program as described in the “Reserve Fund” risk category. This program defines a process for identifying lifecycle funding requirements for the Calhome owned portfolios. This program will be further supported through the implementation of an Enterprise System Solution (See Risk15: Enterprise System Solution (ESS) Implementation) which will include a database to support the collection of appropriate data leading to improved investment prioritization decision making. A hazardous substance management plan is anticipated to be incorporated into the scope of a new system ESS implementation project being initiated within CHC.

Investments continued to be prioritized over 2017 and 2018, resulting in the improvement in the condition and expected life of CHC owned assets. Investment in building envelope improvement projects have been made to address identified deterioration and reduce the associated risk of unplanned failure at these properties. All code required inspections and investments have been maintained. Integration of the Asset Management Program into the planning, operating, maintenance activities, as well as the Capital renewal program continues to be a priority.

Management Mitigation Strategy for Third Party Owned Assets Managed by Calgary Housing Company

Current operating agreements between Calgary Housing Company (CHC) and The City and Provincial property owners do not identify asset management within the scope of CHC contracted services. This limitation had been identified as a risk to CHC in an audit of the CHC asset management program conducted by The City of Calgary Auditor. This limitation was reported to the Council of The City of Calgary. In 2017, CHC management sent letters identifying this limitation to The City and Provincial stakeholders. The letters included an offer from CHC to partner with the property owners to establish asset management programs on a fee for service basis. This asset management program would then provide a disciplined basis for asset condition assessments and capital investment prioritization based on agreed risk and level of service criteria. The program would define how capital investment decisions would be conducted and the resulting allocation of risk responsibility identified. The City of Calgary has responded by providing funding for conducting Building Condition Assessments on the City-owned properties managed by CHC which are targeted to be completed by Q3, 2019. To date no response has been received from the Province to the asset management proposal.