Program Revenue and Costs Background Information

Paper One: Revenue

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 clarity about current Program revenue, comparing it against relevant sector and market benchmarks and considering the likely implications of changes to specific revenue measures.

A second paper, which will be available by 14 July, will focus on Program costs and will, similarly, consider these against relevant benchmarks and model the impact of changes to the cost structure on Program viability.

Together, the two papers aim to provide co-ops with information about Program revenue and costs necessary for them to participate in important discussions about Program viability into the future. 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

Our Co-op Housing Program was established with significant support from government, both in resourcing for co-op establishment and in the provision of funds to purchase housing. The government investment in houses makes up the vast majority of the Program's $800 million property portfolio. This investment in housing came with an expectation that the Co-op Housing Program would use these assets to grow the Program's ability to offer affordable housing to eligible households. To this extent, our Program is a social housing provider, a custodian of this community investment in affordable housing, and continues to have an obligation to deliver and report on these outcomes to government.

Funding arrangements for social housing providers have changed significantly since the establishment of the original CERC Housing Program. In particular, changes to the amount and frequency of capital grants from government and the change from rent rebates to a rent model that incorporated Commonwealth Rent Assistance (CRA) mean that Housing Associations like CEHL no longer receive any operational subsidies from government. The value of the capital investments by government over time means that CEHL does have an ongoing obligation to maximise affordable housing outcomes to eligible households. While CEHL will always seek to access subsidies that become available from time to time, it is important that the CEHL Co-op Housing Program can meet its affordable housing obligations and is viable without external subsidies.

Due to this focus on long-term Program viability, analysis in this paper does not include revenue that is not ongoing. The Program has been the beneficiary of NRAS incentives over the past few years. As this incentive is not ongoing, it has not been included in revenue analysis. NRAS provided an annual incentive for 10 years for eligible properties. Most of CEHL's NRAS incentives are now in the seventh year, and CEHL will face a significant reduction in NRAS incentives received commencing in 2019. This creates a clear timeline to ensure that ongoing Program rent models, maintenance regimes and costs structures underpin ongoing Program viability, and provides significant financial capacity to support any transition required to embed ongoing viability.

3. Assumptions and definitions

The data that forms the basis of the analysis in this paper is approximate only and represents a snapshot at a point of time. 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.

CRA has been excluded from some modelling of future rent scenarios to enable understanding of potential impacts on household income. Where CRA has been excluded, this will be clearly noted in the analysis.

Market rent represents the median rental prices published by the Department of Health and Human Services in 2016.

The paper also assumes property portfolio net growth rate of 20% over 10 years.

The paper uses the following definitions:

- **Market rent** is the rent charged in the private rental market for an equivalent property in a similar location.
- **CEHL maximum rent** is the rent currently specified in the rent policy, established in 2007, based on median market rents in the location.
- **CEHL assessed rent** is the rent charged to households where maximum rent would be more than 25% of their household income. Under the current rent policy, household income for CERC households is calculated on net income and a lower proportion of family tax benefits, while for CMC households, it is calculated on gross income and a slightly higher proportion of family tax benefits.
- **CEHL minimum rent** is the lowest rent charged for a property, based on 25% of typical Centrelink income and 100% of CRA for the relevant household composition.

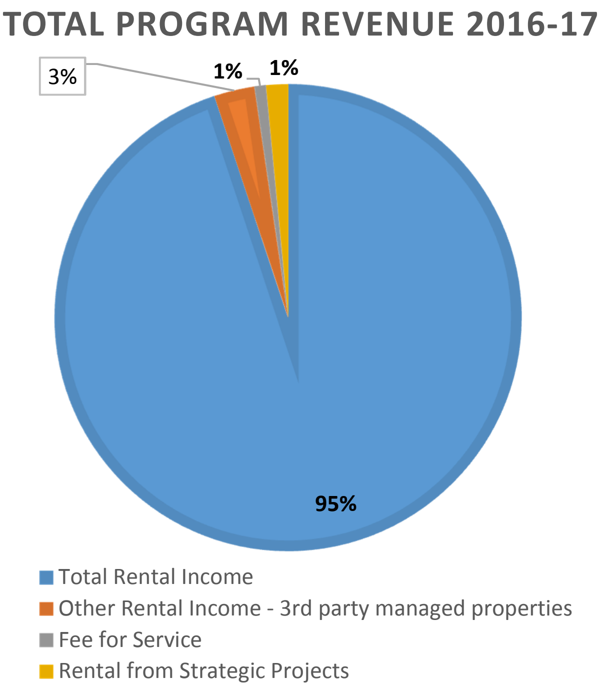
4. Sector benchmarks

Across other social and co-op housing providers, there is variance in relation to how rent is calculated. A review of the rent policies of nine other housing providers identifies that:

- All calculate their rent based on gross, rather than net, household income.
- All have their maximum rent tied to market rent, either set at market rent or at a fixed percentage of it (no less than 75%).
- The majority have their assessed rent set at 25% of household income (plus 15% of family payments and 100% of CRA), and up to 30% for some providers.
- For a specific comparison with a similar co-op housing program, Common Equity NSW sets maximum rent at market rent and assessed rent as 25% of income, plus 100% of CRA. Common Equity NSW does not offer discounted rent for labour.

Total Program revenue

The graph below shows the total Program revenue for 2016-17:



The graph indicates that the vast majority of Program revenue comes from rent paid by tenants of CEHL owned or managed properties.

5. Level of subsidy currently provided within our Program

The CEHL Co-op Housing Program identifies affordability as a key Program Principle. The current affordability benchmark for the Program is that rent should be no more than 25% of principal household income.

The difference between the amount of revenue that would be generated if properties were rented at market rent and the actual Program revenue received represents the amount of subsidy provided by the Program. It is important to note that the capacity to provide this subsidy is generated from revenue received by the Program. There is no external source of ongoing funding available to provide this subsidy.

Dollar value of current of Program subsidy

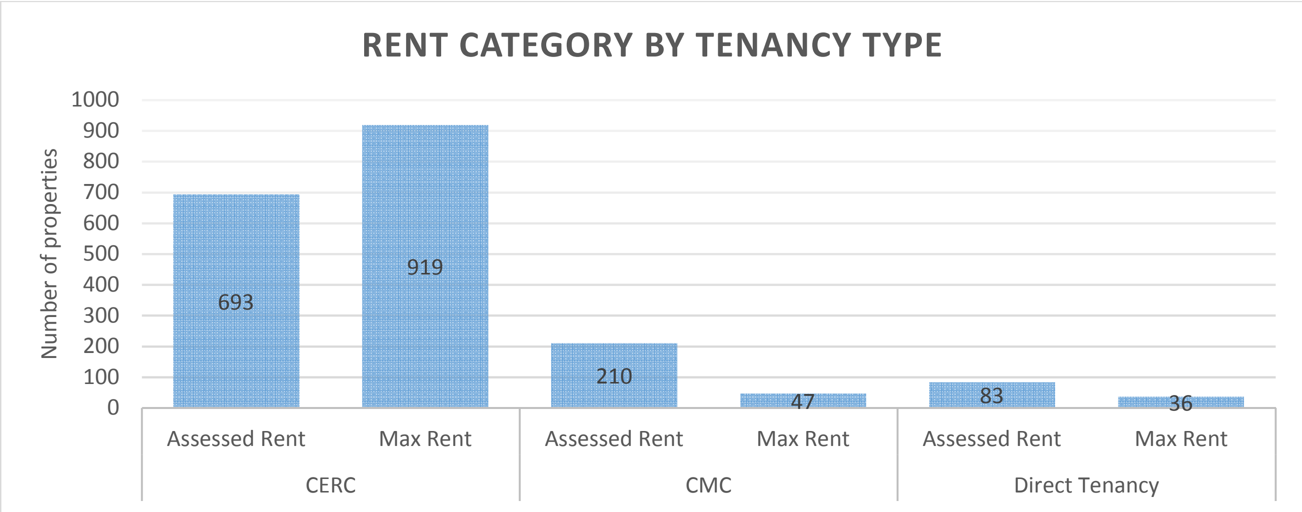
Estimated revenue from market rent:	$34,982,896
Actual rent revenue received 2016-17:	$21,340,698
Dollar value of current Program subsidy:	**$13,642,197**

6. Application of subsidy within our Program

Achieving 25% of income benchmark

Our Housing Program currently offers an assessed rent to any household where paying maximum rent would result in the household paying more than 25% of their income in rent.

Of total rental income, the below graph breaks down the number of tenants on assessed rent compared with maximum rent, by tenancy type.



Number of co-ops	104	6	-
Total number of properties	1612	257	119

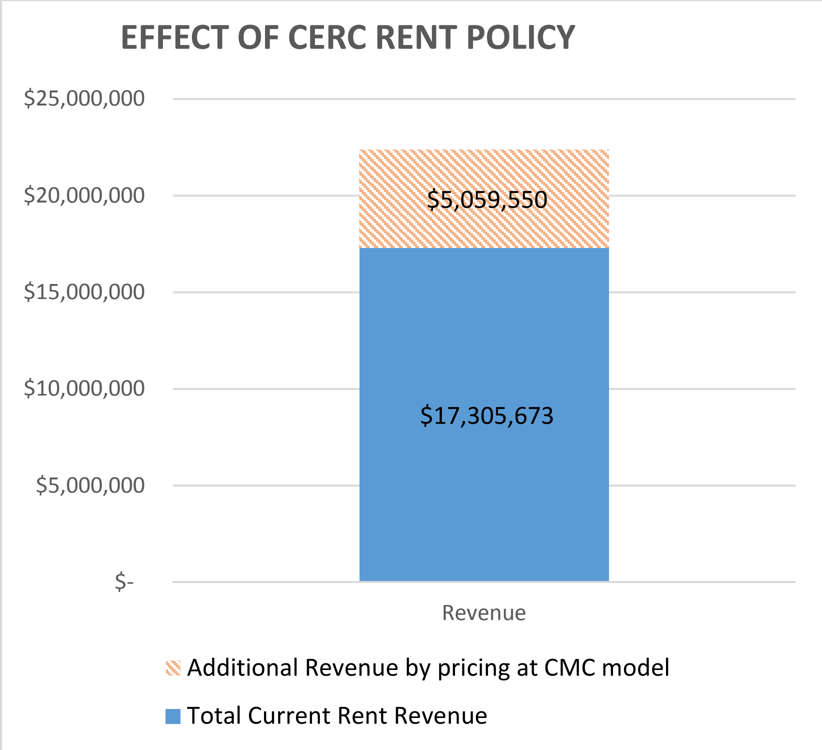
As noted in Section 3, the data is a moment in time snapshot and the provision of updated income information may see a change in split between rent categories. We anticipate that this would reduce the number of households paying maximum rent.

Notwithstanding this, the graph indicates that, across the Program, the split between tenants on assessed and maximum rents is approximately 50/50. Furthermore, the vast majority of Program properties are allocated to CERCs and, of these, over half represent households on maximum rent.

Effect of CERC Rent Policy

In comparison to the rent models applied by other social and co-op housing providers, the CERC rent model includes the amount of rent foregone in recognition of tenancy and maintenance co-ordination provided by CERC members. The CERC rent model use of net (post tax) household income for rent calculations is unusual in the housing sector, with all other providers using gross rent.

Both of these elements of the CERC rent policy reduce the revenue that would otherwise be received by the Program.



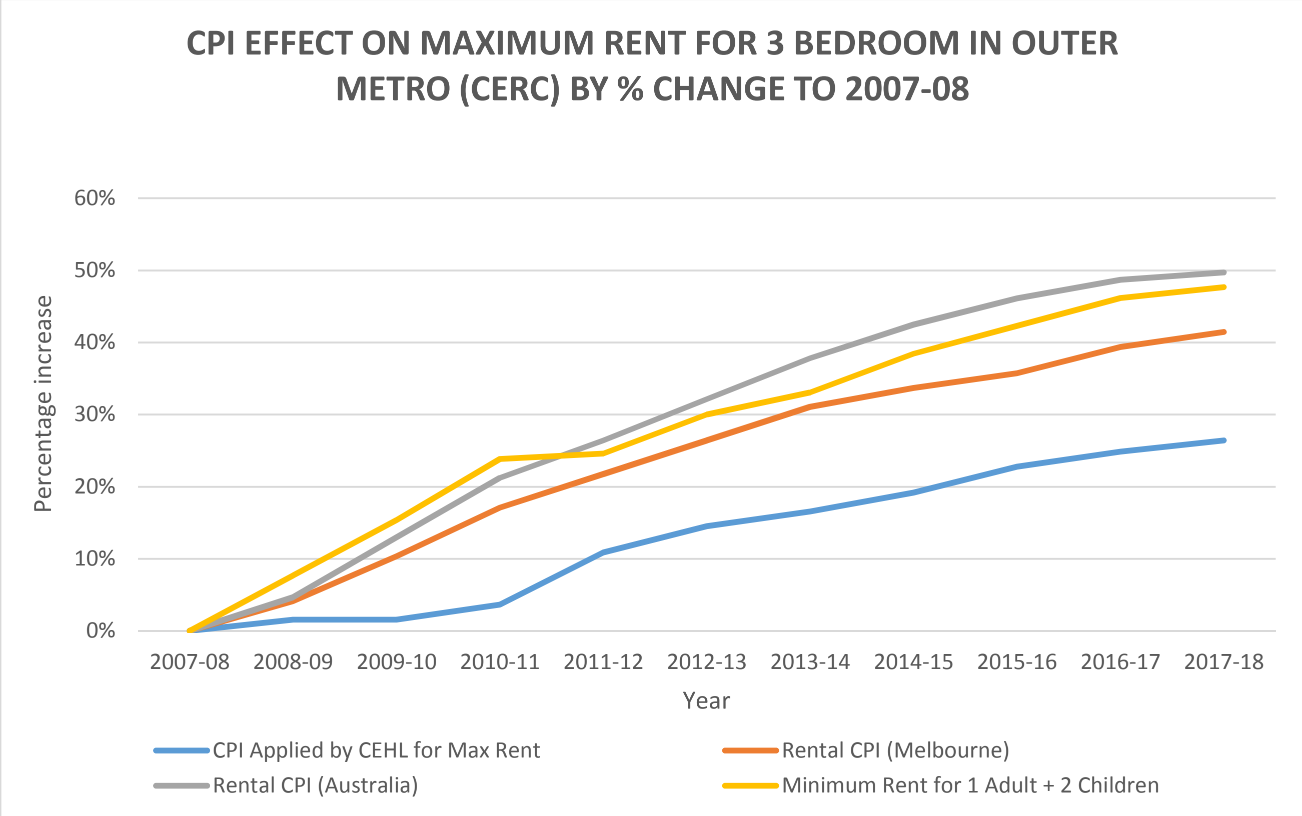
Effect of CPI cap on maximum rent

When established in 2007, maximum rent in the CEHL Housing Program was based on median market rents and the Program chose to restrict annual rent increases to no more than the CPI percentage for the weighted average of eight capital cities. There are a number of CPI measures provided by the Australian Bureau for Statistics, and different CPI approaches are used for different purposes. The weighted average of eight capital cities CPI figure is not an accurate measure of market rent prices, particularly in high value property markets like metropolitan Melbourne. The CPI that the Commonwealth Government applies to statutory incomes is different and applies a higher percentage.

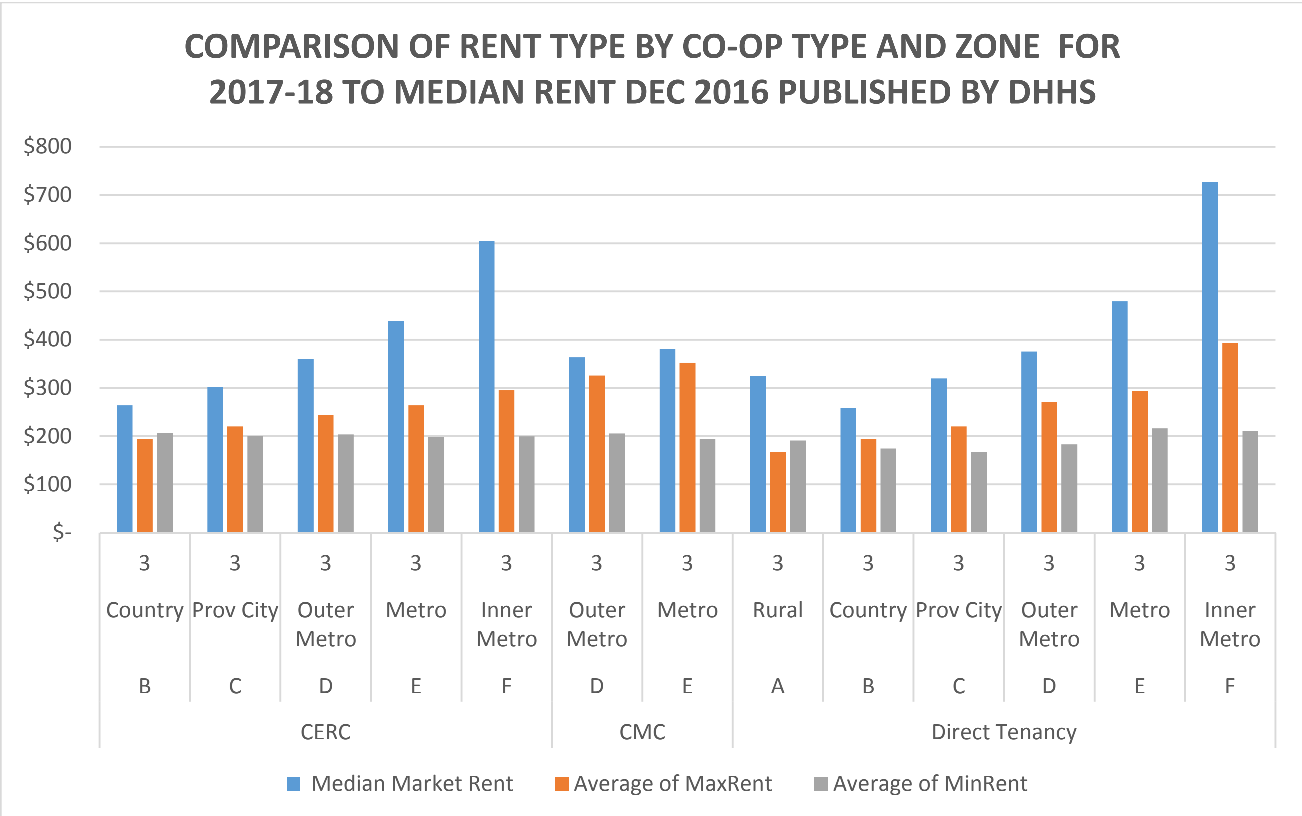
The result of this is that minimum rent has increased at a higher percentage for those on statutory incomes – our lowest income households – and maximum rent has increased at a lower percentage rate for our highest income households.

An additional effect is that maximum rent has been kept low in comparison to the market rent for some locations in the Program. This represents a significant difference from other social and co-op housing providers which continue to have their maximum rent tied to market rent.

The graph below illustrates the effect of the CPI applied by our Program over the past decade by comparing the percentage increase of maximum rent for a three bedroom property in the Outer Metro Region in a CERC against both the true CPI increase over the period and, as an example, the minimum rent increase for a relevant household type (with one adult and two children) in our Program.



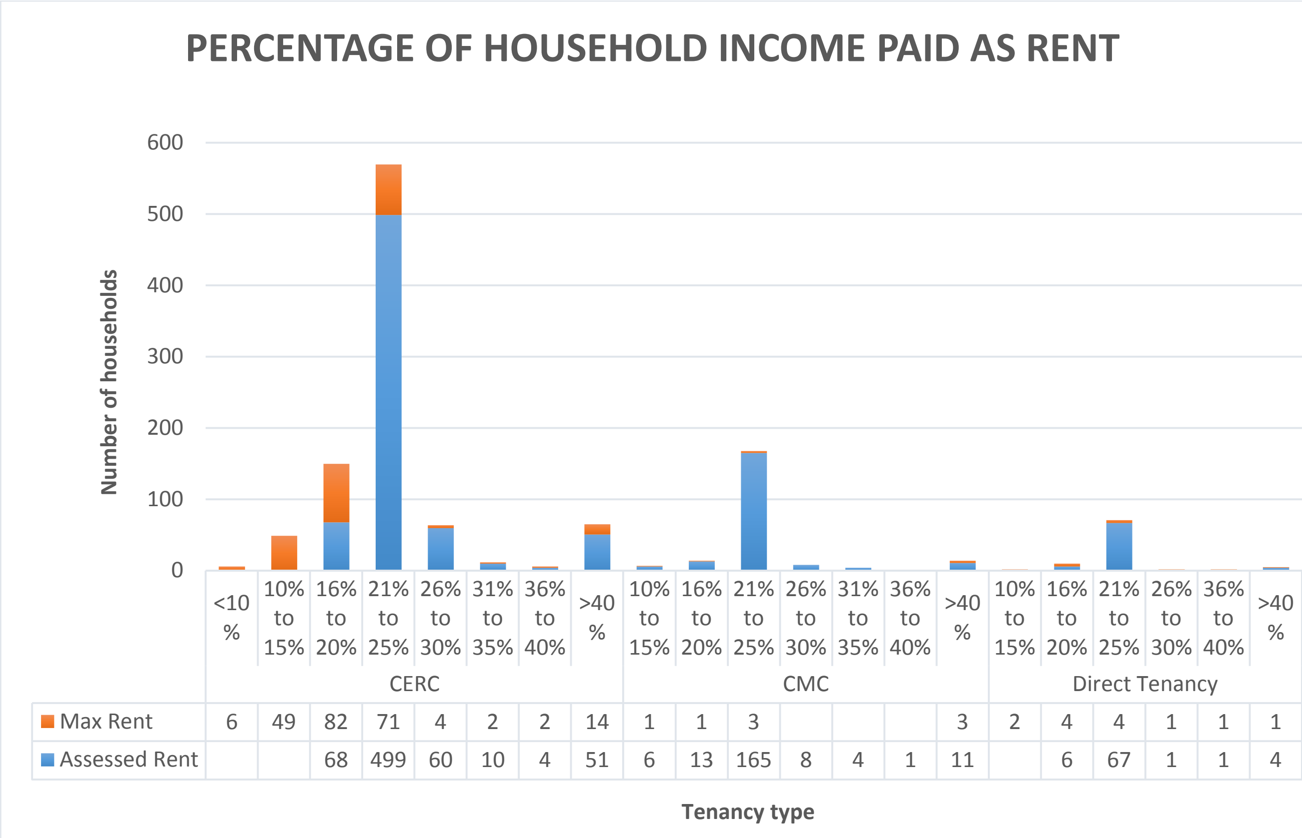
The graph indicates that a significant gap has emerged between the Program's maximum rent and market rent. The current-day dollar value of the gap between market rent and maximum rent, as well as minimum rent, is represented below:



NB: minimum rent figures represented above are an average of actual rents for relevant households in the Program and, therefore, vary.

The graph highlights that, for all rental zones, the average maximum rent for a three bedroom property is less than market rent, in some zones by as much as 40 – 50%. The graph also shows that the artificial cap on maximum rent means that, in a number of rental zones, minimum rent is commensurate with maximum rent and, in some cases, actually exceeds it.

The growing gap between maximum rent and market rent has meant that the majority of those on maximum rent are paying a percentage of their income below the 25% benchmark.



Tenancy type	CERC								CMC							Direct Tenancy					
	<10 %	10% to 15%	16% to 20%	21% to 25%	26% to 30%	31% to 35%	36% to 40%	>40 %	10% to 15%	16% to 20%	21% to 25%	26% to 30%	31% to 35%	36% to 40%	>40 %	10% to 15%	16% to 20%	21% to 25%	26% to 30%	36% to 40%	>40 %
Max Rent	6	49	82	71	4	2	2	14	1	1	3				3	2	4	4	1	1	1
Assessed Rent			68	499	60	10	4	51	6	13	165	8	4	1	11		6	67	1	1	4

The above graph below shows rent as a percentage of a household's income for both assessed and maximum rent. What it shows is that a significant number of households on maximum rent level are paying less than 25% of their income.

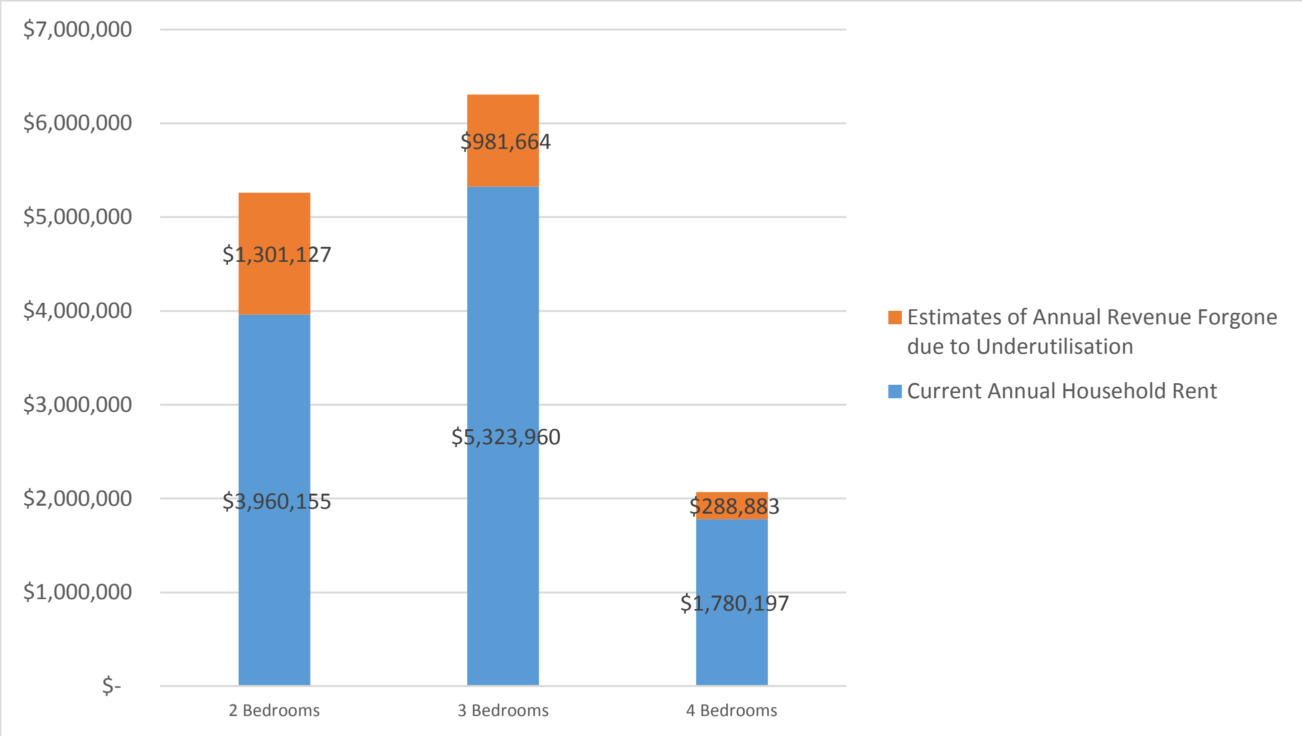
It is important to note that the income refers to net, rather than gross. If the rent figures were compared against gross income, as is the case with other housing associations, the percentage of income paid by those on maximum rent would be even lower.

The above analysis highlights the impact that the artificial capping of maximum rent has had on the CEHL rent model and raises questions about the equity of the current model and the unintended subsidy, and lost revenue that exists within it.

Effect of underutilisation of property

The demographic make-up of our Program has changed significantly since it was established, and many households within the Program are now much smaller than when they first joined. However, the property mix within the Program's portfolio does not reflect the current Program demographic. This results in many properties currently being underutilised.

Accurate calculation of the effect of underutilisation on Program revenue is very complex. CEHL will develop a greater capacity to identify and calculate this. In the meantime, the graph below provides a broad estimate of potential impact, based on a rough comparison of occupants and bedrooms, and an assumption that fully utilised properties would result in a maximum rent calculation. It is anticipated that a more detailed analysis is likely to reduce the impact on revenue.



7. Other revenue sources

Revenue received for services provided is currently the only other revenue source for our Housing Program. Revenue from this source represents a very small proportion of total revenue. To date the majority of CEHL 'fee for service' offerings have been focused on providing selected services to member co-ops. These services are intended to be 'cost neutral' – that is, the fee should cover the cost of delivering the service.

CEHL also provides services to external organisations from time to time. These services are usually focussed on 'like' organisations such as housing co-ops who are not members of our Program and other social housing providers, and are intended to be priced to return a modest surplus to CEHL, but not to generate significant profit.

Current Fee for service offerings:

To member co-ops:

- financial services
- co-op establishment
- co-op development and support
- tenancy management.

To external organisations

- property inspections
- project management.

CEHL has received requests for assistance in co-op governance for non-member co-ops or groups wanting to establish co-ops. This may be an area for future fee for service offerings.

CEHL Capital Investment Strategies

As CEHL operates widely across the residential property market, there are investment opportunities that can, among others things, leverage CEHL's volume purchasing and discount capacity, developer relationships and Charitable Endorsements that can generate financial outcomes that benefit the Program over time.

Co-op Investment Opportunities

Co-ops collectively hold considerable funds in their bank accounts (some $11m). Bulk negotiations with a financial institution could represent a great opportunity to achieve increased financial returns on these funds. Maintenance and expense planning may enable co-ops to utilise term deposits to also achieve greater returns.

8. Focussing questions

The recent development of Program Principles has clarified the aspects members believe are most important to carry forward, and require us to address the Program Principles in all future Program decision-making.

The Program Principles are:

- Affordability and Financial Sustainability
- Changing Needs
- Member Support and Development
- Participation
- Quality of Housing
- Security
- Working Together.

A more detailed summary of each principle can be found here.

Changing circumstance and funding arrangements require us to tackle some challenging questions. The focussing questions below are designed to prompt our thinking as we consider how to balance these principles in future Program arrangements.

- What proportion of assessed rent households and maximum rent households should the Program aspire to?
- Is the current use of subsidy appropriate?
- How should the Program best meet its obligation as a custodian of community assets intending to provide affordable housing to as many households as possible?
- How should the Program manage the revenue impacts of underutilised houses?
- What range of services should CEHL provide? Who should they be offered to, and how should they be priced?