NATIONAL REGULATORY SYSTEM
COMMUNITY HOUSING
A joint initiative of Commonwealth, State and Territory Governments

# NRAS AND THE COMMUNITY HOUSING SECTOR
# A NATIONAL SUMMARY 2019

## PURPOSE

This paper summarises the analysis and insights of participating jurisdictions of the National Regulatory System for Community Housing (NRSCH) on sector preparedness, outlook and implementation of exit strategies as they relate to the cessation of the National Rental Affordability Scheme (NRAS).

## CONCLUSIONS

We have examined the approaches that community housing providers are taking to the progressive loss of subsidies associated with NRAS properties.

Our examination has led us to conclude that across all jurisdictions, CHPs are making significant steps with respect to planning, risk mitigation and identification of potential impact.

We have issued a guidance note to CHPs with exposure to NRAS subsidies, signalling to the sector that this will be a key focus of compliance activities in the coming years (see Appendix 1).

We hold some concerns with a small number of providers who have debt burden relating to the construction or purchase of NRAS properties and will continue to monitor their planning and execution of risk mitigation strategies.

We are committed to the ongoing monitoring of the wind down of NRAS and its impacts over the years ahead.

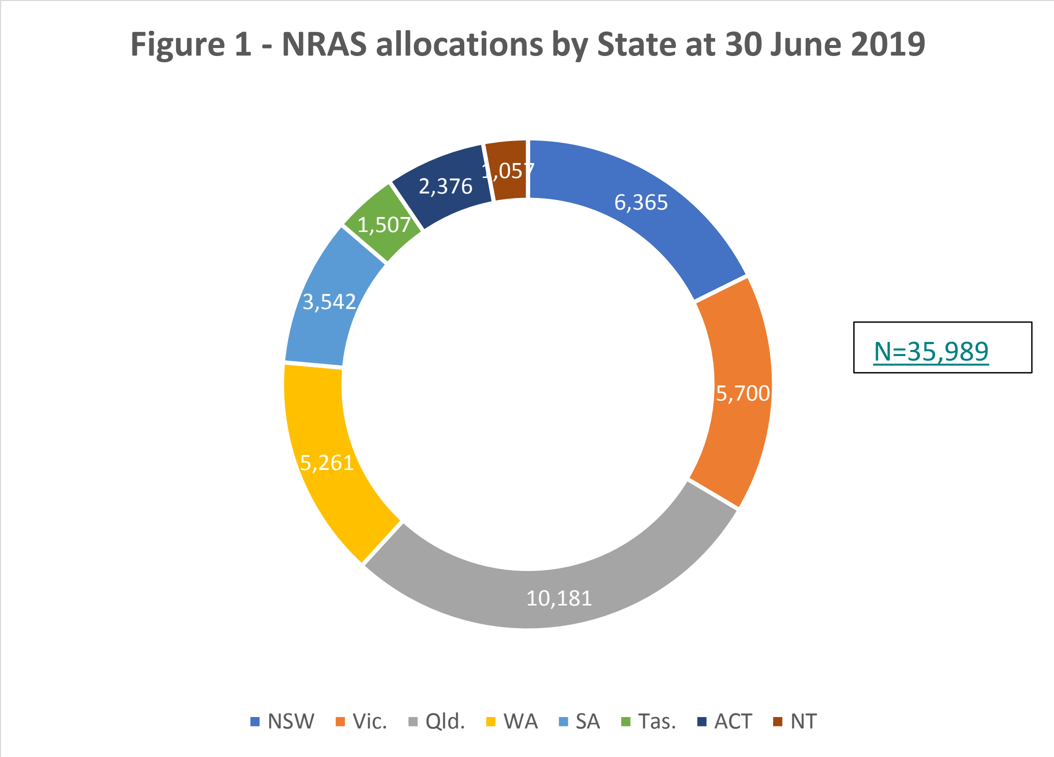
A key issue for our analysis going forward is to understand the impact that the loss of the subsidy has on affordable housing supply and most particularly the impact on those tenants living in the affordable housing created through NRAS.

## OVERVIEW

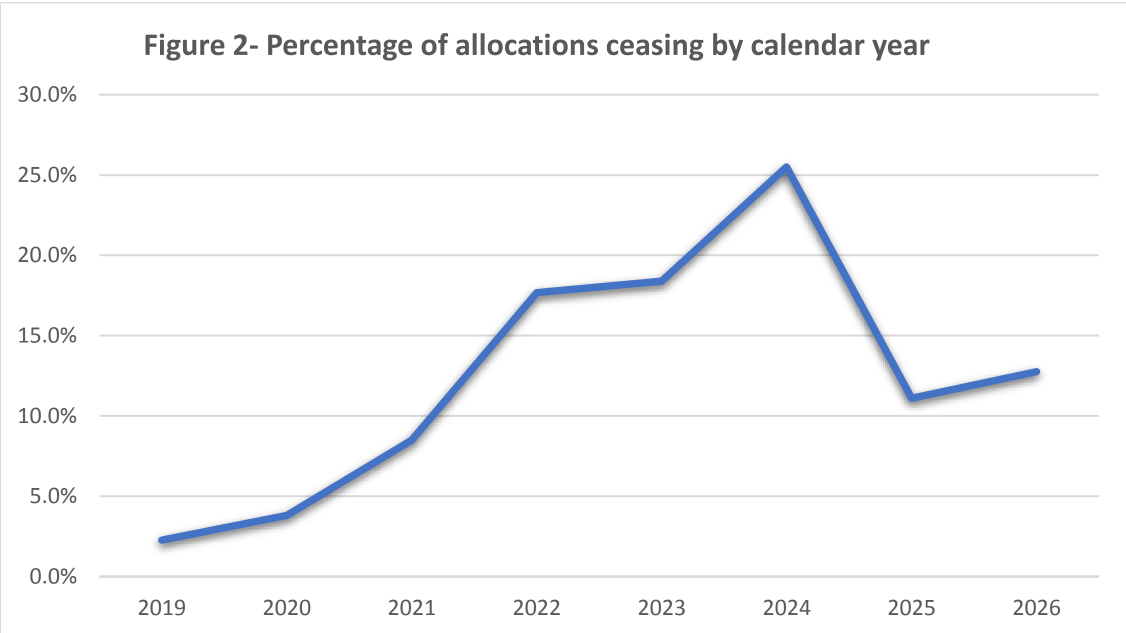
NRAS is an Australian Government affordable housing initiative, delivered in partnership with state and territory governments. The NRAS is administered under a legislative framework comprising the National Rental Affordability Scheme Act 2008 (NRAS Act) and the National Rental Affordability Scheme Regulations 2008 (NRAS Regulations).

The NRAS allocates financial incentives to organisations that provide people on low to moderate incomes with an opportunity to rent homes at a rate that is at least 20% below market value rent. The scheme will conclude in 2026.

NRAS allocations have been distributed Australia wide and include every NRSCH participating jurisdiction (see Figure 1). Registered CHPs with NRAS allocations are represented across all three Tiers predominantly located in Major Cities and Inner and Outer Regional areas.




The staged implementation of the NRAS scheme will result in a gradual wind down of allocations between 2018 and 2026, with the majority (61.6%) of allocations ceasing between 2022 and 2024 as set out in Figure 2.




## RESPONSE BY REGISTRARS

Registrars in participating NRSCH jurisdictions have taken a proactive approach to assessing and monitoring the potential impacts of NRAS cessation on the CHP sector. The analysis has been conducted in the context of standard compliance assessments.

Registrars are committed to the ongoing monitoring of the wind down of NRAS and its impacts and have divided the process into two distinct phases - risk identification / planning and execution risk (see Figure 3 below). While it is expected that each CHP will develop and implement strategies unique to their position, the core elements of planning, execution and monitoring of NRAS exit strategies will be a key focus of compliance activities.

Figure 3. Examples of risks relating to NRAS exposure and stage of strategy implementation

| | Risk identification and planning | Execution Risk |
|---|---|---|
| Managed properties | • Loss of income / cashflow<br>• Reduction in diversity of income | • Barriers to market entry<br>• Competitive landscape<br>• Drain on cashflow<br>• Market conditions<br>• Key Staff |
| Owned properties | • Loss of income and subsidies<br>• Ongoing debt burden<br>• Ageing stock | • Adverse movements in rent or property prices<br>• Increases in costs<br>• Inability to refinance<br>• Lack of liquidity |

A guidance note, (Appendix 1) has been issued to CHPs with exposure to NRAS subsidies, signalling to the sector that this will be a key focus of compliance activities in the coming years.

## FINANCIAL IMPACT AND RISK MITIGATION

The financial impact of NRAS cessation on CHPs is dependant primarily on the following factors:

1. Whether the provider is an owner of NRAS properties and receiving cash or refundable tax offset credits
2. Whether they derive income from the owners of the properties on a fee for service basis through property / tenancy management / compliance fees or head leasing
3. The proportion of income NRAS activity contributes to the provider
4. The proportion of assets which NRAS contributes to the CHPs overall financial performance, and
5. The debt a CHP is carrying as a result of borrowing to construct or purchase NRAS properties.

In the first instance, CHPs are expected to recognise, quantify and plan for the mitigation of these risks in advance, after which their focus should shift to monitoring and implementation.

## CURRENT PLANNING AND EXIT STRATEGIES

Registrars have, to date, observed a diverse range of responses from CHP’s to the impending cessation of NRAS which spans from in-depth scenario testing, incorporation of strategies into forecasts and risk management plans and workshops with stakeholders through to evidence of no (or very little) planning having been undertaken.

Importantly, most of these strategies are at planning stage or in the very early stages of implementation. As a result, execution risk is regarded as a significant factor which will require ongoing monitoring by impacted CHPs and Registrars.

Offsetting this is the fact that Registrars' analysis identifies that there are a significant number of providers who derive a minimal financial benefit from the NRAS program and losses can be absorbed without a material impact to income.

While the risks identified above have the potential to significantly impact on individual CHP's financial viability if not treated, it is important to note that the timeframe over which these risks will be realised in some instances, of up to seven years away – means that some CHPs have adequate time to plan and implement strategies.

There were no providers identified who had a large reduction in subsidies such that it would have a negative impact on their financial viability – over the next two years.

**FEE FOR SERVICE**

Registrars have identified that CHPs who only gain fee for service income from NRAS show low to medium levels of downside risk and provide evidence that they have early development and implementation of strategic / risk management plans to mitigate income loss through cessation of subsidies. Typically, these CHPs have limited capacity to exert direct influence on exit strategies of the NRAS property owners themselves. As a result, their strategies centre on income replacement through alternate means, which include:

- Development / creation of real estate agencies as wholly owned subsidiaries.

  This strategy allows CHPs to continue to provide property management services to NRAS investors post-cessation while potentially growing an income stream through the provision of services to the wider private sector. Evidence to date indicates that several models are being explored, with some CHPs electing to focus solely on property management while others are diversifying into both management and sales offerings. While several CHPs have indicated a desire to emulate the property management model pioneered by Homeground Real Estate in Victoria[1], no evidence of success has been presented to date.

- Expansion of existing income streams.

  This encompasses a wide range of vertically and horizontally integrated products and services and is highly dependent on the CHP's existing business model. More common examples include the expansion of NDIS services and expansion of shared equity arrangements.

- Portfolio growth.

  The recent advent of the National Housing Finance Investment Corporation (NHFIC) and jurisdiction specific funding or stock transfer schemes has presented an opportunity to some CHPs to expand their portfolios. While the key driver behind this approach is more likely to be the funding opportunity itself, a secondary benefit is the replacement of income loss from NRAS activities.

[1] https://www.homegroundrealestate.com.au/news/ato-ruling-information/

## NRAS OWNERSHIP

Ownership of NRAS assets by CHPs presents risks and challenges which require additional planning and mitigation strategies. Typically, these risks involve the loss of NRAS rental subsidies, ownership of ageing assets (which is associated with increased maintenance costs) and, in some cases, debt burden from the initial construction or purchase of NRAS assets. Strategies to address these risks typically include:

- Retaining NRAS portfolio as affordable housing stock.

  While retention of stock appears to be a key goal of a significant proportion of CHPs with NRAS stock, little is known at present about the suggested / planned rent settings for this stock once NRAS subsidies have ceased.

- Refinancing debt.

  Demonstrated results by the NHFIC of lending at substantially lower rates than other financial institutions have provided CHPs the opportunity to refinance existing debt facilities. This has the benefit of reducing the ongoing debt service burden on the CHP and allowing for the potential to retain existing stock without resorting to the immediate sale of assets and provides certainty of funding and costs over (potentially) a 10-year period.

- Sale of stock.

  The two key drivers behind the strategy of NRAS asset sales appear to be asset recycling and / or debt reduction. Both strategies allow CHPs to bank any potential capital gains accrued over the (minimum) 10-year period and redeploy funds as required. Greater transparency of this strategy may be required closer to the cessation date as the impact of local real estate market conditions become clearer.

## TENANT IMPACTS

A key system risk associated with the reduction of NRAS subsidies is the displacement of tenants from affordable housing. This can lead to a flight of demand toward subsidised housing options away from private market renting. An equally likely scenario is that tenants will be pushed into housing stress as they are required to spend a greater proportion of their income on rent in order to remain living where they are.

The analysis summarised here has not sufficiently probed the tenant impact for registrars to make any substantive commentary. This will be a focus of further work.

Registrars will seek to understand through information from providers, what happened to any tenants who had to leave the NRAS accommodation as a result of the loss of subsidy for rent. This inquiry will include a demographic profile of tenants (principally age and family make-up), and as far as is possible information on where they relocated – whether into the provider's social housing portfolio, the public housing portfolio, private rental market, or homelessness. Further we will seek to understand the extent to which providers have entered into discussions with tenants about the impacts on them.

## CONCLUSIONS

Registrars have examined the NRAS exposures for registered community housing providers and have concluded that, at present, there is a broad level of comfort across all jurisdictions at the level of planning, risk mitigation and potential impact.

Following this assessment, Registrars will undertake several actions to continue a level of oversight:

- Increased regulatory monitoring of community housing providers NRAS exit planning processes and strategies as the NRAS cessation years approach.

- Providers who manage properties on behalf of owners/investors to provide more detailed advice to the Registrar about the exit plan for properties after NRAS finalises.

- Collaboration with State, Territory and Commonwealth government agencies

# Appendix 1- Guidance Note

## MANAGING RISKS ASSOCIATED WITH THE WINDING DOWN OF NRAS INCENTIVES

The purpose of this communication is to advise that depending upon your organisation's circumstances, your Registrar may be seeking supplementary information to assess if any unintended consequences could arise from the end of the National Rental Affordability Scheme (NRAS) rounds.

In the 2014-15 Budget, the Government announced it would not progress with any further NRAS rounds and that the scheme would be capped at 38,000 allocations. In coming years, many Community Housing Providers (CHPs) that were successful applicants for properties funded under the NRAS will begin to see financial incentives associated with the scheme cease as the 10 year funding timeframe for each NRAS round is reached. Other providers offer fee for service management of NRAS properties and will be affected by the ending of NRAS incentives.

The Registrars have been monitoring how relevant CHPs are making appropriate provisions/plans to prepare for the winding down of the NRAS incentives as part of their ongoing Compliance Return process under the National Regulatory System for Community Housing (NRSCH). The cumulative view is that the sector is planning for the wind-down and is diversifying in response. The Registrars will continue to monitor this response.

You may not need to adjust your annual returns which indicate plans, business strategies, financial forecasts, scenario testing and policies potentially related to NRAS. However, as the standard compliance assessment of providers' performance now includes the NRAS cut off in their 10 year forecasts, Registrars would like to engage providers more specifically on how they plan to treat the transition and to that effect may ask specific questions in the upcoming Tier1/2 assessment round in order to form a national view on any necessary funding/policy changes.

**Specifically, your Registrar may ask providers that are receiving NRAS incentives or managing NRAS properties and tenancies on behalf of other providers or private developers to share their plans about what they will do with: a) properties they have control over and b) tenancies of all NRAS properties.**

Financial viability is critical to the sector, however, there may be some unintended consequences of planned diversification which adversely impact the provision of affordable housing in the broadest sense. Hence, what – if anything – is to occur to affordable housing properties and tenancies is important for Registrars to understand and your assistance in contributing to this knowledge would be welcomed. As a group, Registrars are concerned to ensure that negative impacts are minimised and we will feed any assessed systemic information back to the sector and through to our funding and policy colleagues.

Should you have any queries regarding this matter please feel free to contact your assigned NRSCH regulatory analyst.