



## **Achieving a viable and sustainable community housing sector: an industry perspective**

June 2009

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## **Executive summary**

CHFA is highly supportive of the Commonwealth's increased policy focus on the community housing sector as a vehicle for growing the stock of affordable rental accommodation in Australia. A dedicated Community Housing Industry Development Section in the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) is now supporting this focus, and there has been a significant increase in funding available to the sector through the National Affordable Housing Agreement, the Social Housing National Partnership, the Homelessness Partnership, and the Nation Building and Jobs Plan. Additionally, there are many positive developments at a state and territory level.

Regarding the future growth of the sector, and any economic modelling that the Commonwealth may use as a basis for its ongoing policy and funding frameworks, CHFA would caution against an over-reliance on viability benchmarking as an assessment tool for growth funding and policy development. Describing characteristics of strong organisations can be a useful capacity building tool, however viability benchmarking, or a 'one size fits all' approach, is likely to stifle innovation, lock many existing providers out of the system, and will not deliver the best outcomes for tenants or government investment. A focus on desirable outcomes, rather than models, is a more sensible approach.

A distinction between scale and viability should also be made in the design of any assessment tool. Care needs to be taken not to confuse economies with viability; that is, instead of focusing on the numbers (size of portfolio, balance sheet, loan to value ratios, income streams and so on), it would be more constructive to develop a set of characteristics of successful organisations. This could be achieved, in part, by developing a rigorous and nationally consistent regulatory framework. Being registered under this framework would provide external assurance of an organisation's capabilities and financial strength. Having a robust and respected regulatory system would obviate the need to measure an organisation's strength in terms of its operational model, scale, or other measures of viability. Funders, lenders, or partners could determine questions of viability by conducting their own due diligence on a case-by-case and project-by-project basis.

Any framework to regulate the community housing sector must also separate the role of regulator and funder. Ideally, all organisations managing below-market rental accommodation should be covered by the same regulatory framework, including State Housing Authorities. A regulatory system should categorise organisations' activities in relation to a 'risk-adjusted' funding process. One possible way of conceptualising the different types of organisations that currently exist would be to break their activities into three broad categories: full development capacity; property 'commissioning' capacity; and property management capacity. Organisations could move between these categories depending on the regulatory requirements for the type of activities that they conduct.

There are currently unprecedented opportunities for community housing organisations to increase their involvement in the development and management of affordable rental accommodation. The ability to capitalise on these opportunities will depend, in large part, on the growth strategies, funding, regulatory, and policy frameworks that are developed by the governments to support this growth. These will pave the way for a strong and viable sector that can continue to deliver housing for an increasing number of low and moderate-income households into the future.

## **Introduction**

The Community Housing Federation of Australia (CHFA) is the national peak body representing community housing providers in Australia. This discussion paper has been prepared in consultation with CHFA's Board.

A project to provide strategic advice to the Commonwealth on achieving a viable and sustainable community housing sector is currently being carried out by the consulting firm KPMG, and has been funded by the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA). KPMG is due to report on this work by mid June 2009. CHFA's Executive Director, Carol Croce, sits on the Reference Panel for this project. This paper aims to articulate the future opportunities and risks for the community housing sector against the backdrop of rapid policy change and an increased focus on the community housing sector as a vehicle for delivering growth in the number of affordable rental dwellings, either as developers, tenancy managers, or both. In doing so, it responds to some of the issues raised in the consultations carried out by KPMG during May and June 2009. This paper discusses three themes: growth, economic modeling, and regulation.

CHFA would like to acknowledge the need for a continued and expanded role for organisations providing housing for Indigenous Australians, regardless of their funding source, tenant population, where they operate, or their current regulatory arrangements.

## **Growth**

CHFA supports a social and affordable housing system that addresses market failure across a continuum of need. This includes responding to homelessness, providing housing and support to tenants with high needs, developing and/or managing rental accommodation for people on low-moderate incomes, and addressing barriers to market access.

Achieving growth that supports these objectives will require a policy and regulatory environment which supports providers that:

- Specialise in meeting specific needs (for example, housing people with disabilities);
- Operate in specific markets (for example, geographic areas, or particular types of housing);
- Operate within specific program areas (for example, NRAS); or
- Operate a broader portfolio across a continuum of tenant profiles, program areas, and financing regimes.

Further, CHFA supports a mix-funded social and affordable housing system, where subsidies are better matched to need. This means full and deep subsidies for meeting the greatest needs, and leveraging subsidies and attracting private equity investment in meeting general market failure. These subsidies could be internal (cross-subsidisation) or external (operational funding and/or rebates from government).

The key benchmarks of a successful social and affordable housing system are its adequacy and effectiveness in delivering good social policy outcomes. As well as measuring the number of dwellings that have been built and managed, two other key indicators of a successful system are:

- The certainty (and predictability) of funding streams and policy environments; and
- The additional outcomes that it delivers for tenants.<sup>1</sup>

CHFA supports a package of funding that includes:

- Direct public investment of new funds linked to social housing supply, and core capital funding to meet short and medium term business plans of community housing organisations, including ongoing operational funding;
- Indirect public investment through the transfer of public housing assets or government land. Stock transfers should be jointly planned with the community housing sector;
- Government land releases for affordable housing;
- Investment through the National Rental Affordability Scheme (NRAS);
- Private investment through debt finance or equity investment;
- Planning system yields through specific regulatory requirements or planning concessions;<sup>2</sup> and
- Charitable tax concessions at all levels of government.<sup>3</sup>

In order to facilitate the growth of national organisations, federal funding through programs and funding agreements such as the National Affordable Housing Agreement (NAHA), the Nation Building and Jobs Plan (NBJP) and NRAS should not attract caveats that limit the use of revenue surpluses and the leveraging of debt finance within a particular jurisdiction.

Funding processes need to set distinct outcomes for different parts of the housing market. This approach has been championed by the Summit Group, which has developed a categorisation system that refers to 'bands' of housing. Such bands of housing would be aimed at different tenant populations, and be typified by different approaches to government investment, rent structure, and length of tenure, amongst other things. To achieve this, funding streams with different goals need to be articulated. Overall, this should translate as a set of outcome driven goals for each band, comprising the number of dwellings managed, and timelines for their construction, including interim timelines.

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<sup>1</sup> This 'housing plus' approach is one of the key distinguishing features of the community housing sector. There is a risk that this will be lost in the event of large-scale stock transfers that are not accompanied by a commensurate increase in the capacity of the sector to allow it to continue offering support and assistance over and above basic tenancy management functions.

<sup>2</sup> Examples of this include the current inclusionary zoning requirements in South Australia, and the model being proposed by a number of inner Melbourne councils, and being led by Port Phillip Council.

<sup>3</sup> To achieve this, Commonwealth guidance to state, territory, and local governments to improve the consistency of tax treatment across jurisdictions will be required.

These funding streams need to be situated within a national infrastructure strategy that is designed to support the community housing sector. Ideally, this strategy would have dedicated funding, and be situated within the NAHA.

Such an infrastructure strategy could comprise:

- Nationally consistent reporting and evaluation arrangements;
- Capacity building focused on growth;
- Capacity building and policy development focused on sustaining existing small and medium sized organisations;
- Regulation focused on risk management (see below);
- An industry-driven quality improvement (or standards and accreditation) system focused on tenant outcomes; and
- A nationally consistent approach to tenant access. This could include a national web-based application system for social and affordable housing.<sup>4</sup>

CHFA would caution against over-reliance on viability benchmarking as an assessment tool for growth funding for the community housing sector. Although describing characteristics of strong organisations can be a useful capacity building tool, viability benchmarking, or a 'one size fits all' approach, will stifle innovation, lock many existing providers out of the system, and will not deliver the best outcomes for tenants or government investment. A focus on desirable outcomes, rather than models, is a more sensible approach.

## **Economic modelling**

It is essential that the economics of the community housing sector are better understood. An independent sector is essentially the sum of a number of community housing businesses. Understanding the business model of community housing organisations is therefore extremely important. Whilst a 'one size fits all' approach to modelling will not provide an adequate understanding of the sector, because the business of any community housing organisation will be contingent on a range of policy positions and organisational priorities, it is nevertheless important for governments and other stakeholders to increase their understanding about what it takes to run a community housing business. This will be helpful in developing and adjusting policy parameters to support the viability of the sector and minimise risk.

Economic modelling is an important component of the work being conducted by KPMG. Many of the initial modeling assumptions in the KPMG work appear to be predicated on a debt financing model. CHFA believes that this modelling should also take into account the outcomes of debt financing coupled with a range of levels of public investment.

One of the key variables in economic modeling for the community housing sector is organisations' income stream, which is a key determinate of an organisation's capacity to leverage debt. This income stream is not just dependent on the way that rent is calculated and the composition of an organisation's property portfolio. The composition of tenants is also crucial in this regard. Organisations that cater for particular tenant

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<sup>4</sup> It is likely, however, that tenant eligibility and priority for access to housing will need to be locally responsive.

groups (or a higher percentage of particular groups within their programs) will have different spending requirements, and differing capacities to service debt. Care needs to be exercised to ensure that policy settings do not encourage a 'race to the bottom', whereby organisations are forced to compete with each other and the private sector by housing people that are predominantly drawn from the upper end of a given eligibility criteria. Conversely, a number of jurisdictions are currently pushing community housing organisations in the opposite direction, i.e. housing people with the lowest incomes and the highest needs. CHFA supports housing models that allow for, and indeed specify, a mixed tenant base. This can be achieved in a number of ways.

Any financial modelling of the community housing sector *as a whole* requires a number of underpinning assumptions. Given that community housing organisations are, to a large extent, creatures of public policy, such assumptions must factor in the policy settings of governments that impact on the way the sector operates. Some of these assumptions, or variables, are discussed below.

- **Who the sector will house.** That is, what type of tenancy profile will result from government targets and funding streams?
- **What social outcomes the sector is expected to deliver.** The wording of the NAHA and associated National Partnerships, and the Government's goals around reducing homelessness, will mean an increased focus on providing assistance to people that are experiencing or at risk of homelessness. For many community housing organisations, this will mean continuing their present work in providing a 'housing plus' model of support, as well as developing and fostering ongoing relationships with other service providers. Achieving a stable, sustainable tenancy for tenants with significant problems or problematic social behaviours requires a level of skilled tenancy support within a housing organisation, as well as access to needed support services. Providing appropriate support services to tenants does have costs attached to it, and some of those costs are 'hidden' in the relationship between the housing providers and support organisations. In short, the type of tenants housed by an organisation has financial ramifications on the bottom line.
- **The impact of state and territory government policies.** It is unlikely that these will remain static. Will the modelling conducted by KPMG be based on, or will it factor in some of the policy changes which have been foreshadowed in state and territory affordable housing strategies? Further, other policy frameworks are likely to evolve within jurisdictions in the event of a significant amount of stock transfers occurring.
- **The type of tenant eligibility criteria and housing allocation procedures that will be used.** These will be key determinants of the cost of providing housing, and the ongoing income stream that organisations will be able to generate.
- **Whether providers will be able to and/or expected to internally cross-subsidise.** That is, will subsidies at some level or for some tenant populations be factored into the modelling?
- **How CRA will be used in calculating tenants' rent.** In conducting any modelling around financial viability for community housing organisations, it is important to remember that CRA (Commonwealth Rent Assistance) is an income subsidy, not a housing assistance payment, and it is tied to the tenant housed,

rather than a dwelling or its market value. As well, 'maximising'<sup>5</sup> CRA doesn't always deliver the maximum amount of CRA, and that will need to be considered in the modelling. 'Maximising' CRA is a major component in the work being conducted by KPMG. There is, however, no assurance that CRA will continue in its present form, that is, allowing tenants of not-for-profit landlords to receive CRA, and those landlords to adjust their rents to allow their tenants to 'maximise' the amount of CRA they receive. There are also tenants (and in particular, many 'key workers', such as single people or couples without children) that are not eligible to receive CRA. The future rate of CRA is not assured, and this may create difficulties for organisations when they conduct due diligence for projects.<sup>6</sup> In the past, certain groups of tenants have had limited or no access to CRA (such as sharers and students) and there is no current Government assurance that such exclusions would not occur in the future. (Rent setting is discussed in further detail below.)

One of the key objectives of the KPMG project is to develop recommendations to 'facilitate continued growth that is not dependent on recurrent government subsidies beyond existing commitments'. In the absence of government funding, community housing providers have three main means of raising income:

1. Rental income;
2. 'Maximising' CRA; and
3. Cross-subsidising the cost of housing low income/high needs tenants, either by having a mix of other tenants, including those on moderate incomes, or conducting other activities (such as property development), the 'profits' from which can be churned back through the organisation.

An organisation's income stream (and any subsidies it might receive) also impacts on its ability to grow and service debt. If a large provider is sustaining a level of service to tenants on very low incomes or with high needs through cross-subsidy only, this will limit its ability to apply a rent stream income to serving a debt for growth. An organisation that wants to maximise its capacity to grow has a disincentive to house those who pay less rent or cost more to house if there is no other subsidy attached.

Both rental income and cross-subsidising highlight the importance of having a predictable and appropriate tax regime that safeguards the charitable status of not-for-profit

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<sup>5</sup> 'Maximising' CRA is a process employed by many not-for-profit housing providers, and in most jurisdictions. Some jurisdictions strongly encourage or mandate this. It involves setting the rent on a property such that a tenant will receive the maximum amount of CRA that they could be entitled to, and then allowing the tenant to keep this CRA, whilst paying a commensurate increase in their rent. In doing so, providers ensure that tenants are no worse off financially than they would be if they were paying rent using an income-based formula and not receiving CRA, but are able to 'capture' this CRA, which increases an organisation's income stream and acts as a de facto form of operational subsidy.

<sup>6</sup> This is because CRA is indexed with CPI, not the rental (or housing) component of CPI. As the demand for housing is increasing at a disproportionate rate to growth in the rest of the economy, it is likely that there will be a widening gap between what tenants can afford to pay and the actual market value of a dwelling and the cost of construction (and therefore an increase in the subsidy required to meet the 'affordability gap').

community housing organisations. CHFA has explored this issue in depth in its submission to the Henry Review into Australia's Future Tax System.<sup>7</sup>

Rental income forms a significant component of organisations' income streams. The KPMG modelling will also need to consider what types of rent-setting models will be used by community housing organisations in future growth, funding and policy scenarios. Other than 'maximising' CRA, a number of different rent setting models are already being used across the community housing sector. The primary methods are income-based and discounted market rent.

Regarding rent setting, another important consideration is the reform areas attached to the NBJP, which have been agreed by the state and territory governments. Reform area (i) states that there will be 'improved efficiency of social housing including through better matching of tenants with appropriate dwelling types and the introduction of rent-setting policies that reflect the type of dwellings occupied by tenants'.<sup>8</sup> It is unclear how this will translate in practice, but it is possible that such a reform could have a significant impact on how rents are charged to tenants.

As noted above, CRA is an income subsidy, not a housing allowance. As a de facto housing allowance that can be fed, through an artificial increase in a tenant's rent, into an organisation's operating budget, CRA is a blunt instrument, and one that operates for historical, rather than logical, reasons. CHFA supports reform, such as that outlined above, that will investigate possible changes to rent structures. The focus above, however, refers to matching *tenants to dwellings*. CHFA believes that a 'root and branch' review of how *subsidies* are matched to dwellings (and to tenants by proxy) is needed. Such a review could investigate a custom-built allowance to bridge the gap between what is affordable for a tenant to pay and the market value of a property. A similar system operates in the UK, where tenants receive subsidies that range from shallow to deep, depending on their capacity to pay rent. Thus, the income stream for providers remains stable and predictable. This system is simpler and fairer for both tenants and providers alike.

The discussion above highlights some of the many variables that will affect any economic modelling. Many of these could change in the future, and this will make any meaningful modelling difficult to carry out. CHFA believes that it not necessary for governments and policy makers to attempt to put numbers around benchmarks of viability. What constitutes viability will be different for different models of operation, tenant groups, geographic locations and so on. Benchmarking of viability has been tried before, and it has failed.

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<sup>7</sup> CHFA's submission is available online at <http://www.chfa.com.au/Downloads/CHFA%20submission%20Henry%20tax%20review.pdf>.

<sup>8</sup> See Schedule C7 in the National Partnership Agreement for the Nation Building and Jobs Plan.

Further, it is important to differentiate between scale and viability. Care needs to be taken not to confuse economies with viability. Instead of focusing on the numbers (size of portfolio, balance sheet, loan to value ratios, income streams and so on), it would be more constructive to develop a set of characteristics of successful organisations.<sup>9</sup> This could be achieved, in part, by developing a rigorous and nationally consistent regulatory framework. Being registered under this framework would provide assurance about an organisation's capabilities and financial strength. Having a robust and respected system would obviate the need to measure an organisation's strength in terms of its operational model, scale, or other measures of viability. Funders, lenders, or partners could determine questions of viability by conducting their own due diligence on a case-by-case and project-by-project basis. It is important to note that, irrespective of the various accreditation and regulatory regimes that operate around the country, this is current practice, and will not create an additional workload.

## Regulation

As noted above, CHFA advises against seeking to predict or adopt as part of a regulatory or funding framework a winning formula or 'preferred' organisational structure, or a preferred level of growth for individual organisations. The regulation and funding of child care, and the associated problems in this area provide a contemporary Australian example of both market and policy/regulatory failure to protect service users.<sup>10</sup>

A regulatory system should have at its core the goal of enabling the sector—and governments—to achieve their policy goals, including growth targets.<sup>11</sup> A key component of a regulatory system is managing risk. Specific outcomes for organisations that receive government funding should be dealt with in contractual arrangements, not through a regulatory system. When regulation morphs into process management and contracts become overly specific about the activities that are required to achieve the purpose of the contract, rather than just specifying the purpose itself, then innovation is stifled.

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<sup>9</sup> Previous research conducted by CHFA identified a number of core variables common to 'successful' community housing organisations, regardless of their size, tenant profile, or geographic location. This research was built upon in a subsequent academic paper authored by Gilmour and Bourke, *The Role of Organisation Structure, Relationships, and Networks in Building Australia's Community Housing Sector* (2008). This paper is available on CHFA's website at [http://www.chfa.com.au/Downloads/Australasian\\_Housing\\_Researchers\\_\(Gilmour\\_%26\\_Bourke\).pdf](http://www.chfa.com.au/Downloads/Australasian_Housing_Researchers_(Gilmour_%26_Bourke).pdf).

<sup>10</sup> The recent collapse of ABC Learning provides a cogent example of such failure.

<sup>11</sup> Creating the right settings in a regulatory system will help to achieve policy goals by enabling organisations. The corollary of this is a system that seeks to protect government assets as its primary purpose. The process of developing the National Community Housing Standards in 2002-03 provides an excellent example of a system that enables organisations. The sector was involved in the development of the standards, and they are set up so that organisations seeking to become accredited are only required to cover off on areas that pertain to their business activities. One of the key features of the development of the standards is that they were developed with the sector, not by its competitors and regulators (i.e. State Housing Authorities).

Having the actual operatives in the system, who have a deep understanding of their sector, participate in developing a national system of regulation will ensure that it appropriately regulates organisations' activities, as well as providing a sense of ownership and agency in the system by the organisations that will be regulated by it.

CHFA supports a regulatory framework, such as that operating in NSW, which separates the role of regulator and funder. Further, a regulatory framework must involve no potential risk of assumption of government control of organisations that are being regulated, and therefore the potential loss of charitable status as a result of regulatory action.

A regulatory system needs to create the right settings, be rigorous in assessing project viability, and then allow diverse organisations respond. The key objective should be about creating a dynamic and sustainable social and affordable housing system. A focus on outcomes, rather than process, will best achieve this.

To achieve this CHFA supports the following:

- Nationally consistent regulation of the sector. CHFA is pleased that the sector has been consulted for the ARTD project that is currently re-scoping the approach to a national regulatory system for community housing providers. There will need to be, however, an ongoing role for the sector to play in the development of a regulatory system—the industry needs to be an integral part of shaping this important work, rather than sitting outside the process. CHFA would also support a ‘tiered’ system that allows for organisations carrying out different types of business to be assessed separately, as required. The key premise of a regulatory system needs to be based on managing risk, and the key to this is managing risk that is appropriate to the activities an organisation conducts (see below).
- A significant upgrading in the capacity within governments to conduct commercial project assessments. This is important because, once organisational risk is regulated (see above), project risk, particularly in a mix-funded environment, is the main area of risk.

Just as there should be an approach that disaggregates the different bands of dwellings for the purpose of driving outcomes of government policy and investment, a regulatory system should categorise organisations’ activities in relation to a ‘risk-adjusted’ funding process. One way of conceptualising the different types of organisations that currently exist would be to break activities into three broad categories: full development capacity; property ‘commissioning’ capacity; and property management capacity. Organisations could move between these categories depending on the regulatory requirements for the type of activities that they conduct. These three broad kinds of organisations, each with different regulatory requirements, are described below.

#### Development status

Organisations that have their own development capacity. This capacity includes sophisticated procurement, project management, and financial capabilities and experience. Additionally, many organisations in this category have a range of professionals, such as architects, on their staff.

#### Commissioning status

Organisations with the capacity to commission development processes, secure title to properties, and benefit from GST and other concessions associated with these activities;

#### Property management status

Organisations that wish to grow or continue operating at their present scale using their tenancy management expertise.

Ideally, organisations could move along this three tiered continuum. Additionally, such a national system of regulation could deal with the potential problem of organisations using assets funded by one jurisdiction to debt finance operations in another jurisdiction by 'ring fencing' these assets. For example, the regulatory framework could stipulate that all new developments and property acquisition from, say, 1 June 2010 be owned by the organisations outright, and that the pre-existing assets remain under the existing arrangements. Over time, these would form a diminishing proportion of organisations' total stock. Accordingly, state and territory governments would have to be mindful of the new regulations when funding any future activities.<sup>12</sup>

CHFA believes that a regulatory system should assess organisations in the same way that a bank would assess a business model. A shift to this type of approach will require governments to employ people that are expert in understanding and evaluating risk, rather than managing processes. It is important to note, however, that risk indicators change over time, and that the regulation should be more concerned with 'broad brush' aspects of an organisation's operations. As noted above, potential funders, lenders, and joint venture partners will conduct their own due diligence to assess risk for individual projects.

## **Conclusion**

CHFA is highly supportive of the Commonwealth's increased policy focus on the community housing sector as a vehicle for growing the stock of affordable rental accommodation in Australia. A dedicated Community Housing Industry Development Section in FaHCSIA is now supporting this focus, and there has been a significant increase in funding available to the sector through the NAHA, the Social Housing National Partnership, the Homelessness Partnership, the Indigenous Partnership, and the NBJP. Additionally, there are many positive developments at a state and territory level.

There are currently unprecedented opportunities for community housing organisations to increase their involvement in the development and management of affordable rental accommodation. Being able to capitalise on these opportunities will depend, in large part, on the growth strategies, funding, regulatory, and policy frameworks that are developed by governments to support this growth. These will pave the way for a strong and viable sector that can continue to deliver housing for an increasing number of low and moderate income households into the future.

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<sup>12</sup> Importantly, safeguards would need to be put in place to ensure that state and territory governments do not try and circumvent this part of the regulatory system by 'regulating by contract', i.e. inserting clauses into contracts with housing providers exerting control over their organisations that would otherwise be covered in a jurisdiction-specific regulatory framework.