NSW Registrar of Community Housing

Tier 1 & 2 Performance Report 2019

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A closer look into the performance of Tier 1 and 2 community housing providers including the financial pressures, economic drivers, the housing policy and program environment and the sector's ability to respond to emerging issues.

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Registrars Overview

Under the objects of national community housing law, the NSW Registrar of Community Housing (the Registrar) seeks to reinforce the viability and diversity of the community housing Sector, protect government and tenant interests, and also induce confidence and encourage financial support for the Sector.

This performance report provides insights on the trends and patterns of NSW Tier 1 and 2 community housing providers (CHPs) for which the Registrar has regulatory coverage.

Over the last year the Registrar has implemented a targeted approach to regulatory activities with a strong focus on protecting government funding and equity by applying better practices.

A number of Campaigns targeting potential areas of emerging risk have also provided valuable insights and analysis of business operations including the viability of the Sector and pressures facing CHPs. This report brings the results of this work together, along with compliance assessment outcomes.

Registrar's key highlights of performance include:

- The Tier 1 and 2 community housing Sector is diverse and viable and will remain viable in the foreseeable future (10 years). In the Registrar's view, governments should be confident in investing in the Sector.

- Performance against most metrics is variable, the biggest change is the number of complaints received by the Registrar about CHPs increasing significantly since the last reporting period. Some of this increase is proportionate to Sector growth. Some is likely to be a natural progression of work the Registrar has completed with CHPs to make their policies and procedures more visible, clearer and accessible to tenants.

- Overall at an aggregate level, the majority of CHPs are meeting targets however decreases of performances were seen across most of the tenancy management services, rent arrears, evictions, occupancy rates and property utilisation metrics. The decrease could be attributed to a range of factors discussed in more detail in the report.

- Metrics seeing an improvement compared to the previous reporting period include improved performance of completing urgent and non- urgent repairs.

- While the Sector is currently operating viably, structural pressures exist that are working against viability incrementally over the long-term. These, combined with less-positive economic settings going forward may increase the pressure on viability. This trajectory should be monitored and considered when conducting long-term planning and developing policy setting. This report provides more detail about the pressures on CHPs.

- Cost pressures will increase for CHPs; this could erode profit margins over the long-term. Cost pressures arise due to a combination of policy and economic settings for which income is not keeping pace, and include reducing levels of subsidy and higher costs of business working with government.

- Pressures are forcing companies to diversify and commercialise which is a strength of the Sector over public housing; however, has consequences for the traditions of the not-for-profit Sector.

- From the Registrar's view, key considerations arise for government to adjust how CHPs are commissioned. Stock Transfers to the CHP Sector have drawn attention to the significant capacity of CHPs to improve tenant and asset outcomes over the public housing sector. Strong balance sheets have to date assisted most CHPs use a proportion of their profit margin on tender and contract compliance. However streamlining tender costs and contracting and oversight duplication could ease some of the pressures on CHPs over the next 5-10 years.

- In addition, the lack of certainty for CHPs operating in the national disability market has created some closer scrutiny of forward forecasts of these CHPs by the Registrar.

The NSW community housing regulatory system

The Registrar is a statutory appointment under section 10 of the *Community Housing CHPs (Adoption of National Law) Act 2012* (NSW), referred to as the National Law. The Registrar reports directly to the Minister for Department of Communities and Justice (DCJ) and registers CHPs based on guidelines set by government.

The Registrar is responsible for administering the National Regulatory System for Community Housing (NRSCH) in New South Wales (NSW). The Registrar also administers the New South Wales Local Scheme (NSWLS). The National Regulatory Code requires CHPs to be well-governed, financially viable and to perform in compliance with standards to deliver quality housing services.

The Sector we Regulate

As at 30 June 2019, the Registrar regulated 155 CHPs who managed over 47,000 properties, this included assets held in NSW and assets in other states managed by CHPs with primary jurisdiction NSW. The NSW Registrar also monitors the performance of Tasmania and Northern Territory registered CHPs on behalf of those governments Registrars. This report does not include providers or assets in Northern Territory or Tasmania nor is not reflective of performance of providers in Tasmania and Northern Territory.

As at 30 June 2019 there were:

- 22 Tier 1 CHPs
- 12 Tier 2 CHPs
- 121 Tier 3 CHPs

NSW Tier 1 and 2 registered CHPs are those operating at a larger scale of property and tenancy management. They are most often large-scale housing CHPs who have asset procurement and development functions (and the ability to grow social and affordable housing supply through construction, purchase or acquisition) and/or complex tenancy and property management functions that operate at scale.

Tier 1 and 2 CHPs account for 22% of social and affordable housing CHPs with primary jurisdiction in NSW but manage and/or own over 95% of the entire NSW community housing Sector assets.

This report contains performance data for NSW Tier 1 and 2 CHPs only.

Registration and Compliance

From 2014 (when the NRSCH commenced) to June 2019, the total number of registered CHPs has increased from 13 to 155. In earlier years of the scheme the increase can be attributed to the transition and take up of the scheme. The last two years (2017-2019) have seen the Sector grow by 10 extra CHPs.

In the last year, 13 new companies entered the scheme and five companies exited the scheme. Most of the new registrations were in the Tier 3 Sector which can be attributed to government policy and program changes and funding requirements.

The increase in CHPs has not impacted the Tier 1 and 2 Sector. There seems to be ongoing stability within the Tier 1 and 2 Sector with only two new registrations in the 1 and 2 Tiers (one in each) in the last three years and only two Tier changes; one went from a Tier 2 to a Tier 1 and another from a Tier 3 to Tier 2.

The 2018/19 financial year saw the largest number of cancellations since the inception of NRSCH; a total of six CHPs, all in the Tier 3 Sector. Five applied to have their registration cancelled for business purposes. One had their registration forcibly cancelled. (Noting this decision remains subject to appeal as at 30 June 2019).

Registered CHPs by Tier, Primary Jurisdiction NSW as at 30 June each year

Registered CHPs by Tier, Primary Jurisdiction NSW as at 30 June each year						
	FY14	FY15	FY16	FY17	FY18	FY19
Tier 1	7	17	19	20	20	22
Tier 2	5	11	11	11	11	12
Tier 3	1	100	111	114	116	121
Total	13	128	141	145	147	155

Performance of the NSW Tier 1 and 2 community housing sector

As at 30 June 2019, of the 34 Tier 1 and 2 CHPs with NSW jurisdiction, 24 had at least one completed standard compliance assessment in the reporting period 2018/19.

The Registrar conducted a total of 26 standard compliance assessments, a further seven assessments in progress at the end of the reporting period and 10 targeted assessments were completed. Of those who had a standard assessment, two CHPs had two standard compliance assessments completed and nine had at least one targeted assessment completed.

Of the total 34 CHPs, five CHPs had both a standard and targeted assessment completed, one CHP had two targeted assessments completed and three CHPs had one targeted assessment only.

The Registrar notes these CHPs are subject to other programs of intensive scrutiny and has sought to include those layers of scrutiny within the assessment process to reduce red-tape. Such scrutiny includes CHP reporting to other jurisdictions (such as ACNC and Aged Care) as well as the many layers of contract reporting levied on CHPs in NSW.

Trends in Recommendations

Trends in recommendations made by the Registrar to improve provider performance are an indication of the health of the Sector. Overall trends indicate CHPs registered under the NRSCH are very responsive to continuous improvement and invest in better practices.

Of the 24 standard compliance assessments completed in 2018/19, 19 CHPs received recommendations in their final report.

The Registrar notes that CHPs responded well to draft report recommendations. There was a total of 38 recommendations made at draft report stage across the 24 CHPs. Five CHPs addressed recommendations between draft and the final report, with a reduction of 8 recommendations overall.

Of the 24 CHPs assessed, five received no recommendations, of these, two had improvement opportunities. A total of 27 improvement opportunities were suggested across the 24 providers.

The Registrar found no improvements necessary in Performance Outcome 3 (Community Engagement), with no CHPs receiving any recommendations in this area. This is consistent with the previous financial year. Performance Outcome 6 (Management) also saw no recommendations given in this financial year.

The Performance Outcome which saw the largest number of CHPs (7) receive recommendations for 2018/19 compliance round was Performance Outcome 1 (Tenant and Housing Services). This Performance Outcome also saw the largest number of recommendations given (13). This Performance Outcome also saw the most number recommendations made in the previous reporting period 2017/18 (26 recommendations were given).

Of all CHPs who received recommendations in Performance Outcome 1, the majority received recommendations related to managing complaints, among other recommendations; indicative of the Registrar's focus on improving performance in this area (especially prior to the expansion of tenant numbers expected under the NSW social housing management transfer program). While this has been an area of continuous improvement for CHPs, the Registrar notes there is no comparable human service outcome reporting for public housing for comparative purposes. Also aligned to this expansion, the number of complaints has risen significantly from the last reporting periods (2017/18) to this year (2018/19).

Comparisons between recommendations made in the previous year can be difficult.

In 2017/18 there were 28 Tier 1 and 2 CHPs who completed a standard compliance assessment, four more than the 2018/19 financial year.

There was a total of 77 recommendations given for the 2017/18 compliance assessment round across the 28 CHPs. This is 50% reduction in the number of recommendations between the two reporting years. All Performance Outcomes saw a reduction of recommendations given, a significant improvement across the Sector.

The largest number of recommendations made were in Performance Area 1 with 26 recommendations given to 17 providers. This Performance Outcome had a 50% decrease in comparison to the number of recommendations given for the 2018/19 compliance assessment round, along with 10 less providers receiving recommendations.

In 2017/18 there were 72 improvement opportunities made across 28 CHPs, while in 2018/19 there were 27. This is a significant reduction in comparison to the previous financial year, noting there were four less providers assessed.

Improvements seen in Performance Outcomes could be attributed to a more focused and targeted effort on these Outcomes in the preceding year. For example, in 2017/18, 35% of Tier 1 and 2 CHPs were given recommendations in Performance Outcome 5 to address weaknesses around the quality of their conflict of interest (COI) policies and 11% were suggested improvement opportunities regarding a disconnect between policy and practice of COI management. These figures triggered a need to further understand current practices and to determine how best practice in COI management can be achieved in the Sector. In the 2018/19 assessment compliance round a Campaign has focused on improving those practices.

Number of recommendations by Performance Outcome 2018/19							
2018/19	PO1	PO2	PO3	PO4	PO5	PO6	PO7
Tier 1	5			4	2		
Tier 2	8	3		2	2		4
Total	13	3	0	6	4	0	4

Number of providers receiving recommendations 2018/19							
2018/19	PO1	PO2	PO3	PO4	PO5	PO6	PO7
Tier 1	4			3	1		
Tier 2	3	3		2	2		3
Total	7	3	0	5	3	0	3

Number of recommendations by Performance Outcome 2017/18							
2017/18	PO1	PO2	PO3	PO4	PO5	PO6	PO7
Tier 1	13	7		2	6	4	2
Tier 2	13	5		7	9	5	4
Total	26	12	0	9	15	9	6

Number of providers receiving recommendations 2017/18							
2017/18	PO1	PO2	PO3	PO4	PO5	PO6	PO7
Tier 1	9	5		2	5	4	2
Tier 2	8	3		3	6	3	3
Total	17	8	0	5	11	7	5

Assets

As at 30 June 2019, the Registrar regulated 155 CHPs who managed over 47,000 properties, this included assets held in NSW and assets in other states managed by CHPs with primary jurisdiction NSW. There has been an overall increase in assets regulated by the NSW Registrar over the last two years from 40,821 assets in June 2018 to 47,144 assets in June 2019, a difference of 6,323. There are around 40,600 assets located in NSW, the remainder sit across other jurisdictions.

Despite the increase (predominantly being in the Tier 1 Sector), the true growth in new units of accommodation is not reflected in these numbers. Using asset numbers to calculate the growth in new units of accommodation is unreliable and problematic, although gaining a deeper understanding at an individual CHP level helps to estimate the areas where asset numbers have changed/increased. Therefore it is estimated the true growth in the Sector is minimal, potentially around 100-200 properties.

There are a range of factors to understand the limited net increase in assets such as:

NSW Government programs such as the NSW Social Housing Management Transfers and the Social and Affordable Housing Fund (SAHF) have occurred in the Tier 1 and 2 Sectors increasing asset numbers. Although not all CHPs at the time of reporting had accounted for the increase in property numbers, it is estimated this increase is around 1600 properties since last financial year. Transfers increase properties managed by CHPs but do not lead to an increase in social housing numbers overall. A significant increase is also expected for the next financial year given transfers continue into the 2019/20 financial year. Most of these are tenanted, others are new units (under the SAHF).

The Registrar has encouraged CHPs to register at least 700 - 800 affordable housing properties that were not accounted for in the last reporting period (2017/18). Accounting for affordable housing properties can be quite confusing when overlaid with social housing properties. The Registrars are working to improve the data quality in this area and will pursue options such as issuing guidance material, validating increases in asset numbers at compliance assessments and also collecting property level data into the future.

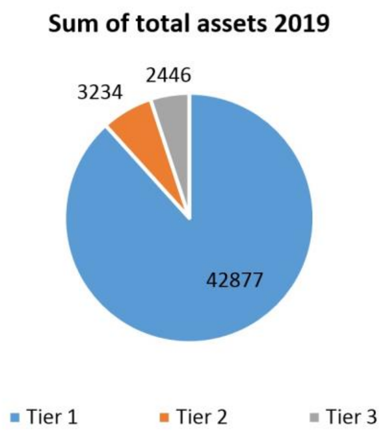
One new Tier 1 provider (managing affordable housing properties) was registered with the NSW jurisdiction who manage a large portfolio of assets (over 3,500), although most of those assets are in other jurisdictions.

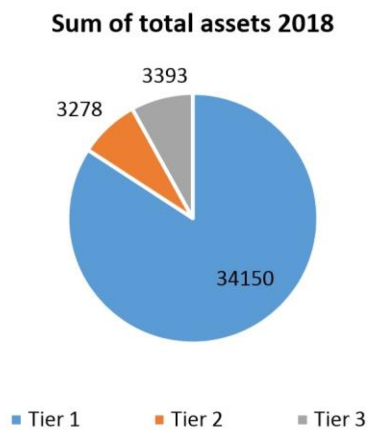
Some CHPs have increased their portfolios through development of new units.

Aboriginal housing providers are seeking registration under the current NSW strategy to transition these providers to an established regulatory regime. These providers bring existing social housing stock. For example one new Tier 2 Aboriginal provider has been registered who manage over 300 existing properties.

Tier changes can impact on asset numbers, not reflecting true growth but more a shift in where the assets are recorded, although this does not affect overall asset numbers.

Cancellations of CHPs (in the Tier 3 Sector) has seen assets shift to higher Tiers via amalgamations.





In terms of property numbers, the sector is dominated by a relatively small number of large providers. For instance, the NSW Registrar currently has registered 122 Tier 3 CHPs, however each of the top five Tier 1 providers hold more properties than all Tier 3 CHPs combined. The Registrar is working at enhancing its reporting systems so this graph, along with others, will be updated in real time on its website.

Trends in non-financial performance outcomes

Reporting against metrics varies across provider and accommodation type. The Registrar uses these margins as indicators for monitoring and not as specific measures of provider performance. The following performance data is based on 24 CHPs with a completed standard compliance assessment in the reporting period 2018/19. There are no comparative performance metrics available with non-registered Sectors within social housing such as public housing and Aboriginal housing.

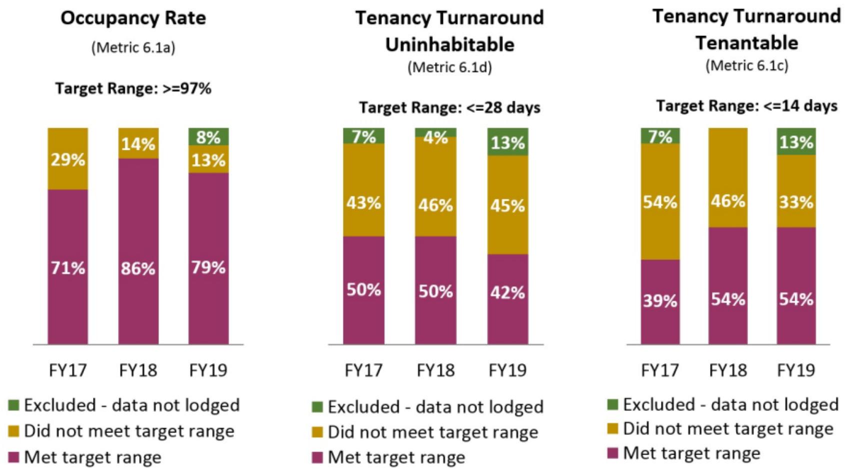
Property Utilisation

The target range for occupancy rate is greater than 75%. Of the CHPs who submitted data, 79% met the target. This is a decrease of five providers from the last reporting period.

The target range for tenancy turnaround (uninhabitable) is less than 28 days. This reporting period saw a decrease in the number of CHPs meeting the target range (42% or 10 CHPs) Last reporting period saw 50% meet the range, a change of four providers.

The target range for tenancy turnaround (tenantable) is less than 14 days. This reporting metric remained stable with the last reporting period with 54% of CHPs meeting the target.

Given this metric has historically seen adverse performance across the Tier 1 and 2 Sector, the Registrar will continue to engage with the Sector to improve data quality in reporting on this area with an aim to reducing the ambiguity of reporting targets. A Campaign was conducted in the 2017/18 compliance assessment round for Tier 1 and 2 CHPs, focusing on property utilisation metrics.



Rent Outstanding

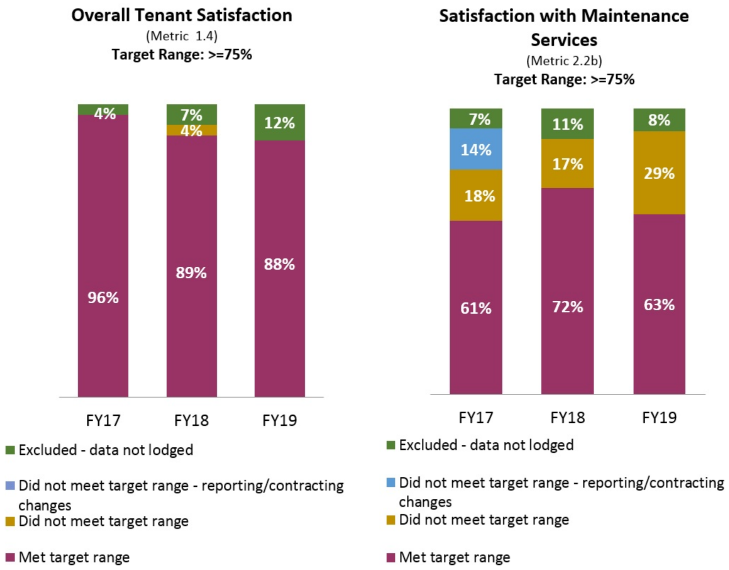
CHPs continue to perform well in relation to meeting the target range for rent outstanding (target is less than 2.5%). A total of 95% (or 23 of the 24 CHPs who completed at least one standard compliance assessment) met the target with the average of 1.09% across all Tier 1 and 2 CHPs.

Tenant satisfaction rate (metric 1.4)

The target range for overall tenancy satisfaction rate is greater than 75%. In 2018/19, of the CHPs who submitted the data for this metric (21 submitted), 100% of CHPs met this range, indicating there is a large proportion of satisfied tenants. Three CHPs did not submit the data. The average satisfaction rate across the 21 CHPs who submitted is 87.6%. [1]

The target range for satisfaction with maintenance services is greater than 75%. A total of 15 of the 22 CHPs who submitted data relating to tenant satisfaction with maintenance services met this target. The average satisfaction with maintenance rate is 79%, this remains the same as last reporting period in 2017/18.

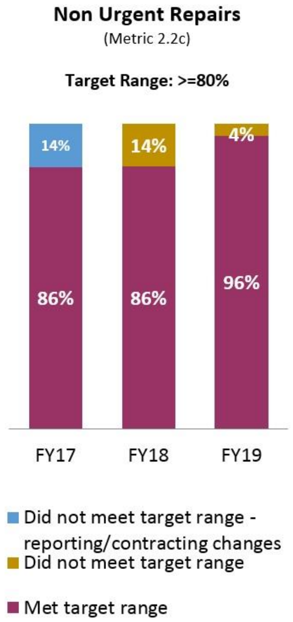
A significant increase in the NSW community housing property portfolio is expected due to government initiatives underway. Hence, it is important for the Sector and the Registrar to understand the basis for any changes and adjust performance to remedy any identified performance issues before the impacts of this expansion are felt.

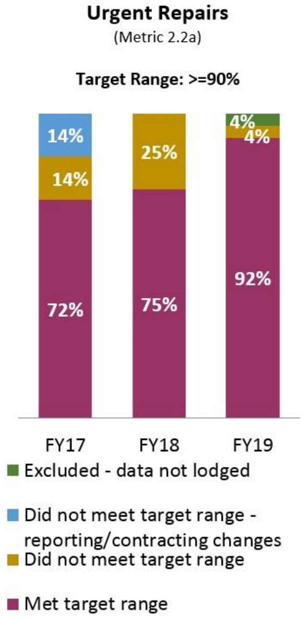


Repairs and Maintenance

In 2018/19 there was an increase in CHPs who met the target range for non-urgent repairs (target range greater than 80%) with 96% (23 of the 24) of CHPs meeting the range.

The target range for urgent repairs (target greater the 90%) saw 92% (22) of CHPs meeting the range. This is an improvement from the previous year which recorded 75% (21) of CHPs assessed meeting.



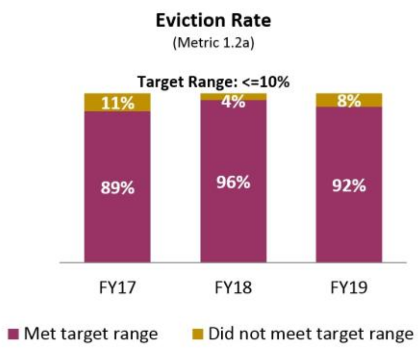


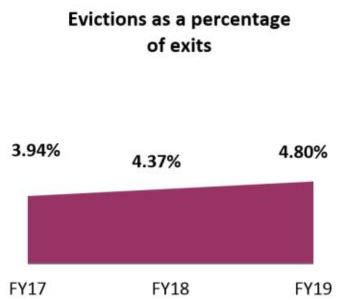
Evictions

Evictions as a portion of exits (target range less than 10%) has seen a reportable decline since the previous year. In the 2018/19 reporting period 92% (or 22 of the 24 who reported) met the range and in 2017/18, 96% of CHPs met the target range.

The average percentage of evictions across all CHPs is 4.80%, which is an increase since the previous year. Eviction rates do not coincide with the number of tenancy exits per provider. Tenancy exits for the year on average was 262. The least being a CHP with 8 exits (aged care provider) and the largest was 991 exits (a general community housing provider).

A provider who had 904 exits for the year recorded that only seven of those were evictions (or 0.7% of all exits) whilst another provider had 991 exits and recorded 89 as evictions (9% of all exits). Variances can vary markedly based on the level of holdings of affordable housing stock; which often has different eviction triggers.





Complaints

The number of complaints received by the Registrar has increased over the past two years with the steady expansion of the Sector (especially with social housing management transfers).

In 2017/18 a total of 85 complaints were received, whilst in 2018/19 153 complaints were received. This rise is commensurate with the Registrars 2017 forecast of such an increase.

The increase can be attributed to a number of factors including:

Visibility of policies and procedures Campaign – clearer definitions of the circumstances under which tenants can make a complaint and/or appeal has driven the increase in tenants complaining, and in addition circumstances under which CHPs would make appealable decisions.

Social Housing Management Transfer (SHMT) Program – For the 10 CHPs involved in management transfers, total complaints to the registrar increased from 33 complaints in 2017/18 to 82 complaints in 2018/19. As part of the SHMT Campaign, the Registrars engagement with CHPs involved in the program has identified a number of program design issues which have manifested requiring further consideration, ongoing monitoring and reporting. Early indicators show that there may be regulatory implications for CHPs and the Registrar, including additional resources required to report and monitor compliance, given CHP's performance will likely decline initially following transfers as they absorb the costs of public housing in repairs and utilisation, impacting rent and complaints.

Other performance metrics

The number of governing body meetings held in the year to 30 June 2017/18 on average was 10 per provider and in 2018/19 the average was also 10. Of the 24 CHPs assessed 14 paid sitting fees while nine others did not (one provider did not provide data). Most CHPs who pay sitting fees are substantially larger than those that don't.

Four had governing body members who are tenants of the provider.

The largest number of tenant positions for a governing body was four. This has remained the same since the last reporting period. The Registrar conducted a Campaign into the Membership arrangements of CHPs as part of the 2018/19 compliance assessment rounds.

Financial Performance of the Sector

Tier 1 and 2 financial performance trends

The NSW Tier 1 and 2 Sector is diverse in terms of both its primary business type and financial size. The total asset value outlined in this section of the report captures the entire NSW Tier 1 and 2 Sector; it includes 34 CHPs and uses their most current and previous submitted financial performance reports.

The NSW Tier 1 and 2 Sector is assessed as financially viable with no significant compliance concerns identified.

Combined profit as measured by Operating EBITDA[2] (Earnings Before Interest, Tax, Depreciation and Amortization) was $171.03 million and Operating Income was $ 2.43 billion, translating Operating EBITDA Margin of 7.04%.

Overall the amount of interest bearing debt for the NSW Tier 1 and 2 Sector remains small compared to value of total assets of CHPs considered. Total aggregate debt valued at approximately $495 million with total assets valued at approximately $9.9 billion translating to a Sector gearing ratio of approximately 4.96%.

The majority of Performance Outcome 7: Financial Viability recommendations made by the Registrar to Tier 1 and 2 CHPs since 2014 have been administrative in nature and did not reflect provider performance.

One of the financial income pressures for the Tier 1 and 2 Sector is the future of NRAS incentives. The Registrar can clearly identify (through compliance assessment data submitted by CHPs) that the downward trend of NRAS incentives is gradual from forecast year 2020 to 2026, then the incentive drops considerably.

For those CHPs who receive NRAS incentives, whilst the incentive drops dramatically post cessation, they are forecasting an increase in operating EBITDA in terms of dollar value. Operating EBITDA margin remains stable at 11-12% for most of the forecast years and interest cover ratio is above 3 times in all except one forecast year.

This means that CHPs are anticipating replacing the loss of NRAS funding by diversifying operational activities and generating other income streams. Net operating cash-flows are also expected to increase across the 10-year forecast.

Based on the data and this analysis, the downward trend of NRAS incentive does not seem to threaten the viability of the community housing Sector. However the cessation of NRAS is likely to impact affordable housing stock with some rent adjustments to market rates expected.

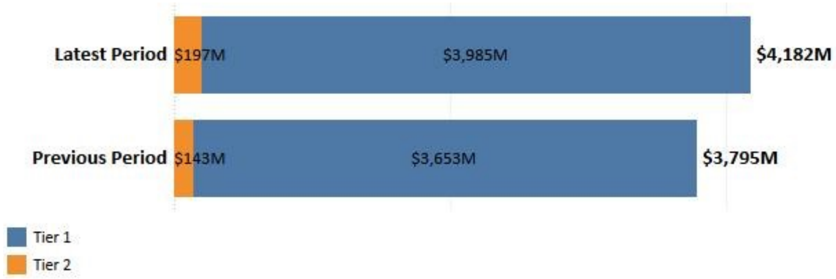
As part of the planned enhancements to reporting systems the Registrar will consider in greater detail the financial assumptions provided by CHPs. Additional guidance may be provided to ensure future financial trends are accurately reported.

Financial Performance of the Sector

The following two graphs (Total Assets and Housing Assets) break down balance sheet values for the latest and previous financial periods by Tier. Overall both graphs show a comparable increase across financial periods but there is a significant difference between Tiers.

In Total Assets the proportion between Tiers is roughly equal however for Tier 2 CHPs the majority of their balance sheet assets are related to non-community housing operations such as aged care.

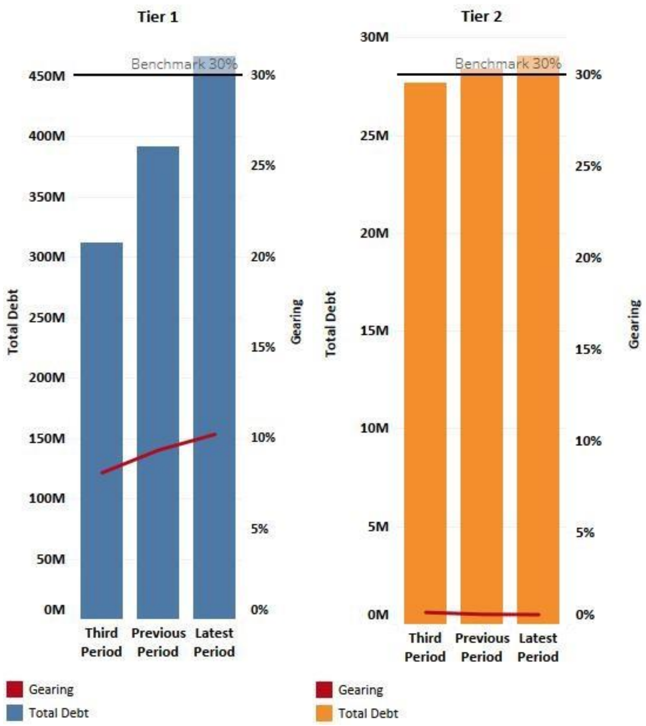
This is shown in the Housing Assets graph with over 95% of housing assets as measured by dollar value managed by Tier 1 CHPs.



When viewed in light of total assets (beyond just housing and assets) in the graph above, Tier 2 CHPs appear much larger due to the skewing effect of several very large Aged Care CHPs in the Tier 2 Sector. This is expected to change in the coming periods due to a significant proportion of SAHF properties expected to be constructed by Tier 2 CHPs.

Debt versus Gearing

These graphs compare by Tier the overall dollar value of interest bearing debt to the level of gearing. The line at the top of the graphs represent the NRSCH benchmark for gearing. As shown below while debt levels are increasing, the gearing ratio, particularly for Tier 2 CHPs remain modest. This indicates the Tier 2 Sector has the capacity to absorb additional levels of debt sustainably.

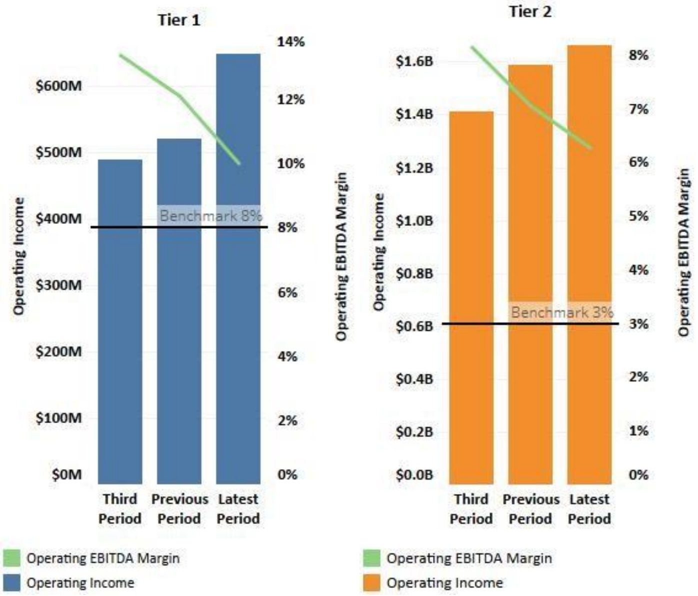


These measures will be a focus for the Registrar in coming periods as debt levels are expected to increase, in part due to government programs such as SAHF and NHFIC.

Income versus Profitability

These graphs compare by Tier the overall dollar value of operating income to profitability as measured by the Operating EBITDA Margin. The line at the top of the graphs represent the NRSCH benchmark for profitability which is set at 8% and 3% for Tiers 1 and 2 respectively.

These graphs show that while operating income has increased, profitability has declined. However these movements are not a compliance concern. Profitability is comfortably above benchmark and the declines for both Tiers are due to one off factors which may not affect subsequent periods.



The Registrar will closely monitor these metrics in the coming periods to see how the sectors profitability is affected by government programs in particular the impact of the SHMT.

Campaign Outcomes

An evolving Sector - positive practices, changing behaviours and improvements

Repairs and Maintenance Satisfaction

In 2017, the Registrar identified in its Annual Statement of Performance Report a dip in performance in Tier 1 and Tier 2 CHPs repairs and maintenance reporting. As a result, the Registrar conducted the Repairs and Maintenance (R&M) Campaign in 2018. The scope of the Campaign was largely preventative and targeted improved understanding to inform any potential/emerging weaknesses. The Campaign included advising CHPs of the identified dip in performance; engaging the Sector to form guidance on the Registrar's expectations; a deeper analysis of all Tier 1 and 2 provider performance; engaging CHPs in risk identification and treatment and reviewing individual provider treatment plans. A follow-up report was recently conducted, to review the findings and re-assess performance in this area post Campaign.

Overall, Tier 1 and Tier 2 CHPs who received recommendations and improvement suggestions during the 2017/18 compliance assessment sufficiently satisfied the Registrar's requirements. The Campaign was a positive influence on the Sector, the Registrar's previous recommendations were sufficiently addressed with some notable improvements on CHP's behaviour. The Sector has shown improvement in performance and meeting thresholds when compared to the previous reporting year. A small group of CHPs saw decreasing performance. Some declines in performance above the threshold were also noted but still related to strong results. A few CHPs' results stayed the same as previous years.

The Registrar is aware that performance in this area may be negatively impacted as a result of asset transfers to those CHPs selected under the Social Housing Management Transfer program. In response, the Registrar has initiated a Campaign to monitor performance specific to those CHPs, with a particular focus on the potential decline in areas such as responsiveness, satisfaction rates, and viability where properties do not meet anticipated standards, or costs associated with repairs on transfer exceed budgeted allowances. Initial indications from the Campaign are that a decline in repair and maintenance performance of several large CHPs due to imposed constraints on their systems is likely in the next reporting year and will continue through the following year. This decline is likely to be of a size that is visible in national reporting data.

The Registrar is also working with other Registrars to consider broader improvements on recording CHPs asset level data that could assist in reporting and separating assets/programs where the CHPs have no set repairs responsibilities.

Conflict of Interest

In the 2017/18 compliance round, the Registrar noted an increase in recommendations and improvement opportunities around the quality of COI policies and some disconnect between policy and operational practice. Given the recent Royal Commission into Misconduct in the Financial Services Industry and its commentary on the importance and impact of having a robust COI management system, the Registrar thought it necessary to evaluate current COI practice and management in the community housing Sector.

The Campaign found all participating CHPs have a COI policy and procedure, however, the quality of documentation and its integration into operations differ and can be categorised into two distinct groups.

Some CHPs have adequate COI management systems that are well imbedded into the organisation's culture and relevant policies are comprehensive and the practice of policies can be clearly demonstrated at all levels of operations. Or alternatively some CHPs have difficulties in demonstrating a practice of their policies and the COI policy is general in its guidance, often lacking clear definitions of actual, potential and perceived COI and the recording document lacks management strategies.

The reason for such a division within the Sector can be attributed to the following,

- a CHPs' maturity around COI management and consequent knowledge of risks around COI malpractice that is relevant to their business

- a historical regulatory approach that relies on a self-reporting system in conjunction and needs to heighten skills in assessing culture and COI management

The Registrar will continue to engage with CHPs to offer consistent and clear guidance around better identifying indicators of potential non-compliance within an increasingly complex Sector.

The report details key findings around the conduct and culture in the community housing Sector and the link between regulation and COI management.

Memberships of CHPs

The Registrar undertook investigations after previous compliance rounds indicated differing membership arrangements for some CHPs. It was identified that a possible shift in membership base could have impacts on the sustainability and viability of organisations. Appropriate governance arrangements and ensuring that CHPs are well governed to support the aims and intended outcomes of the business is a requirement under the NRSCH.

The NSW Registrar targeted this area of performance across all Tier 1 and 2 CHPs in NSW as part of their annual compliance assessment. The Registrar found no evidence of a drastic shift in membership base of Tier 1 and 2 CHPs, although has identified some areas of positive practice and other considerations that CHPs may take into account based on the scale and scope of their business operations.

Property Utilisation

A Campaign was conducted in the 2017/18 compliance round to address concerns identified by the Registrar over the quality of property utilisation metrics reported as part the NRSCH compliance assessment process. The Campaign led to interaction with individual CHPs on a range of measures to improve the quality of utilisation data. The Registrar used the Campaign to initially test the quality of property utilisation data in the 2017/18 compliance period.

In the 2018/19 compliance period, data was retested to assess if the quality of data had improved. Along with other findings, the Campaign supported the need for the Registrars' to collect property utilisation data at the individual property level, that more research is required and that enhancements need to be made to the Registrar's analytical systems.

The National Rental Affordability Scheme

The Registrars have been monitoring how CHPs are making appropriate provisions/plans to prepare for the winding down of the National Rental Affordability Scheme (NRAS) incentives as part of their ongoing Compliance Return process under the NRSCH.

This paper is designed to support analysts and the regulator to adjust regulatory activities and monitor any impacts the cessation of the NRAS program may have. The paper provides guidance around how the regulator may respond to CHP behaviours and sets the direction for any further monitoring work focused on NRAS.

Viability of the Sector

How do we assure viability? Facilitating government investment in community housing - protecting the investment

The community housing Sector has been the subject of a number of reviews over recent years which address such issues as the application of economic parameters and settings to social benefit. These include the NSW Independent Pricing and Regulatory Authority (IPART) 'Review of rent models for social and affordable housing', and the Australian Government Productivity Commission 'Report on Government Services.

The Sector has undergone significant and sustained policy change. These changes have occurred structurally, through the size and shape of the Sector; programmatically through new and adapted programs; and through policy changes in Commonwealth and State governments. Further change has come from broader economic conditions.

The community housing Sector is facing increasing complexity with regard to both the operating environment in which they are working and the operational complexities required of their businesses. Client needs are becoming more complex, service delivery expectations are increasing, and reporting and compliance requirements are growing. A large proportion of CHPs are also focusing on diversification as a means of responding to the reliance on low-growth, government-linked income sources. This has not only introduced an increasing range of challenges and requirements but has led to increased pressure on costs.

The Registrar recently commissioned an analysis of the viability of the Tier 1 and 2 NSW Sector; part of the process involved isolating several expenditure and income pressures, identifying core drivers, and conducting sensitivity analysis to consider possible future scenarios.

It was found there are several strategic and economic factors that are clearly acting on the Sector and although while providing some pressure, they have also collectively been set optimally for some time, as is the case in the broader economy. Existing pressures have a significant impact on the Sector and should be understood, monitored and their effects considered in a regulatory and policy context in years to come.

From an operating perspective, the Sector is forecasting continued and growing profitability. However taking into account interest and depreciation, while profitability is forecast to continue, it will do so at a declining rate as interest expense obligations grow and depreciation increases from growing portfolio sizes. Considering only housing related segments of CHP's (i.e. excluding areas of business such as aged care), profitability is also anticipated to continue from an operating perspective.

Reflected in continued positive earnings, CHPs are forecasting that total income from housing related businesses will continue to be greater than total expenses. CHPs are forecasting that rent will form a larger portion of total revenue over the forecast period, with declines in capital grants and NRAS (as the scheme winds up). Property expenses are forecast to reduce in proportion of total expenses, while employee expenses are forecast to increase.

The analysis also showed that CHPs receiving transferred units as part of the Social Housing Management Transfers are forecasting lower profit margins than those not receiving transfers, however greater growth rates. By the end of the forecast period, profitability for the two CHP types generally equalises.

Pressures impacting CHP profit margins over time

The pressures noted above arise from a combination of policy and economic settings, and include:

- Rents/Subsidies - The end of NRAS and the general escalation rates of income streams smaller than the growth in costs of inputs (e.g. Commonwealth Rent Assistance and community housing rent).

- Maintenance costs and issues such as:

    - Costs are increasing faster than the income streams that offset them (especially in company projections where they are involved in the social housing management transfer).

    - Short term lease structures de-incentivise preventative maintenance, costing more over time.

- Employee related costs including:

    - Complexity of front-line staff mix required for service coordination (especially with increased expectations for the provision of 'wrap-around' services and for additional layers of reporting for the SHMT).

    - Executive and management staff required to operationalise more complex business models.

    - Corporate overhead costs, including: processes and systems, tenders, project management teams, joint venture costs, legal costs, data, reporting, compliance and monitoring.

- Strategic pressures such as:

    - Economic conditions have been largely optimal for a sustained period. It is unlikely that these will remain in place over coming years.

    - Costs of capital are likely to increase which will have a greater impact due to increased diversification thorough borrowing and development. While the national bond aggregator will assist through discounting rates against the market, the underlying market rates will likely increase in the medium term.

    - Asset value growth rates are likely to be lower which results in less flexibility of strategy.

    - The flexibility of asset control and the ability to align the characteristics of the stock to the characteristics of the clients is a key efficiency mechanism for future planning.

    - Strategic business systems are required to be more complex and thus require more investment up-front and potentially in maintenance.

Two potential negative consequences arise from these pressures over time that require ongoing monitoring, as well as innovation in policy and regulatory responses over the long term. These potential negative futures include:

- The combination of these pressures and likely shifts in the housing markets in NSW reducing the collective/Sectoral viability over the long term.

- The need for businesses to diversify to mitigate these pressures generates additional commercialisation risks on the Sector.

Sensitivity Analysis

To this point the Sector has been able to deal with pressures through diversification with increasing maturity of commercial elements. The Sector has strong balance sheets indicating a systemic level of capital.

Analysis of the Sector's 10-year forward projections has enabled the Registrar to isolate and identify key factors impacting viability. Targeted engagement (through self-reported survey data from CHPs) has assisted the Registrar to further develop and test key themes. It is clear the Sector is sensitive to movements in these pressures over the long term.

To quantify the level of sensitivity, analysis was undertaken by changing the average percentage growth rate by 1% to 2.5% (-% for income drivers and +% for expense drivers) between forecasts 2018 and 2027 for the key drivers.

The sensitivity analysis showed that the biggest impacts on the Sectors financial viability occur in small declines in assumed rental growth and assumed property expenses. This sensitivity analysis has significance for the design of any new housing programs in NSW and also the management of the current social housing management transfer.

Looking Forward

How do we respond to pressures as a Sector?

Confidence in the Sector to deliver outcomes for government not achievable by public housing remains well-founded. CHPs are on the whole, well-performing and viable activities that actively support and connect their tenants to improved outcomes. Similarly, assets are more rigorously maintained and utilised than other comparative Sectors.

This analysis supports the Registrar's continued focus on assisting departmental stewardship and commissioning to reduce unnecessary costs and red tape on business which reduce the supports available for the disadvantaged. The acquisition of new sources of validation data is necessary as CHPs continue to diversify in the face of reducing subsidies and grants.

Opportunity also exists to improve national comparability and analysis of activity, trends and monitoring, as well as recognition of emerging or growing pressures. Combining this with some of the data capture and uniformity suggestions above would also provide a very strong basis for a national benchmarking regime.