Registrar of Community Housing

5. Financial Viability

Version 2.0
Contents

1. Introduction 2
   1.1 What is financial viability? 2
   1.2 Financial Performance Report 2

2. Collecting information 3
   2.1 Information collected at registration 3
   2.2 Compliance review information requirements 4

3. Assessing viability – what we look for 4
   3.1 Assessing profitability and cash flow 4
   3.2 Assessing short-term liquidity 6
   3.3 Assessing capital structure 6
   3.4 Overall financial assessment 7

4. Further guidance and support 9

Appendix A - Glossary of terms 10
1. Introduction

1.1 What is financial viability?

Financial viability is the ability to generate sufficient income to meet operating payments, debt commitments and, where applicable, to allow growth while maintaining service levels.

Assessment of financial viability is an integrated process involving a review of an organisation’s audited financial statements, financial performance reports, business plan and other information that supports financial analysis.

The initial focus of the financial viability assessment is an organisation’s audited financial statements for the previous financial year. The results are assessed with the budget and financial projections in the business plan. The trends in actual results over a three year period are then assessed and projected forward over one to three years (depending on the registration class of the organisation).

To place these results into a broader context, the organisation’s business plan is used in order to understand their future plans as well as their perspective on the business, growth (where applicable) and risks.

The business plan will provide insights into the organisation’s resource management, growth plans (where applicable), capital structure and liquidity. The business plan provides the roadmap to guide the organisation towards its long term goals. The financial plan is a vehicle to allow the organisation to realise its long term goals.

While it is imperative to ensure that organisations do not operate with excessive levels of risk, the capacity of Class 1 and Class 2 providers to develop and increase the availability of community housing is also assessed. Therefore, in the assessment of financial performance, a view is gathered of the extent to which organisations are financially viable.

1.2 Financial Performance Report

The Registrar of Community Housing uses a financial performance report (FPR) to assess the financial viability of community housing organisations.

The FPR assists the Registrar in the statutory duty of regulating community housing organisations.

The FPR reviews organisation performance over a six year period for Classes 1 and 2 and a four year period for Classes 3 and 4 using a comprehensive suite of performance measures. Linked with the business plan, the report is a powerful tool for the assessment of organisation performance and the impact of future decisions on organisation viability.

The FPR is a Microsoft Excel document that features eight worksheets for the community housing organisations’ financial information. The contents of the FPR are:

1. Contents
2. Instructions: detailed instructions on completing the FPR and a description of financial terms used in the report
3. Cover sheet: includes space for the organisation to enter their details and the Chief Financial Officer’s or Director of Finance signature
4. Financials: seeks historical and forecast financial information
5. Ratio analysis: financial data automatically generated from data entered into the Financials worksheet
6. Trend analysis: graphs automatically generated from data entered into the Financials worksheet. Organisations must provide comment on significant or abnormal fluctuations
7. Assumptions: A set of potential assumptions about the organisation’s business such as Consumer Price Index increase and growth to be completed as required
8. Disclaimer
The Registrar’s expectations of organisations will vary, and will depend on a number of factors, including:
- whether the organisation is registered as a Class 1, 2, 3 or 4 provider
- the risks that impact on the organisation
- whether the organisation has a major development or growth program relative to its size and experience
- the range of activities undertaken by the organisation

The majority of work undertaken to assess an organisation’s financial viability is desk based via the review of documents submitted to the Registrar. The nature of the review is determined by the risk assessment of each organisation. Other documents reviewed during assessment include the business plan and management accounting information.

An organisation’s most recent FPR will be regularly reviewed.

2. Collecting information

For registration and compliance reviews, organisations are required to submit their business plan, FPR and audited financial statements, together with the auditor’s management letter and the organisation’s response, if applicable.

Organisations are first required to demonstrate financial viability during the registration process.

2.1 Information collected at registration

Copies of the past three financial year’s audited statements are collected as well as a financial performance report. The Registrar also collects information about:
- financial management and financial policies
- detailed budget for the current year
- tracking against current budget
- approach to growth and funding
- non-housing activities undertaken by an organisation

Class 1 and 2 providers are engaged in development activities, together with the financing of a proportion of this growth through external sources (such as private debt), which results in higher risk profiles than Class 3 and 4 providers. Therefore, the level of data required from Class 3 and 4 providers is less than that required from Class 1 and 2 providers.
All organisations are required to submit the FPR in electronic format.

The FPR also allows organisations to carry out self analysis of financial performance and viability.

Organisations can:

- be aware of information used for assessment and how it is used
- review ratios calculated automatically as data is entered in the template
- provide comments to assist in the interpretation of the organisation’s performance

2.2 Compliance review information requirements

Once an organisation achieves registration, financial viability is assessed periodically to ensure compliance with the Regulatory Code. This includes providing relevant records and information to the Registrar upon request and allowing the Registrar to inspect premises or records at any reasonable time. Organisations must submit audited financial statements, the business plan and a FPR to the Registrar.

In addition, details of any significant variations to an organisation’s financial policy should be provided to the Registrar as soon as possible.

3. Assessing viability – what we look for

In assessing financial viability, both short term and longer term viability are taken into account.

The financial viability of an organisation is largely assessed from information generated by the FPR. The report demonstrates an organisation’s performance over the past three years and the next three years for Classes 1 and 2. Classes 3 and 4 provide historical data for the past three years and budget information for one year only.

The FPR analyses the financial viability of the entire organisation. The Registrar needs to be confident that the organisation is financially viable and sound, and requires financial information relating to the whole organisation, not individual services.

3.1 Assessing profitability and cash flow

Longer term financial viability concerns the ability of an organisation to meet future financial obligations as they fall due.

The ultimate financial basis of viability is adequate profitability and cash generation over the asset cycle together with the management of long term debt.

Although registered organisations may be ‘not for profit’ entities, the profitability of an organisation is important from a number of perspectives, including:

- providing a ‘buffer’ against future adverse circumstances
- allowing for the long term replacement/refurbishment of housing stock
- funding growth (where applicable)

Each organisation’s profitability is affected by its environment, condition of housing stock, growth projections and client requirements.
Given the potential for significant discrepancies between accounting profit and cash flows, a provider’s cash flow is also assessed.

The analysis of cash flows is likely to provide indicators subject to greater volatility due to the impact of capital expenditure and movements in working capital. Consequently, analysis is focused on trends and average movement over a number of periods. Trends are also reviewed before and after the removal of capital grants and non-recurring items.

In analysing profitability and cash flows, the focus is on:

- **Sustainability** – the extent to which historical cash flows and profits are sustainable, and not reliant on non-recurring items or capital grants
- **Growth** – where applicable, the potential for growth and also the impact of growth on profitability and surpluses
- **Stability** – the extent to which cash flows and profits provide a stable base for growth and debt service

The assessment of profitability and cash flow ensures a provider’s operations offer sufficient resources to enable growth where applicable, replacement of assets as required and protection against adverse situations.

<table>
<thead>
<tr>
<th>Indicator type</th>
<th>Examples</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stability and growth of earnings</td>
<td>• Earnings Before Interest and Tax (EBIT)</td>
<td>Provides insight into the stability of earnings and an organisation’s ability to generate surpluses on an ongoing basis.</td>
</tr>
<tr>
<td></td>
<td>• Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Net Profit</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Return on Assets</td>
<td></td>
</tr>
<tr>
<td>Revenue and expense analysis</td>
<td>• Percentage of income from rent</td>
<td>Provides an indication of the sustainability of an organisation’s revenue and expenses.</td>
</tr>
<tr>
<td></td>
<td>• Trend analysis</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Maintenance of properties</td>
<td></td>
</tr>
<tr>
<td>Efficiency measures</td>
<td>• Housing stock owned and/or managed</td>
<td>Provides an indication of the organisation’s capacity for growth and resource utilisation.</td>
</tr>
<tr>
<td>Cash flow measures</td>
<td>• Operating cash flow</td>
<td>Analysis of operating cash flow provides an indication of the organisation’s ability to generate cash.</td>
</tr>
<tr>
<td></td>
<td>• Internal financing ratio</td>
<td></td>
</tr>
</tbody>
</table>
3.2 Assessing short term liquidity

Assessment of an organisation’s short term financial viability is based on data submitted in the FPR with the focus on whether the organisation is able to meet short term commitments as they fall due.

Organisational problems are also considered to determine whether they foreshadow financial concerns or might lead to loan covenants being breached.

<table>
<thead>
<tr>
<th>Indicator type</th>
<th>Examples</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Immediate liquidity</td>
<td>Quick ratio</td>
<td>Provides an indication of organisation’s ability to meet short term liabilities as and when they fall due.</td>
</tr>
<tr>
<td></td>
<td>Amended quick ratio</td>
<td></td>
</tr>
<tr>
<td>Short/medium term liquidity</td>
<td>Refinancing risk</td>
<td>Provides an indication of more systemic liquidity issues.</td>
</tr>
<tr>
<td></td>
<td>Net assets</td>
<td></td>
</tr>
<tr>
<td>Tenancy liquidity measures</td>
<td>Arrears</td>
<td>Provides insight into the organisation’s tenancy management.</td>
</tr>
<tr>
<td></td>
<td>Bad debts</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Vacancy/voids</td>
<td></td>
</tr>
</tbody>
</table>

3.3 Assessing capital structure

Capital structure refers to an organisation’s long term funding structure and reflects the sources of funding the organisation has utilised to acquire fixed assets.

Organisations may be funded from a number of sources including:

- external borrowings
- capital grant contributions
- donations of cash from stakeholders in the provision of affordable housing
- cash and asset contributions from parent or associated entities

Undertaking external borrowings enable an organisation to leverage the investment in community housing and potentially deliver greater growth in the level of community housing.

Increased levels of external borrowings do result in an increased level of organisation financial risk as it becomes contractually obligated to pay interest and repay debt.

The optimal level of organisation external borrowings is dependent upon the ability of an organisation to service borrowings and assets available as security to borrowers.

Analysis of an organisation’s capital structure is focused upon the:

- level and growth of external funding
- covenants placed on borrowed funds
- ability of the organisation to service external funding

Longer term viability concerns the ability of organisations to meet all future financial obligations as they fall due.

Growth for organisations typically results from the purchase of property which is supported by government capital grants, operating surplus, private finance and
contributions from philanthropic organisations. Therefore, assessment of capital structure applies primarily to Class 1 and 2 providers.

The following table summarises the indicators used to assess capital structure.

<table>
<thead>
<tr>
<th>Indicator type</th>
<th>Definition</th>
<th>Rationale</th>
</tr>
</thead>
</table>
| Debt analysis  | • Balance and growth in net interest bearing debt  
• Leverage  
• Interest coverage  
• Debt coverage  
• Cost of capital | Used to determine the extent to which an organisation is reliant on external funding. |
| Asset based    | • Balance and growth in fixed assets | Provides insight into an organisation’s growth |

3.4 Overall financial assessment

In assessing overall financial viability, the following aspects are considered:

• History and management - the traditional and future clients of the organisation, financial and management policies adopted by the organisation and the organisation’s business risks and mitigation strategies
• Operating environment - the strategic response of management to factors operating within that environment and the impact of those strategies on the scale of the operation
• Profitability - in particular looking at operating margins and financial efficiency after removing the impact of capital grants and other one-off financial impacts
• Cash flow dynamics - and an organisation’s ability to meet its financial obligations
• Capital structure and debt management

Other information that effects the determination of an organisation’s financial viability includes the organisation’s capacity to meet its financial obligations.

It is not possible to prepare a comprehensive financial analysis of an organisation, or any organisation, by focusing solely on available financial data.

Financial ratios quantify and highlight key financial relationships but have limitations. They do not explain underlying causal factors and whether such factors might improve or worsen.

Financial data is considered within the context in which the organisation operates, including the quality and experience of management, the organisation’s strategic objectives and the risks to achievement of those objectives.

Before making a final assessment, the business plan and other performance criteria are used to apply a context to financial information.
The following indicators demonstrate an organisation’s willingness and ability to provide sufficient information on which to base a financial assessment.

<table>
<thead>
<tr>
<th>Indicator type</th>
<th>Definition</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unqualified accounts</td>
<td>✷ Existence of an unqualified audit report</td>
<td>A qualified report may highlight potential concerns about an organisation’s financial management and viability. The Registrar investigates further and discusses results with the organisation and its auditor.</td>
</tr>
<tr>
<td>Timeliness of submission</td>
<td>✷ Extent to which required information is submitted in a timely fashion</td>
<td>Extended delays in submission of information may indicate issues with respect to an organisation’s financial management and solvency.</td>
</tr>
<tr>
<td>Commentary on financials</td>
<td>✷ Explanation of major variances, changes or events in most recently completed financial statement</td>
<td>Assists with the analysis of the underlying viability of an organisation and allows the Registrar to more clearly understand the organisation’s financial statements.</td>
</tr>
</tbody>
</table>
4. Further guidance and support

The Registrar of Community Housing has developed a series of publications to provide guidance and information on the new regulatory system and registration process.

All publications can be downloaded from the Publications and Forms page of the Registrar’s website www.rch.nsw.gov.au.

The website features a Financial Performance Report fact sheet and a read only version of the Financial Performance Report to help organisations familiarise themselves with the spreadsheet. The Application and Evidence Guidelines also outline the financial requirements of the Regulatory Code.

Organisations can obtain the registration resources at registration briefing sessions held prior to their scheduled registration.

For further information on registration, please contact the Registrar on:

Tel: 1800 330 940  
Fax: (02) 8741 2522  
Email: registrar@housing.nsw.gov.au

Web: www.rch.nsw.gov.au

The NSW Federation of Housing Associations, in partnership with Homelessness NSW, provides training, resources and support services to organisations applying for registration.

The support program includes:

- Workshops
- Materials and resources
- Bulletins
- Provider hotline

Information on the registration support program can be viewed on the Federation’s website http://www.communityhousing.org.au/C5_regulatory.html

To access the Federation’s registration support services, please call (02) 9281 7144. To access Homelessness NSW’s registration support services, please call (02) 9319 7111.
Appendix A - Glossary of terms

Capital Property
A property asset owned by the Land and Housing Corporation and leased by Housing NSW to a community housing organisation for them to manage and sub-let to a resident as subsidised rental housing.

Properties owned jointly in a partnership arrangement between the Land and Housing Corporation and a community housing provider are capital properties when they are sub-let to a resident as community housing.

Properties owned by the community housing organisation either solely or in a partnership arrangement with another organisation such as a local council, church organisation or another community organisation are capital properties when they are sub-let to a resident as subsidised rental housing.

Community housing
Housing provided for people on very low-to-moderate incomes that is affordable and appropriate to their diverse needs.

Community Housing Agreement/Assistance
May include, but is not limited to, funding, land, lease and partnership agreements.

Community housing provider
A body corporate delivering community housing services to tenants in NSW.

Community Housing Division
The division of Housing NSW that is responsible for the state-wide and regional administration of the community housing sector.

Community Lease
Is generally a lease, funding agreement or contract with Housing NSW (as the Land and Housing Corporation).

Co-operative
An organisation that is owned, controlled and used by their members. They are distinguished from other forms of incorporation by their participative ownership, democratic structure and use of capital for mutual rather than individual benefit. Co-operatives are registered under the Co-operatives Act 1992 (NSW).

Crisis Accommodation
Short term (less than three months) accommodation for homeless people or people who are at risk of homelessness.

Development
Refers to properties being developed or redeveloped where the development project is being managed by a community housing provider. A property is under development when funds have been committed to the development project.
Housing NSW
The agency responsible for managing the NSW Government’s housing portfolio and developing broader housing strategies, headed by the Chief Executive and reporting to the Minister for Housing.

Incorporated association
A small non-profit community-based group or club incorporated under the Associations Incorporation Act 1984 (NSW). It provides an easier and relatively inexpensive means of establishing a legal entity compared to forming a co-operative or a company.

Leasing subsidy
A subsidy paid to the community housing organisation under the terms of the Community Housing Leasing Program (CHLP) to lease properties from the private sector. The subsidy amount is the difference between costs paid to landlords (capped at the RBB median for the total portfolio) less rent charged to tenants and allowances for losses due to rental debts written off.

Program evaluation
A structured approach to evaluating the goals, processes and impacts of projects, policies and programs.

Property acquisition
A property may be acquired through Housing NSW stock transfer or provider funded acquisition.

Public housing
Dwellings owned or leased and managed by state or territory housing authorities to provide affordable rental accommodation.

Regulatory Code
The code set out in Schedule 1 of the Housing Regulation 2009 that establishes the compliance requirements for registered community housing providers in relation to their operations and provision of community housing.

Shared equity agreement
Refers to properties owned jointly in a partnership arrangement between the provider and Housing NSW.

Social housing
Government assisted housing, usually involving the provision of a subsidy, with the objective of household and community well-being. Social housing includes public, community and Aboriginal housing.

Transitional Accommodation
Short to medium term (three to 18 months) social housing available to people exiting or transitioning from crisis accommodation.
For more information, please refer to the other guides in this series:

1. The Regulatory Framework
2. The Registration Process
3. The Application and Evidence Guidelines