1 April
2021

APRA: Capital Framework for ADIs

Joint Submission from the Community Housing Industry Association (CHIA), National Shelter, Homelessness Australia, 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 had a long-term critical role within Australian society and economy, addressing housing industry market failure and meeting public policy outcomes.

Ongoing access to competitive terms of capital investment are critical to the NFP community housing sector being able to deliver new homes into the future.

This document builds on the arguments made in our first submission and responds to comments made by APRA to the earlier consultation. We respectfully suggest that the specific characteristics that distinguish the community housing sector from the commercial real estate industry seem not to have been fully appreciated.

Our concern remains that APRA's capital framework proposals have a potential negative impact on the sector and its mission. APRA's proposals to take a commercial approach to risk weightings for the NFP sector does not reflect the low-risk nature of our business model or the regulatory and performance frameworks that provide significant oversight of community housing providers' operations.

We note APRA proposed to move IPRE exposures off the supervisory slotting approach and allow IRB ADIs to use internal models for this asset class. Any signalling that APRA places on the sector will be critical to how the pricing will land with banks and lending.

The sector's performance during the past year demonstrates our resilience and low risk. Unlike the private rental sector, our vacancy rates remained very low and rental incomes are robust. The vacancy rates experienced in NFP Community Housing Sector Providers are lower than private rentals in general due to the level of demand and efficiency in keeping residences occupied, which reduces risks in losses associated with vacancy periods often experienced in private rents and even in public housing. It is also a testament to the management practices of which NFP Community Housing Sector Providers are dedicated to ensuring housing options for low-income households are met to the extent possible.

APRA could take further assurance that the community housing sector has been recognised as a long term 'partner' by State and Federal Governments as well as the National Housing Finance and Investment Corporation (NHFIC). It is unlikely that the Federal government would agree to guarantee 12 year bonds if it believed there was a risk of default. Or that State Governments would be extending contracts from three to 20 years in any absence of confidence that the Community Housing Sector are financially viable long term.

Assigning the NFP sector within the more volatile and largely commercial property settings, would suggest that both the National Regulatory System for Community Housing (NRSCH) and ACNC registration do not offer protections against organisational failure. This could send an inaccurate signal to potential investors. Further, it would again be working against the policy outcomes sought by the Commonwealth and State Governments.

The implications from attributing volatile property investment characteristics to a long term, stable, and mission driven community infrastructure portfolio need to be fully thought through. We appreciate that APRA believe that there might not be any adverse consequences from the proposed treatment, but it is not clear that this will be the case.

The sector requests that APRA re -examines its current proposed classification recognising this is a regulated sector that focuses on providing long term secure homes. It is not a business model that seeks to make gains through capital gains on property investment.

Finally, the sector is growing and continues to explore additional ways in which it can provide new housing options for low to middle income earners. The availability of a broad range of well-priced finance options is critical to the success of increasing housing options for the many Australians without access to safe and secure homes.

In summary:

1. There should be no negative impact on the NFP Community Housing Sector Providers from the arrangement APRA puts in place.
2. Either a NFP Community Housing Sector Providers exemption 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 or other like sectors such as aged care. (Alongside the owner-occupiers P&I category)

Our organisations will arrange a meeting to further discuss and explain our submissions.

Context

This submission is focused entirely on the potential consequences to the registered not for profit housing industry from the current review of the capital framework for authorised deposit taking institutions.

Our response is informed by discussions with APRA officials undertaken to clarify their rationale for the treatment of lending to registered NFP Community Housing Sector Providers as synonymous with 'mum and dad' property investors rather than residential mortgage owners or other similar sectors such as aged care. 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.

From the consultations there is a view that the proposed treatment will have minimal impact on the NFP Community Housing Sector and that the larger financial institutions will have the flexibility to continue funding the industry in the same way as they have always done. While there is an increased understanding of our sector, there is risk that the capital framework within which we operate will have a potential negative impact on our industry and the supply of affordable homes.

The submission reinforces the nature of the NFP housing industry, its policy settings, regulatory environment, confidence of government and a proven track record as an economic shock absorber. There is much to be gained by recognising the industry as inherently low risk and should be treated separately from the investment property sector.

The response builds on our previous submission which was informed by a number of expert views. Griffith University Business School were instrumental in bringing together a body of research to underpin the submission. BDO and the Australian Banking Association (ABA) also provided background information on the technicalities of the capital framework and advised on the submission content. A wide range of CHPs and financial institutions have all had a significant input with modelling showing the potential impact of higher borrowing costs on the delivery of new affordable homes set out in Appendix 1.

NFP COMMUNITYHOUSING PROVIDERS

CHPs have demonstrated capacity to successfully deliver new social and affordable homes.

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.

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 Tier1 or Tier2 in the National Regulatory System for Community Housing (NRSCH) and/ or classified as Housing Associations as in Victoria and WA, 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 100,000 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 Inquiry[1] into the capacity of the affordable housing industry found the community housing sector to be a 'strong cohort of commercially-oriented and independent NFP organisations with considerable capacity for further growth'. Also pointing out that 'many small-registered providers also have the potential for modest growth'.

CHPs are regulated, required to register with the state or territory regulatory office and subjected to annual compliance assessments.

The recent NRSCH publication[2] provides a recent summary of the current financial health of the sector. It demonstrates the viability of the sector while also providing evidence that the regulators have not been 'captured' by the sector. It is also worth noting that the sector was able to manage the impact of COVID-19 without adverse effects on operations or its tenants in contrast with other sectors. This resilience is the nature of our business and who we house, but nonetheless critical in determining the risk weighting that should be attached to the sector.

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

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 ensures that, in extreme circumstances, a business is wound up without loss to tenants and investors.

Social and Affordable Housing demand on the rise

Social and Affordable housing 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 an additional 1.01 million affordable homes will be required. to meet the demand for these two groups.

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

[2] NRSCH-Snapshot-Report-Performance-Financial-2019-2020-Updated-2-November-2020-circulated-out-of-session.pdf

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

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.

CHP supported by state, territory and federal governments

The NFP community housing sector operates within a stable public policy framework that has been operational over a long period.

Over the past 40 years there has been a shift towards community housing as a policy goal of the Commonwealth and State Governments on a bi-partisan basis.

This is reinforced by the confidence of the Federal Government in our sector as future place for government and private partnerships.

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.

Over the longer term this public policy framework has been supported by Federation Agreements, such as the Commonwealth State Housing Agreement, the National Affordable Housing Agreement (NAHA) and the National Housing & Homelessness Agreement (NHHA). Dedicated “social infrastructure” such as the National Regulatory System for Community Housing (NRSCH) and the

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

National Housing Finance Investment Corporation (NHFIC) have also been legislated to support the sector's growth.

To put this into perspective, over the past two and a half years here have been three bond issues amounting to $1.6b in investment going to the sector. This shows the strong confidence in the sector as a long-term safe-haven for investment.

State Governments are extending management contracts from three to 20 years in the confidence that the Community Housing Sector are financially viable long term.

Tri-partite agreements and provisions in the regulatory systems around the requirements should an organisation be wound up are important features that protect investors and provide assurance of the position of community housing.

In Victoria in late 2020, $5.3b has been directed to deliver social housing outcomes with the NFP community housing sector to be the prime delivery vehicle.

In addition, the revenue streams are safe, long term and considered to be 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 community housing sector Providers access Commonwealth Rent Assistance. This effectively makes Government the ultimate counterparty to the financial system we operate within.

Further to this, outside of COVID social security, payments are Indexed and this flows through to the rent tenants pay to CHPs.

NFP community housing sector Providers were stress tested during COVID and the GFC with long standing international data and evidence base as being a buffer to economic shocks.

The documented experience of the sector (domestically and internationally) during 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[5] to be registered and remain registered.

ACNC compliance powers[6] include providing regulatory advice, Enforceable Undertakings, Directions, suspending or removing board members, and ultimately, revoking charity status.

CHPs also need to be registered in one of three regulatory regimes specifically dedicated to community housing. All three, NRSCH and Victorian/ WA systems, share the same approach with relatively minor

[5] https://www.acnc.gov.au/for-charities/manage-your-charity/governance-hub/governance-standards
[6] https://www.acnc.gov.au/raise-concern/regulating-charities/how-we-ensure-charities-meet-their-obligations

differences to cater for different jurisdictional settings. For simplicity, this submission focuses on the NRSCH.

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 CHPs 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.

Robust and long-standing governance

The Australian regulatory regimes have increased the requirements on CHPs to have the highest levels of governance, which has been reinforced by the requirements of lenders.

Unlike other Sectors there has not been a default and to our knowledge this has not been the case in places such as the UK where the sector has been operating at scale for many years. In Australia we have adopted many of the UK features that add to the due diligence and governance frameworks that we operate in. If further evidence is required the English and Scottish housing association sectors' performance is supportive of this position.

Some strong governance features to emphasis:

- 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.
- There is an expanding group of highly skilled senior executives, drawn from the private, public and industry sectors.
- Sophisticated financial, HRM and risk management policies often with dedicated Risk & Audit Committee structures and internal audit / deep dive checks and balances.

It is worth considering that our sector is as well governed as the aged care sector. Who have a lower risk position based on financial position and revenue streams. Whilst there are challenges for the aged care sector, our risk profile should be on a par, or lower, based on past and projected performance/ non failure, low revenue risk and no failures from our sector.

CHPs are non-speculative, not market cycle driven and government backed to develop homes to operate for the long term

Our sector is generally immune to recessionary impacts and is countercyclical to economic shocks.

Property investors are often driven by capital gain, respondent to market cycles and personal financial circumstances, our sector is better described as Profit For Purpose (PFP).

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 incentives 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 housing are not awarded lightly.

The sector's mission is to deliver long term housing 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 robustness of the sector. In the US the low-income housing sector underpinned by tax credits saw housing continue to be developed and to grow despite challenges around this crisis.

During the GFC, boards were not driven by the 'urgency' of the market 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 stabilising 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 housing need.

Based on an estimation of additional financing costs on CHPs being treated as investors, we have carried out modelling in 2019 which also considers a future lens as has been out by forecasts for the financing environment in 2023 onward (as set out in Appendix 1). The current financing and investment environment has potentially lower costs and reduced social impact loss there is still a significant impact that additional weighting would place on NFP community housing entities.

It is also worth recognising that the signalling under this Framework will impact the risk teams view of social housing. We note (as per section 6.4) APRA proposed to move IPRE exposures off the supervisory slotting approach and allow IRB ADIs to use internal models for this asset class.

Banks are currently working through their internal models to ensure the risk profile of social housing is accurately reflected which will result in a lower risk weighting for these exposures. Any signalling that APRA places on the sector will be critical to how the pricing will land with banks and lending.

The risk of could be an additional 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.

CHPs have tended to use NHFIC for their finance, however the financial eco-system for social and affordable housing and continued growth of the sector will depend on a range of financial institutions. It is not in the Commonwealth or States policy intent to see perverse and 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.
- An unintended change in the finance and investment eco-system.
- Reduced social impact investment and housing outcomes for tens of thousands of Australians.

About our Organisations

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 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 representative body of 35 leading growth 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.

Appendix I

Risk weighted modelling based on 2019 and post 2023 finance scenario.

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%