CEHL
Common Equity Housing Ltd
More Than Just Housing

Program Revenue and Costs Background Information

Paper Two: Costs

1. Introduction

The recently established Program Principles highlight the aspects members believe are most important and must be reflected in all future Program decision making. Changing circumstance and funding arrangements require us to tackle some challenging Program questions, and it's important that Program members have access to information and analysis, to enable them to participate in these critical Program discussions and develop Program responses that represent an appropriate balance of Program Principles.

This paper provides information and analysis about current Program costs and considers the impact of changes to the cost structure on Program viability.

This is the second of two papers on Program revenue and costs that aim to provide co-ops with information necessary for them to participate in important discussions about Program viability into the future. The first paper focussed on current Program revenue and, similarly, considered this against relevant benchmarks and modelled the implications of specific revenue measures.

The papers will inform a series of future work, including:

- A review of the adequacy and equity of the current rent model
- Development of service level standards
- Property portfolio growth and management

The rent model review will be the first of these projects and will involve deep engagement with co-ops and members. Further information on the review will be provided at the 2017 CEHL Conference on Friday, 18 August.

2. Context

The costs of running our Co-op Housing Program add up to one 'total Program cost pie', regardless of how they are divided between CEHL and co-ops. In considering the long-term viability of our Program, analysis in this paper will consider costs for the Program as a whole, rather than break them down between CEHL and co-ops.

It is important to highlight that the ability of the Program to influence its costs varies according to the specific cost. For some costs, such as the market cost of housing or council rates, there is nothing the Program can do to materially alter them. For other costs, such as maintenance and service levels / resourcing, decisions made by the Program can have a significant positive or negative effect.

The table, below, sets out key Program costs and, for each, the Program ability to influence them:

Cost	Program ability to influence
Market cost of housing	None
Council rates	None
Interest payments	Low
Insurance	Low
Maintenance	High
Service levels / resourcing	High
Vacancy costs	High

This paper focusses analysis on those costs the Program has capacity to influence.

In considering our Program costs, it is worth noting that some of our costs relate to aspects that are unique to our Program, including:

- **Our co-op housing model**, which features a shared maintenance model, a strong emphasis on co-op resource and development and a range of cross-agency compliance and reporting requirements.
- **Our member-based structure**, which requires resourcing and expenditure on Program development and engagement.

Other cost considerations that, while not unique to our Program, are still important to note in the analysis include:

- **Our geographical spread**; in excess of 2,100 properties stretching from Mallacoota to Mildura.
- **Ageing tenant members**; current average age of 57 that is projected to continue to rise. Continued ageing of Program membership has the potential to result in an increase in costs associated with minor property modifications and the need for liaison with appropriate aged care services.
- **Social housing obligations**; a commitment to provide a subsidy to eligible households and to report on this, stemming from being the recipient of a community investment in affordable housing.

3. Assumptions

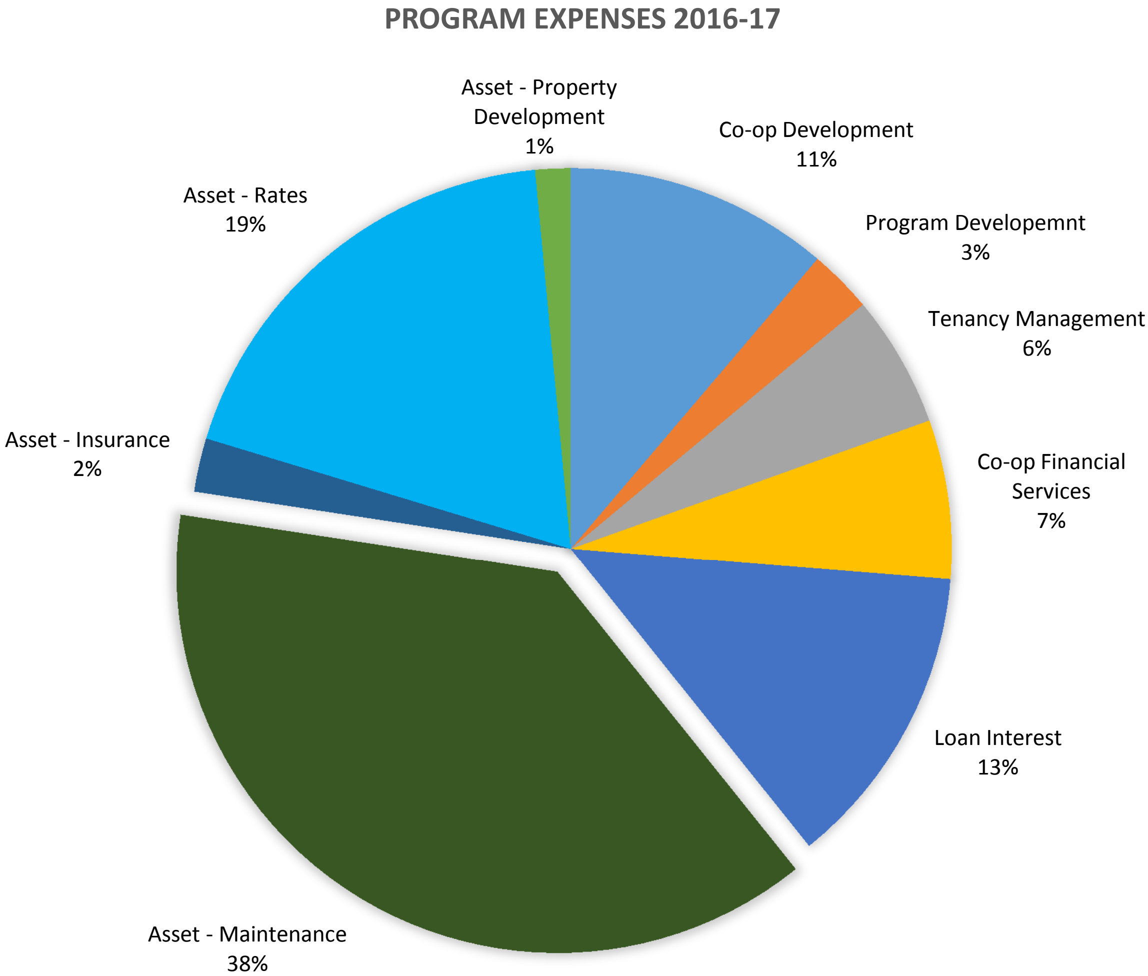
The data that forms the basis of the analysis in this paper is approximate only. Where data is not available, a reasonable estimate is used.

All scenario modelling takes into account all relevant Housing Registrar, corporation, tax and charitable status requirements.

Due to the focus on long-term Program viability, analysis in this paper will focus on ongoing costs and not include any one-off Program costs. This is consistent with the revenue paper, which excluded revenue that was not ongoing.

4. Total Program expenditure

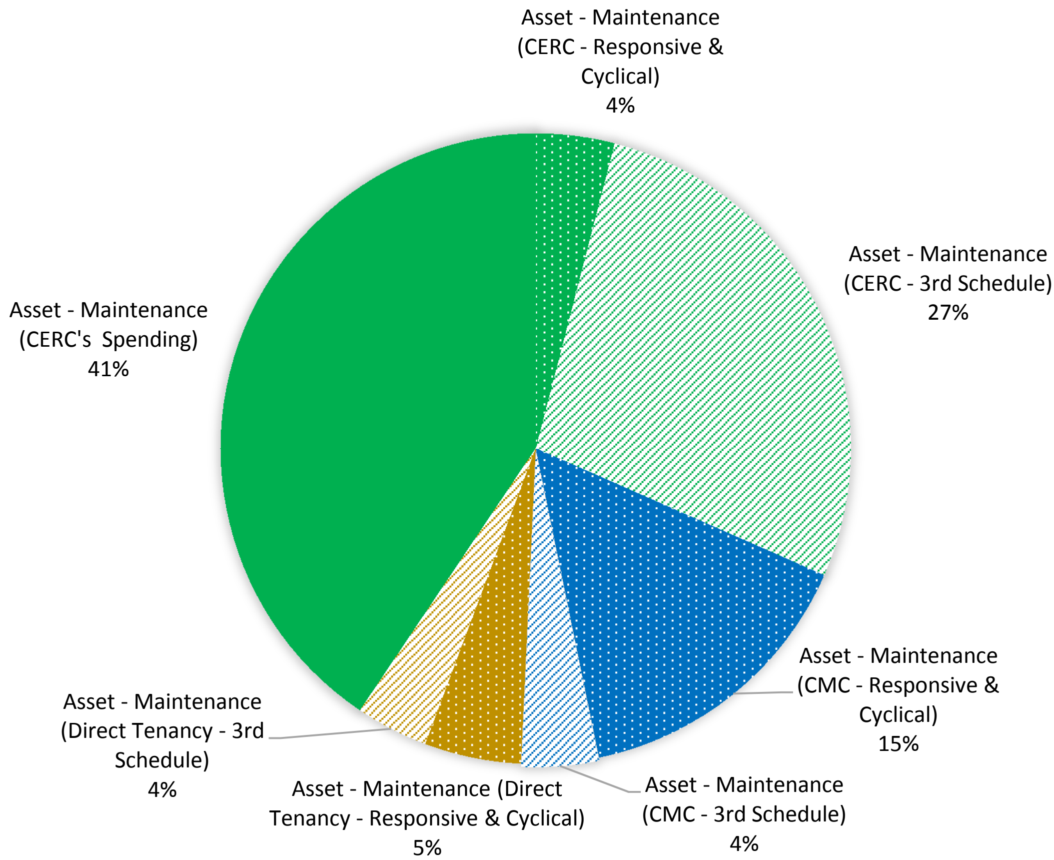
The graph below shows total Program expenditure for 2016-17:



The chart indicates that the biggest areas of expense for the Program relate to asset maintenance (38%), rates (19%) and loan interest (13%).

Of the total maintenance spend, the chart below breaks this down into its component parts:

BREAKDOWN OF ASSET - MAINTENANCE EXPENSES 2016-17



The chart indicates that, of the 38% total asset maintenance expenditure:

- 41% represents maintenance spend by CERCs
- 4% represents CEHL's support to the CERCs in delivering responsive and cyclical maintenance
- 27% represents CEHL's 3rd schedule maintenance spend for CERCs
- 15% represents CEHL's spend on responsive and cyclical maintenance for CMCs
- 4% represents CEHL's 3rd schedule maintenance spend for CMCs
- 5% represents CEHL's spend on responsive and cyclical maintenance for direct tenancies
- 4% represents CEHL's 3rd schedule maintenance spend for direct tenancies.

Cost reduction strategies

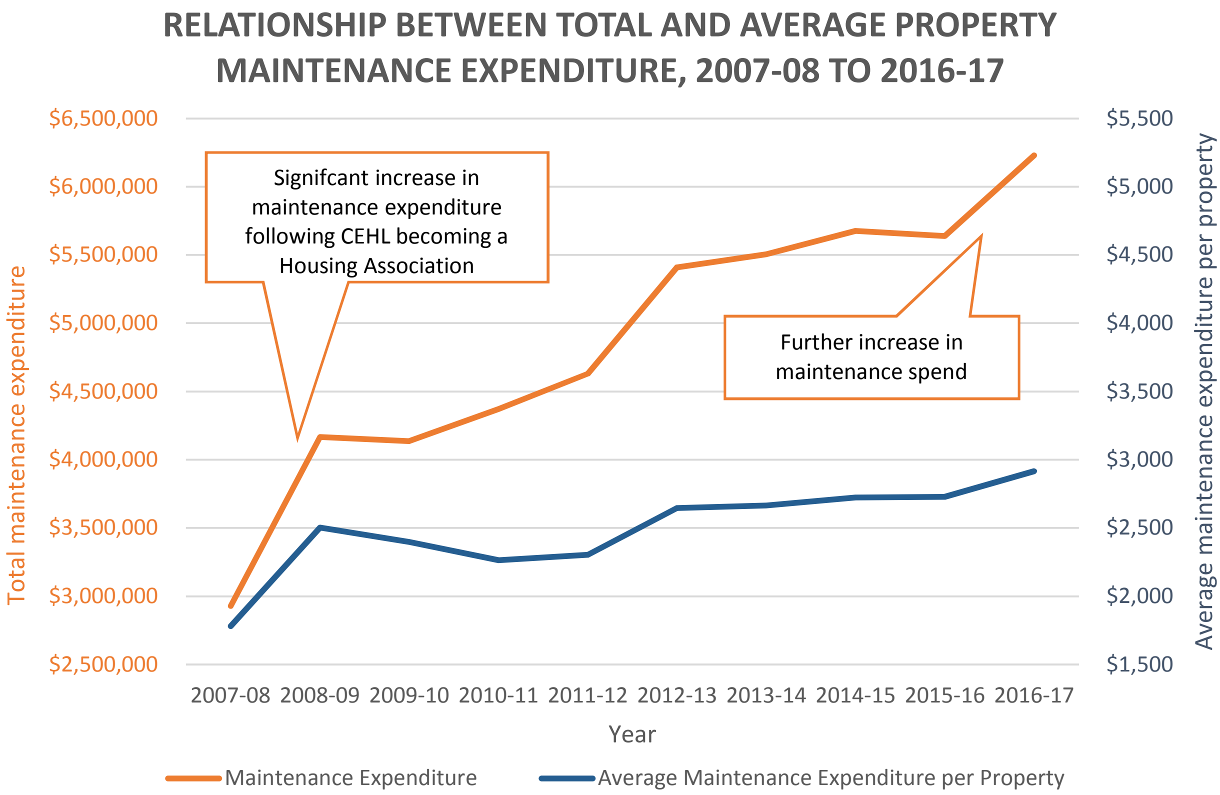
Since 2014, when the interest expense on the Program's core debt was in excess of $4m, substantial debt restructuring has been undertaken to halve the cost of finance down to its current level of around $2m per annum (2018 Budget).

Cost savings have also occurred across wide areas of CEHL's operations, including reducing the motor vehicle fleet by 30% and overall vehicle fleet operating costs by 50%.

These operational cost savings have been invested into additional maintenance spend (including additional employees to support this) and the focus on program development. Over the next few years operational cost pressure will remain, particularly in the area of employment costs due to legislated wage increases in the community sector.

Discussion in the revenue paper highlighted the revenue received through 'fee for service' offerings. Initial analysis indicates that the cost of providing these services currently exceeds the revenue they bring in. CEHL will undertake further analysis to accurately assess 'fee for service' costs and identify relevant benchmarks to compare CEHL costs to.

Maintenance expenditure



The graph above shows the relationship between total and average property maintenance expenditure for the period 2007-08 to 2016-17.

The graph demonstrates a 113% increase in total Program maintenance expenditure over the 10 year period.

For maintenance expenditure per property, the figures represented are an average only. Actual annual spend per property will always vary according to age, condition, and a number of other factors. Some costs occur regularly and predictably, while others occur in peaks where expensive components come to the end of their useful life (e.g., a hot water service) or where several components require replacing at one time (e.g., a major upgrade). CEHL uses an averaged baseline budget, such as the maintenance cost data provided in FDP information packs, to guide annual maintenance planning and budgeting. Recent strategy and system upgrades will provide a more accurate understanding of the current and ongoing maintenance needs specific to the program's property portfolio in the future.

Despite the increase in maintenance expenditure within the Program, there is still an ongoing maintenance underspend compared with the community housing sector benchmark. This is represented in the table below:

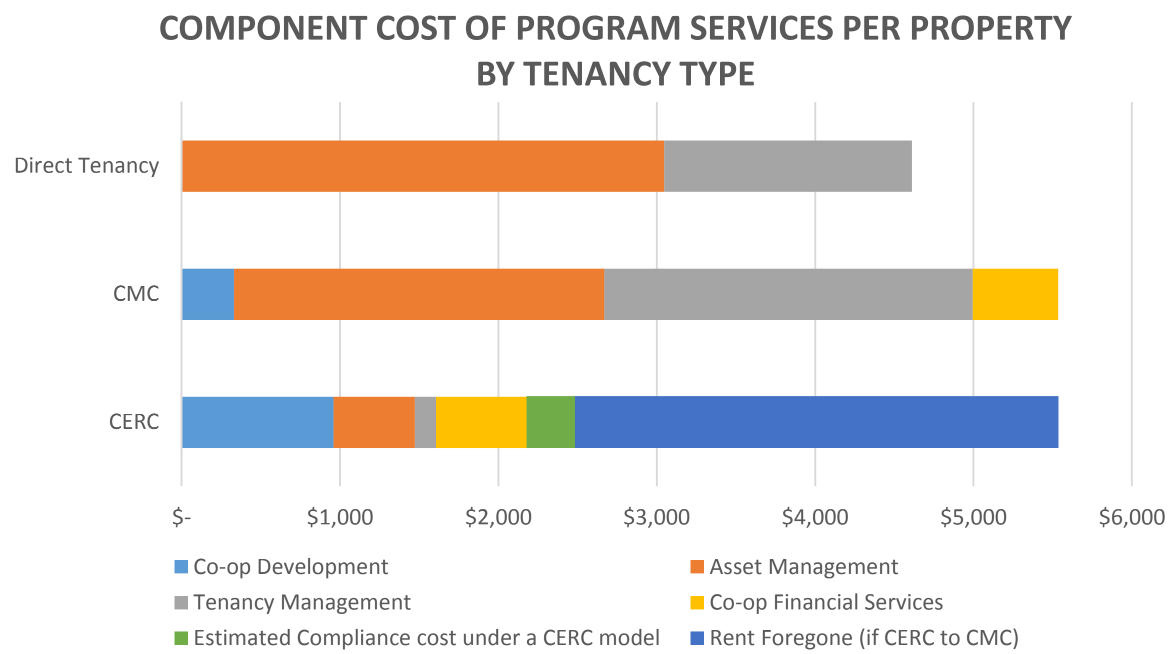
	Sector benchmark	CERC	CMC	Direct tenancy
Average maintenance spend per property per year	$4,000	$3,172	$2,109	2,736

The table shows that across all Program tenancy types, the average maintenance spend falls short of the sector benchmark. Furthermore, it is likely that revenue and cost pressures on the sector mean that the benchmark figure may itself not represent an adequate spend per property.

In thinking about our ongoing viability, the Program needs to consider how to build in and sustain an appropriate ongoing maintenance spend. Separately, the Program will ascertain the size of the historical maintenance underspend and develop approaches to address this through its asset management strategy.

5. Co-op Housing Program Delivery

As noted in section two, the co-op housing model is a unique feature of our Program. Delivering housing outcomes using a co-op housing model has a range of benefits both to individuals and communities that aren't clearly reflected in a cost analysis. The analysis that follows is focussed on those components that are able to be quantified and compared.



The chart above compares the current cost of the Program service delivery per property by tenancy type. It demonstrates that, when the cost of the rent discount and CEHL resourcing and compliance oversight are factored into the CERC model, the cost to the Program of the CERC and CMC models is approximately equivalent.

However, it should be noted that with Program growth, this delivery cost per property cost is likely to reduce under a CMC model, as economies of scale are harnessed. A similar reduction is not anticipated under the CERC model, as the service delivery structure will result in an increasing number of small co-ops which cannot harness economies of scale and each requiring resourcing and support.

The chart also demonstrates that both co-op models are more expensive than direct tenancy, due to the costs associated with co-op development and support.

Service levels / resourcing

While the above graph shows the average Program delivery cost per property based on the tenancy model, the Program does not currently make a distinction between co-ops that require a significant level of support and those that require a relatively lower level. For example, a co-op experiencing particular issues in relation to tenancy management or governance may require a deeper level of development and support than a co-op which is, comparatively, functioning well.

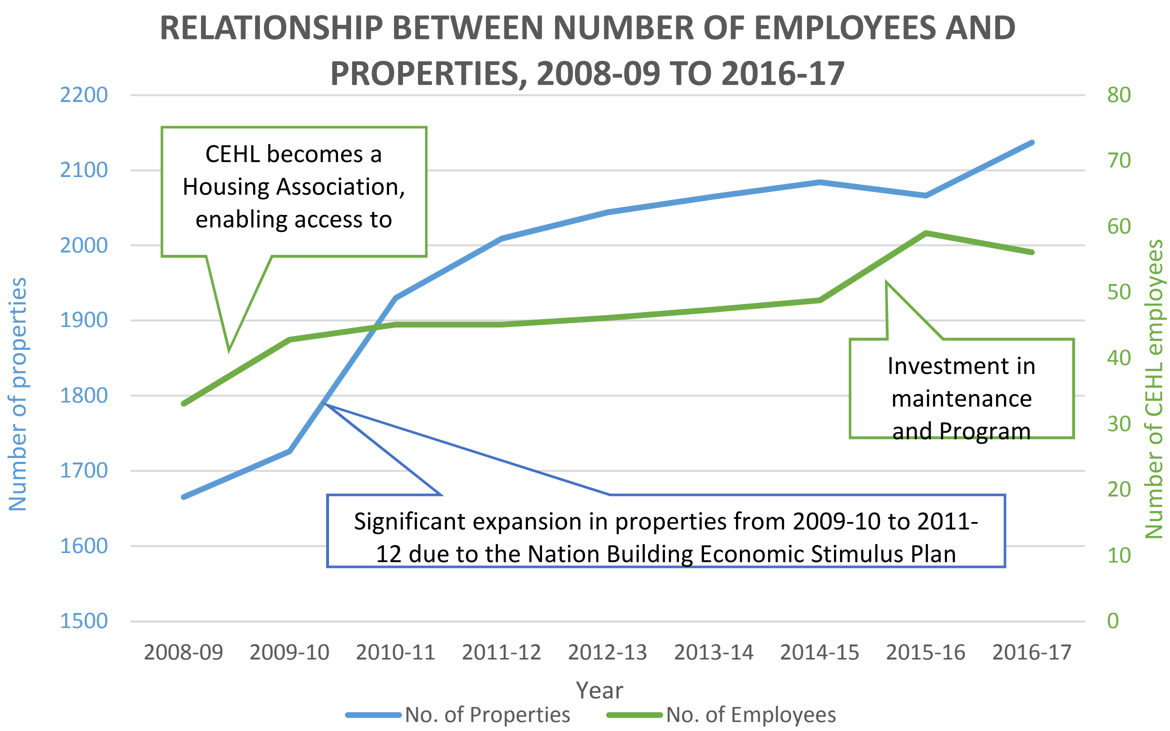
The other variables not captured in the graph are the differences in resourcing co-ops relating to their size and geographical location. This will also be a focus of further analysis.

In the absence of defined service level standards, the Program currently has no way of determining an equitable allocation of time and resources to co-ops and if, and how, proactive and reactive interactions with co-ops should be differently considered.

Vacancy costs

Delays in re-tenanting vacated properties represents a significant cost to the Program through forgone rent revenue. The cost of vacancies to the Program is estimated to be in excess of $300,000 per year. CEHL and co-ops each have a role in minimising vacancy times through improved coordination of the member selection and maintenance processes. It is anticipated that the long-term planning co-ops are currently undertaking will help co-ops and CEHL manage vacancies in a timely manner in the future. A focus on reducing vacancy times will be a focus of further Program development.

6. Preparation for meeting Program challenges and opportunities for growth



The graph above shows the total CEHL employees compared with the total number of properties for the period 2008-09 to 2016-17.

The graph demonstrates two distinct increases in CEHL staffing numbers – the first in 2008-09 when CEHL increased its head count and skills base to enable its registration as a Housing Association. This set the Program up to access capital funds, including through the Federal Government's Nation Building initiative.

The second increase in staffing occurred in 2014-15 and reflected a concerted effort to increase both the Program's spend on maintenance, as discussed in section four, as well as its strategic capacity and ability to plan for future growth.

As noted in the revenue paper, the Program is operating in an environment where there are fewer opportunities to access operational subsidies from government. Given this, there is a greater need for the Program to take a strategic approach to government relations and stakeholder engagement, to allow us to make a strong bid for opportunities when they do arise.

The focus on Program development recognises a change in the lifecycle of co-ops in the Program, in relation to such things as ageing memberships and changing participation levels. There has, therefore, been a need to support and resource co-ops to better plan for the future.

The recent investment in CEHL's capacity will enable the Program to prepare for and accommodate growth in the near future without significant additional costs being incurred. An important aspect of Program development will be to establish organisational cost benchmarks that support appropriate Program growth, create economies of scale and reflect the service and resource levels desired by Program members.

7. Focussing questions

What is the appropriate size of our property portfolio, given our cost structures?

How can maintenance costs be reduced through building standards, cyclical and responsive maintenance, FDP and cycling of assets?

Should the Program have minimum service level standards and, beyond this, fee for service arrangements? What implications would this have for oversight and compliance requirements?

What cost efficiencies are available through the use of technology? What support do co-ops and members need to realise this?

What is the ability of co-ops to minimise vacancy times? How can CEHL support co-ops to do this?

Should the fee for 'fee for services' fully cover the cost? Are there instances where the cost should be subsidised?