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Revisions to the Capital Framework for Authorised Deposit-Taking Institutions

Joint Submission from the Community Housing Industry Association (CHIA), National Shelter and Power Housing Australia

Revision to the Capital Framework for Authorised Deposit Taking Institutions

A submission from the Not for Profit Registered Housing Industry

Summary

The Not-For-Profit (NFP) registered community housing sector has an important role to play within Australian society and the economy, addressing housing industry market failure and meeting public policy outcomes.

The availability, price and terms of capital investment are critical to the NFP sector being able to deliver new homes.

The sector sits within a dedicated risk-based “Regulatory System” and brings together public, community and private resources to achieve its mission.

This submission addresses the sector’s concern that APRA’s current directions, in terms of its response to the Basel 111 proposals, will have a negative impact on the sector and its mission and that APRA’s proposals to place the NFP sector within the “other residential mortgages” does not reflect a rational approach to the low risk and higher regulation NFP business environment and business model.

In looking to place the NFP sector within the more volatile and largely unregulated “investment” property settings, APRA will be effectively ignoring the “National Regulatory System” and the “ACNC” as regulators of risk. Its approach will be working against the Policy outcomes sought by the Commonwealth and State Governments.

In addition, APRA will be attributing volatile property investment characteristics to a long term stable-mission driven- community infrastructure portfolio.

The sector is seeking recognition from APRA that acknowledges it is a regulated sector driven by long term community outcomes and that the scale of financing that is required by the sector in the future is increasing.

In addition, the arrangements need to support the increased volume of business that enables financial institutions to properly invest in the specialist knowledge and systems that underpin the sectors future growth. This in turn builds and maintains capability and ensures better project assessment and lower risk exposure. The last thing anyone wants is a de-skilled finance sector in this essential part of the market.

Finally the NFP sector is diversifying its products and services to respond to customer need. Over the last few years we have seen an increase in Shared Equity Home Ownership, Disability Housing and other market innovations to meet diverse need and lending should assist ongoing innovation which caters for significant housing supply gaps in this space.

The outcomes we are seeking are:

1. There should be no negative impact on the NFP residential sector from the arrangement APRA puts in place.
2. Either a NFP exemption (If APRA does adopt 'Materially Dependent' under BASEL 111) or an APRA classification should be determined that has the effect of placing NFP residential housing into the "Standard" residential mortgage categorisation for risk-weights. (Alongside the owner-occupiers P&I category)
3. The sector is seeking diversification and competitiveness within the finance sector and is seeking recognition of the role other medium scaled institutions can play alongside the built-in flexibility for the big five institutions.

We look forward to further dialogue with APRA to address our concerns.

About the Organisations Making the Submission

This submission is made jointly by three national representative organisations, all of which share a commitment to the provision of housing that is affordable to households on very low to moderate incomes.

The Community Housing Industry Association (CHIA) is the industry peak for community housing providers across Australia. The industry provides one in five of Australia's social housing properties, complementing public housing. Community housing providers manage a $30 billion-plus portfolio of more than 80,000 rental properties, which, are home to people who are on low and moderate incomes and who find it hard to access affordable or appropriate housing in the private market. Our 155 members include the largest to those with less than 100 homes. Our members provide a diverse range of housing for Aboriginal people, people with disabilities and the formerly homeless.

National Shelter is a non-government peak organisation that aims to improve housing access, affordability, appropriateness, safety and security for people on low incomes. Since 1976 it aims to work towards every Australian having access to housing that is affordable, adequate, secure and meets their needs.

Powerhousing Australia is a national peak network of 34 larger registered community housing providers who develop and manage social and affordable housing. PowerHousing Australia is the Australian member of the International Housing Partnership which brings together housing organisations across the UK, USA, Canada and Australia.

About the Submission and its Preparation

As noted at the outset, this submission is focused entirely on the potential consequences to the registered not for profit housing industry[1] from the proposals resulting from the current review of the capital framework for authorized deposit taking institutions.

[1] Throughout this submission we are concerned with NFP CHPs that operate within one of the three recognised regulatory systems (the National – NRSCH; the Victorian scheme and the WA system). Other non

Our response is informed by the discussion with APRA officials to clarify their rationale for the treatment of lending to registered not-for-profit housing organisations as synonymous with 'mum and dad' property investors rather than residential mortgage owners. Our understanding is that the standards being set by APRA reflect the Australian finance sector's higher exposure to residential mortgages and an intention to keep the framework simple and straightforward. Thus the argument goes, having a separate treatment for the not for profit housing industry risks overly complicating the framework.

APRA believes that the proposed treatment will have minimal impact on the not for profit housing industry and that the larger financial institutions will have the flexibility to continue funding the industry in the same way as they have done in the past. However, APRA acknowledged they were unfamiliar with our industry and the policy setting and regulatory framework within which it operates and had not formally considered the potential negative impact on our industry and the supply of affordable homes.

The submission has been kept concise and focuses on the nature of the not for profit housing industry, its policy settings and the regulatory environment in which it operates. Our aim is to demonstrate the rationale for recognising the industry as inherently low risk and thus appropriately treated separately from the investment property sector. The consequences of not doing this are also illustrated.

The response is an exercise in collaboration. Griffith University Business School have been instrumental in bringing together a body of research to underpin the submission. This is collated in the submission's appendix 2 and is a standalone document. BDO and the Australian Banking Association (ABA) have provided background information on the technicalities of the capital framework and advised on the submission content. SGCH, Evolve Housing and NAB have all had a significant input. SGCH have in particular provided outline modelling showing the potential impact of higher borrowing costs on the delivery of new affordable homes set out in Appendix 1. Mike Myers from the NAHC has provided invaluable assistance in providing resources to allow us to make this submission.

We also acknowledge the extension granted by APRA to allow us to put together this submission.

registered organisations may use the name CHP too. A number may be indigenous Community Housing Providers which in some jurisdictions operate within different frameworks.

The Registered Not-For-Profit Housing Sector in Australia – Well Managed and Regulated

There are almost 400 Registered NFP community housing providers (CHPs) registered in one of three regulatory systems operating across Australia. Of these CHPs there are around 90 organisations registered as T1 or T2 in the National Regulatory System for Community Housing and WA or classified as Housing Associations in Victoria which own and / or manage the majority of community housing. All these 90 organisations have been assessed as having the capability to develop new homes, with many of the larger CHPs having already developed new social and affordable properties.

In total CHPs manage a $30 billion-plus portfolio of more than 80,000 rental properties, which are home to people who are on low and moderate incomes who find it hard to access affordable or appropriate housing in the private market. Our sector now manages around 20% of the total social housing portfolio in Australia - 25% if Indigenous community housing providers are also included.

The Australian Housing and Urban Research Institute (AHURI) in its 2017 Inquiry[2] into the capacity of the affordable housing industry found in its report profiling the community housing sector that there is a 'strong cohort of commercially-oriented and independent NFP organisations with considerable capacity for further growth' whilst also pointing out that 'many small registered providers also have the potential for modest growth'.

In considering the NFP industry's operating context, it is noted that the sector is strongly connected to State Government social housing capabilities and resourcing and that the sector itself has access to sophisticated external advice, strong skill-based governance and wider networking and partnering arrangements.

NFP HOUSING PROVIDERS

CHPs have demonstrated capacity to successfully deliver new homes. In NSW alone they will have by 2020 delivered 2700 properties at a value of $1B including $266 million of CHPs' own equity and $432 million in debt finance. At least 23,000 homes have been developed.

CHPs reinvest their profits to improve services and increase the amount of housing they offer.

NFP CHPs have a range of competitive advantages, including: tax exemptions and the ability to take out loans against their assets.

CHPs' charitable status means that they are more cost effective in delivering social and affordable housing.

CHPs are viable, ethically run businesses driven by strong missions and values.

CHPs are careful stewards of public assets with a commitment to transparency: they are accountable through robust regulation and contractual arrangements.

CHPs have proven capability in managing tenancies and properties, supporting people, and building strong communities.

[2] https://www.ahuri.edu.au/research/final-reports/278

In addition as noted above and explained further below registered CHPs operate in a regulatory environment that significantly reduces the risk of business failure through early intervention to manage and address issues and if necessary, a managed pathway to ensure that in extreme circumstances a business is wound up without loss to tenants and investors.

The demand for Social and Affordable Housing – CHPs provide services and accommodation which are in very high demand - we don't face slumps…..

The housing the sector manages is in short supply. Recent research by City Futures, UNSW 'Filling the Gap'[3] estimates there is a current shortfall of 437,600 homes affordable to households in the bottom income quintile and an additional 213,700 affordable to those in the second bottom income quintile. Factoring in the projected need to 2036 the researchers estimate in total that an additional 1.01M homes that are affordable to these two groups will be required.

There are also over 150,000 households on social housing wait lists. It is a feature of the households in need and the sectors response that in economically 'good times' or 'bad times' high unmet demand remains strong.

Infrastructure Australia in its 2019 Audit[4] reinforced the scale of the problem with Australian social housing identifying the funding shortfalls, the consequences in terms of the incidence of housing stress (11% of all Australian households were so defined in 2017) and the increase in homelessness between 2011 and 2016.

Infrastructure Australia also identified the potential for CHPs to be part of the solution. The community housing sector is growing, supporting governments to deliver high-quality services to social and affordable housing tenants. **Leveraging** further growth in the sector can increase innovation in social and affordable housing delivery and management, and improve the quality of housing services for tenants.

While government funding for new supply is limited CHP revenue streams are high quality and the industry's growth is supported by state, territory and Federal governments

The registered CHP sector operates within a relatively stable public policy framework.

Since the 1980's, increasing community housing has been a policy goal of the Commonwealth and State Governments on a bi-partisan basis. This has been articulated through Federation Agreements, such as the Commonwealth State Housing Agreement, the National Affordable Housing Agreement

[3] http://communityhousing.org.au/wp-content/uploads/2019/03/Modelling_costs_of_housing_provision_FINAL.pdf

[4] https://www.infrastructureaustralia.gov.au/sites/default/files/2019-08/Australian%20Infrastructure%20Audit%202019%20-%206.%20Social%20Infrastructure.pdf

(NAHA) and latterly the National Housing & Homelessness Agreement (NHHA). Dedicated "infrastructure" such as the National Regulatory System for Community Housing (NRSCH) and the National Housing Finance Investment Corporation (NHFIC) have also been legislated to support the sector's growth.

In addition the revenue streams are high quality. Over half of social housing tenants rely on Government benefits: about one third are over aged 55 and the majority are lower income households. Most tenants of NFP access Commonwealth Rent Assistance. This effectively makes Government the ultimate counterparty to the financial system we operate within.

In addition, social security payments are Indexed and this flows through to the rent recipients pay to CHPs.

The documented experience of the sector internationally through and after the 2008 GFC provides evidence of the stability of the sector, its underlying cashflow driven by demand and the regulated context that ensures standards in Governance and in all prudential matters.

Registered NFP CHPs operate within a strong regulatory framework

All charitable organisations must be registered with the Australian Charities and Not-For-Profit Commission (ACNC) and must meet their Governance Standards to be registered and remain registered.

ACNC compliance powers include providing regulatory advice, Enforceable Undertakings, Directions, suspending or removing board members, and ultimately, revoking charity status.

The CHPs this submission concerns also need to be registered in one of three regulatory regimes specifically dedicated to community housing. All three - the NRSCH, Victorian and WA systems share the same approach with relatively minor differences to cater for different jurisdictional settings. For simplicity this submission focuses on the NRSCH.

NRSCH – IN SUMMARY

Set up in 2014 it aims to ensure a well governed well managed and viable community housing sector.

Registered organisations need to demonstrate compliance against seven performance standards including financial management, government and probity.

CHPs are required to make regular returns and are assessed for compliance at a frequency and to a degree commensurate with their risk.

Registrars have information and inspection powers and a graduated range of enforcement responses. Registrars can appoint a statutory manager .

As part of being eligible for registration, CHPs must have an approved wind up clause in their constitution to ensure against loss to investors and **harm to tenants.**

Since NRSCH was established 34 small (T3) CHPs have had their registration cancelled. In all but one case this was at the request of the CHP or because they merged.

The 2018/19 Annual Report Part 1 [5] from NRSCH clearly illustrates the generally excellent performance of CHPs with a minimum of 98% compliance for each performance standards.

In addition to formal regulatory regimes, CHPs also operate under multiple contractual frameworks for the management and development of new housing.

Further the use to which it can put assets is severely constrained by state government caveats. This is far removed from the investor driven context where APRA is proposing to place CHPs. In addition, the due diligence by the finance institution lending to CHPs will invariably involve the CHP engaging with its Government partner or working through the security provided by Government (part funded) assets.

Clearly Government has put in place dedicated Regulatory Structures to protect vulnerable residents, provide assurances to private and government funders and to ensure public confidence in these important policy outcomes. We contend that APRA should give this significant weight in setting the risk weighting of our sector.

If further evidence is required the English and Scottish housing association sectors' performance is telling. While there have been a very small number of housing associations that have 'failed' both the tenants and the investors have not suffered losses. Alan Murie[6] in his history of the Housing Corporation 'Moving Homes' provides a readable synopsis of the role of regulation in managing risk and responding to governance concerns in a growing sector at a similar stage to the Australian sector that should reassure.

CHPs are well governed

The regulatory regimes have placed high expectations on CHPs' governance which has been reinforced by the requirements of lenders. Typically, CHPs have:

- Skill based Board of Directors with a mix of member nominated and independent non-executive directors exercising strategic control and setting high level policies within their Governance Charter
- Highly skilled senior executives, drawn from the private, public and industry sectors
- Effective financial, HRM and risk management policies often with dedicated Risk & Audit Committee structures and internal audit / deep dive checks and balances.

CHPs are not market cycle driven and generally rely on government subsidy to develop homes. We are not speculators - we are in the business for the long term

Most property investors are driven by capital gain. Decisions are driven largely by market cycles and personal financial circumstances.

CHPs generally develop new homes in response to funding opportunities provided by state and Federal governments – typically a capital injection such as land, an operating subsidy or tax incentive

[5] https://www.nrsch.gov.au/__data/assets/pdf_file/0005/671189/Annual-Report-2018-2019-Part-1-23072019.pdf

[6] 2008, Murie, A: Moving Home - The Housing Corporation 1964-2008, :Politicos

it can use to attract private capital. This means CHP development is subject to delivering specified outcomes and brings with it significant oversight of its progress. Contracts to develop are not awarded lightly.

The sector's mission is to deliver long term outcomes and their financial and operating model are not premised on market cycles – indeed the contracts under which they secure government funding often require them to provide the housing for very long periods if not 'in perpetuity'.

The experience of the NFP sector during the GFC illustrates the 'unriskiness' of the sector. When across parts of the world capital values fell considerably, the business model for NFP was to take the balance sheet hit and continue to service the debt from the steady and reliable income streams that they rely upon. (Often Government incomes).

Boards were not driven by the 'urgency' of the market sector but by maintaining their supply of long term social housing. Even more so at a time of need. There were no 'failures' in the UK and Europe that impacted banks and some housing associations actually entered the market to take up / build more dwellings, representing good value for their mission and contributing modestly to the stabilizing efforts of Governments.

Why does APRA's treatment of the sector matter?

In essence anything which might increase the sector's financing costs comes at a price in terms of meeting unmet community need.

Based on an estimation of additional financing costs consequent on CHPs being treated as investors, we have carried out high level modelling as set out in Appendix 1.

Our estimate of the impact of not receiving the Basel 3 exemption is 45 bps, basically the current difference between owner-occupied P&I loans and investor interest only loans at current rates. For the sector to address the unmet demand for social and affordable housing requires a significant investment of new debt and equity capital to be brought into the sector. APRA-regulated bank debt is an important component of this and a 45 bps premium in the cost of borrowing by the sector equates to up to $40 million pa in additional interest cost. The opportunity cost of this level of increased cost is up to 100 social and affordable homes pa not being built, every year.

While CHPs could it is supposed use NHFIC for their finance the continued growth of the sector will depend on a diverse range of financial institutions, alongside subsidy-gap funding by way of Government land, grants or other support and, we would suggest it is not in the Commonwealth or States policy interest to see potential negative outcomes such as:-

- The cost of capital rising and/or the availability of capital declining.
- The NHFIC increasingly positioned as **the** sector lender if other funders cannot respond adequately and innovatively to the sectors needs.

Appendix I

APRA Submission - High Level Modelling

Housing Target				Funding %		Funding ($'000)		Debt ($'000)		Funding Cost			
Type	**Number**	**Cost ($'000)**	**Total**	**Debt**	**Equity**	**Debt**	**Equity**	**NHFIC**	**Bank**	**NHFIC**	**Bank (with exemp.)**	**Bank (no exemp.)**	**Additional Cost p.a ($'000)**
Social Homes	100,000	400	40,000,000	45%	55%	18,000,000	22,000,000	18,000,000					
Affordable Homes	100,000	400	40,000,000	45%	55%	18,000,000	22,000,000	9,000,000	9,000,000	2.00%	3.00%	3.45%	**$40,500**
Total	**200,000**		**80,000,000**			**36,000,000**	**44,000,000**	**27,000,000**	**9,000,000**				

Key Assumptions

1 **Debt Funding provided as follows**

	Social	Affordable
NHFIC	100%	50%
Bank	0%	50%
Total	**100%**	**100%**

2 **Additional bank cost with loss of exemption - provided by James W (NAB)**

Principal & Interest	0.30%
Interest only	0.45%