2007 ANNUAL REPORT TO
CANADA MORTGAGE AND HOUSING CORPORATION

PORTFOLIO PERFORMANCE

AUGUST 2008

[Edited to protect confidentiality.]

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Executive Summary

In this report the Agency is able to offer its first comprehensive assessment of how its client housing co-operatives are performing as a group. (Our 2006 report presented data drawn principally from co-operatives in Ontario and PEI, where the Agency began operations first.) The data set for this report consists of the 461co-operatives whose annual information return (AIR) for a fiscal year ending between September 2006 and August 2007 was received and validated by the Agency no later than February 15, 2008.

At the end of 2007, the full Agency portfolio comprised 515 federal-program housing co-operatives that together operated 31,220 residential units. Co-operatives developed under the S27/61 programs made up 10 per cent of the portfolio; S95 co-operatives 61 per cent; FCHP (ILM) co-ops 25 per cent; and PEI NP and Urban Native housing co-ops one per cent. Three per cent of our client co-operatives acquired properties under multiple programs.

B.C. was home to 34 per cent of the portfolio, measured by number of client co-operatives; Alberta to 10 per cent; Ontario to 53 per cent; and PEI to two per cent. At the end of 2007, 46 per cent of our clients employed paid staff; 35 per cent purchased services from a property-management firm; 10 per cent paid only a bookkeeper; and 10 per cent were administered entirely by volunteers. The data set for this report, disclosed in detail in Appendix A, constitutes 90 per cent of the Agency's portfolio and is representative by program, province and management type.

Compliance

At the end of 2007, 69 per cent of clients in the data set were in full compliance with their CMHC operating agreement. Among the compliance variances identified, the most common, at 19 per cent of all variances, was the minor one of failing to seek the Agency's approval before spending from the capital replacement reserve on an eligible item. Only one per cent of Agency clients had serious operating-agreement breaches. These included mortgage arrears and a failure to file required financial reports within seven months of the co-op's fiscal year end.

Risk

Risk-rating is the Agency process that flags co-operatives that are in financial difficulty or at risk of failing to meet their financial obligations. The composite risk rating assigned to each client reflects its financial strength, current operating results, physical condition and other factors. In 2007, 80 per cent of Agency clients in the data set had Good or Excellent liquidity (our measure of financial strength) and 71 per cent Good or Excellent financial results. Seventy-seven per cent were maintaining their property in Good or Excellent condition. Taking these three indicators into account, along with other risk factors such as whether a co-op held enough insurance, only 42 per cent of our clients received a composite risk rating of Low or Moderate. The rest were rated Above-Average or High risk.

Operating Performance

Vacancy Losses

While seven out of 10 co-operatives in the data set reported low or no vacancy losses for 2007, a troubling 12 per cent tallied losses of more than three per cent of their potential revenue from housing charges.

Bad Debts and Arrears

The majority of Agency clients either had no losses to bad debts in 2007 and no arrears at year end or their combined arrears and bad-debt expense amounted to one per cent or less of the share of occupancy charges payable by members (i.e., the full occupancy charge less geared-to-income subsidies and rental inducements). However, one in ten posted cumulative arrears and bad debts of more than five per cent of occupant housing charges, and one quarter had one or more board members with arrears of over $100 at year end. The median arrears and bad-debt expense ratio for co-operatives with one or more directors in arrears was 62 per cent higher than for the full data set.

Capital-Replacement Reserve

The median year-end balance for this reserve for all co-operatives in the data set was $3,152 per unit, with most co-operatives in Poor condition having a lower balance. If co-operatives with workouts are excluded, the median rises only a little to $3,448 per unit. Only three per cent of clients in the data set held reserves at the end of their 2007 fiscal year of $10,000 per unit or more. About 10 per cent of Agency clients had an approved plan in place for building the reserve and spending from it. (There is no obligation under any program operating agreement to have a plan in place.)

Other Perspectives

Program Perspective

The ILM program, which ran from 1986 to 1991, inclusive, is the under-performer among the programs the Agency administers. Thirty per cent of co-operatives operating under this program had a composite risk rating of High in 2007. Median vacancy losses were the highest, at 0.6 per cent of gross housing charge potential, as was the median arrears and bad-debt ratio, at 1.1 per cent. ILM-program co-ops put a median of $48 per unit per month into their capital replacement reserve, as compared to $84 (the median for S27/61) and $100 (S95) for other Agency clients. Co-ops under the S27/61 program had the best overall risk profile as a group and the lowest median vacancy losses (0.2%). The performance of S95 co-ops fell between that of the other two main programs.

Provincial Perspective

Ontario had the second largest proportion of co-operatives rated High risk in 2007 (20%) and also saw the greatest median vacancy losses (twice the Alberta rate and three times the rate for B.C. and PEI.) Ontario also reported the highest combined arrears and bad debt ratio, at one per cent. PEI had the greatest proportion of Agency clients at High risk (30%), but co-operatives in that province were in better physical condition than co-ops in Ontario, even though Ontario co-ops spent more on their buildings. Ontario co-ops also had the highest administrative spending rate, at 8.4 per cent of total expenses before contributions to reserves, while B.C. co-ops spent only 4.1 per cent on administration and put more money into their capital replacement reserves than co-ops in other regions.

Management Perspective

Volunteer-run co-operatives enjoyed the smallest vacancy losses, the lowest combined year-end arrears and annual bad-debt expense ratio (median ratio: 0.2%) and the highest median rate of contributions to the capital replacement reserve. However, more co-ops with paid staff were identified as in Good or Excellent physical condition (87%), with volunteer-only co-ops at 71 per cent and co-ops that contract with a management firm close behind them at 69 per cent.

Looking Ahead

The information drawn from this data set will serve as a baseline to gauge future trends in our client co-operatives' collective performance. With our staff trained, our systems in place and our strategies and tools tested and fine-tuned, the Agency is already anticipating next year's results, when we expect that a comparison with 2007 will show that our efforts are beginning to bear fruit.

Chapter 1: Introduction

Under the terms of our service agreement with Canada Mortgage and Housing Corporation, the Agency for Co-operative Housing is required to report once a year on the performance of the federal-program co-operatives with which we work ("the Agency portfolio"). Our portfolio report for 2007 takes on a special importance. Although our second report, this is the first in which we are able to share performance data for most of our portfolio. The report therefore draws the baseline against which the future performance of the Agency portfolio can be assessed. We expect to return to the data presented here regularly in the coming years.

While our 2006 report to CMHC was as thorough as we could make it in the circumstances, as we opened for business only in May 2006 in the East and four months later in the West, it was necessarily incomplete. That report discussed the initial performance status of 144 co-operatives that had filed information returns with the Agency for fiscal years ending in 2006 and whose returns we had validated by February 15, 2007. The data set therefore represented less than 30 per cent of the 502-strong Agency portfolio as at the end of 2006. Moreover, it was very heavily weighted towards Ontario, with 88 per cent of co-ops coming from that province (Ontario clients represented 53 per cent of our portfolio at the end of 2006). While we will occasionally contrast performance in the past year with 2006, it is well to remember that while the comparison may be interesting, it cannot provide a basis for conclusive statements.

In contrast, this report for 2007 presents data for co-operatives from all regions in which the Agency operates for fiscal years ending in the period September 2006 to August 2007 [1]. Because clients have four months to file their Annual Information Return and associated reports after their fiscal year end, this cut-off point has allowed us to include information from 461 co-operatives, or 90 per cent of the 515-co-op Agency portfolio at December 31, 2007. Data from the remaining 54 clients is excluded, either because the co-op was late in filing its return or because we did not have an opportunity to process the return before our February 2008 cut-off date. Appendix A provides a comparison of co-ops in the data set with the full Agency portfolio, looking at those characteristics of relevance for this review. As the comparison shows, the data set is fully representative of the portfolio. This isn't surprising, given its size.

The report begins by discussing the portfolio as a whole, starting with its compliance status, which is not touched on elsewhere. We go on to review its risk profile and operating performance against various indicators. In subsequent chapters we look at the performance of the portfolio by program and by province. Chapter 5 looks at the portfolio from the perspective of the four different management models in use. We conclude with a few thoughts about what we see in the portfolio now and what we think lies ahead.

1. Throughout this report, except where the context otherwise requires, "2007" means a year ending any time between September 30, 2006 and August 31, 2007.

Chapter 2: Portfolio-Wide Perspective

Portfolio Facts and Figures

The distribution by program, province and management model of the 461 housing co-operatives from which data were drawn for this report (the "data set") is shown in the table on this page.

Compliance Profile

The first responsibility of the Agency is to ensure that the housing co-operatives in our portfolio comply with the terms of the operating agreements they entered into with CMHC as a condition of receiving financial assistance under the federal co-operative housing programs. An important step in the compliance-management process is our annual compliance review of each co-op. The review examines information drawn from the Agency's records and co-ops' AIR filings, including the financial pages and co-operative's representations. Compliance variances—failures to comply with specific terms of the operating agreement or program guidelines—are classified as minor variances, material variances or breaches, according to their severity[2].

PORTFOLIO FACTS & FIGURES

Total number of co-ops in the data set: 461

Distribution by Program:		
S27/61	49 -	11%
S95	283 -	61%
FCHP	114 -	25%
UN/NP PEI	3 –	1%
Multiple*	12 –	3%
*excluded from program-related charts		
Distribution by Region:		
B.C.	164 -	36%
Alberta	42 -	9%
Ontario	245 -	53%
PEI	10 -	2%
Distribution by Management Model:		
Management Company	160 -	35%
Paid Staff	211 -	46%
Paid Bookkeeper	45 -	0%
Volunteer Only	45 -	0%

In reviewing the information that follows, the reader should note two points. Until the fourth quarter of 2007 we treated mortgage arrears as a risk factor but not as a compliance failure. We now recognize arrears as both, since maintaining the mortgage in good standing is a requirement

2. Variances are classified according to the following criteria:

Minor compliance variance: a variance from the operating agreement or program guidelines that neither has an impact on the short- or long-term viability of the project nor results in public funds committed for the program being misused or being seen to be misused.

Material compliance variance: an operating-agreement compliance failure that does not threaten the viability of the co-operative in the short term but that, if left unresolved, could have an impact over the longer term; the compliance failure will not result in public funds committed for the program being misused or perceived as being misused.

Breach: an operating-agreement compliance failure having an impact on the viability of the co-operative in the short term or that could result in public funds committed for the program being misused or being perceived as being misused.

of the operating agreement under all programs. However, in the compliance statistics below, only the two instances appear of mortgage arrears first reported in the fourth quarter of 2007.

The second point has to do with late financial filings. Initially, we identified failure to file within three months of the deadline as a material compliance variance. On re-examination, we redefined it as a breach and, effective with the start of the fourth quarter of 2007, began classifying all new incidences as such. The number of such cases is not material, however, in either category.

Of the 461 co-operatives in the data set, 69 per cent were fully compliant with their operating agreements and other program requirements at the end of December 2007. The remaining 31 per cent (141 co-ops) had variances—some more than one. One in four co-ops had a material variance. At one per cent of the portfolio, co-ops with breaches were rare. The following table provides a breakdown of compliance variances by type.

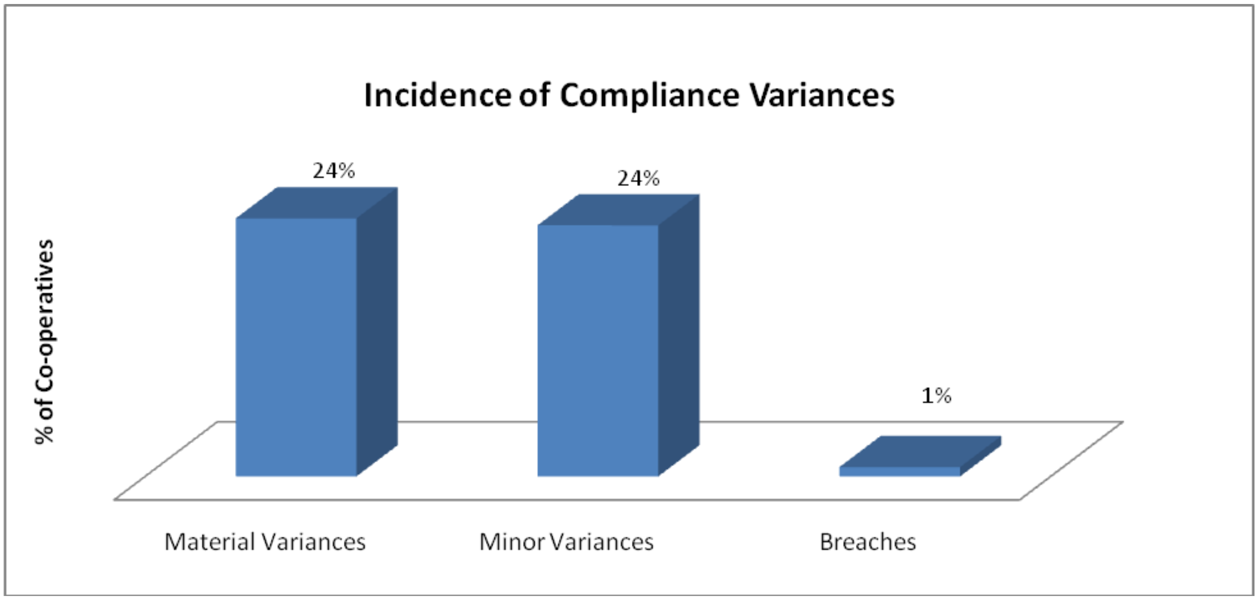

Figure 1

As the table on the next page shows, failure to consult the Agency before spending from the replacement reserve on eligible items was both the minor variance most often seen and, at 19 per cent, the commonest of all variances. The situation at the end of 2006 was not dissimilar. Among material variances, replacement reserve funding variances increased from 2006 to the end of 2007, when they made up 16 per cent of all variances for co-ops in the data set.

Table 1: Types of Compliance Variances

Breaches	# of variances	% of total variances
Audited statements more than 3 months overdue	2	1%
Mortgage arrears	2	1%
Total Breaches	**4**	**2%**
Material Variances		
Replacement reserve funding variances[3]	37	16%
Non-compliance with Net Operating Revenue Policy (S95 only)	16	7%
Refund of excess federal assistance overdue (UN, PEI NP, S95)	14	6%
Spending from replacement reserve on ineligible items	11	5%
Subsidy-surplus reserve funding variances (S95 only)[4]	7	3%
Other	27	12%
Total Material Variances	**112**	**50%**
Minor Variances		
Failure to seek approval for eligible replacement-reserve spending	43	19%
Audited statements less than 3 months overdue	12	5%
Annual Information Return overdue	10	8%
Other	35	16%
Total Minor Variances	**109**	**48%**
Total Variances	**225**	**100%**
Total Co-operatives with Variances (no. and % of data set)	**141**	**31%**

Risk Profile

The Agency's second mandate is to protect the public's investment in the federal co-operative housing programs. We do this by identifying and taking action to mitigate CMHC's risk as either the principal lender to a housing co-operative or the guarantor of its NHA-insured loan or both.

The Agency's Risk Management Model

3. Variances here fall into three sub-categories: failure to contribute to the reserve at the required rate; failure to back the reserve fully with cash or investments; and failure to allocate fund investment earnings to the fund.

4. failure to back the reserve fully with cash or investments and/or failure to allocate fund investment earnings to the fund

Our risk-management model takes as its starting point the belief that the following six conditions, if met, assure a housing co-operative's continuing financial success:

- Revenues are budgeted at a level sufficient to meet the co-operative's costs and to permit contributions to a reserve for capital repairs and replacements.
- The units are occupied.
- Housing charges at the budgeted rates are collected in full and on time.
- The property is kept in a good state of repair.
- Capital repairs and replacements are carried out when due.
- The assets from which earnings are drawn are adequately insured.

The ability to meet the above conditions depends in turn on the presence of several pre-conditions. Excluding those that are beyond anyone's control today, these pre-conditions are a viable rental market and good governance and effective management of the co-op. The Agency's risk-assessment process tests whether a co-operative meets all of the above-noted conditions and pre-conditions for success on a continuing basis.

Composite Risk Rating

Key to our risk-management process is the assignment of a composite risk rating to each co-operative in our portfolio. A portrait of a co-operative's overall risk profile, the composite rating reflects the Agency's evaluation of the co-op's current health and future prospects, based on separate assessments of its financial strength, current financial performance and physical condition, all viewed in light of the current economic and market environment and other risk factors, such as the sufficiency of the co-op's capital replacement reserve. Although strongly informed by the results of standardized tests performed for each co-op, the rating is ultimately judgement based.

The composite rating, which is assigned upon review of the co-op's Annual Information Return and may be updated during the year in response to external developments or actions the co-op takes or fails to take, guides the Agency's subsequent risk-management activities with each client and allows us to focus our time where it is most needed.

Possible risk ratings are Low, Moderate, Above Average and High. Definitions for these ratings appear in Appendix B: Definitions of Composite Risk Ratings.

As at February 15, 2008 (the cut off date for AIR validations for this report), almost equal numbers of co-operatives had an acceptable composite risk rating (Low or Moderate: 42%) or a rating that raised a red flag for the Agency (Above Average: 43%). These figures represent a decline of seven points from 2006 in the percentage of co-ops that achieved a Low or Moderate risk rating and a five-point increase in those rated at Above Average risk. Fifteen per cent of the Agency's clients carried a composite rating of High, up slightly from 13 per cent at the end of 2006. However, reliable comparisons between the two years are not really possible because of the difference between the data sets in size and representativeness.

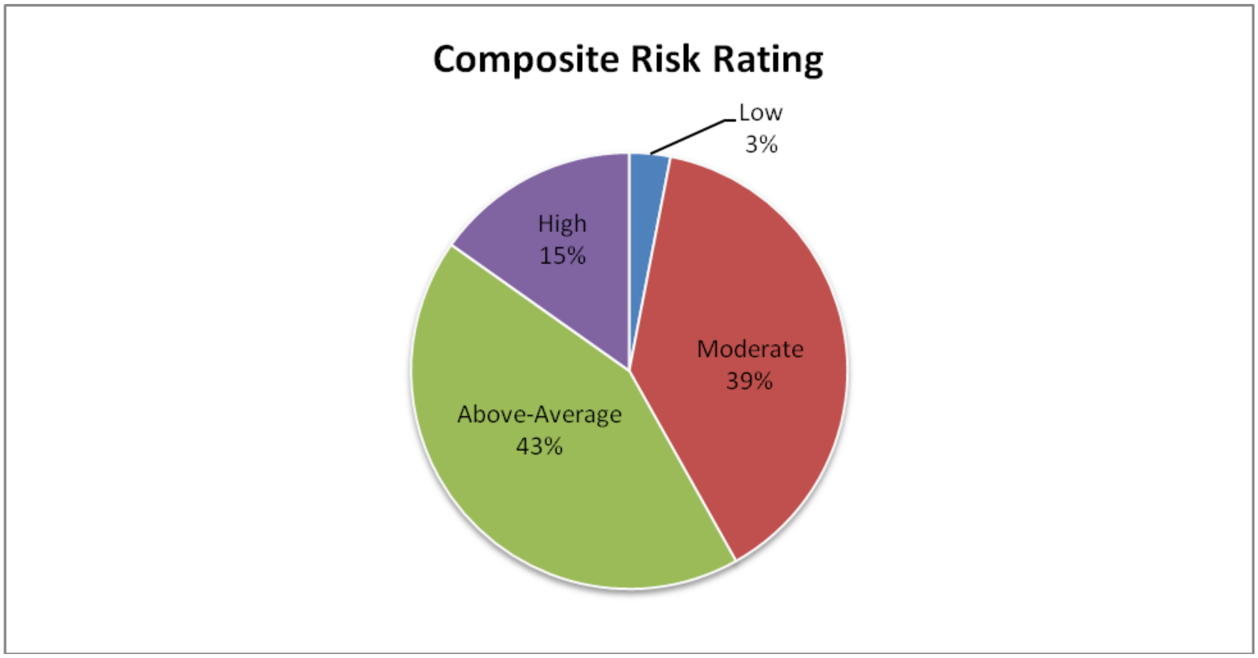

Figure 2

Liquidity Indicator

It may help cast further light on the risk profile of the Agency portfolio to look separately at results for each of the three key indicators that inform the composite risk rating of every housing co-operative: the co-op's liquidity, its current earnings and its physical condition.

From the financial data gathered through the Annual Information Return, the Agency calculates a liquidity ratio for each co-operative. A balance-sheet test, the ratio reveals the co-op's financial strength, as measured by its ability to service its non-negotiable financial obligations. From the ratio, one of four possible liquidity ratings is derived: Excellent, Good, Fair or Poor.

Over the past year we have seen signs of improvement in this measure, with the percentage of clients achieving an Excellent score five points higher than the 56 per cent observed for 2006. A smaller proportion of co-ops are rated Fair (7%, down from 11%) or Poor (13%, down from 14%), while the percentage rated Good is unaltered. Again, however, the different data sets used in the two years prevent us from placing much weight on the change over 2006.

Net Income Indicator

The net-income ratio is an income-statement test, intended to identify whether or not, on a current basis, a co-operative is earning sufficient income to allow it to meet all of its operating and debt-service costs and to make a reasonable contribution to its capital replacement reserve. Again, possible ratings are Excellent, Good, Fair and Poor.

The percentage of co-ops with a net-income rating of Poor has dropped three points from 2006 to 17 per cent, and there is a marginal increase in ratings of Fair and Good. But again, no reliance should be placed on the apparent changes, due to the differing data sets.

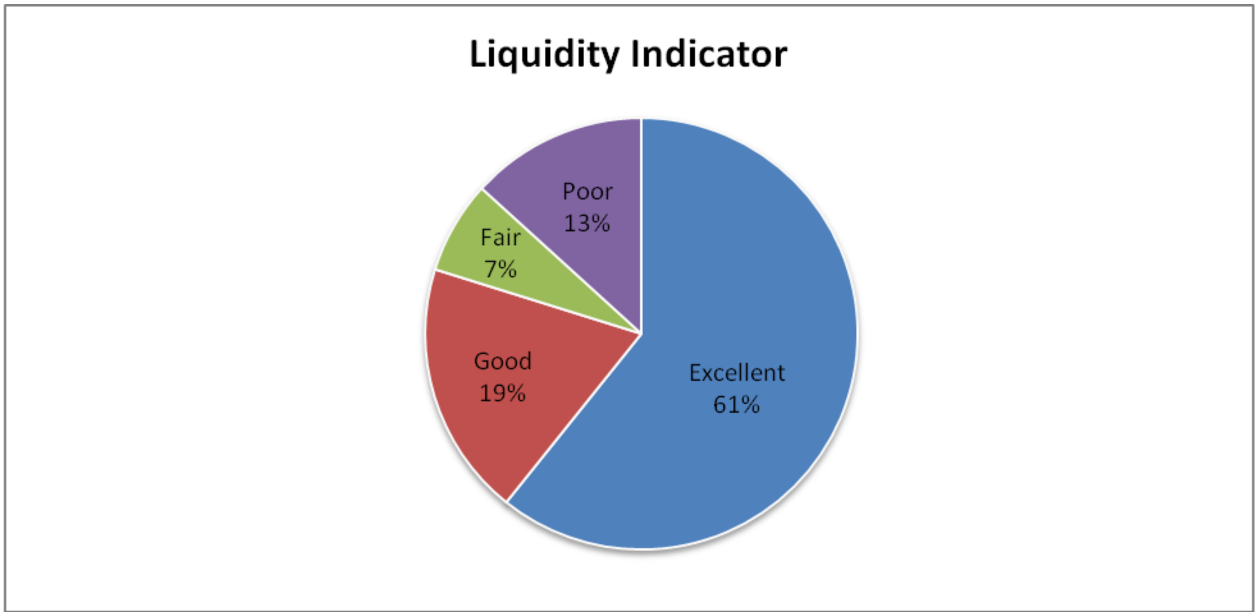

Figure 3

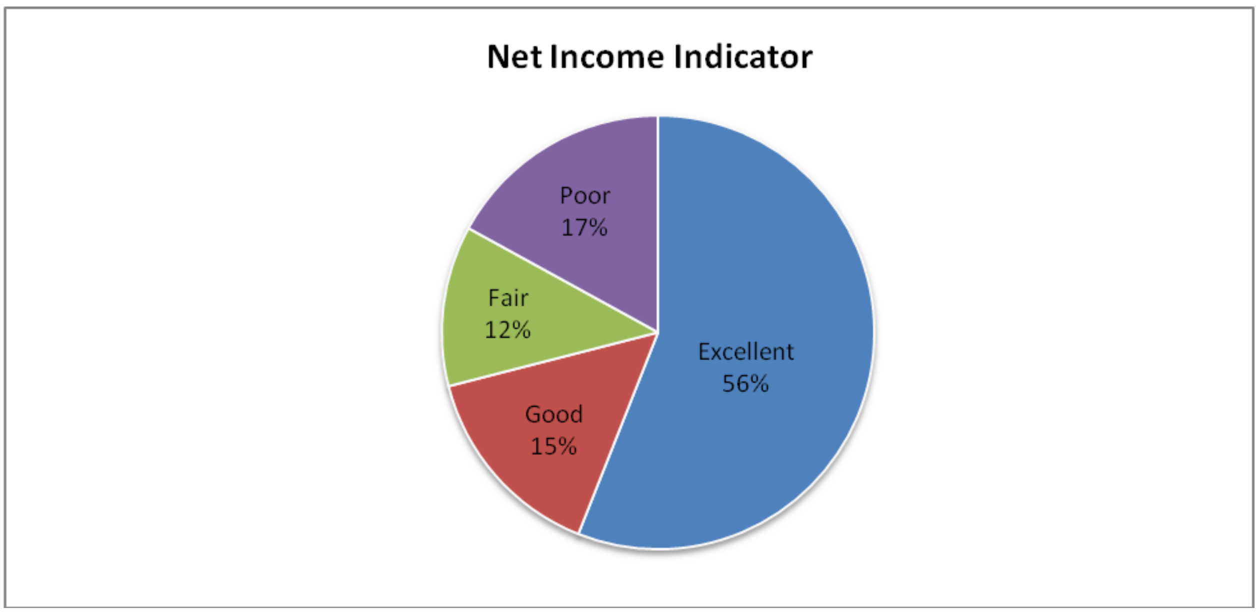

Figure 4

Physical Condition Ratings

The physical-condition rating is the product of a visual inspection of a co-operative's property conducted every second year. Systems and components are rated individually according to their condition and the results translated through an algorithm into a global condition rating that is carried into the Agency's information system. Again, four ratings are possible: Excellent, Good, Fair and Poor.

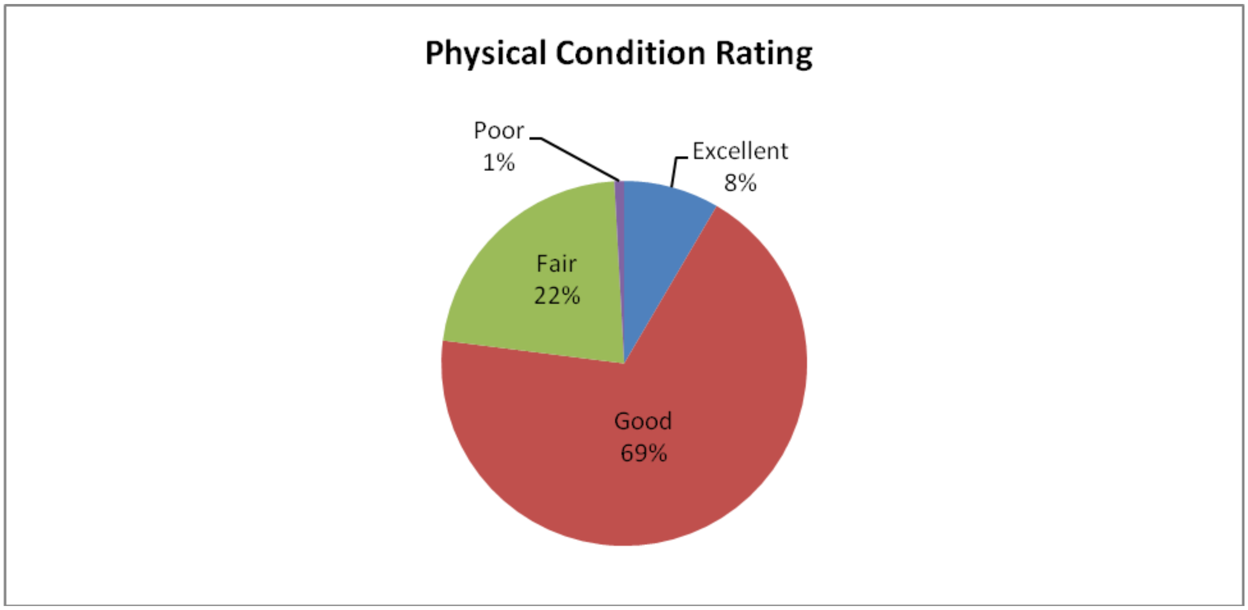

Figure 5

The Agency recorded a significant drop in Excellent ratings from 2006—to eight per cent from 26 per cent—and increases in Good and Fair ratings—to 69 and 22 per cent, respectively, from 55 and 15 per cent. Data presented in the regional perspectives section of this report suggest that these changes have to do, at least in part, with the difference in the 2006 and 2007 data sets. However, another factor may be contributing to the changed results. Our 2006 report noted significant differences between physical-condition ratings based on the CMHC inspections and those resulting from the Agency's. The shift in the physical-condition profile of the overall portfolio from 2006 to 2007 may in part reflect the higher proportion of 2007 ratings drawn from the Agency's own inspections. (We carried out 355 inspections in 2007: more than twice the 150 performed in 2006.)

Further Risk Indicators

The three leading indicators discussed above tell only part of the story behind the distribution of composite risk ratings. As important are the further risks identified below, which our information system tests for following the receipt and validation of a co-operative's Annual Information Return. If any are present, the co-op receives an Above Average or High Risk rating, as the case may be, regardless of its liquidity, net-income and physical-condition ratings. The elevated rating remains in place until the condition has been investigated and the concern resolved.

The presence of any of the following risks, whether identified during the annual review or between reviews, triggers a High risk rating:

- scheduled mortgage payments overdue
- property taxes in arrears
- absence of guaranteed full replacement-cost insurance against fire and other perils
- adverse audit opinion or denial of opinion

- major fire, material incident of fraud or other loss of insurable assets reported, where the loss is not substantially recoverable from the proceeds of insurance or indicates a failure of internal controls.

If any of the following risks, but none of the risks above, is present, the Agency will rate the co-op at Above Average risk:

- material contingent liability or future commitment other than land-lease payments reported on financial statement
- one or more directors more than $100 behind with their housing charges at year end
- quorum of board of directors not in office
- qualified audit opinion reflecting a scope limitation
- auditor's management letter reports significant deficiencies in internal controls
- failure of any major building component
- some or all of the following insurance coverage not in place, or policy limit below required level:
  - loss of rents coverage (limit = > 12 months' gross housing charge potential)
  - public liability coverage (limit = > $2 million)
  - crime coverage, including fidelity bonding, in the amount of at least the lesser of $1,000 per unit or $100,000 total or, if the co-op uses the services of a property-management firm, $25,000
- filings with the Agency more than three months overdue.

Of the 73 housing co-operatives in the data set carrying a High composite risk rating at February 15, 2008, nine had Further Risk Indicators that alone would produce this rating. However, it is noteworthy that all nine would carry a rating of High even without the presence of these further risk factors. The situation of co-ops rated Above-Average is more complex. Of the 461 co-ops in the data set, 282, or 61 per cent, showed evidence when their Annual Information Return was filed of Further Risk Indicators that would lead to an Above-Average rating. Thirty per cent of this group, alerted by their Agency relationship manager, took quick action to address the risk factors, reducing the proportion of co-ops with an Above-Average rating to 43 per cent of the data set. Of this group, 40 per cent would see an improved rating but for the presence of specific Further Risk Indicators. These co-operatives represent fertile ground for the Agency's risk-management efforts, since most of the risk indicators in question, such as director arrears and inadequate insurance, are susceptible to correction in the short term. The first step we take when facing a client judged to be at above-average risk is to encourage the co-op to address these specific risks. For their part, motivated by a desire to improve their standing, co-ops often move quickly to address the factors once identified. The Agency's Co-op Data Report, which allows a co-operative to judge its comparative performance on certain key indicators, such as arrears, provides further stimulus for improvement.

Moving the key indicators—liquidity, net income and physical condition—takes time and patience. By the time a co-op files its return with the Agency for a completed financial year, it is well into the next year. Its first opportunity to address a developing financial problem decisively may not come until it is setting its budget for the year afterwards and, even then, it may take several years for the co-op to turn its performance around.

Insurance

One of the first things the Agency did when we began operating was to establish the voluntary insurance standards cited above. The table below shows the extent to which co-operatives within the 2007 data set met these standards at the time of their 2007 AIR filing, compared with the previous year. Owing to the timing of their transfer to the Agency, 189 of the 461 co-ops in the data set filed their first full AIR for their 2007 fiscal year and only a partial return for 2006. Partial returns do not contain the representations from which information on insurance is drawn. The data shown for 2006 are therefore broadly indicative but not conclusive. With that caveat, it appears that the Agency is having some success in increasing compliance with our insurance standards.

Table 2: Insurance Coverage

Coverage	Proportion of Co-ops in the Data Set Insured to Recommended Limit	
	2007	2006
Guaranteed-replacement-cost insurance against fire and other perils	98%	99%
loss of housing charges	77%	79%
public liability insurance	89%	85%
fidelity bonding	78%	72%
directors' and officers' liability	95%	95%

Operating Performance

Each housing co-operative's composite risk rating reflects the extent to which it has met the nine conditions and pre-conditions of financial success discussed in the preceding section, as does the risk profile of the portfolio as a whole. Several of the same factors merit separate attention as bearing on a co-op's operating efficiency. These are examined further below.

Vacancy Losses

Every month a unit of housing in a co-operative goes unoccupied, the co-op records a permanent loss of revenue, increasing the amount it must earn from the occupied units and, when the vacancy rate is high and persistent, placing its long-term and, in extreme cases, even its short-term survival at risk. The first chart below shows vacancy losses for the data set, measured as a percentage of a co-op's annual gross housing charge potential[5]. While an impressive number of clients reported no vacancy loss at all for 2007 (26%) and the largest cohort (44%) kept losses to less than one per cent of gross housing charge potential, a disturbing 12 per cent posted losses in excess of three per cent. The median vacancy loss for Agency clients in the data set was 0.35 per cent.

5. Gross housing charge potential is the maximum revenue attainable from occupancy charges, before deducting rent-geared-to-income subsidies and rental inducements or other discounts, if all units are occupied.

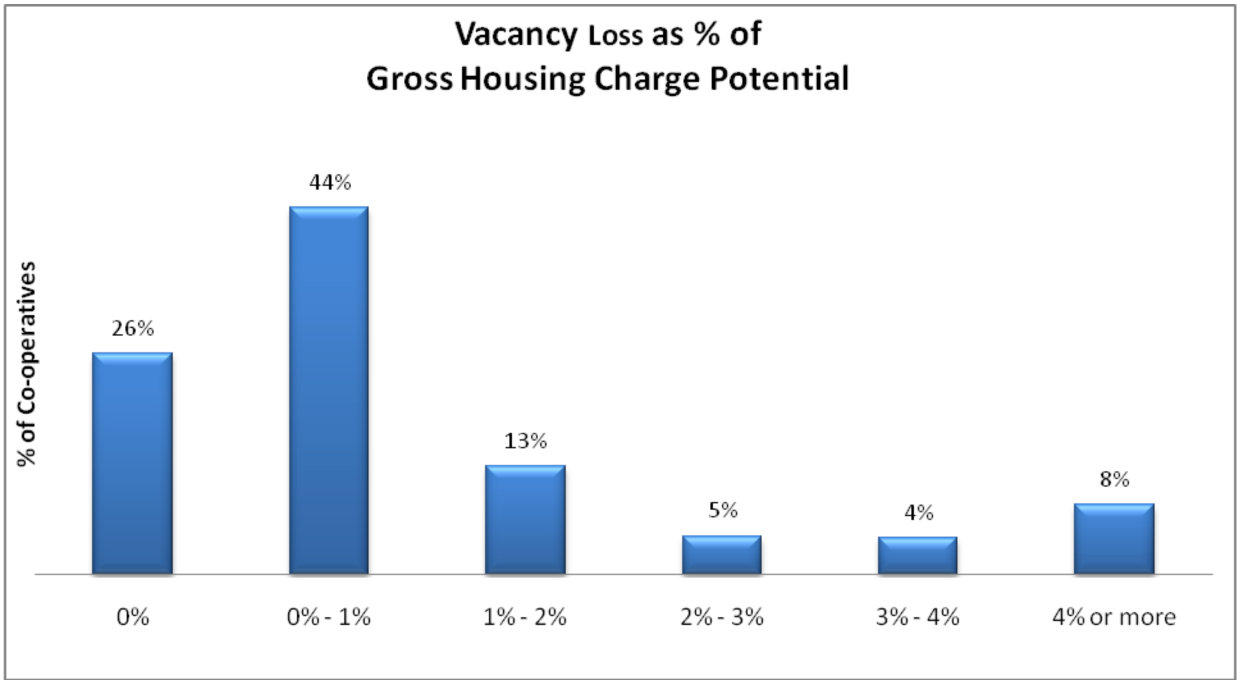

Figure 6

It is instructive to look as well at the dollar cost of vacancies. The chart on the next page shows the distribution of vacancy losses in the data set, measured on a dollar-per-unit-per-year basis. The median loss in 2007 was a very low $30 per unit per year. However, 14 per cent of co-oops in the data set incurred annual losses of $250 per unit or more, with six per cent reporting losses of at least $500 per unit.

In 2007 only three co-ops reported attempting to reduce vacancies by offering rental inducements[6], up from one (of a data set of 144 co-ops) in 2006. The lowest total cost of inducements reported was $320 and the highest $21,523, compared with $2,700 last year.

Arrears and Bad Debts

Two related measures of a co-operative's financial performance were examined together: arrears and bad-debt expense. The former captures the amount owing from past and present occupants at the end of the fiscal year reported and not previously written off, net of any allowance recorded for bad debts. It includes both overdue monthly housing and other charges and the unpaid portion of member shares, loans and deposits payable over time. Bad-debt expense represents the increase in the allowance for doubtful accounts recorded in the year, or, if the co-op has not set up an allowance, the amount written off as uncollectible during the year. Measuring arrears and bad-debt expense together standardizes the data for differences in co-ops' accounting methods and assiduousness in allowing for bad debts. We look at the sum of the two as a ratio of the total occupants' share of annual housing charges, thereby normalizing the data for differing vacancy rates and percentage contributions to total housing-charge revenue from income-based subsidies

6. A concession, such as one month's occupancy at no charge, or other benefit, such as a free microwave oven, designed to entice a prospective member or tenant to take up occupancy.

(e.g., income-tested assistance and rent supplements), allowing for a fairer comparison among co-ops. As the second chart below chart shows, just over a majority of co-ops reporting (54%) had either a net bad-debt recovery or combined arrears and bad debts equal to less than one per cent of the occupants' share of annual housing charges. While the median rate was a respectable 0.8 per cent, 46 per cent of co-ops in the data set show considerable room for improvement, with fully ten per cent reporting combined arrears and bad debts of five per cent or more.

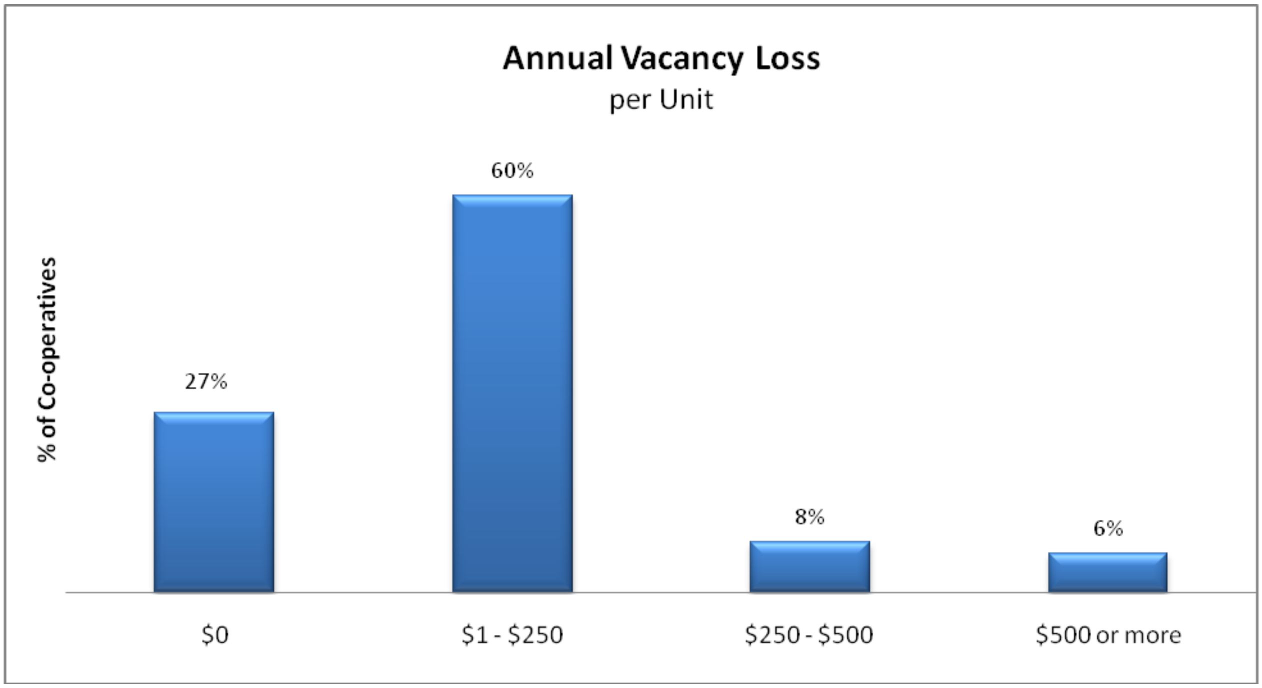

Figure 7

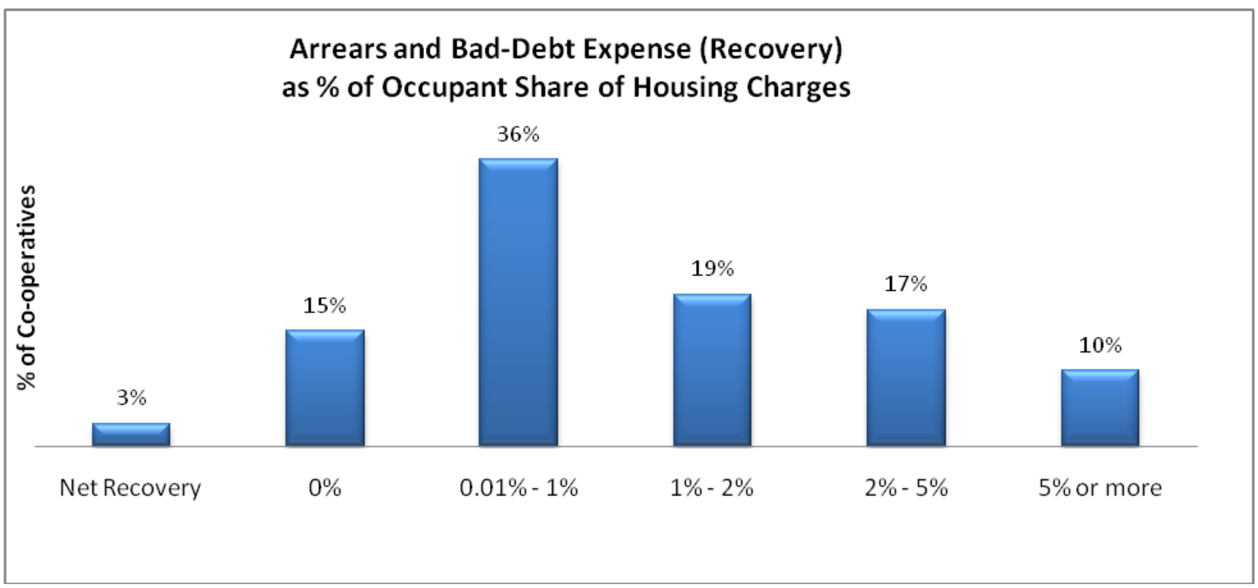

Figure 8

Directors in Arrears

From the outset, the Agency has taken an interest in the question of directors of housing co-operatives who are in arrears of their financial obligations to their co-op, asking in the Annual Information Return for both the number of board members in arrears and the amount that together they owe. Now that sufficient data have accumulated, we are able to confirm our early hunch that co-ops with directors in arrears exhibit less discipline in arrears management generally. As at their 2007 year end, 32 per cent of co-ops in the data set had one or more directors in arrears, with the amount owing ranging from $46 to $5,743 per director in arrears. The median amount owing was $458. If we exclude average amounts under $100 as being immaterial, the percentage of co-ops with directors in arrears falls to 26 per cent. The median arrears and bad-debt expense ratio reported by these co-ops was 1.3 per cent, 62 per cent higher than the portfolio-wide median.

Investment in Physical Plant

Under-spending on the physical plant—whether on preventive and corrective maintenance or the replacement of worn-out or obsolete capital components—is as often a precursor of financial difficulties as it is a symptom. A co-operative in a strong rental market can let the condition of its property slide without suffering the consequence of rising vacancies. (Other effects will obviously result, such as a decline in the quality of accommodation offered). A co-op in a weak market disinvests in the maintenance of its buildings and grounds at its peril. Yet, all too often, as the market weakens and interest in the co-op begins to wane, co-ops respond to the resulting loss of revenue by cutting back on upkeep costs, starting a vicious cycle that slowly but steadily pulls them into difficulties from which they cannot extract themselves without outside help.

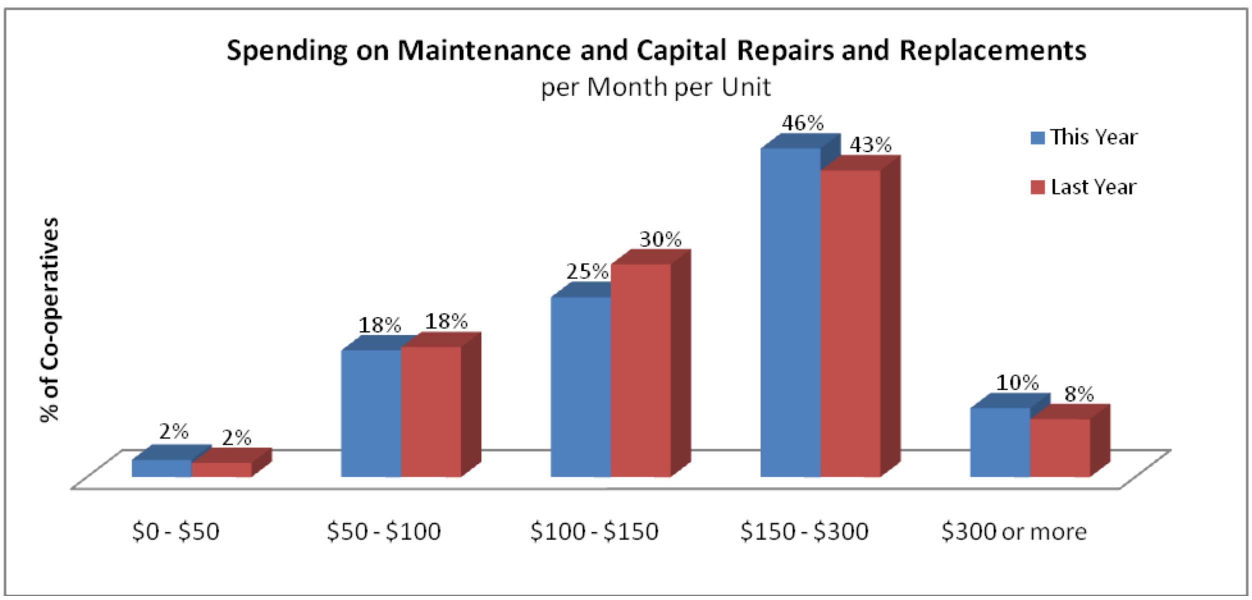

Figure 9

The chart above looks at combined spending on maintenance and capital repairs and replacements. (Note that, due to lack of available data, spending financed either through loan proceeds or the co-op's own working capital and amortized to operations over more than a year is excluded from the analysis.) We have chosen to look at these together, rather than separately, as not all housing co-operatives use the same definitions in determining whether an item is a capital or an operating expenditure.

Median spending on capital repairs or replacements and corrective and preventive maintenance together was $160 per unit per month in 2007. Future portfolio reports will examine the correlation between physical-condition ratings and levels of current spending on the physical plant.

Capital Replacement Reserves

The median age of housing co-operatives in the Agency portfolio was just over 24 years at the end of 2007[7]. Information on the age of our clients' buildings is not available, but the average building is certainly older than this, since a proportion of co-ops acquired and upgraded existing properties, rather than building new structures. Whatever the precise age of its property, the average Agency client now needs to invest significant funds in capital repairs and the replacement of worn-out building components. The chief method used in the co-operative housing programs for funding capital work is to draw from a capital replacement reserve accumulated through annual charges to operations and, in some cases, transfers of any operating surplus earned in a year. Borrowing to fund repairs is much less common, probably because it is achieved only with some difficulty. All of the operating agreements prohibit housing co-operatives from registering a second charge against their real property without CMHC's permission; second mortgages normally attract a higher rate of interest than first mortgages, especially if uninsured; and many co-ops lack one or both of sufficient equity in their property to secure a second loan and the capacity to repay a new loan from their rental income. To date, CMHC has been unable to support the typical technique used in the private sector to pay for major work to properties: taking out a new, larger loan with a suitably long amortization period and using the proceeds to fund needed repairs, after paying out the balance of the existing financing.

In this environment, it is imperative to keep a watchful eye on co-ops' capital replacement reserves. The chart on the next page shows the distribution of closing reserve balances for the 2007 fiscal year across the portfolio, broken out by physical-condition rating.

The median reserve balance in 2007 was $3,152 per unit. The median rises only slightly, to $3,448, if co-operatives with financial workouts, many of which have no replacement reserve fund, are excluded. A very large proportion of co-ops in Poor physical condition held balances below the median level, suggesting that they have under contributed in the past. Co-ops in Fair physical condition had the second-highest representation in the lower spending categories and the second-lowest representation in the highest category, again suggesting a pattern of under contributing. Co-ops in excellent shape are more likely than co-ops whose condition is rated Good to hold a lower balance, perhaps reflecting recent spending from the reserve.

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7. calculated from the interest adjustment date on the co-operative's first mortgage loan

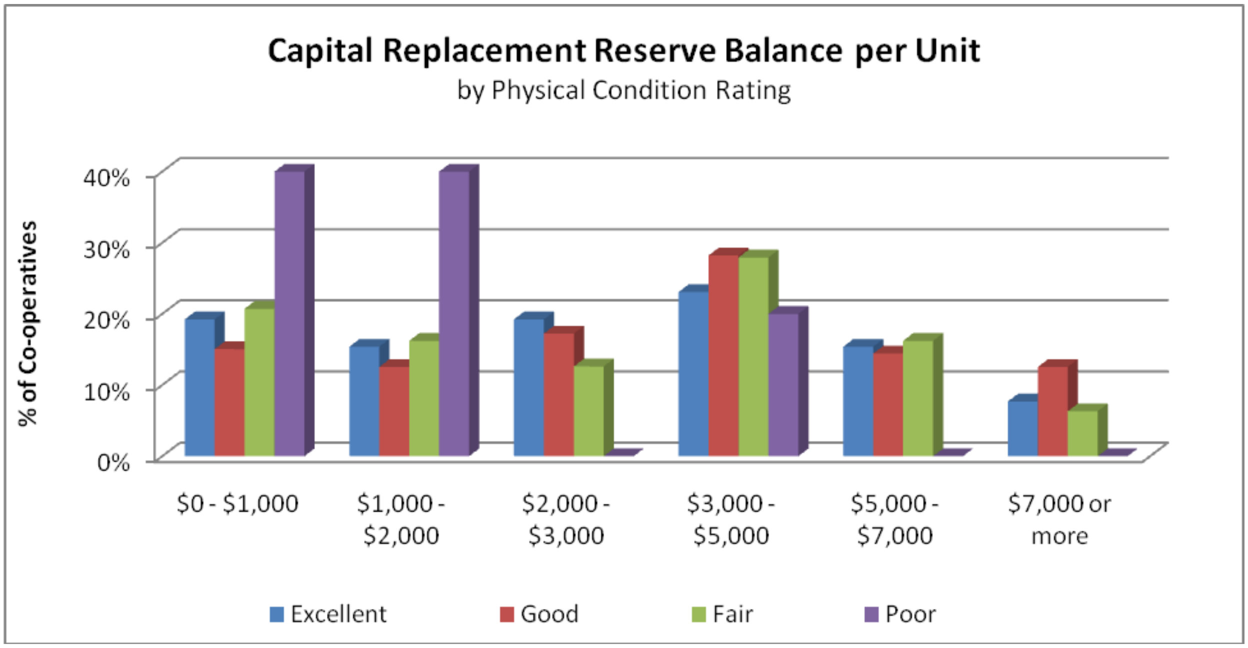


Figure 10

The next chart looks at the distribution of co-operatives' capital replacement reserve balances across the whole portfolio, excluding extreme outliers[8] and co-ops with financial workouts. A startling 24 per cent of clients held less than $2,000 per unit in their reserve at the end of 2007 and only eight per cent had balances of $8,000 or more. Given the age of the portfolio, these numbers are cause for concern.

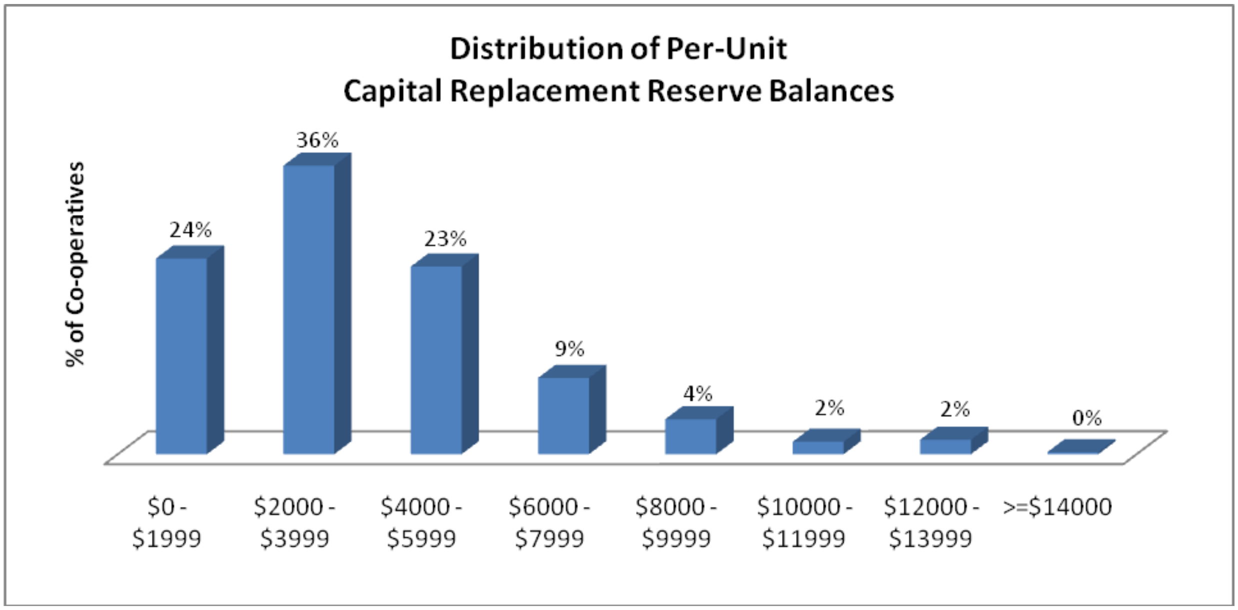


Figure 11

8. co-ops that fall outside the fifth to 95th percentile range

To normalize the data for varying housing forms and geographical locations and to facilitate year-over-year comparisons, we also looked at capital-reserve balances as a ratio of the insured replacement cost of the co-operative's property. The chart below shows that nearly 31 per cent of co-operatives without financial workouts held balances at the end of 2007 equivalent to less than two per cent of the insured replacement value of their buildings (again, extreme outliers are excluded). Only 12 per cent of Agency clients had reserves exceeding six per cent of insured value. The median balance was 2.9 per cent.

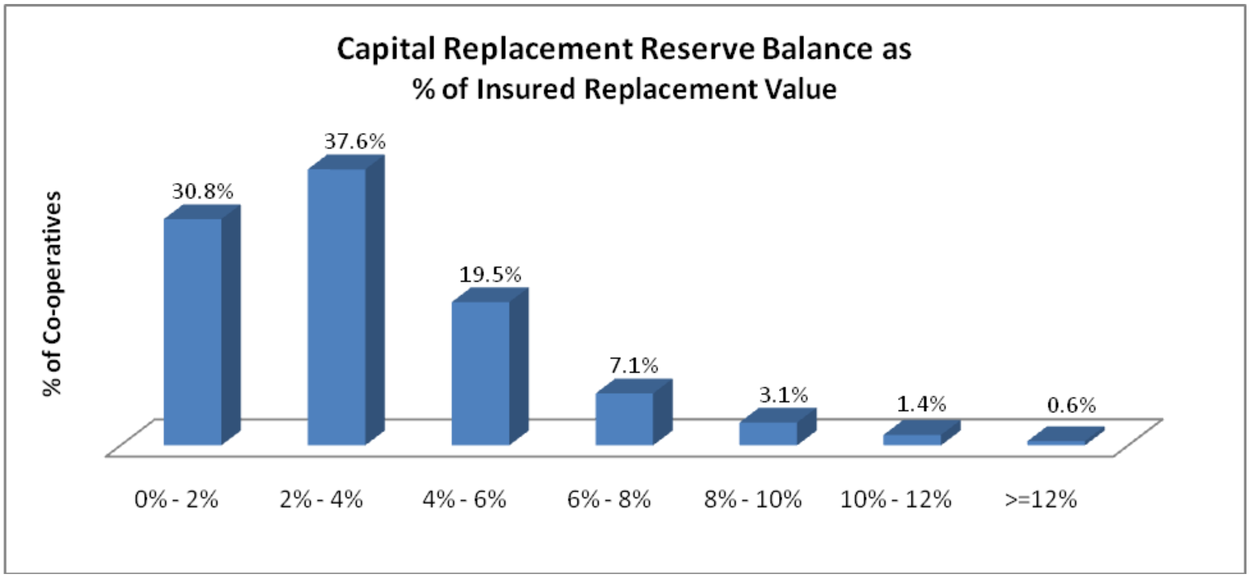


Figure 12

The first chart on the next page presents a picture of 2007 contribution amounts to capital replacement reserves. (Supplemental contributions from operating surpluses are omitted.) The median monthly contribution in 2007 was $58 per unit. In addition to the budgeted contribution from operating revenues, 134 co-ops made supplemental contributions from operating surpluses. On average, each of these co-ops contributed an additional $32,417 in 2007. The median annual supplemental contribution was $23,706.

A second chart provides a look at levels of annual contribution to capital reserves over 2007 as a percentage of insured replacement value. It shows that 78 per cent of co-ops in the data set[9] contributed an amount equal to less than one per cent of the insured replacement value of their property. The median annual contribution rate in 2007 was .64 per cent of insured replacement value.

9. Here the data set excludes co-ops that fall outside the fifty to 95th percentile range for per-unit insured replacement value.

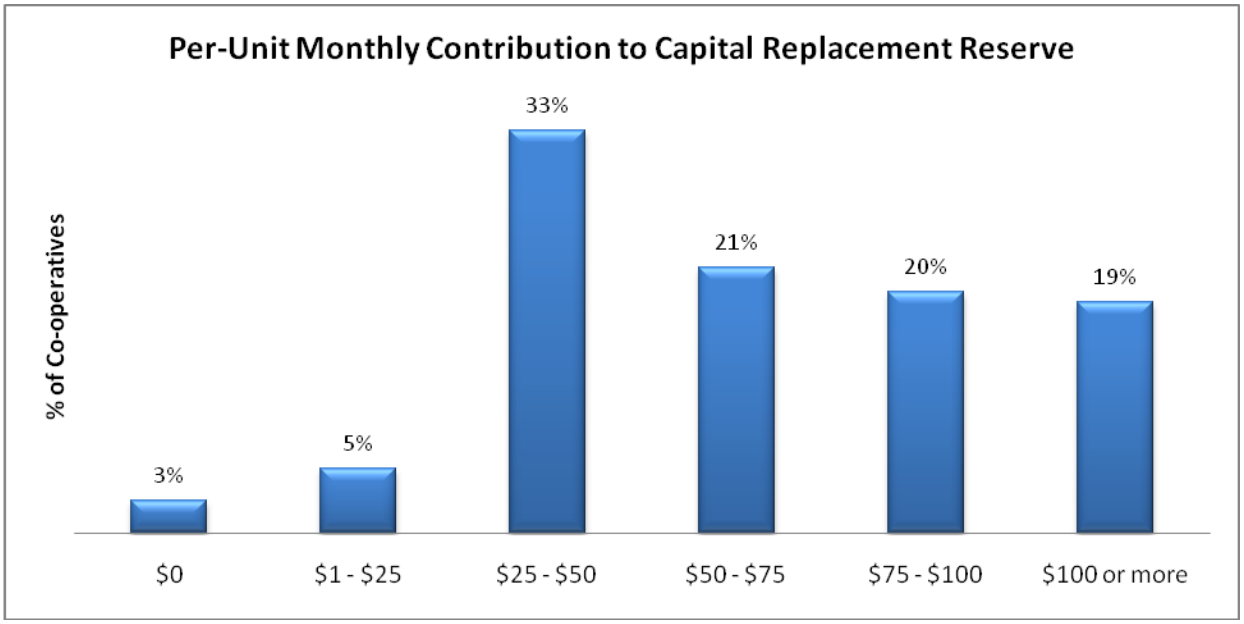


Figure 13

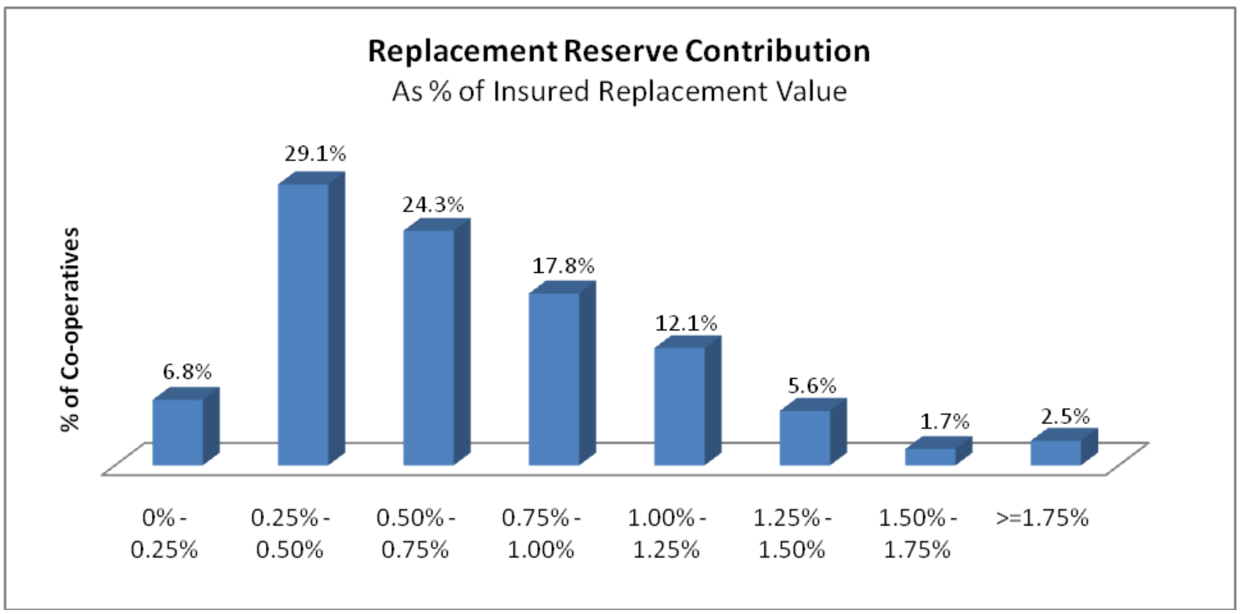


Figure 14

A third chart shows the distribution of contribution amounts as a percentage of total annual debt service and operating costs (excluding reserve contributions[10]). In 2006 the portfolio was divided roughly equally among co-operatives that devoted less than five per cent of their operating spending to funding their replacement reserve, those that spent between five and ten per cent and those for which contributions represented more than ten per cent of operating spending.

10. The median contribution from operations to capital replacement reserves in 2007, as a ratio of combined debt service and operating costs excluding the contribution, was 7.8 per cent.

Contributions as a percentage of total expenses rose perceptibly in 2007 but, again, the reader should bear in mind the difference in data sets.

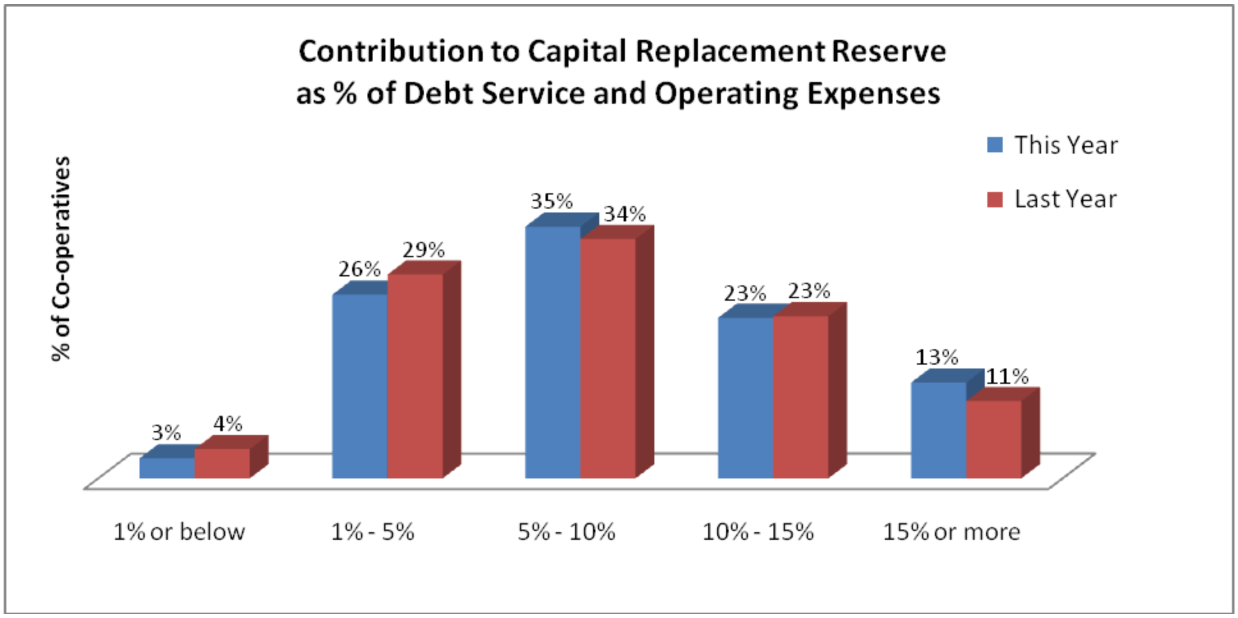


Figure 15

How much a specific housing co-operative should be setting aside in its capital replacement reserve each month is a function of many factors unique to the co-op including its age; its existing reserve balance; the co-op's maintenance practices; the remaining useful life of the building components that will require replacement before the first mortgage is repaid in full; the anticipated cost of expected replacements; and the rate of return anticipated on reserve investments. In the absence of a detailed replacement-reserve study, it is all but impossible to answer the question with any reliability. For this reason, the Agency strongly encourages its client co-operatives to commission such studies. We have had some success, with the number of co-ops with approved plans on hand increasing 36 per cent between the time we assumed responsibility for the portfolio and the end of 2007. (Plans are approved for a three-year period and must be updated every three years after that.) However, as the following table shows, only a small minority of clients in the data set—fewer than ten per cent—had approved plans at that date.

Table 3: Approved Capital Replacement Reserve Plans[11]

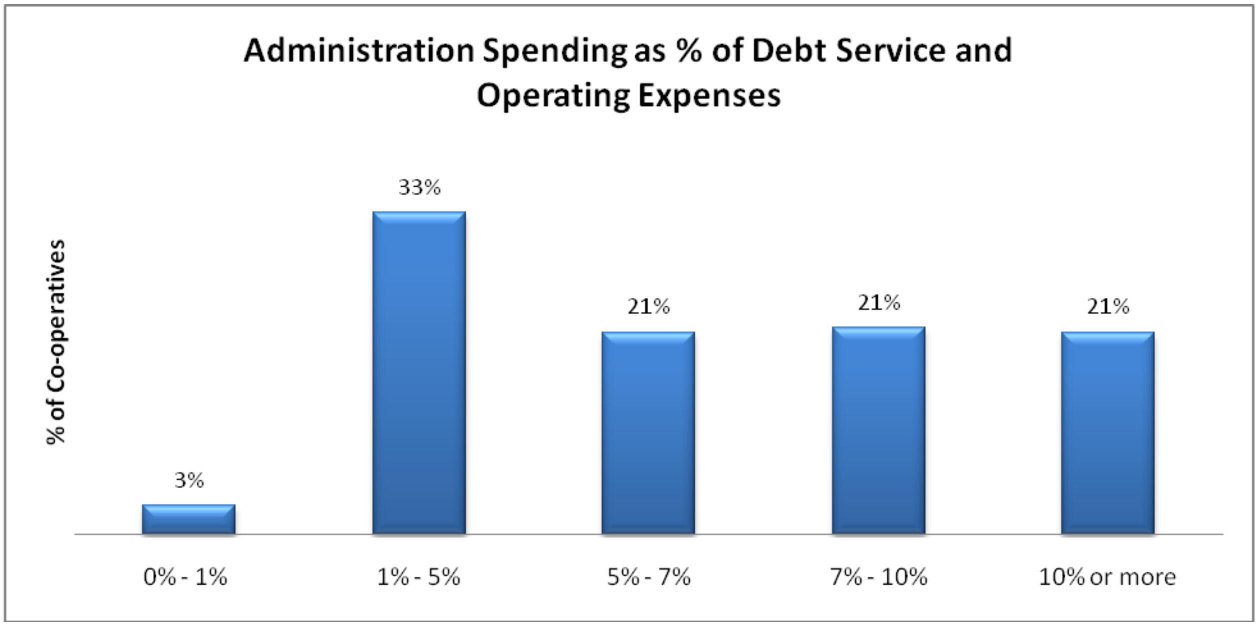
As at Initial Transfer	36
As at 31 December 2006	37
As at 31 December 2007	49

While we cannot be definitive on the point, the building condition and capital-replacement-reserve studies the Agency has reviewed thus far point to a typical recommended contribution of $175 per unit per month, greatly in excess of the median 2007 contribution of $58 observed in the Agency's portfolio as a whole. Though $175 may appear high, it does not seem unreasonable when compared with the $122 per month one building consultant quoted to us as the average contribution to condominium capital replacement reserves, given that condominiums are responsible only for the repair and upkeep of those parts of the property held in common and so not for capital work to unit interiors.

Administration Costs

The chart on the next page shows the ratio of administrative costs to total spending on debt service and operating expenses in 2007, compared with 2006. Fifty per cent of co-operatives in the data set held administrative expenses to 6.3 per cent or less in 2007, about the same as in 2006. A significant number of Agency clients have relatively high administrative expenses, with 42 per cent posting spending rates of between five and 10 per cent and 21 per cent spending 10 per cent or more. (Note that contributions to the capital replacement reserve are excluded from operating expenses for the purpose of this analysis, slightly increasing the weight of administrative spending.) Our analysis did not examine the correlation between administrative spending levels and overall operating performance, making it difficult to draw any conclusion about appropriate spending rates. However, we can observe that a substantial portion of the data set has administrative costs in excess of CMHC's guideline of six per cent of project revenues.

11. The number of plans the Agency has approved is higher than the 13 suggested by the numbers in the table. Sixteen of the approved plans on hand at the time of the portfolio transfer were not updated and have now expired. (Eight of the 16 co-ops concerned now have financial workouts and are no longer permitted to maintain a reserve. Plans for the other eight did not meet the Agency's standards, so that a simple update was not sufficient.) Altogether the Agency approved 29 plans in our first year and a half of operation, plus one other for a co-op not in the data set.


Administration Spending as % of Debt Service and Operating Expenses
% of Co-operatives
3%
33%
21%
21%
21%
0% - 1%
1% - 5%
5% - 7%
7% - 10%
10% or more
Figure 16

Chapter 3: Program Perspective

Facts and Figures

By far the largest proportion of Agency clients (64%) operate under the S95 Co-operative Housing Program, delivered between 1979 and 1985. The Federal Co-operative Housing (ILM) Program, in effect from 1986 to 1991, is the second largest program we administer, making up one quarter of our portfolio. Thirteen per cent of our clients operate under the oldest program—the S27/61 program—which ran from 1973 to 1978. Finally, three per cent of our clients have operations under more than one federal program and the remaining 0.8 per cent are funded under one of the deep-subsidy programs (pre-86 and post-85 Urban Native Programs or Post-85 PEI Non-profit Program). As the chart to the right shows, the distribution, by program, of the data set examined in this report is very close to the distribution of our full portfolio.

FACTS & FIGURES BY PROGRAM

S27/61	49 –	11%
S95	283 –	61%
ILM	114 –	25%
UN/NP PEI	3 –	1%
Multiple*	12 –	3%

*excluded from program-related charts

To obtain a clearer picture, we have excluded multi-program co-ops from the analyses presented in this chapter. Clients operating under the deep-subsidy programs are also excluded: because the economic model of these programs is fundamentally different—all residents pay a charge geared to income and the full difference between their payments and the sum of eligible project expenses is covered by federal assistance—comparisons with the other programs would not be meaningful.

Risk Profile by Program

Composite Risk Rating

We have discussed the Agency's risk-rating system in the previous chapter, and in some detail. Here we will look at the risk profile of each of the three main co-operative housing programs. The S27/61 Program has the best profile. More co-operatives operating under it had a Low or Moderate composite risk rating as of February 15, 2008 and fewer a High risk rating. At the other extreme, the FCHP (ILM Program) had many more co-operatives at High risk and fewer with Low and Moderate composite ratings. The risk profile of the S95 Program was close to that of the S27/61 Program but slightly worse, with 56 per cent of co-ops rated Above-Average or High risk, compared with 51 per cent.

The fundamental features of each program do much to explain these results. For example, the S27/61 Program featured very long-term (50 year) fixed-rate equal-payment mortgages from CMHC for 100 per cent of capital costs less a 10 per cent capital grant. (The grant is earned over the amortization period of the mortgage.) Because inflation rates were very high during the 10-year period after the program was introduced, the equal-payment mortgage had the effect of reducing the monthly debt service in real terms—not only from year to year, but even from month to month—and with it the economic rent relative to market rent. As a result, over time, housing charges in these co-ops became comparatively inexpensive. Although required replacement reserve contributions were extremely low, with no program requirement for increases over the years, once CMHC agreed to allow them to put more money aside for capital purposes, many of these co-ops made up for lost time through contributions that were substantially higher than those of other programs. These factors together make it easier for S27/61 Program co-ops to achieve a current risk rating of Low or Moderate.

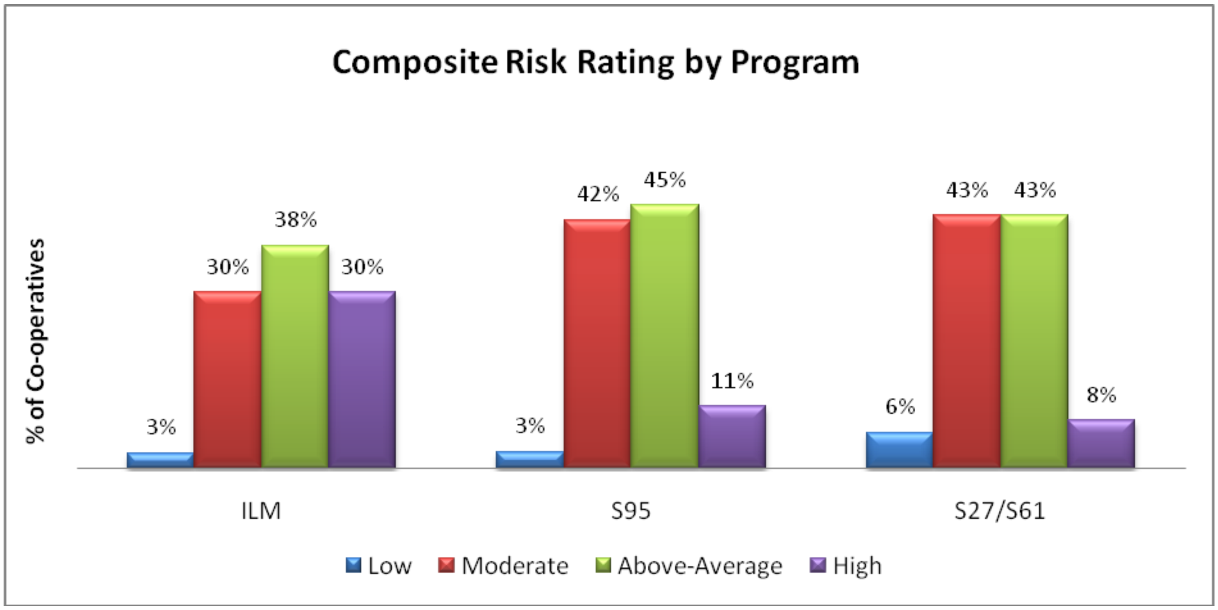


Figure 17

There are nonetheless housing co-operatives operating under this program that are at risk. Many of the acquisition/rehab co-ops developed through the S27/61 Program bought very old properties and did less initial renovation work than was really required, owing to cost pressures at the outset and, in the early days, the absence of experienced resource groups to advise and supervise. As a result, some found themselves in early need of additional financing or even, in some cases, multiple rounds of loan increases. When some of these co-ops have later found themselves facing repair needs they lacked funds to address, CMHC's technique for assisting them has been to allow them to divert mortgage repayment funds towards repairs. (In a few exceptional circumstances, CMHC has provided a second mortgage through its direct lending facility.) The resulting accumulation of mortgage arrears is capitalized and repaid over what remains of the original amortization period. The problem with this approach is that the effective borrowing rate—a costly eight per cent—has for a long time exceeded the market rate, making it difficult for co-ops under this program to return to health, once they find themselves in difficulty. Moreover, as the time remaining in the original 50-year amortization period grows ever shorter, this workout approach becomes less and less viable for co-ops newly facing repair needs. To date, CMHC has declined to allow S27/61 co-ops with closed mortgages—the great majority—to refinance their existing debt with new long-term loans, the most obvious solution in the circumstances, citing its need to meet its matching obligations to the federal government.

In sharp contrast, the Federal Co-operative Housing (ILM) Program provided an NHA-insured index-linked mortgage for 100 per cent of capital costs with a 30-year amortization period and a 35-year term. Apart from a short period after the introduction of the Goods and Services Tax, inflation has been relatively low for the past 20 years. As a result, because under this program the mortgage payment changes annually in accordance with changes in the CPI less 200 basis points, mortgage payments have fallen not only in real (i.e., post-inflation) dollars but—each year that inflation has been below two per cent—in nominal terms as well. The ILM co-ops benefited from initial federal assistance equal to the difference between the economic rent and the market charge. This assistance is adjusted annually at same rate at which the mortgage payment is adjusted.

Although these program features promised well, much of the benefit was lost when the initial housing charges were not set toward the lower end of market, according to previous practice, but at whatever it seemed the market would bear. In addition, at the time the program was launched, the federal government had adopted a different approach to budgeting for housing programs; it committed itself to spending a fixed dollar amount, rather than to the delivery of a specific number of housing units, as in the past. The budgeted program funds proved insufficient when the ILM interest rate came in higher than expected and a building boom forced up capital costs for both land and construction far beyond the level anticipated when the program budget was set. A competitive process for awarding federal-assistance allocations worsened the problem by rewarding proposals that underestimated capital and operating costs and overestimated revenues from market rents. As a result, housing co-operatives developed under this program began their operations with very little leeway during the inevitable period of finding their feet. The recession of the early 1990s was a catastrophe for many, especially in hard-hit Ontario, where market rents fell in current dollars, leaving many co-ops with housing charges pegged above market. Fifteen years later, some of these co-operatives have not recovered from the combination of underfunded development, excessive initial housing charges and weak or stagnant rental markets.

Liquidity Indicator

Looking at the liquidity Indicator, ILM co-operatives are least likely to have an Excellent rating, and more must be rated Poor. By contrast, 78 per cent of S27/61-Program co-operatives, and two-thirds of co-ops under the S95 Program, have Excellent liquidity. More than one quarter of ILM co-ops—28 per cent—have Poor liquidity and another nine per cent only Fair liquidity, compared with 15 per cent in these two categories for the S95 Program and six per cent for the S27/61 Program.

Net Income Indicator

Looking at the net-income indicator on a program-by-program basis, the S95-Program co-operatives have slightly better results than those in the older program. However, fewer than half as many ILM co-operatives are rated Excellent and more than twice as many are rated Poor.

Physical Condition Rating

The same finding carries through to co-ops' physical condition. Despite being the youngest among the federal-program co-operatives, ILM co-ops are, respectively, 50 per cent and 100 per cent more likely to be in Fair or Poor condition than their S95 and S27/61 cousins.

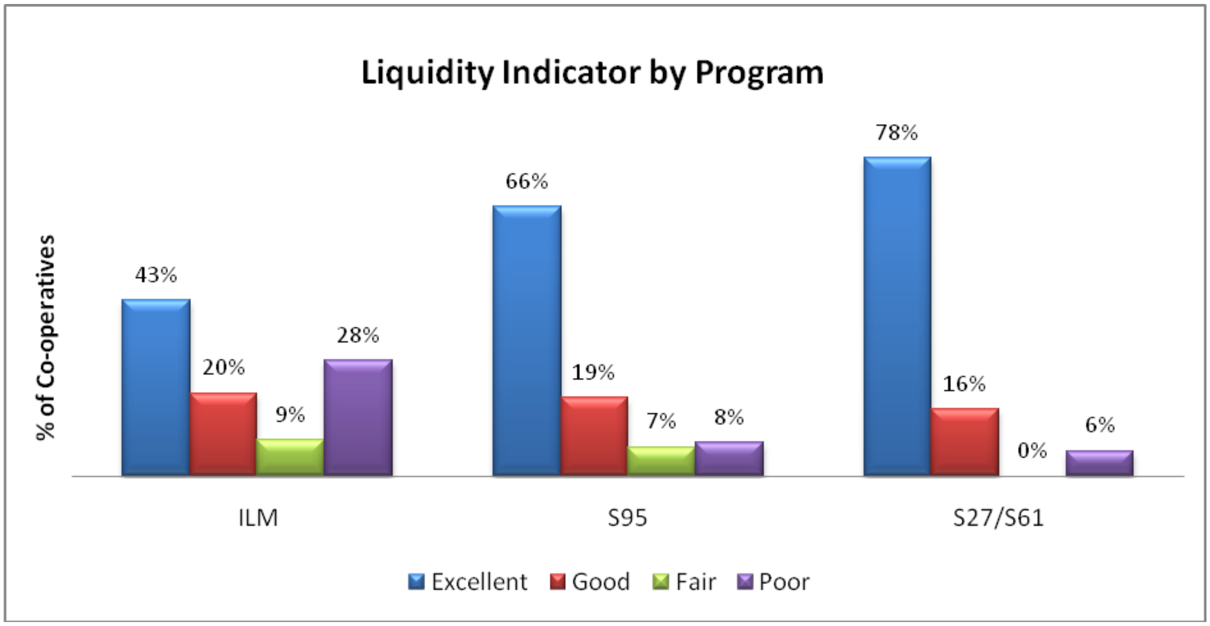


Figure 18

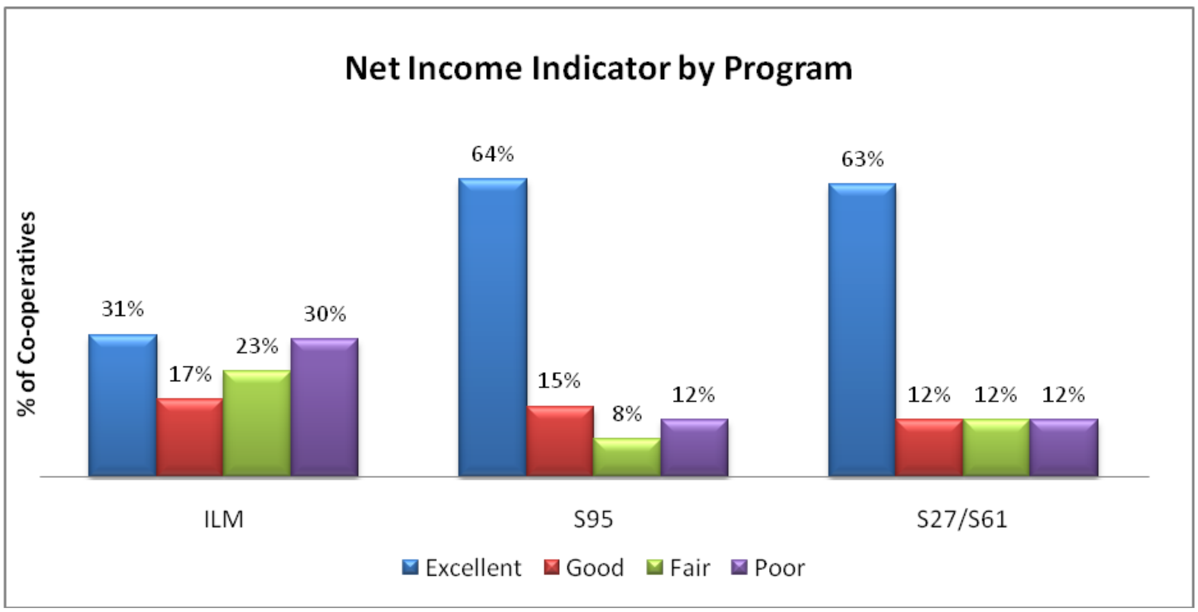


Figure 19

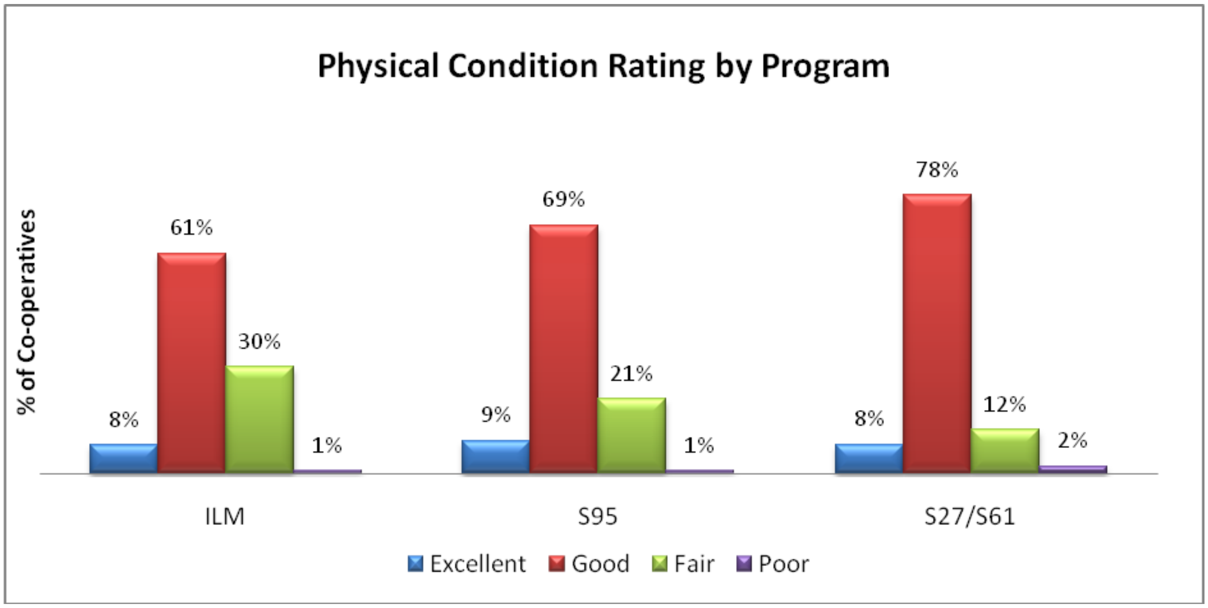


Figure 20

Operating Performance by Program

Vacancy Losses

Looking at annual vacancy losses, S27/61 co-operatives are faring best, possibly because of lower housing charges. Their median vacancy loss reported in 2007 was 0.2 per cent, compared with 0.3 per cent for S95-Program co-ops and 0.6 per cent for co-ops operating under the ILM Program. Thirty-seven per cent reported no vacancy losses in 2007, compared with 27 per cent and 21 per cent for S95 and ILM co-ops, respectively. A markedly higher percentage of ILM co-operatives posted vacancy losses exceeding two per cent of their annual gross housing charge potential than co-ops in either of the other two programs. As discussed above, the starting housing charges in that program were set at a higher level in relation to market than had been the practice under the other two programs. Whatever other factors may come into play, this must partly explain the poorer performance of ILM co-ops against this indicator.

Arrears and Bad Debts

Less understandable is the poorer performance of the ILM Program in the area of arrears and bad debts. The median combined arrears and bad-debt expense ratio reported for ILM co-ops in 2007 was 1.1 per cent of total annual housing charges payable by occupants. By contrast, the median rates for S95 and S27/61 co-ops were 0.65 and 0.72 per cent, respectively. It may be that where housing charges are higher relative to market and units correspondingly harder to fill, co-operatives are less discriminating in the selection of new members. Or the difference may point to weaker management of the ILM co-ops. (As is observed later in this chapter, ILM Program co-operatives dedicate a lower proportion of their budget to administration.) We have done no analysis to test either of these hypotheses.

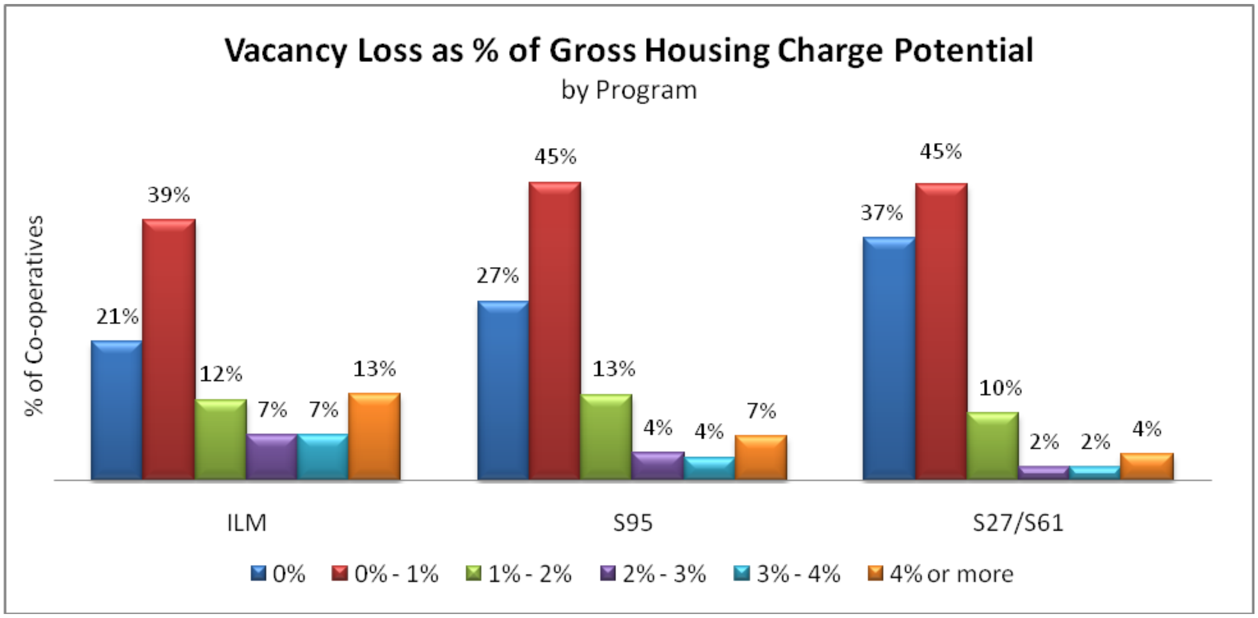


Figure 21

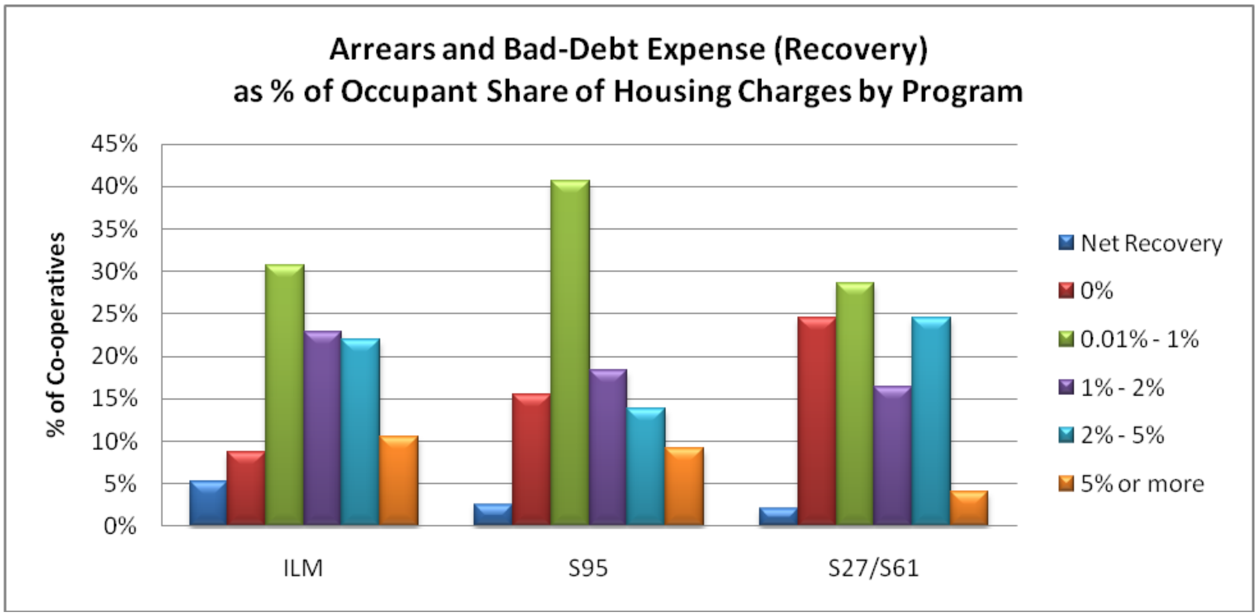


Figure 22

Investment in Physical Plant

There are also differences among the programs in the investment co-operatives make in their physical plant. The median reported combined spending on maintenance and capital repairs and replacements for ILM-Program co-ops came in at $144 per unit per month in 2007, notably lower than the $153 reported for S27/61 co-ops and $167 for S95 co-ops. However, these medians exclude capitalized repairs and, given the relatively high proportion of ILM-Program co-ops with financial workouts, this may account for the lower median for this group.

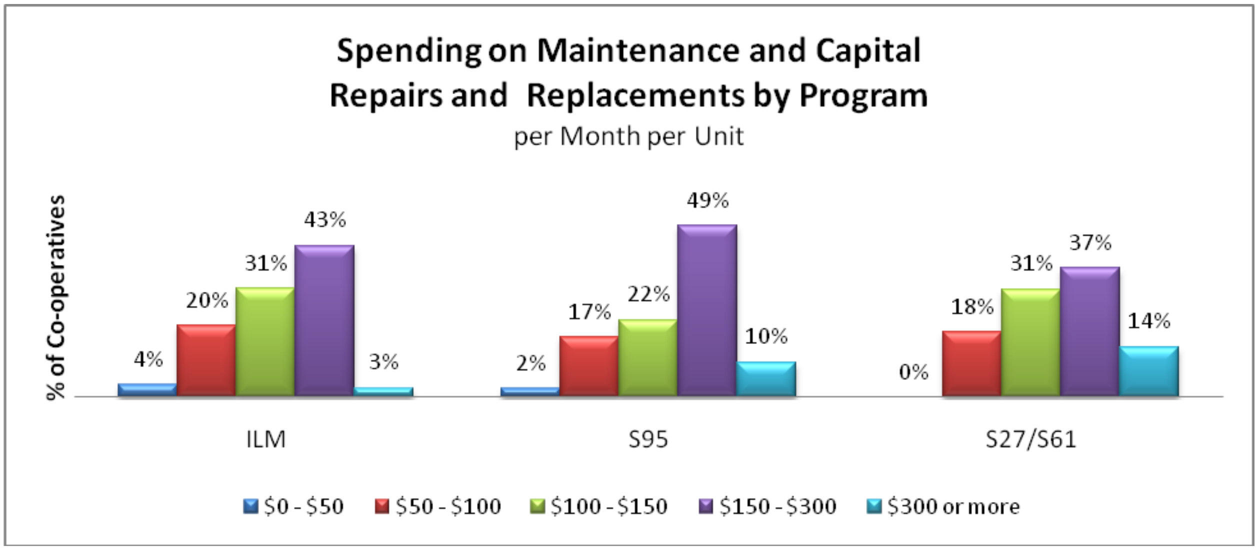


Figure 23

Capital Replacement Reserves

At $48 per unit per month, the median replacement-reserve contribution reported for 2007 for the ILM Program was dramatically lower than median rates for the other two programs (S27/61: $84; S95: $100). (Note that this last figure does not include supplemental contributions to the capital replacement reserve under the Net Operating Revenue Policy.) We had not expected to see this, since, at 0.6 per cent per year of the initial project capital cost, starting contribution rates in this program were much higher than in the earlier programs, a fact that may explain why the proportion of ILM co-ops contributing less than $25 per unit a month to their reserve is distinctly lower than in either of the other two programs. On the other hand, the rates for ILM co-ops are indexed annually at the same rate as the monthly mortgage payment: the change in the Consumer Price Index, less two percentage points. Unless a co-op takes the initiative to increase its base contribution, its rate will fall steadily in real terms over time.

Co-operatives under the other two programs are under no obligation to change the amount they contribute to their reserve from one year to the next and, from the higher proportion of co-ops contributing small monthly amounts, it would appear that some do not. But other data suggest that co-ops have recognized that the contribution rates mandated in the operating agreements are woefully inadequate and are taking the initiative to increase their contributions. While only one-third of co-ops under the ILM Program recorded contribution rates in excess of $50 per unit a month in 2007, 67 per cent and 69 per cent of S95 and S27/61 co-ops, respectively, contributed at this level. The S27/61 co-operatives are the oldest and can expect to have the highest capital expenses in the short and medium term. This may explain why nearly 30 per cent of them contributed more than $100 per unit each month to their capital replacement reserve in 2007—higher than under any other program.

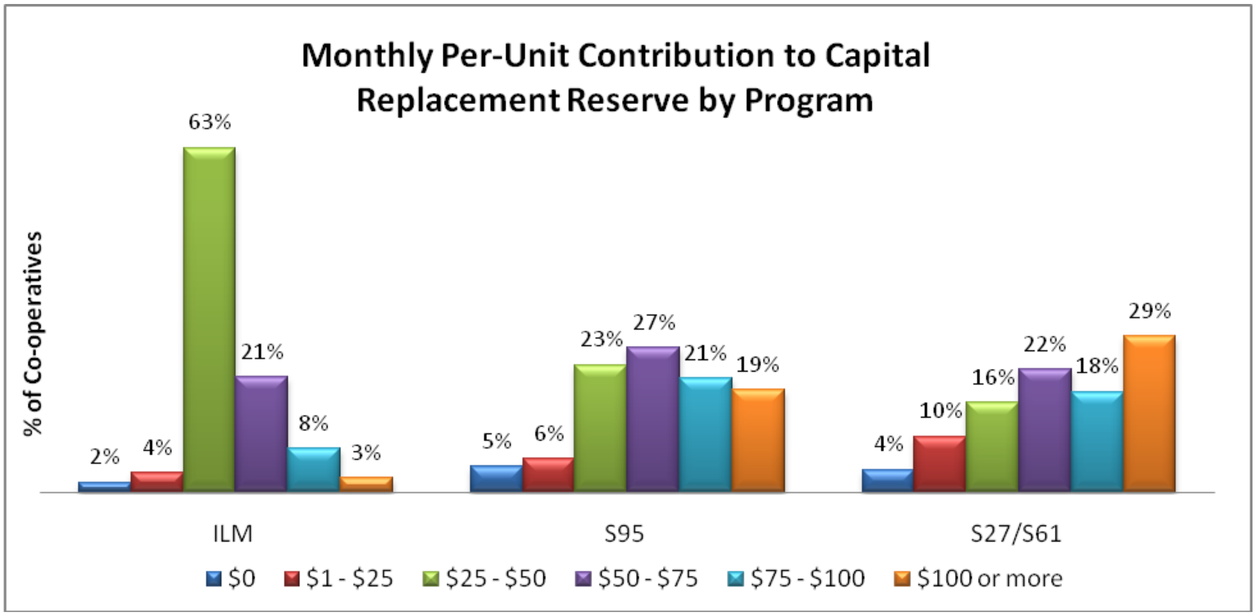


Figure 24

Administration Costs

In 2007, ILM-program co-operatives spent proportionately less on administration than co-ops under other programs. Median spending for this cohort was 4.7 per cent of total debt service and operating costs (excluding contributions to capital replacement reserves), compared with 7.2 per cent for S95 co-ops and 6.9 for S27/61 co-ops. This may have to do with financially pressed ILM co-ops having a limited number of places where they can cut spending, but likely is also driven in part by the six per cent guideline for administrative spending applied to co-operatives with a financial workout. It also needs to be said that housing charges in the older programs are typically lower than in the ILM Program. Whatever else is at work, the high proportion of S27/61 and S95 co-ops with administration spending rates over ten per cent surely reflects, at least in part, their lower debt-service cost.

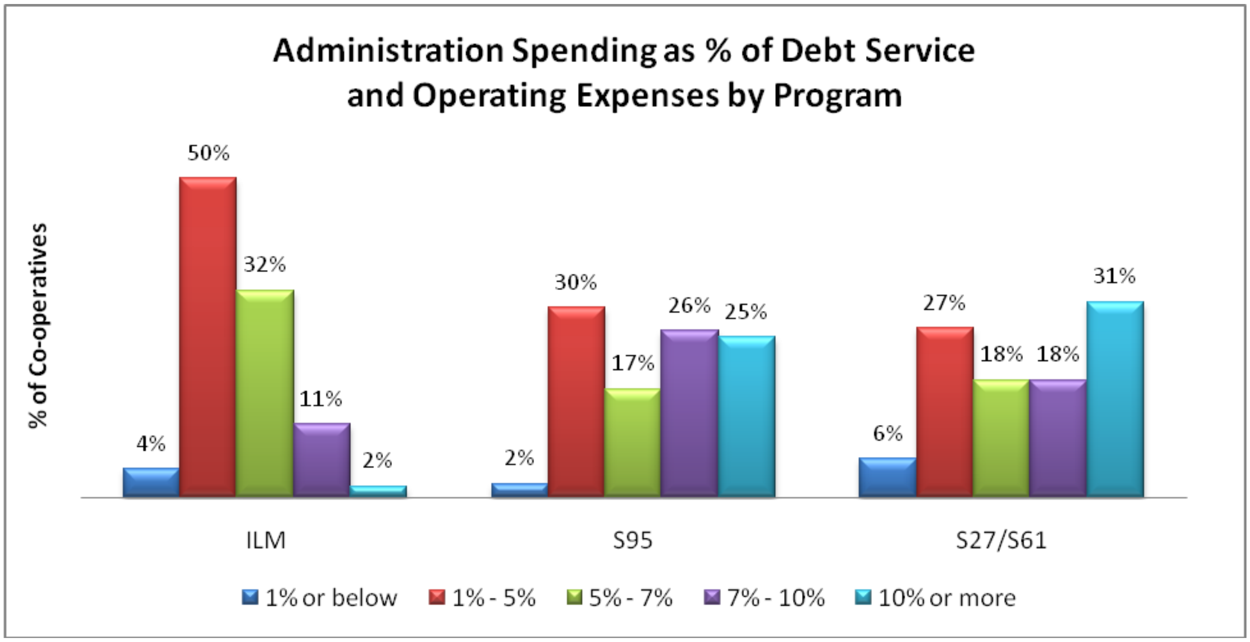

Administration Spending as % of Debt Service and Operating Expenses by Program
% of Co-operatives
50%
32%
4%
11%
2%
30%
2%
17%
26%
25%
27%
6%
18%
18%
31%
ILM
S95
S27/S61
1% or below
1% - 5%
5% - 7%
7% - 10%
10% or more

Figure 25

Chapter 4: Regional Perspective

Facts and Figures

A little better than half (53%) of the Agency's portfolio is located in Ontario and the remainder distributed across three other provinces: British Columbia (34%), Alberta (10%) and Prince Edward Island (2%). As the table to the right shows, the provincial distribution of the data set used for this report closely mirrors that of the Agency's full portfolio. Data from co-operatives operating under all programs are included in the analysis that follows.

FACTS & FIGURES BY REGION

B.C.	164 –	36%
Alberta	42 –	9%
Ontario	245 –	53%
PEI	10 –	2%

Risk Profile by Province

Composite Risk Rating

Differences in the regional performance of the Agency portfolio are as interesting as the program differences. The poorest performer is PEI, where fully 80 per cent of the data set had a composite risk rating as of February 15, 2008 of Above Average or High. Closer study shows that the weaker performers were spread among all of the housing programs we administer in the province. What co-ops rated High risk did have in common was Poor liquidity, the result of a combination of factors, including past operating losses, relatively low member capital contributions and, in some but not all cases, high occupant arrears.

Ontario saw both the best and the worst of results in 2007. Viewed from the angle of co-operatives at risk, it was the second-worst performer, with 20 per cent of co-ops carrying a composite rating of High. In this case, there were marked differences among programs in the incidence of co-ops at high risk. About half of ILM-Program co-ops in Ontario carried a composite risk rating of High, compared with less than 10 per cent of S27/61 co-ops and a little more than 10 per cent of co-ops operating under the S95 Program. The poor performance of the ILM-Program co-ops in the province is in stark contrast to the situation in the Agency portfolio as a whole where, though the worst performers as a class, only 30 per cent of ILM co-ops are at High risk. We believe that weaker rental markets in Ontario have a good deal to do with this difference.

Ontario outperforms the other provinces with respect to co-ops not at risk. At 46 per cent, the proportion of co-ops with Low or Moderate composite risk ratings was the highest. Consistent with this and the finding reported in the previous paragraph, the province had the lowest proportion in the data set of Agency clients rated Above-Average risk.

Alberta saw the lowest proportion of co-ops rated High risk in 2007, at seven per cent. Ten per cent of B.C. co-ops were rated High risk, the second-best provincial performance. In addition to the factors examined later on in this chapter, the strong rental markets in these two provinces have much to do with this result. By contrast, B.C. and Alberta are home to a higher proportion of co-ops rated Above Average than Ontario.

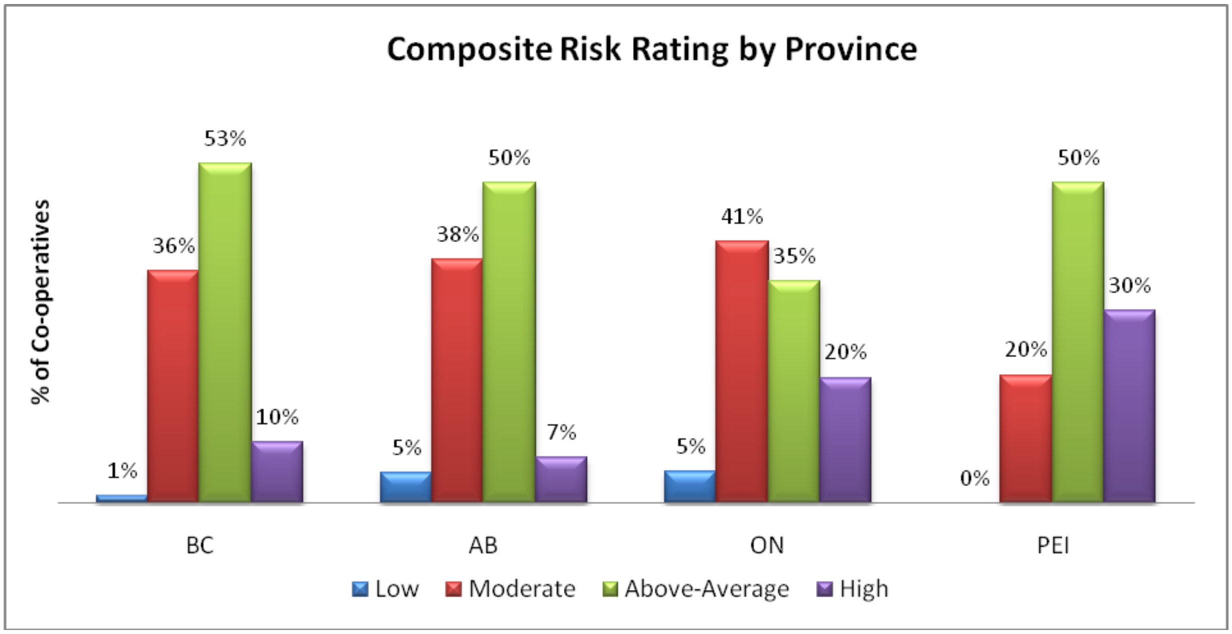


Figure 26

Liquidity Indicator

Consistent with having a larger proportion of co-ops rated High risk, PEI and Ontario, in that order, ranked worst on liquidity in 2007, viewed from any angle. B.C. co-ops ranked highest, with Alberta not far behind.

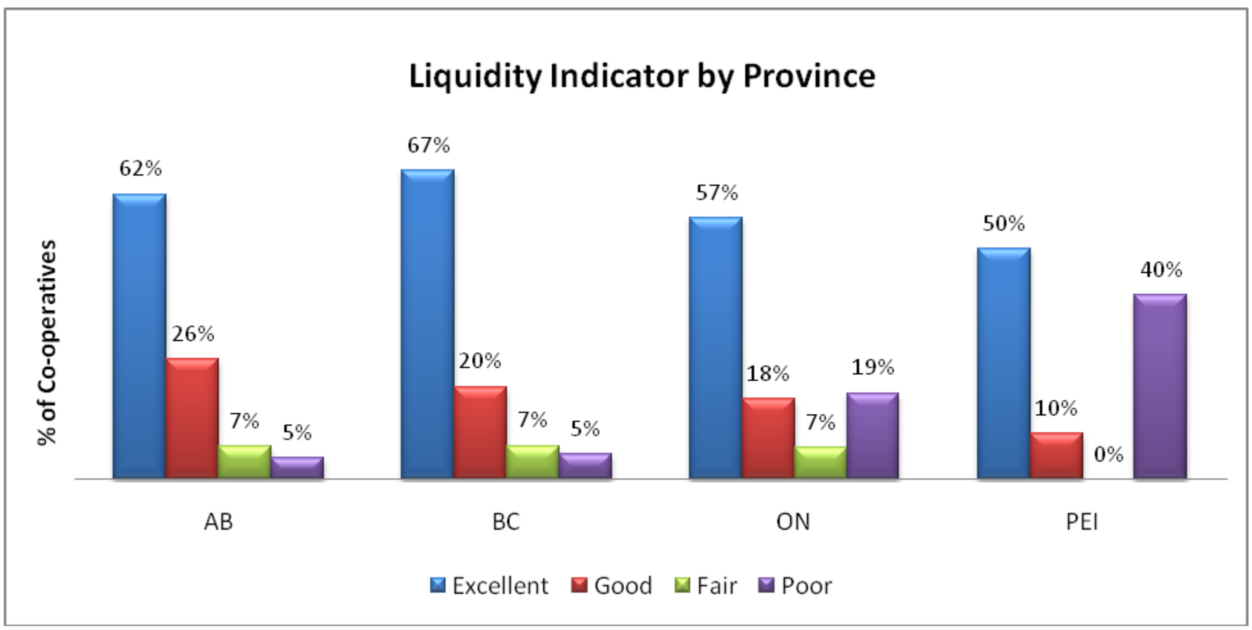


Figure 27

Net Income Indicator

As the next chart suggests, PEI was the weakest performer in 2007 from the viewpoint of current operating results, with 60 per cent achieving a net-income indicator of no better than Fair.

Alberta performed the best, holding the highest proportion of co-ops achieving an Excellent rating and the lowest scoring Fair or Poor. Results in Ontario were more extreme, with 60 per cent of co-ops demonstrating Excellent net income and 19 per cent Poor. B.C. had more co-ops in the middle, with 38 per cent scoring Good or Fair.

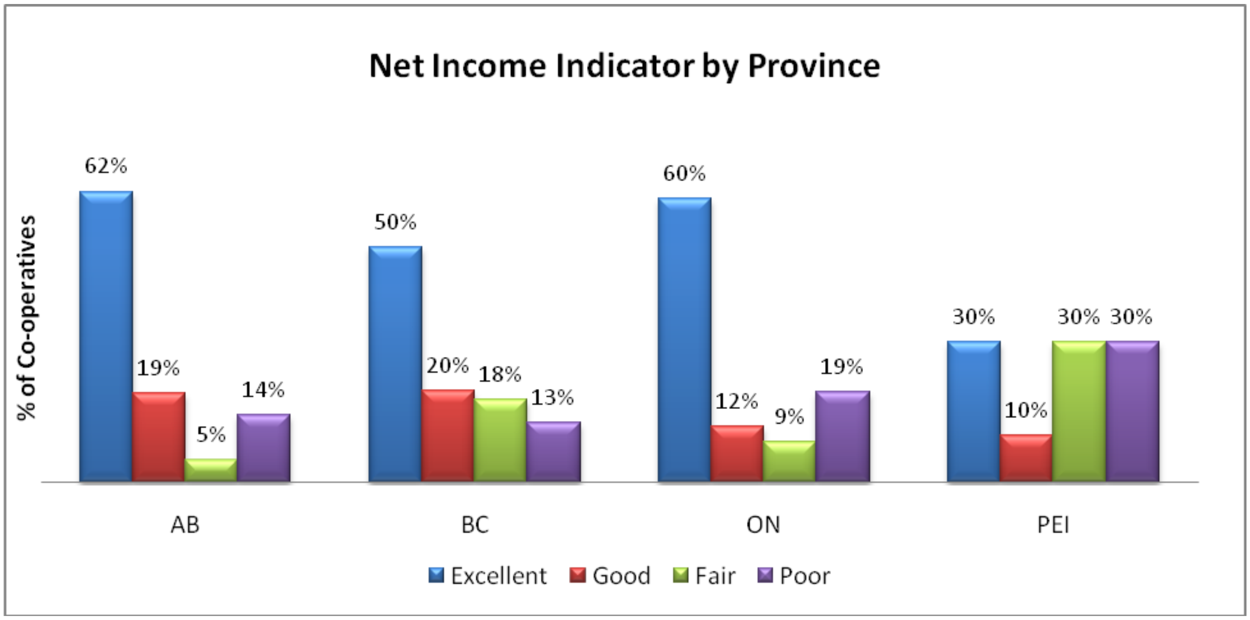


Figure 28

Physical Condition Rating

Results to date suggest that housing co-operatives in Ontario and PEI are in better physical condition than Agency clients in the West. Ninety per cent of PEI co-ops in the data set are rated in Good condition. Among Ontario co-ops, 13 per cent carry an Excellent physical-condition rating and 73 per cent a rating of Good. In both B.C. and Alberta fully one third of co-ops in the data set are in no better than Fair condition (note that the B.C. results do not reflect the high number of co-ops with premature building envelope failure, as those co-ops awaiting remediation remain with CMHC). Only three per cent and five per cent of Agency clients in B.C. and Alberta, respectively, are rated in Excellent physical condition.

Speculatively, we can consider a number of reasons for this regional variation. Western rental markets are sellers' markets for housing co-operatives, as well as for contractors and trades, who can pick and choose among many possible customers. In addition, given the years of rising rental markets in the large cities, co-operatives may not have needed to place the same emphasis on curb appeal and well maintained unit interiors that has been required of co-ops in the soft markets of the East. It is also possible that because of changes in our physical-condition rating system made over the course of 2007, accurate comparisons are not yet possible.

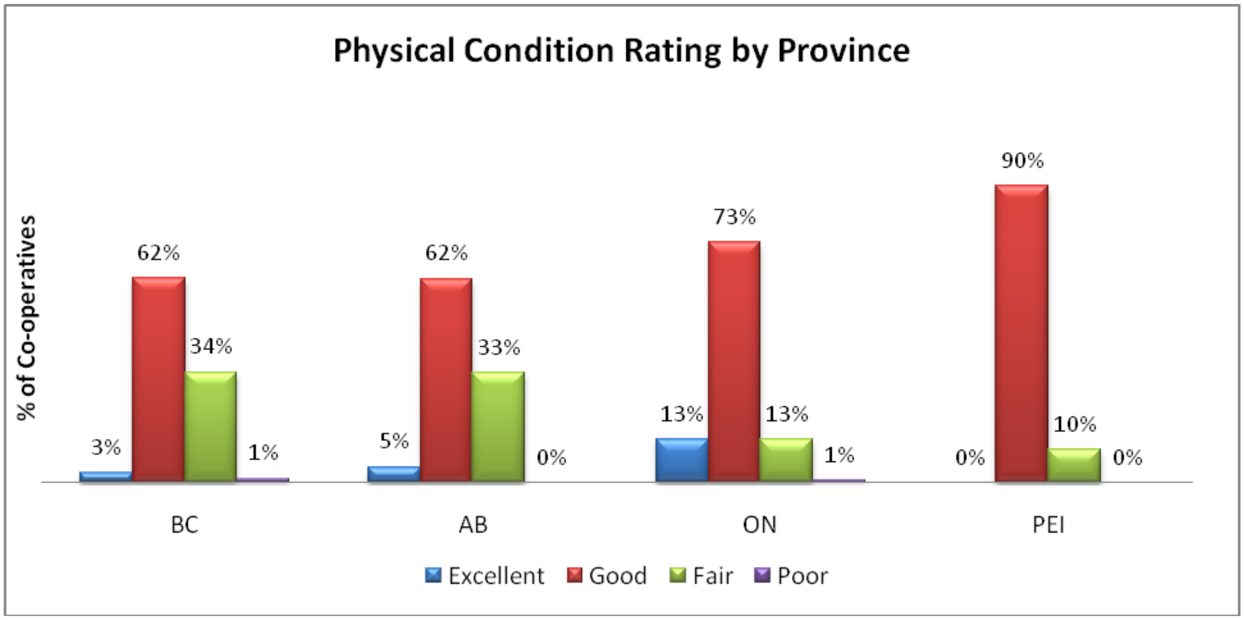


Figure 29

Operating Performance by Province

Vacancy Losses

The chart on the next page shows the vacancy-loss distribution for each province, with losses measured as a percentage of the co-op's gross housing charge potential (defined in Chapter 2). PEI appears to have both the highest proportion of co-ops with no vacancy losses at all, at nearly 50 per cent, and the second-highest rate of co-ops losing four per cent or more of their potential revenue to empty units. The former statistic is slightly misleading: deep-subsidy-program co-ops do not report vacancy losses on their financial statements, as the units have no fixed housing charges (all occupants are charged a monthly amount geared to their income). The Agency does ask these co-ops to report the number of vacant units at year end, however. If we take those reports into account, the proportion of PEI co-ops without vacancies in 2007 falls to less than 30 per cent.

That PEI is over-represented among co-ops with high vacancy losses is less surprising than at first it may seem and reflects the very small average size of co-ops in the PEI data set. In a small co-op, a single vacant unit will result in a high percentage vacancy loss. Consistent with the strong rental markets in the major urban centres of B.C. and Alberta, housing co-ops in that province show substantially lower vacancy losses than Ontario co-ops, reporting median rates of 0.2 per cent and 0.3 per cent, respectively, compared with 0.6 per cent for Ontario (the median rate for 2007 for PEI was 0.2 per cent).

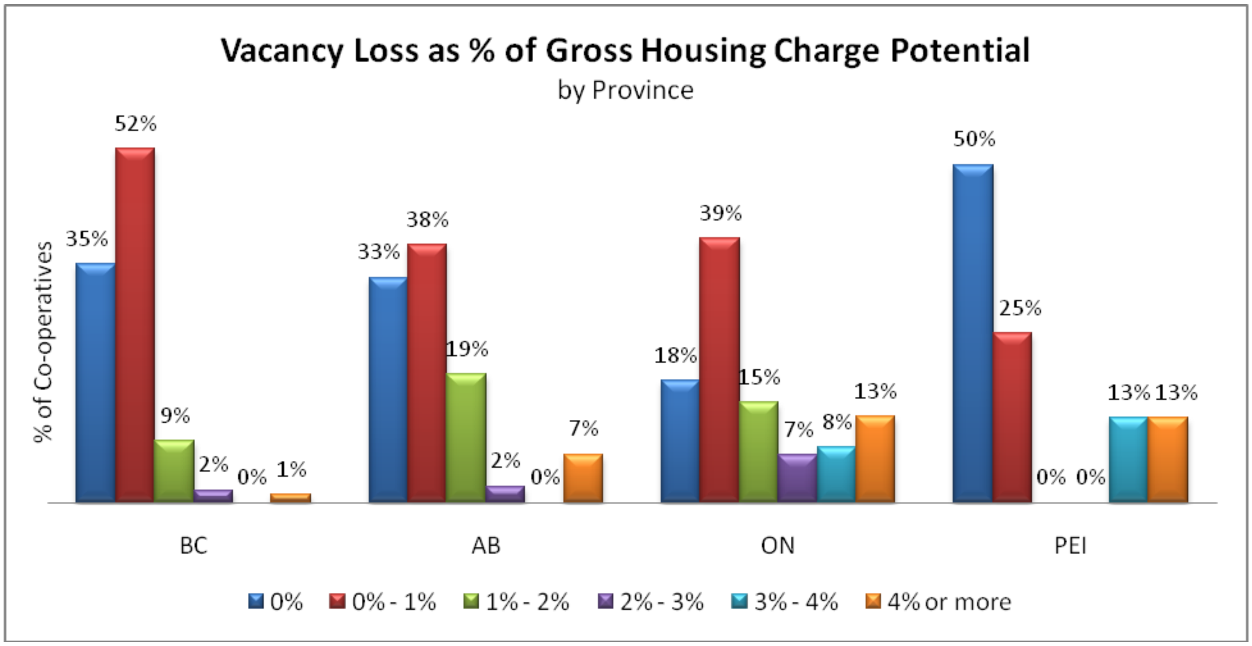


Figure 30

Arrears and Bad Debts

Distinct regional variations are also to be seen in combined year-end arrears and annual bad-debt expenses, measured as a percentage of occupants' share of annual housing charges. At 0.4 per cent, B.C. and PEI were tied in 2007 for the lowest median arrears and bad-debt-expense ratio. However, a closer look shows that PEI recorded a higher proportion of co-ops with no arrears and bad debts at all. Alberta has the next lowest median arrears and bad-debt-expense ratio, at 0.5 per cent. Ontario posted a median of twice the Alberta rate and has the highest proportion of co-ops in all categories above 1.0 per cent. Does weaker demand lead co-ops in the province to be less selective in recruiting new occupants, accounting for the higher incidence of occupant arrears? Are there cultural factors at work? Does the larger average size of Ontario housing co-ops explain it? It will require additional analysis to test these and other hypotheses.

Investment in Physical Plant

Median spending rates on maintenance and capital repairs and replacements varied considerably across the Agency's provincial portfolios in 2007, and not obviously in relation to regional differences in price levels, despite what one might expect. Ontario recorded the highest median spending rate, at $175 per unit per month[12]. Alberta's median rate was the lowest, at $123. Median rates for B.C. and PEI fell in between, at $149 and $134, respectively.

12. As noted earlier, capitalized expenditures, whether debt-financed or paid from working capital, are not included in the rates reported.

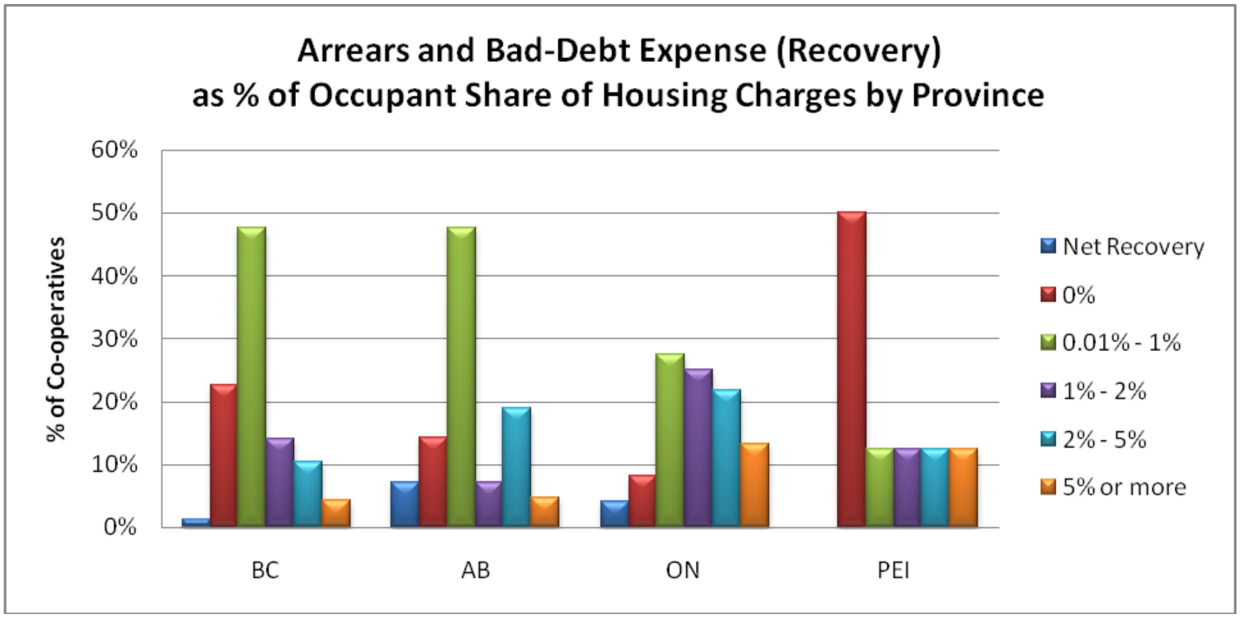


Figure 31

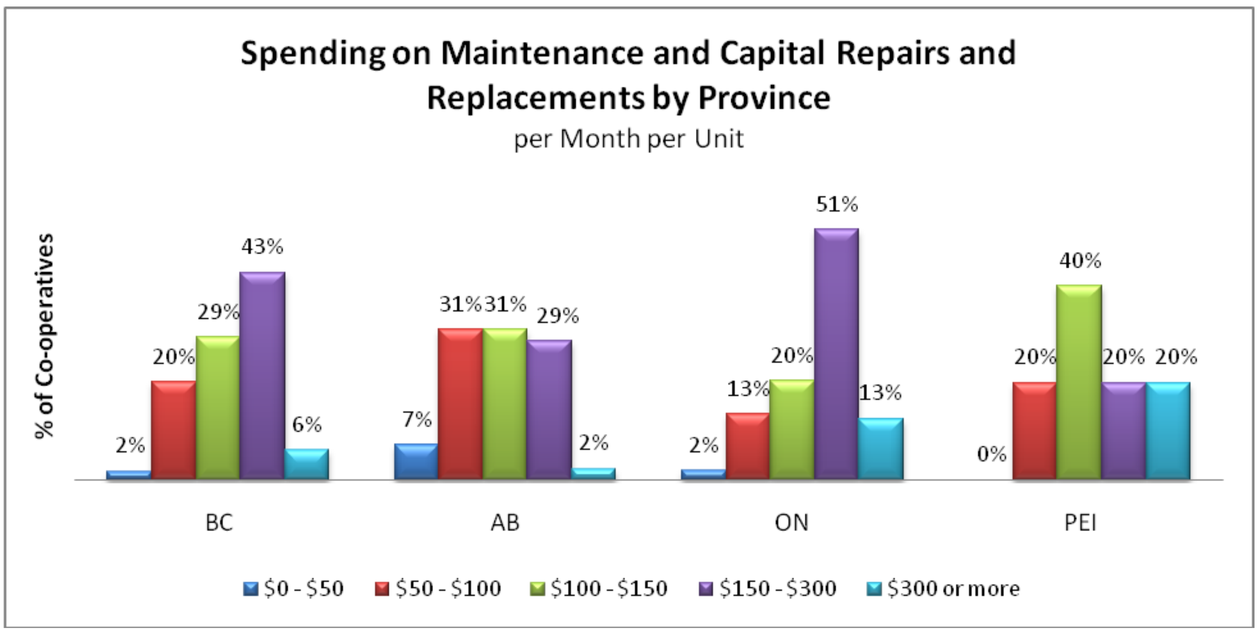


Figure 32

Capital Replacement Reserves

The chart on the next page shows the distribution for each province of replacement-reserve contribution rates reported for 2007. In comparison with the variation by program noted earlier, little difference is to be seen in the median contribution rate from one province to another. Reported rates were $55 per unit per month for B.C., $59 for each of Alberta and Ontario and $60 for PEI. However, closer examination points up some differences worth noting in the distribution within each province. A disturbing number of Alberta co-ops either made no contribution in 2007 or paid in less than $25 per unit per month, while no PEI co-op contributed so little. There was less variation at the top end, with Alberta, Ontario and PEI reporting about the same proportion of co-ops contributing $75 per unit per month or more. B.C. had a slightly lower proportion of co-ops contributing at this level.

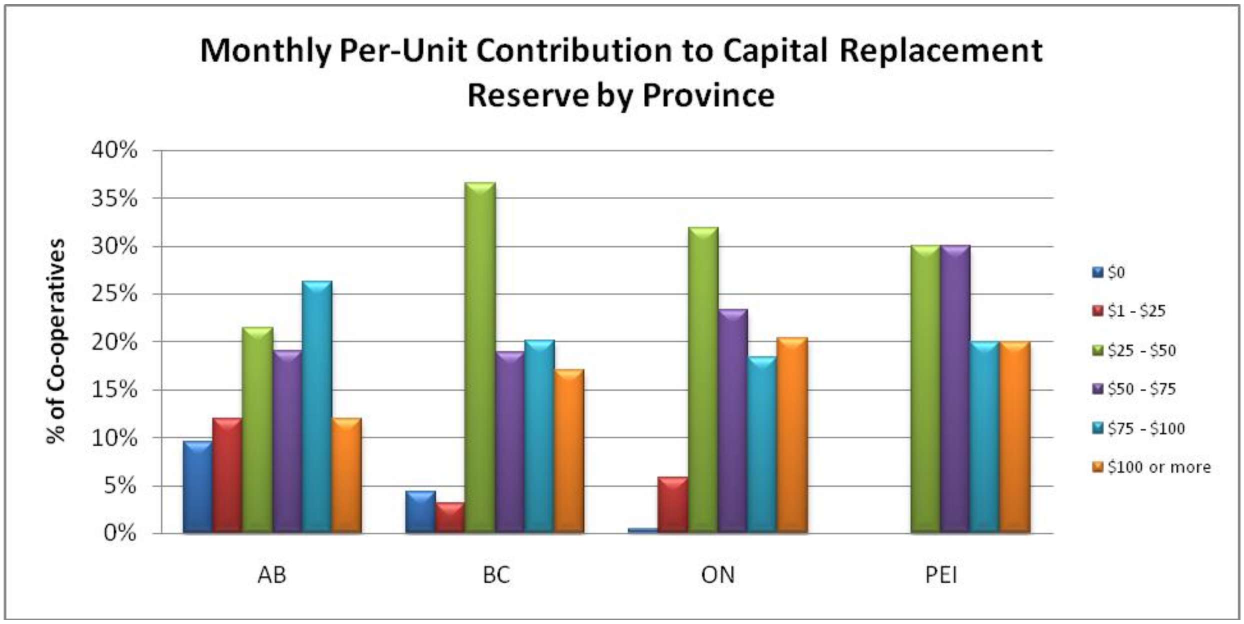


Figure 33

Administration Costs

As the next chart shows, there are striking provincial differences in administration spending rates within the Agency portfolio, with median rates ranging from a low of 4.1 per cent in B.C. to 8.4 per cent in Ontario. Alberta had the second-lowest rate, at 4.5 per cent and PEI the second-highest at 6.4 per cent. Without excluding other possible explanations, we must note the much greater prevalence in B.C. and Alberta of low-cost management models. One quarter of co-operatives in the B.C. data set and 30 per cent of Alberta co-ops are either managed and operated entirely by volunteers or employ the services of a bookkeeper only, compared with fewer than 10 per cent of co-ops in Ontario. PEI co-ops are, on average, smaller than their cousins in other provinces, contributing to their higher percentage spending on administration.

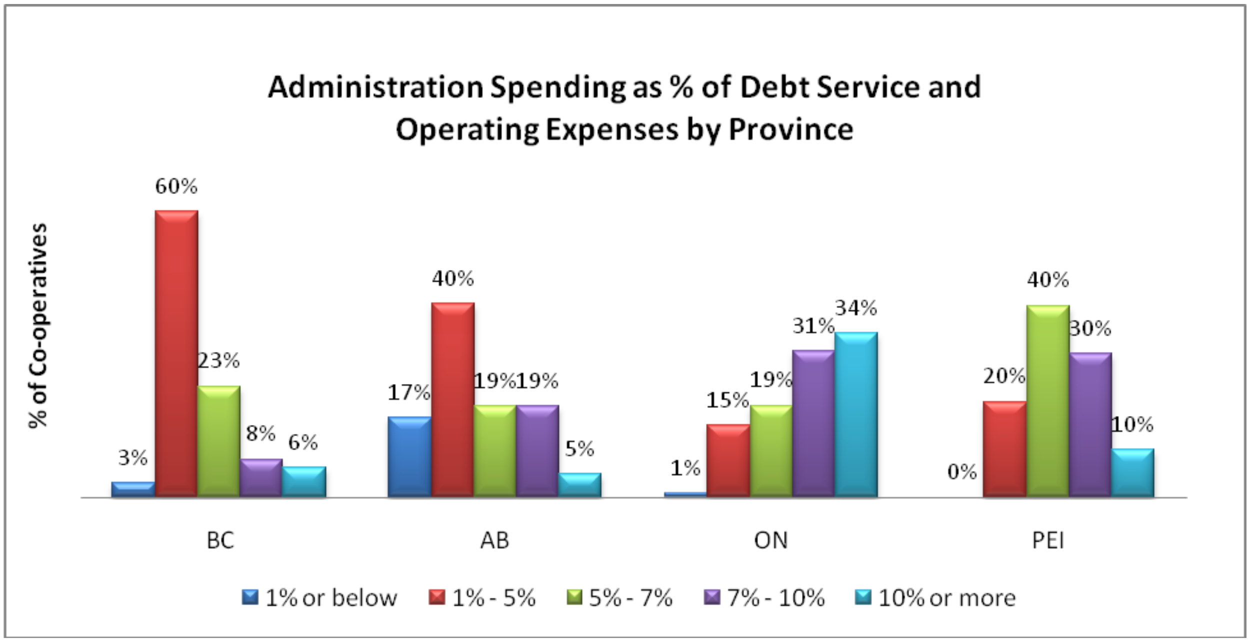

Administration Spending as % of Debt Service and Operating Expenses by Province
% of Co-operatives
60%
23%
3%
8%
6%
40%
17%
19%
19%
5%
1%
15%
19%
31%
34%
0%
20%
40%
30%
10%
BC
AB
ON
PEI
1% or below
1% - 5%
5% - 7%
7% - 10%
10% or more

Figure 34

Chapter 5: Management Perspective

Management Models

The housing co-operatives the Agency works with make use of four different management models. In order of prevalence, these are

- paid staff,
- a property-management firm,
- a paid bookkeeper, and
- volunteers only.

FACTS & FIGURES BY MANAGEMENT MODEL		
Paid Staff	211 –	45%
Management Firm	160 –	35%
Paid Bookkeeper	45 –	10%
Volunteers Only	45 –	10%

Forty-five per cent of co-ops in the data set have paid staff. Equal numbers either employ only a bookkeeper or operate and manage their properties with volunteer labour, and just over one-third of co-ops use the services of a property-management firm.

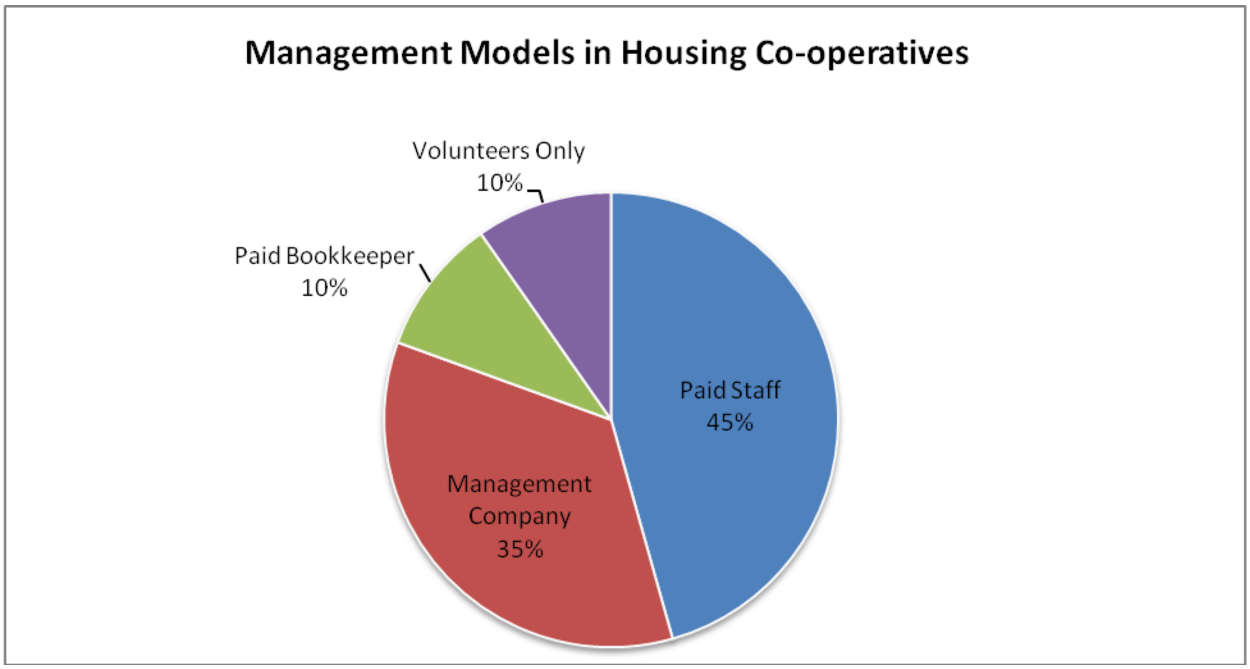


Figure 35

As the chart on the next page suggests, size is a significant determinant of the choice of management model. Not surprisingly, the great majority of housing co-operatives that depend entirely on the effort of volunteers for their operation and management—69 per cent—have fewer than 50 units and none has 100 units or more. The average volunteer-managed co-op in the Agency portfolio has 37 units, compared to 62 units for all co-ops. Even more striking, three-quarters of co-ops who supplement the efforts of volunteers with only a paid bookkeeper have fewer than 50 units and a negligible number more than 100 units. No doubt for practical reasons, the direct-staff model is less prevalent among smaller co-ops, with most that use this model having more than 50 units. There appears to be a regional factor at work here as well: the average size of housing co-operative in the Agency portfolio is highest in Ontario (69 units), where the management-company model is less well known.

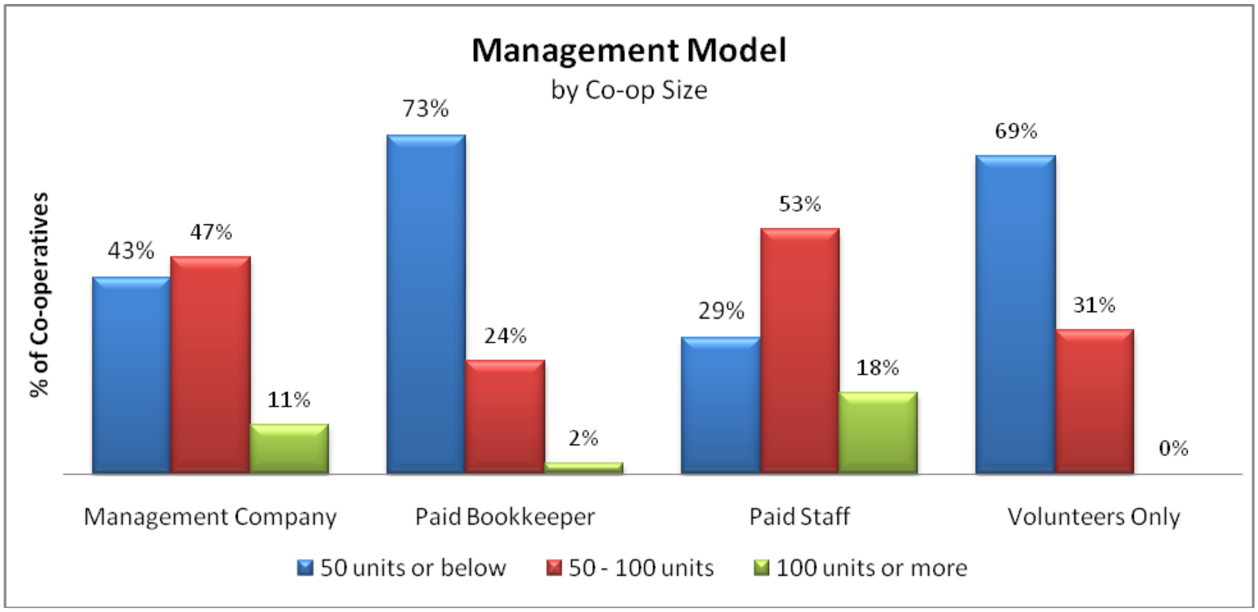


Figure 36

That there are sharp regional differences in the choice of management model is shown by the chart below. Housing co-operatives using the services of management companies are heavily concentrated in B.C., where the model has long been popular, and those with their own employees in Ontario. In common with B.C. co-ops, the Agency's PEI clients are more likely to choose the management-company model. As earlier noted, the highest proportions of co-ops relying only on volunteers or a paid bookkeeper are found in B.C. (25%) and Alberta (30%).

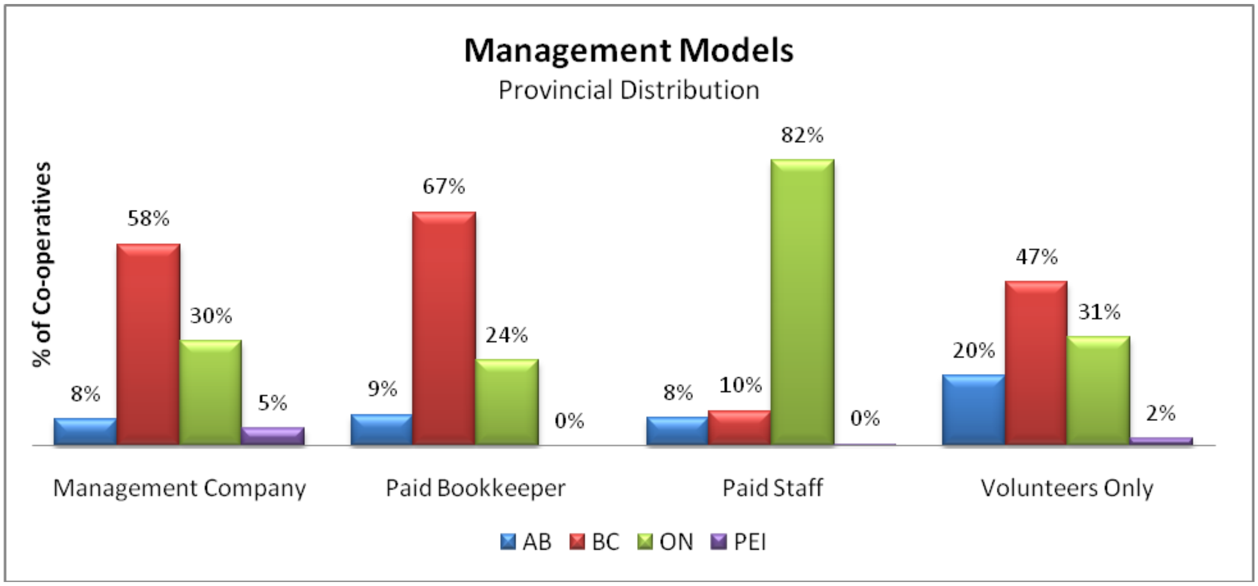


Figure 37

Risk Profile by Management Model

Composite Risk Rating

While further analysis would be required to say why, the chart below shows that volunteer-led co-operatives are more likely to carry a composite risk rating of Low than the rest of the portfolio (5% versus 3% for the whole data set) and least likely be rated High risk (2% versus 15%). Co-ops employing their own staff show the same rate of Low composite ratings (5%), but a much greater incidence of High ratings (16%). The picture changes when one looks at favourable ratings together (Low and Moderate) versus unfavourable ratings (Above Average and High). Viewed this way, volunteer-led co-ops have the same risk profile as the portfolio as a whole (42% favourable, 58% unfavourable) and co-ops with paid staff outperform all other groups (51% favourable, 49% unfavourable). Co-operatives depending on a paid bookkeeper alone to supplement the efforts of volunteers have a distinctly poorer risk profile (28% favourable, 72% unfavourable), while co-ops using contracted property-management services are in the middle (38% favourable, 63% unfavourable).

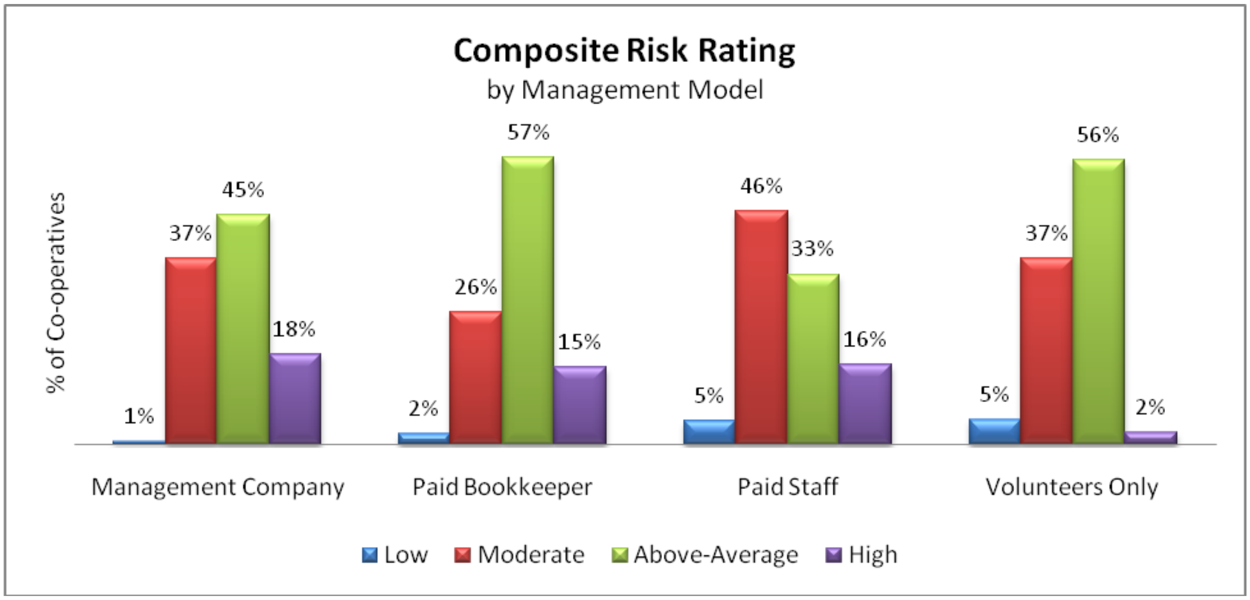


Figure 38

Liquidity Indicator

Volunteer-only co-ops had the best liquidity in 2007, with 93 per cent receiving favourable ratings (Good or Excellent) and only seven per cent unfavourable (Poor or Fair). Each of the paid staff and bookkeeper-only cohorts performed as well as the portfolio as a whole (80% favourable, 20% unfavourable), while co-ops with management companies scored poorest on this indicator (76% favourable, 23% unfavourable). There are almost certainly other reasons behind this; without further analysis, it would be premature to assume that a causal relationship exists between management model and liquidity.

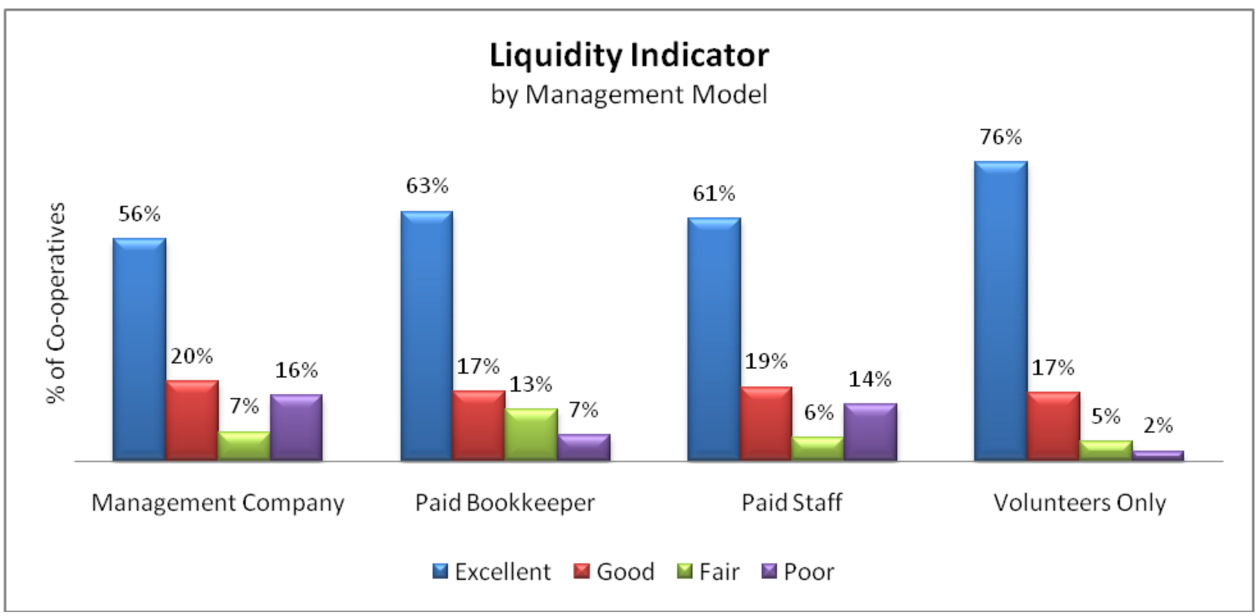


Figure 39

Net Income Indicator

The picture for this indicator is somewhat similar, with volunteer-led co-ops as a group outperforming the other cohorts (83% favourable ratings, 17% unfavourable) and those employing management firms scoring worse (67% favourable, 33% unfavourable). Co-ops with paid staff did as well as the portfolio as a whole (71%/28%), while co-ops with only a bookkeeper did better (76%/24%). Again, we do not have evidence to support the view that a causal relationship is at work here.

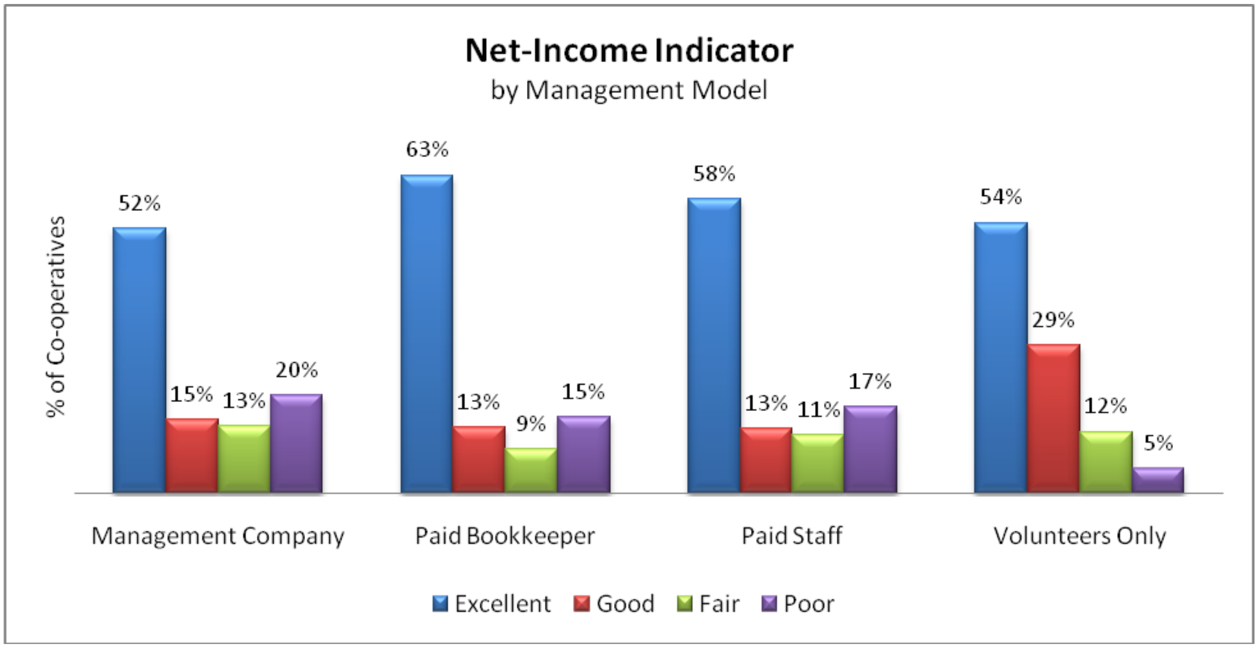


Figure 40

Physical Condition Rating

Co-operatives with paid staff significantly outperformed on this indicator in 2007, with 87 per cent holding a favourable physical-condition rating of Good or Excellent and only 12 per cent a rating of Poor or Fair, against portfolio-wide ratings of 77 per cent and 23 per cent, respectively. Volunteer-run co-ops as a group scored next best (71% favourable, 29% unfavourable), while the other two cohorts carried ratings noticeably below the portfolio-wide norms (management company: 69%/31%; bookkeeper only: 68%/33%).

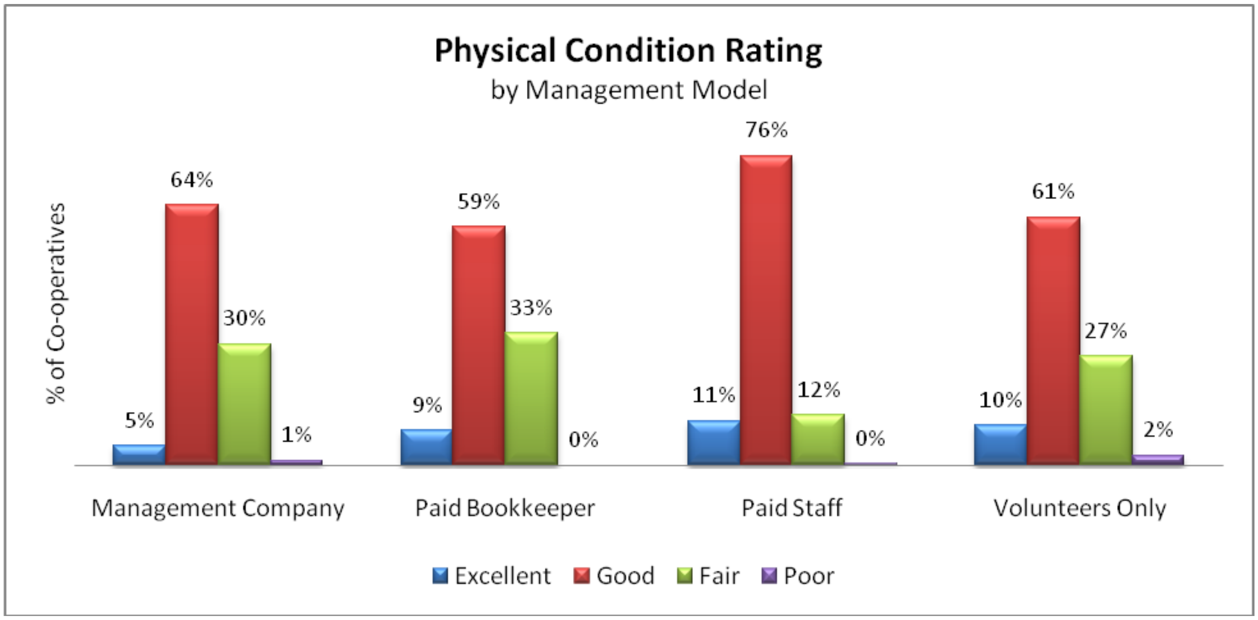


Figure 41

Operating Performance by Management Model

Vacancy Losses

Co-operatives employing their own staff or the services of a property-management firm experienced the highest levels of vacancy loss in 2007, with about 60 per cent losing between one and $250 per unit per year. Volunteer-only co-operatives enjoyed the best results, with just below 60 per cent reporting no vacancy loss at all and more than 35 per cent losses of under $250 per unit.

The relative performance of the different management models is unchanged if one looks instead at vacancy loss as a percentage of each co-op's gross housing charge potential. Volunteer-run co-ops enjoyed a median loss of zero, compared to those with paid staff or a management company, both of which posted loss rates of 0.4 per cent. Co-ops with only a paid bookkeeper were in second place, with a median vacancy loss of 0.1 per cent of gross housing charge potential.

One immediate explanation for these results occurs to us: co-ops without any staff or only a bookkeeper are smaller and, having lower expenses, are often priced below the market. When only the occasional unit comes available, it may be successfully marketed by word of mouth.

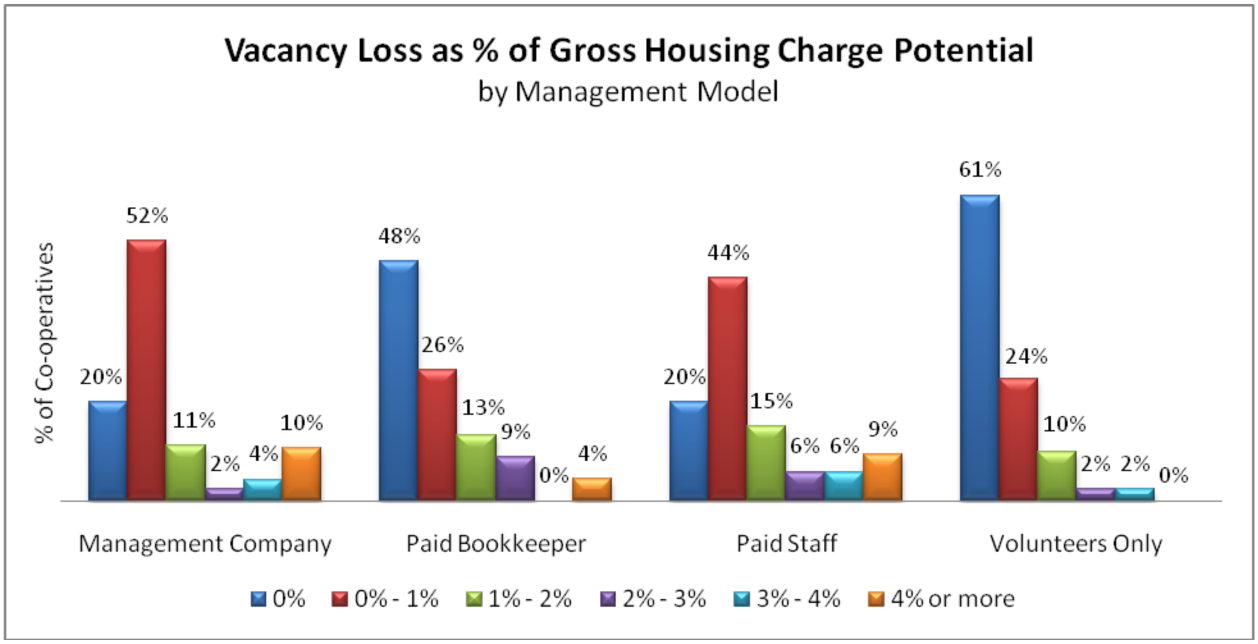


Figure 42

Arrears and Bad Debts

As a group, co-operatives managed only by volunteers had more success in 2007 in collecting arrears and preventing bad debts than did their peers: they held both the highest proportion of co-ops reporting neither arrears nor bad debts and the lowest percentage of co-ops with a combined arrears and bad-debt expense ratio of five per cent or more. The next most successful cohort was co-ops with only a paid bookkeeper: just below 30 per cent of this group reported either no arrears or bad debts at all or a net recovery in the year. However, a significant proportion had an arrears and bad-debt expense ratio of five per cent or more, pointing to a more variable performance for this group than for the cohort of co-ops with all-volunteer management. While showing better results at the negative end, co-ops with management companies or direct staff performed worse overall as a group, with far fewer reporting a combined arrears and bad-debt ratio of zero.

Median ratios of combined arrears and bad-debts reflect these observations, ranging from 0.2 per cent for volunteer-only co-ops, through 0.4 per cent for co-ops with paid bookkeepers, to 0.8 and one per cent, respectively, for those employing management companies or their own staff.

Investment in Physical Plant

Co-operatives using the direct-staff model led in spending on maintenance and capital repairs in 2007, reporting a median expenditure rate of $173 per unit per month. (As elsewhere in this report, this number captures only capital expenditures charged in full to the replacement reserve or operations and excludes spending that is capitalized and amortized to operations over time.) Volunteer-only co-ops were not far back, at $162. Co-ops with only a paid bookkeeper lagged noticeably behind at $134, while the median spending rate for co-ops using contract property-management services came in at $155. We have done no analysis to try to explain this variation in results.

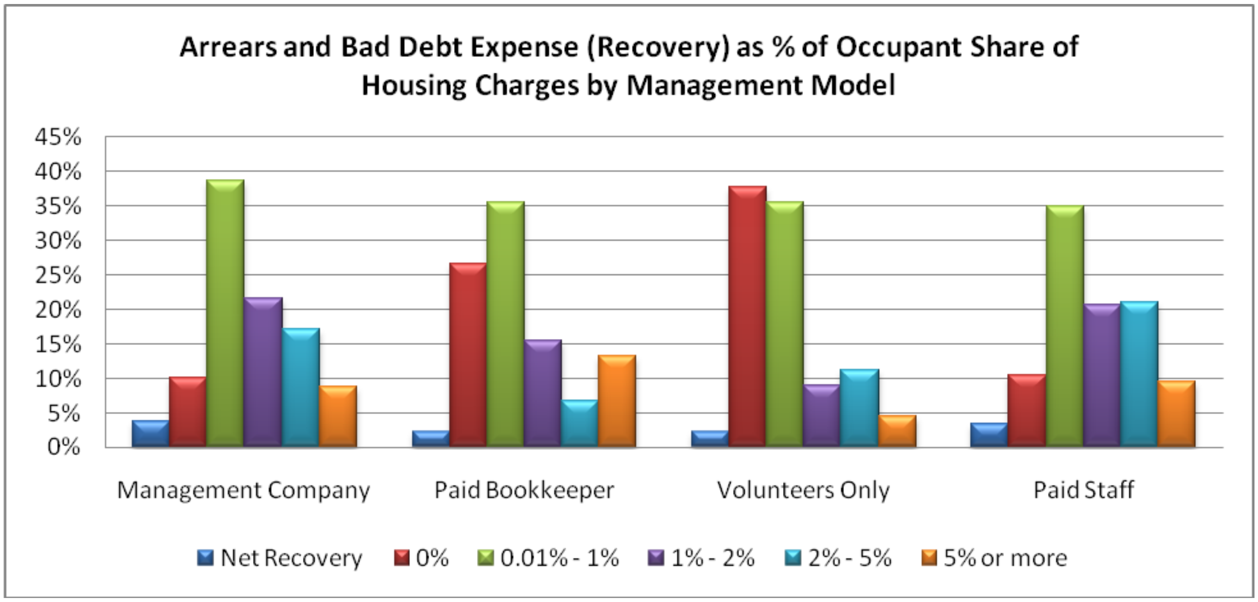


Figure 43

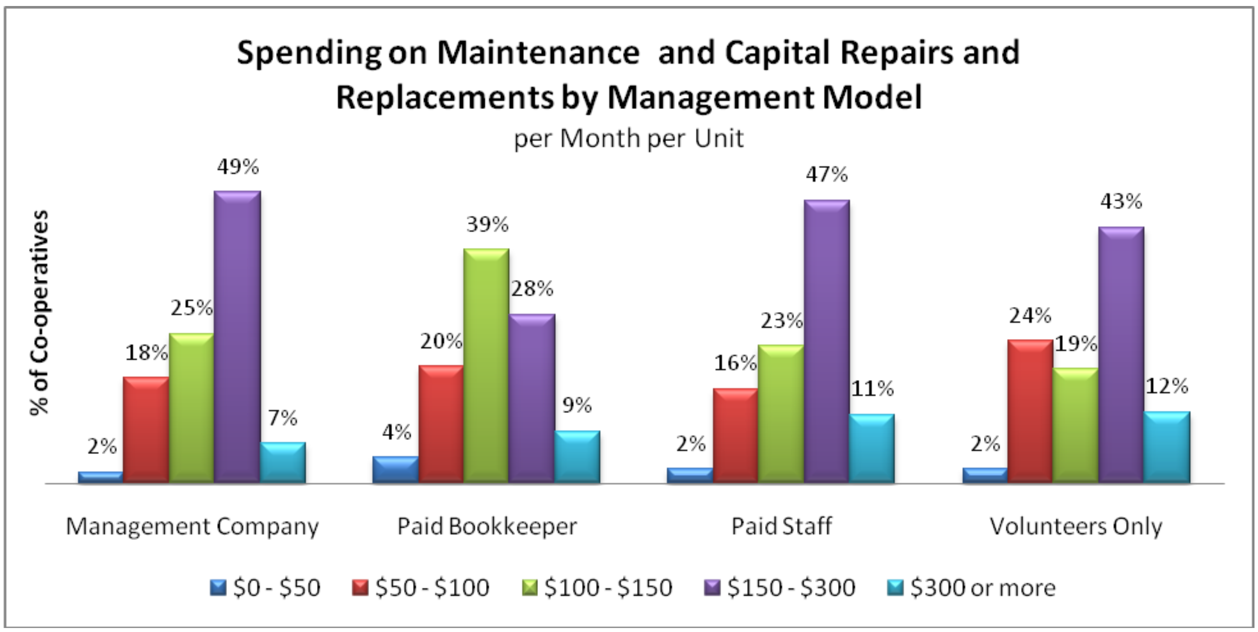


Figure 44

Capital Replacement Reserves

Volunteer-run housing co-operatives also led the way in contributing to their capital replacement reserves in 2007, reporting a median contribution rate of $77 per unit per month, well above the portfolio-wide median of $58. At the same time, they were more likely than other co-ops to set aside either nothing at all or less than $25. Co-ops with only a paid bookkeeper were the next highest contributors, at $63 per unit per month, while those with paid staff came in just above the portfolio-wide median at $59. Co-operatives using contract property-management services put aside the least from operating revenues, with a median contribution rate of $54.

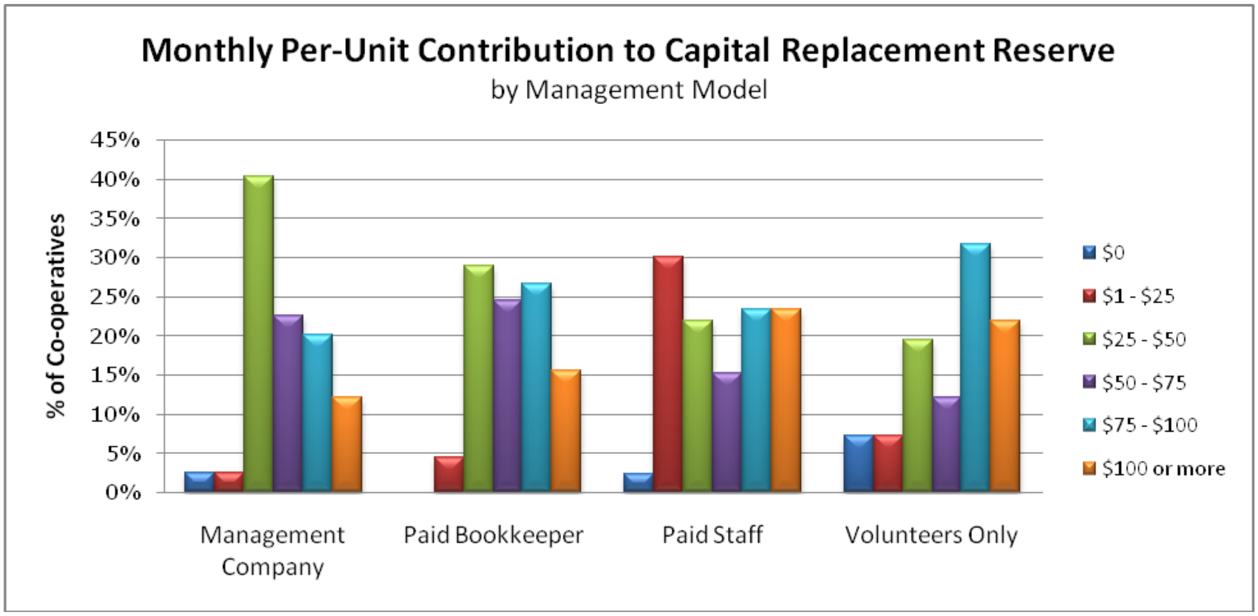
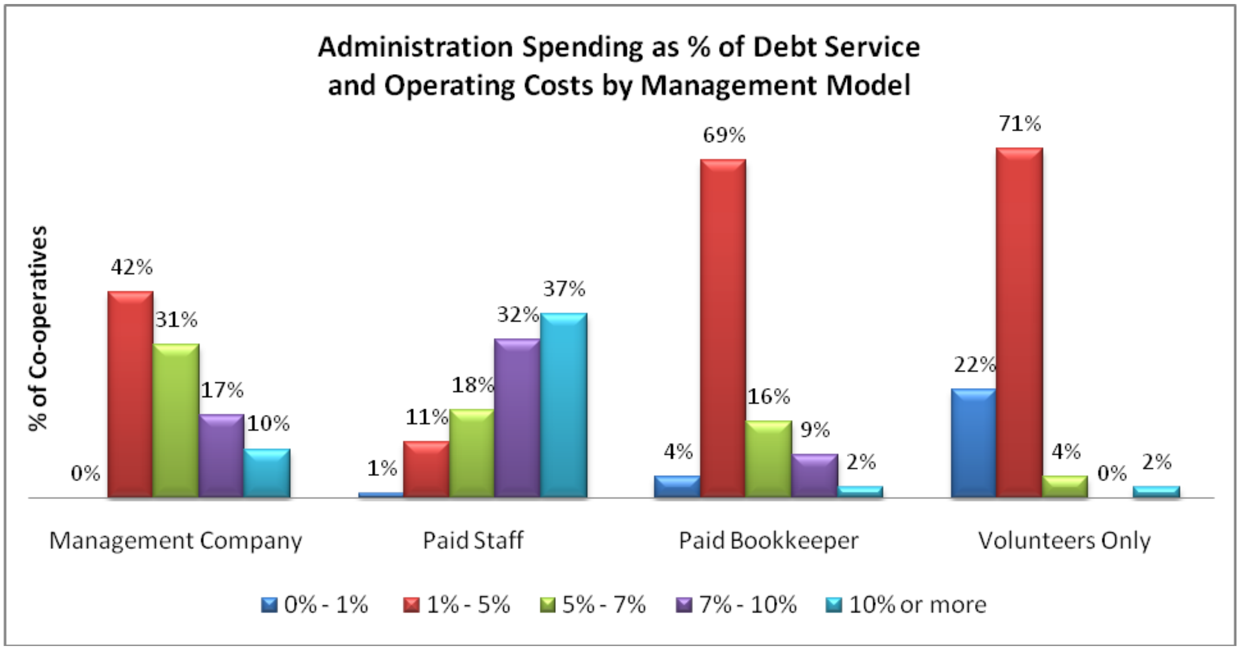


Figure 45

Administration Costs

Just as one would expect, co-operatives with no paid help, or only a bookkeeper, spent less on administration in 2007 than those employing their own staff or contract property-management services. Median spending rates reported were 1.5 per cent for volunteer-operated co-ops, 3.5 per cent for those with only a bookkeeper, 5.4 per cent for co-ops using property-management firms and 8.6 per cent for co-ops employing staff. Again, operating costs are exclusive of replacement-reserve contributions, pushing up the medians.

We have done no research into the question why the approach of hiring a property-management company is significantly more economical than the direct-staff model. One reason may be that a range of service levels is available from contract property managers, at least from those that specialize in providing services to housing co-operatives. Not all firms offer, and not all co-ops buy, the full range of services.



Administration Spending as % of Debt Service and Operating Costs by Management Model
% of Co-operatives
42%
31%
17%
10%
0%
1%
11%
18%
32%
37%
4%
69%
16%
9%
2%
22%
71%
4%
0%
2%
Management Company
Paid Staff
Paid Bookkeeper
Volunteers Only
0% - 1%
1% - 5%
5% - 7%
7% - 10%
10% or more

Figure 46

Chapter 6: Looking Back, Looking Ahead

The year 2007 provides the Agency with a baseline from which we will be able to measure the progress of the entire portfolio as we fulfill our mandate of managing the risks associated with the co-operative housing programs, preventing and managing mortgage defaults, maintaining compliance with the terms of the CMHC programs and operating agreements and, at the same time, helping co-operatives to perform as well as they are able to. Although not able to report extensively on the West in 2006, we now have two to three years of data in our information system for all clients, except those retained for some time by CMHC.

With this information in hand, we are ready to look towards the future. Our staff are trained and our essential systems are in place. We have tested our strategies and tools and modified them as appropriate. We are confident that with patient, consistent work and a generous sharing of information, co-operatives will respond to our approach. At present, our confidence is based on anecdotal, experiential information garnered by our front line staff. By the date of our next report, we expect to be able to produce the first solid comparison with the baseline, which will show by the improvement in struggling and well-run co-operatives alike that the Agency's efforts are beginning to take effect.

Appendix A: The 2007 Data Set and Full Agency Portfolio Compared

	Data Set*	Portfolio
Co-operatives	461	515
%	90%	100%
Units	28,609	31,220
%	92%	100%

* co-operatives whose AIRs for fiscal years ending between 30 September 2006 and 31 August 2007 were received and validated by 15 February 2008

Distribution By Program	S27/61	S95	FCHP (ILM)	UN/NP (PEI)*	Multiple*	Total
Data Set	49	283	114	3	12	461
%	11%	61%	25%	1%	3%	100%
Portfolio	54	314	127	5	15	515
%	10%	61%	25%	1%	3%	100%

* excluded from program analysis, as numbers were insufficient

Distribution By Province	B.C.	Alberta	Ontario	PEI	Total
Data Set	164	42	245	10	461
%	36%	9%	53%	2%	100%
Portfolio	177	52	274	12	515
%	34%	10%	53%	2%	100%

Distribution By Management Model	Management Company	Paid Staff	Paid Bookkeeper	Volunteer Only	Total
Data Set	160	211	45	45	461
%	35%	45%	10%	10%	100%
Portfolio	182	233	46	54	515
%	35%	45%	9%	10%	100%

Appendix B: Definition of Composite Risk Ratings

Low Composite Risk: *A strong, well-managed housing co-operative.* The combination of its excellent physical condition, accumulated earnings and reserves, position in the marketplace and current capacity to contribute to its replacement reserve make it resilient to adverse market and economic conditions. Provided it continues to be well managed, the co-operative should be able to fund needed repairs and replacements and meet its debt obligations for the foreseeable future, without external support.

Moderate Composite Risk: *A sound, generally well-managed housing co-operative.* It is in good or better physical condition, has access to adequate cash resources and is able to make an adequate or better contribution from earnings to its replacement reserve, after covering its debt service and all normal operating expenses. The co-operative should be able to remain in sound financial and physical condition, provided it continues to be well managed and economic or market conditions do not deteriorate significantly. It does not require external support or intervention

Above-Average Composite Risk: *The co-operative has issues that warn of emerging or potential financial difficulties.* One or more of the following conditions is present: the co-operative is in fair, but not poor, physical condition; its earnings are sufficient to cover current expenses but do not allow for an adequate contribution to the replacement reserve; its combined accumulated earnings and replacement reserve are low and access to other cash resources, such as member shares or deposits, is limited; or vacancy losses or housing charge arrears are significantly above the median level for its peers. No indicators of high risk are present, but the co-operative may be challenged in funding needed capital repairs or meeting its obligations in the future, especially if the market is weak or weakens. It will require effective management and some ongoing monitoring and support.

High Composite Risk: *The co-operative is in financial difficulty or is poorly managed.* One or more of the following conditions is present: the co-operative's earnings are insufficient to cover its debt service and current expenses; it has insufficient revenue after covering its debt service and current expenses to allow an adequate contribution to the replacement reserve; it has an accumulated operating deficit, a low or non-existent replacement reserve and limited access to other cash resources, such as member shares or deposits; vacancy losses or housing charge arrears are unusually high; the co-operative has urgent or major repair requirements that it is not able to fund; it is behind with its mortgage payments or property taxes; it has suffered a major loss of assets through fire or malfeasance against which it was not adequately insured; or it is suffering from a failure of governance. Without intervention and continuing support, and possibly a financial workout, the co-operative is at risk of failure.

Appendix C: Median 2007 Performance Data

	Annual Vacancy Loss as % of Gross Housing Charge Potential	Vacancy Loss per Unit per Year	Ratio of Combined Arrears and Bad Debts to Occupant Share of Housing Charges	Combined Spending on Maintenance and Capital Repairs per Unit per Month*	Per Unit Capital Replace-ment Reserve Balance	Capital Replace-ment Reserve Contri-bution per Unit per Month**	Replace-ment Reserve Contri-bution as % of Total Operating Expenses*	Supple-mental Contribu-tion to Reserve per Contri-buting Co-op*	Adminis-trative Spending as % of Total Service and Operating Costs
Full Data Set	0.4%	$30	0.8%	$160	$3,152	$58	7.8%	$23,706	6.3%
Program									
S27/61	0.2%		0.72%	$153		$84			6.9%
S95	0.3%		0.65%	$167		$100			7.2%
ILM	0.6%		1.13%	$144		$48			4.7%
Province									
B.C.	0.2%		0.4%	$149		$55			4.1%
Alberta	0.3%		0.5%	$123		$59			4.5%
Ontario	0.6%		1.3%	$175		$59			8.4%
PEI	0.2%		0.4%	$134		$60			6.4%
Management Model									
Management Company	0.4%		0.8%	$155		$54			5.4%
Paid Staff	0.4%		1.0%	$173		$59			8.6%
Paid Bookkeeper Only	0.1%		0.4%	$134		$63			3.5%
Volunteer Only	0.0%		0.2%	$162		$77			1.5%

* excludes those capital expenditures amortized over time ** excludes supplemental contributions made from accumulated surplus