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

Part 4

Sector Performance - Financial 2018 - 2019

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About this document

This report provides an overview of the financial performance of the community housing sector across participating jurisdictions in Australia, namely New South Wales, Queensland, South Australia, Australian Capital Territory, Northern Territory and Tasmania.

This is the fourth and final part of a series of reports issued in 2019 for the NRSCH reporting period 2018-2019.

Part 1 – NRSCH Overview
Released July 2019

Part 2 – Our Performance
Released August 2019

Part 3 – Sector Performance – Non financial
Released November 2019

Part 4 – Sector Performance – Financial
Released November 2019

This is the second published Annual Overview report for the NRSCH, compiled by the NRSCH National Office in collaboration with all NRSCH participating jurisdictions. Previous published NRSCH reports can be found at https://www.nrsch.gov.au/publications/nrsch-reports.

SCOPE OF REPORT

This part of the annual overview, Part 4 – Sector Performance- Financial, provides a picture of the community housing sector using measures and ratios which indicate financial viability.

The financial analysis carried out in this section is based on information submitted in the 2019 Financial Year. Due to time differences between compliance activities of the NRSCH and the official reporting of financial results by Community Housing CHPs (CHPs), financial results from financial year 2018 (FY18) have been used with historical comparisons against the preceding financial year (FY17). This methodology represents a shift from the previous report and, as such, comparing figures from the NRSCH's previous Annual Overview (in particular Tables 1 and 2 on the succeeding pages) will yield different results.

To learn more about the NRSCH, as well as local policies and news please visit https://www.nrsch.gov.au/states_and_territories/jurisdiction-policy. For further information about the Regulatory Framework, regulatory principles, and how Registrars deliver their functions under the NRSCH please visit https://www.nrsch.gov.au/publications/nrsch-framework. Information and guidance on how the NRSCH assesses financial viability can be found here https://www.nrsch.gov.au/publications/financial-reporting-guidance.

Key Findings

- The community housing sector continues to demonstrate strong financial position and performance with the majority of CHP's results at or above key financial metrics.
- Rent revenue and housing assets both saw modest increases between FY17 and FY18, Operating EBITDA fell during the period due to a reduction in operating grants.
- While debt rose across the sector, there is no evidence of financial stress at present. Several funding programs across a number of jurisdictions are providing incentives to leverage housing assets to grow available housing stock and their impact will be monitored into the future.
- The year ahead (early 2020) will see changes to the Financial Performance Report (FPR) in response to changes in accounting standards. Feedback has been sought from the sector on the likely impact of the changes to the accounting standards and to ensure that amendments to the FPR are in line with expectations.

A financially viable community housing sector

Under the NRSCH guidelines, a community housing provider is required to demonstrate that they are financially viable at all times. This is assessed against three broad criteria:

1. Ensuring a viable capital structure (PO7a)
2. Maintaining appropriate financial performance (PO7b), and
3. Managing financial risk exposure (PO7c).

The viability of CHPs is assessed using a suite of indicators used to assess financial performance. The financial measures include thresholds for some requirements as an indicative guide to assessing performance results. The thresholds do not determine capacity or compliance per se. Rather, they provide a transparent level of performance as a starting point against which results can be assessed in the context of the provider's individual situation.

As mentioned in the previous report (Section 3 – Non financial), the sector experienced significant growth in tenancies due to: organic growth; 23 new CHPs; and a large-scale transfer of assets. Additionally, this year also saw the first rounds of funding delivered by the National Housing Finance and Investment Corporation (NHFIC) albeit mostly for refinancing purposes. These events are expected to have an impact on cashflow (e.g. increased income from rent), lower interest expenses on debt from refinancing and balance sheets (e.g. housing transfers). Given the timing of these initiatives and the reporting cycle, the full impacts of these events are not expected to be known until early 2020 while CHPs finalise and publish their FY19 financials following their Annual General Meetings over the next several months.

The Year Ahead

The next 12 months see further changes and challenges in the CHP sector relating to financial reporting and viability. These include:

Winding down of NRAS subsidies. Registrars continue to monitor the development and execution of exit strategies for CHPs exposed to National Rental Affordability Scheme (NRAS) subsidies and asset ownership. While financial viability remains a core focus of attention, possible impacts of strategies on tenant outcomes will also be examined.

NHFIC lending for construction projects. Having developed a construction lending product, the NHFIC has indicated strong initial demand from the sector and is working with a number of CHPs across the country to help finance projects. Registrars intend to monitor the impact of this increased activity on both the sector's and individual provider's forecasts to ensure appropriate risk mitigation strategies are being implemented.

FPR changes. Registrars have sought feedback from the sector in relation to the upcoming Australian Accounting Standards Board (AASB) changes for Not-For-Profit organisations. This feedback will be used to both better understand the expected impact on Provider's reporting and to ensure that any changes to the Financial Performance Report (FPR) are in line with sector expectations and needs. An amended FPR is expected to be released in the first quarter of 2020.

Sector Snapshot

The sector enjoyed a modest increase in rent revenue during the periods examined due largely to ongoing stock transfers, general inflation and revenue from new stock. While a positive result, this was offset by a reduction in Operating Grants which, in turn, weighed on Operating Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA). Figure 2, on the succeeding pages, indicates that this reduction has been felt predominantly by Tier 2 CHPs.

Housing assets grew due to similar factors as rent (as outlined above) as well as economic factors such as ongoing increases in housing prices, particularly around metropolitan areas. The increase in housing debt continued the trend from the previous report and is predominately related to a housing program in one jurisdiction, however, when weighed against the overall increase in asset values, the rise in debt had a negligible impact on balance sheets.

Table 1 – Revenue snapshot

	Rent Revenue	Total Grants	Operating EBITDA
FY 17	$558,846,572	$1,498,204,851	$233,581,369
FY18	$632,006,319	$1,394,158,069	$212,430,789
% change	13%	-7%	-9%

Table 2 – Asset snapshot

	Housing Assets - written down value	Total Housing debt	Net Assets	Total Assets
FY 17	$5,842,372,467	$576,783,175.0	$7,473,933,140	$12,139,852,400
FY18	$6,438,090,422	$641,504,520.0	$7,932,171,775	$12,869,417,874
% change	10%	11%	6%	6%

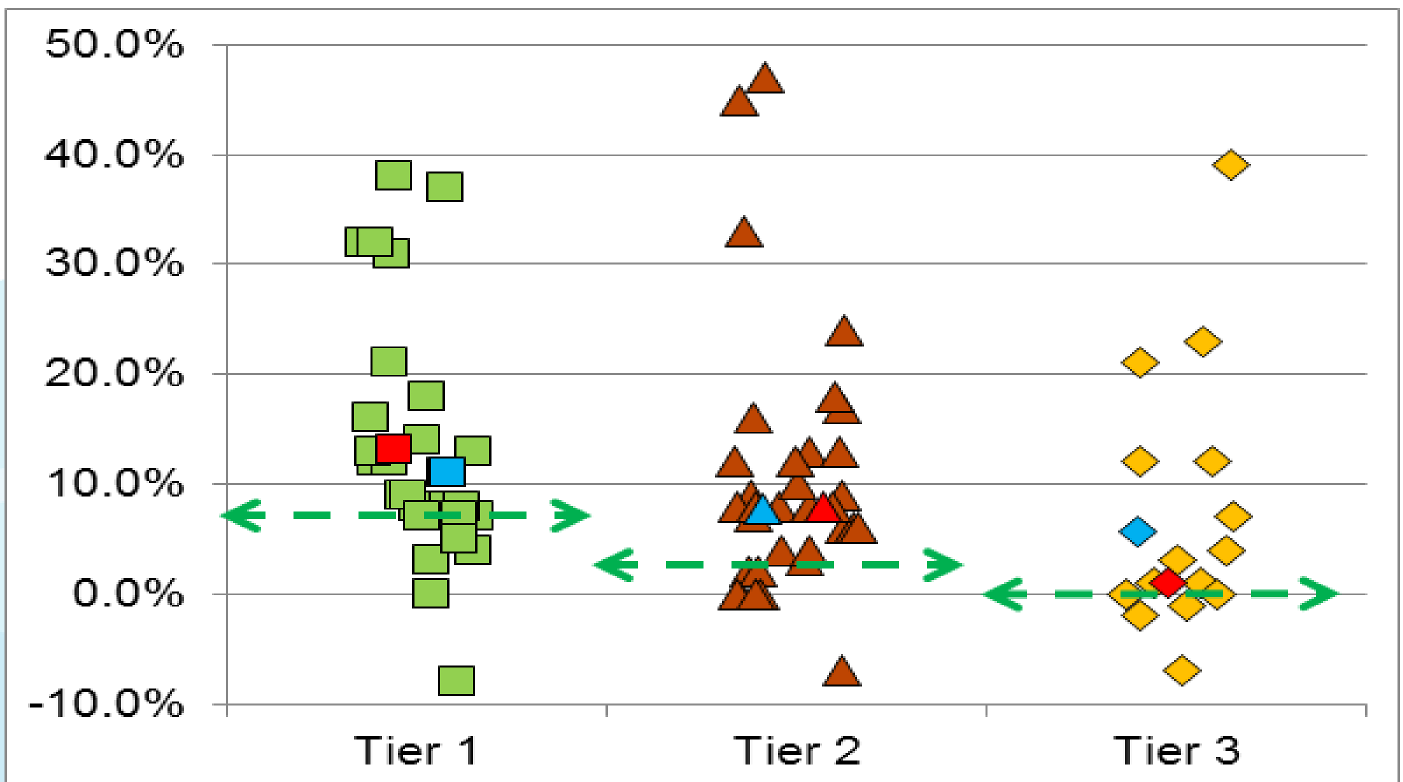
Ratio Analysis

While a convenient analytical tool, and one used extensively by the NRSCH to assist in determining if a CHP is financially viable, financial ratios only form a part of the overall assessment of compliance. In assessing compliance, analysts also take into account factors which may be influencing these ratios in order to provide better perspective to their assessment. Factors such as the size and complexity of the CHP, business, economic and investment cycles and strategic objectives are all considered in conjunction with the financial indicators outlined in this report. An equally important aspect of assessing compliance with Performance Outcome 7 is the demonstrated ability of a CHP to identify, monitor and mitigate any financial risks they may be facing. Once combined, these factors are able to provide sufficient context in which to make a decision on the viability of a CHP.

Operating EBITDA Margin

Operating EBITDA Margin is calculated as operating earnings before interest tax depreciation and amortisation divided by operating revenue. This is a key measure of profitability and is monitored by Registrars to ensure CHPs are generating sufficient margin to achieve business goals.

Figure 1: Operating EBITDA Margin – FY18

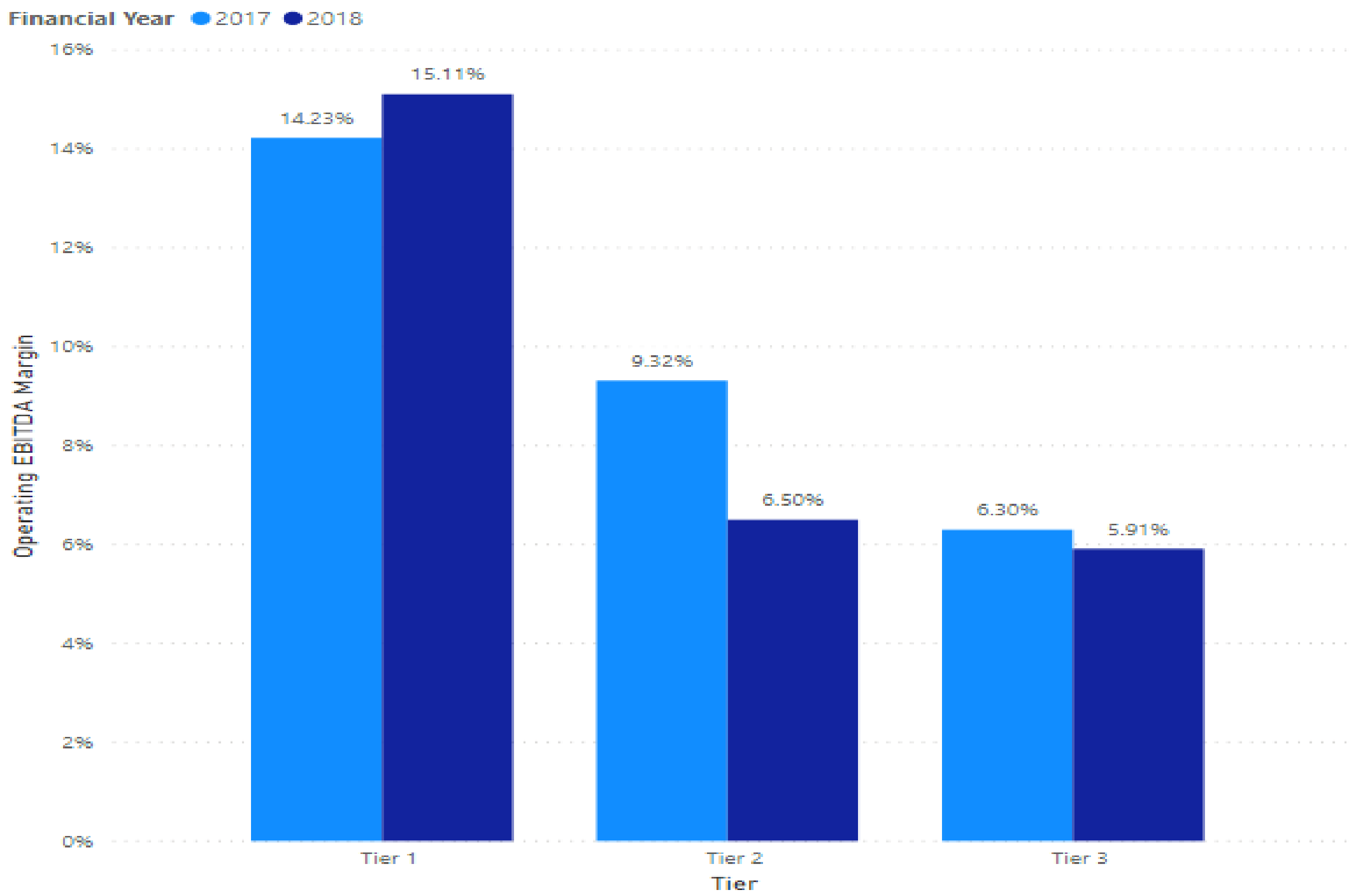


Markers in **BLUE** represent median values. Those in **RED** represent weighted averages. GREEN arrows represent NRSCH thresholds.

Based on Figure 1 above, the average operating EBITDA margin for Tier 1, Tier 2 and Tier 3 CHPs indicates a good profitability of community housing CHPs with a very small number of CHPs operating on negative margin.

As indicated earlier, Operating EBITDA has experienced a fall across the sector due to decreases in operating grants. This is not expected to impact viability in general as it is assumed that CHPs cease to provide the services funded by the operating grants and therefore not accrue expenses against them.

Figure 2: Operating EBITDA Margin – historical simple average comparison

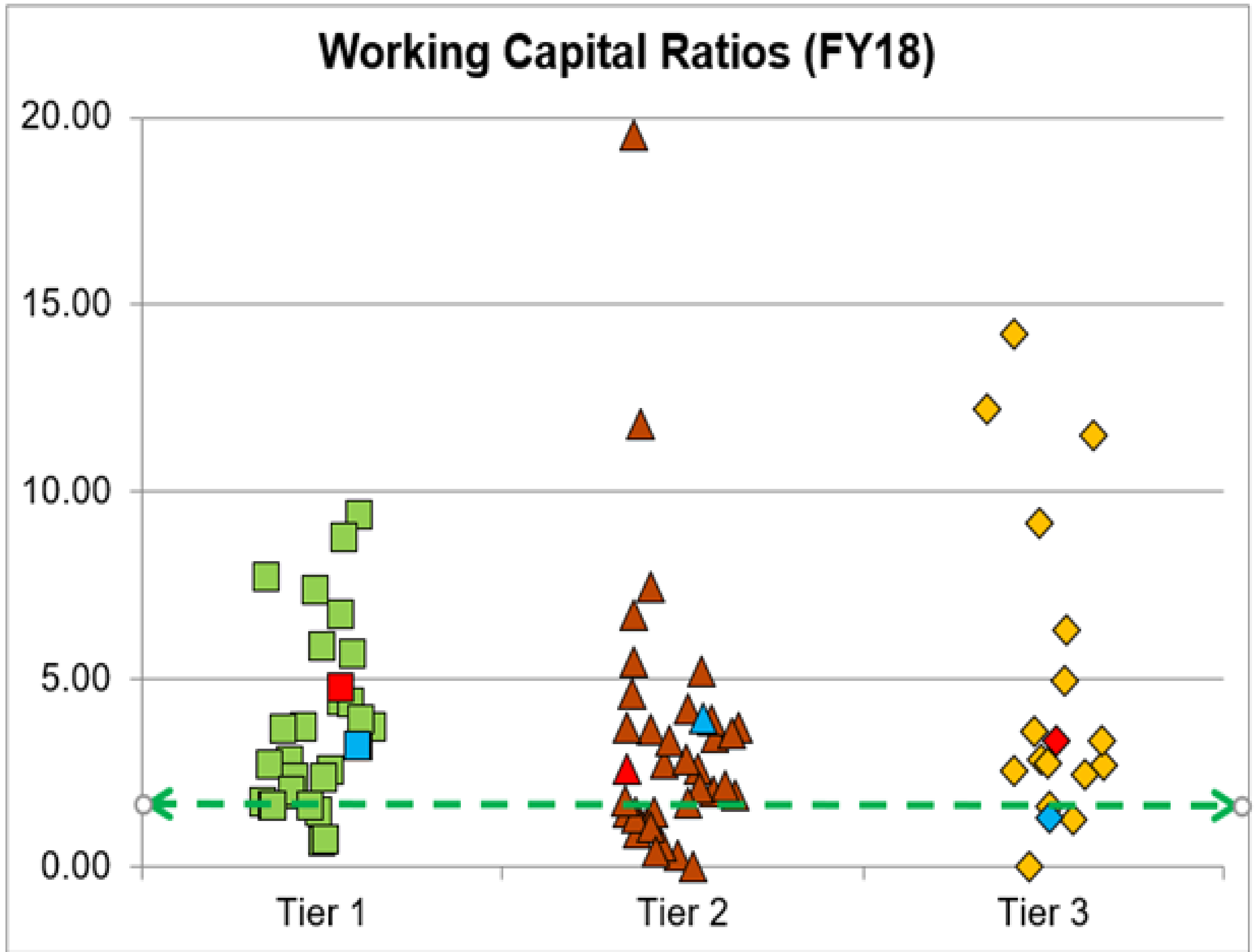


Working Capital Ratio

Working Capital Ratio is calculated as current assets less restricted cash divided by current liabilities less unspent capital grants and accommodation bonds. This is a key measure of liquidity and is monitored by Registrars to ensure CHPs have a sufficient capacity to absorb adverse financial events.

Given its focus on current assets (which include cash balances), this ratio can have a tendency to fluctuate from year to year depending on the current business cycles being experienced by CHPs. For example, CHPs undergoing expansion or changes to their business models (e.g. transitioning to NDIS) may exhibit significant variances in figures from year to year while cash is spent, and reserves are replenished. This is particularly true for smaller Tier 3 CHPs whose (typically) smaller current asset balances are at risk of greater fluctuation.

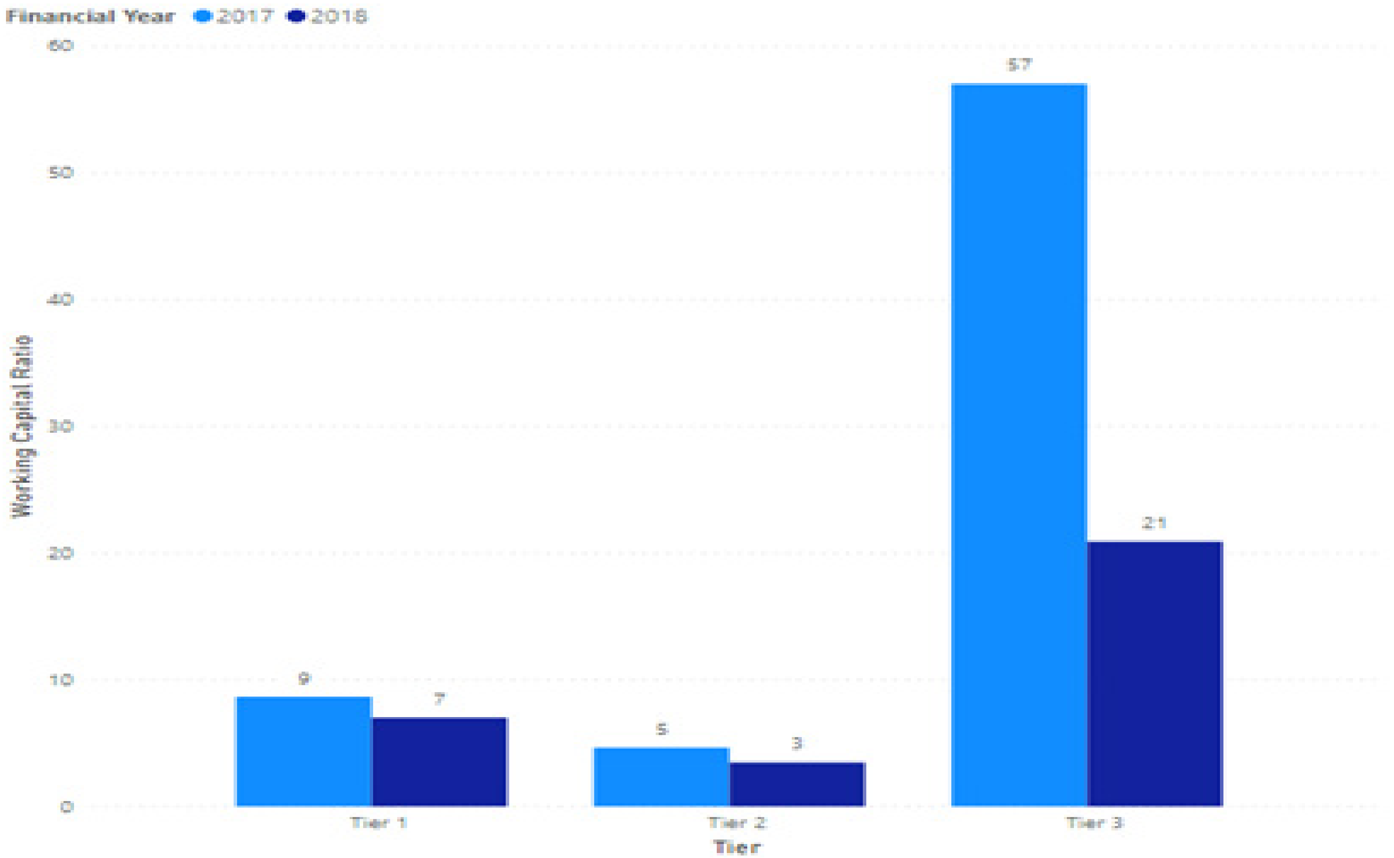
Figure 3: Working Capital Ratio – FY18



Markers in **BLUE** represent median values. Those in **RED** represent weighted averages. GREEN arrows represent NRSCH thresholds.

Figure 3 on the average shows that Tier 1, Tier 2 and Tier 3 CHPs demonstrated capacity to support and pay for currently maturing obligations with working capital ratios above a 1.5 threshold.

Figure 4: Working Capital Ratio – historical simple average comparison

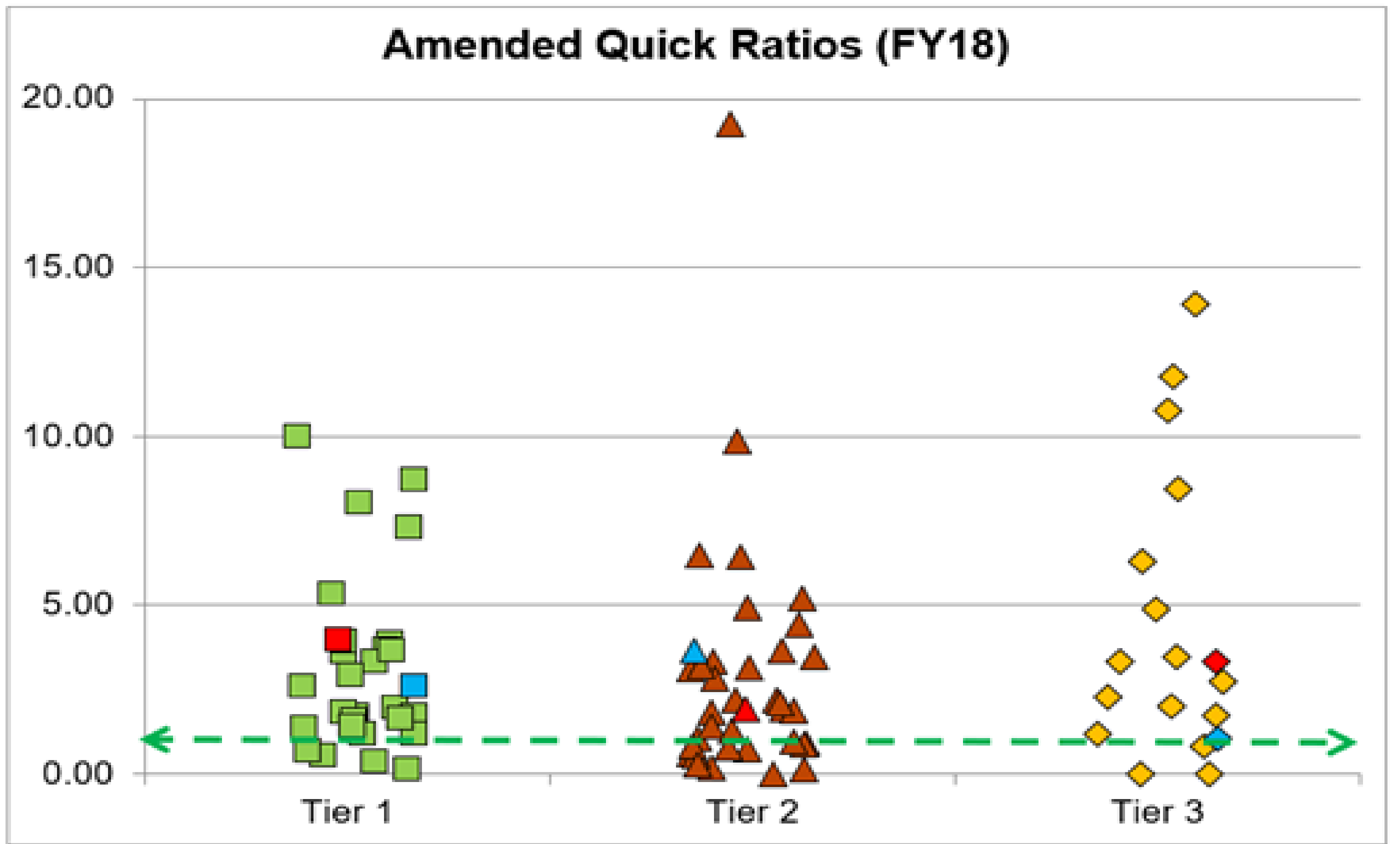


Amended Quick Ratio

Amended Quick Ratio is calculated as cash plus short-term investments plus unused overdraft divided by total current liabilities less accommodation bonds less unspent capital grants. This is a key measure of short-term liquidity and is monitored by Registrars to ensure CHPs have a sufficient capacity to absorb adverse financial events.

While this ratio is an important indicator of short-term liquidity, CHPs facing longer term, structural challenges to their finances will also need to show adequate risk identification and mitigation strategies to ensure that they can meet their financial obligations - while taking the necessary steps to ensure a return to a more stable position.

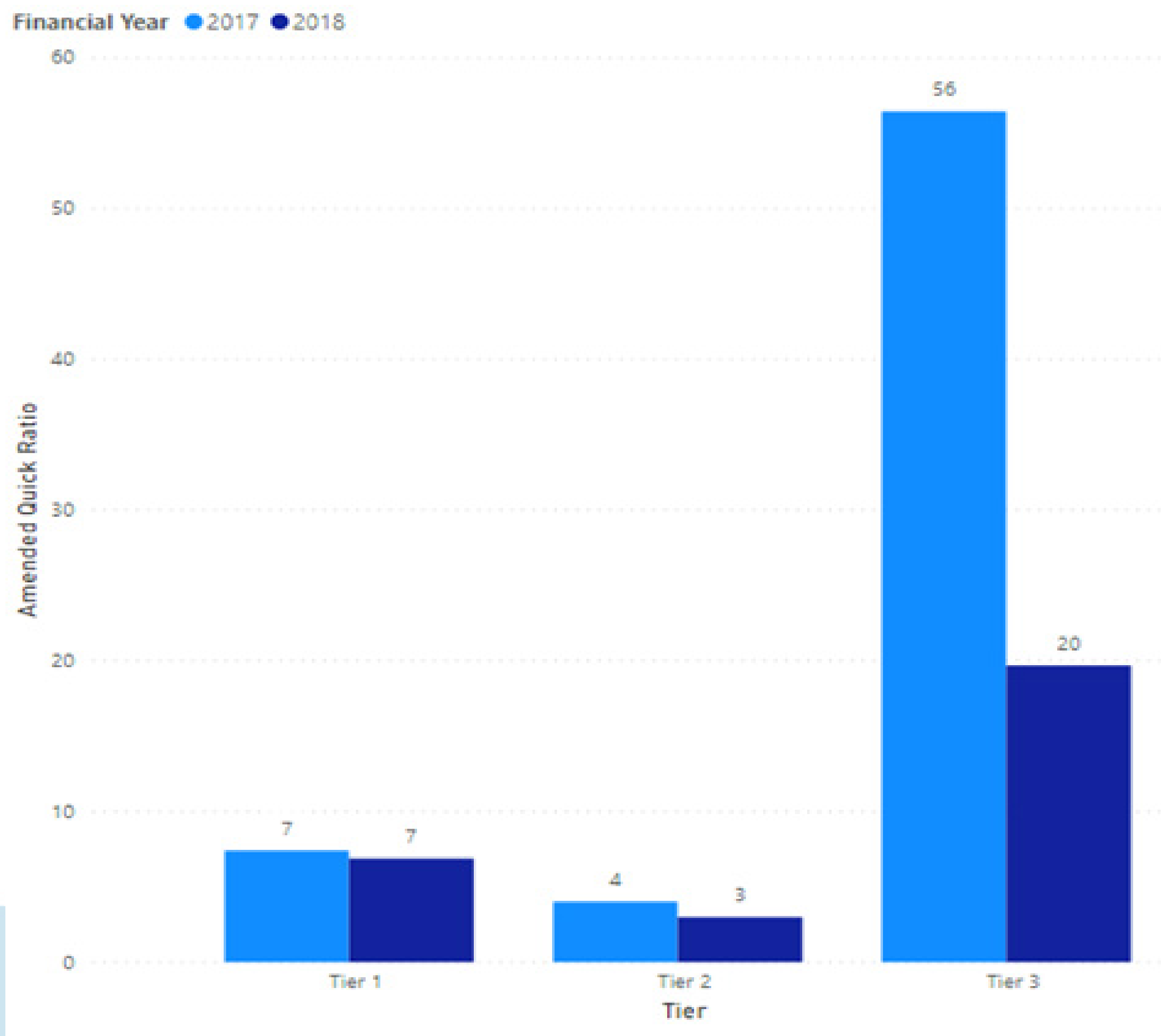
Figure 5: Amended Quick Ratio – FY18



Markers in **BLUE** represent median values. Those in **RED** represent weighted averages. GREEN arrows represent NRSCH thresholds.

Figure 5 above indicates that the substantial majority of CHPs have adequate financial resources to withstand short term adverse events. Those CHPs below threshold may need to demonstrate the capacity to mitigate risks or access to alternate funding options.

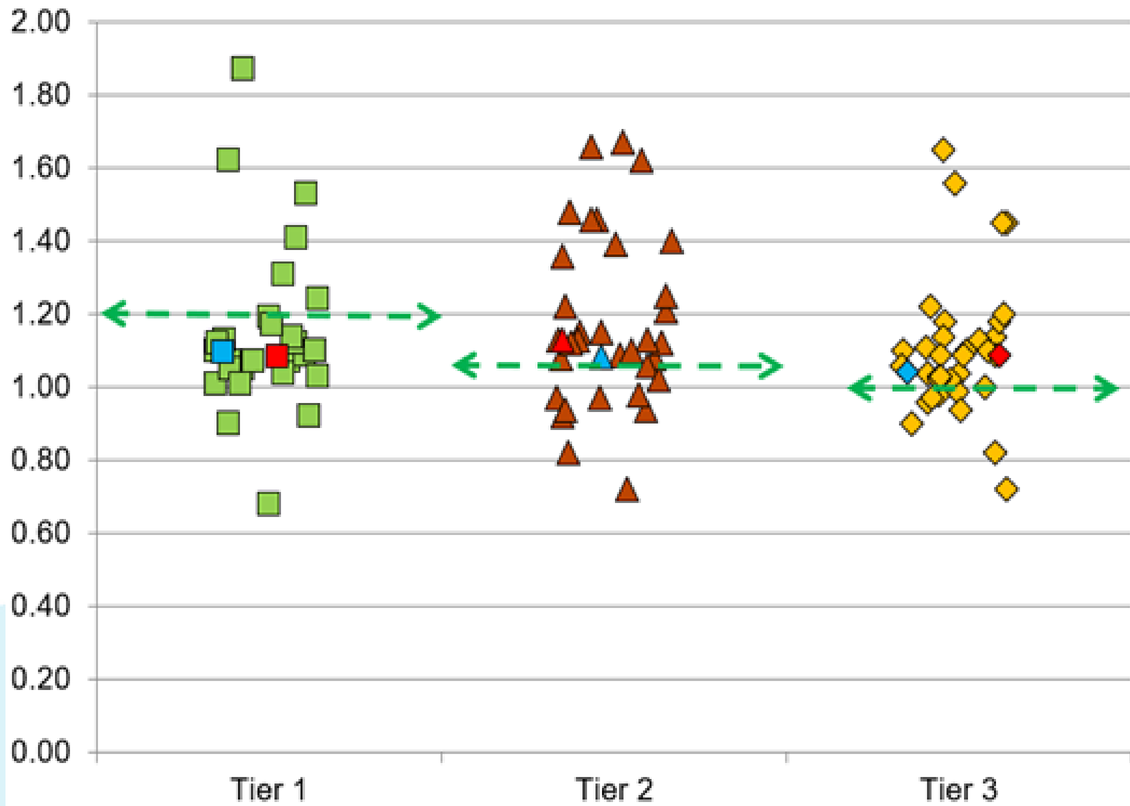
Figure 6: Amended Quick Ratio – Historical simple average comparison 2017-2018



Operating Cashflow Adequacy Ratio

Operating Cashflow Adequacy is calculated as operating cash inflows divided by operating cash outflows. This is a key measure of financial performance and is monitored by Registrars to ensure CHPs are generating sufficient cash flows from operations to achieve business goals.

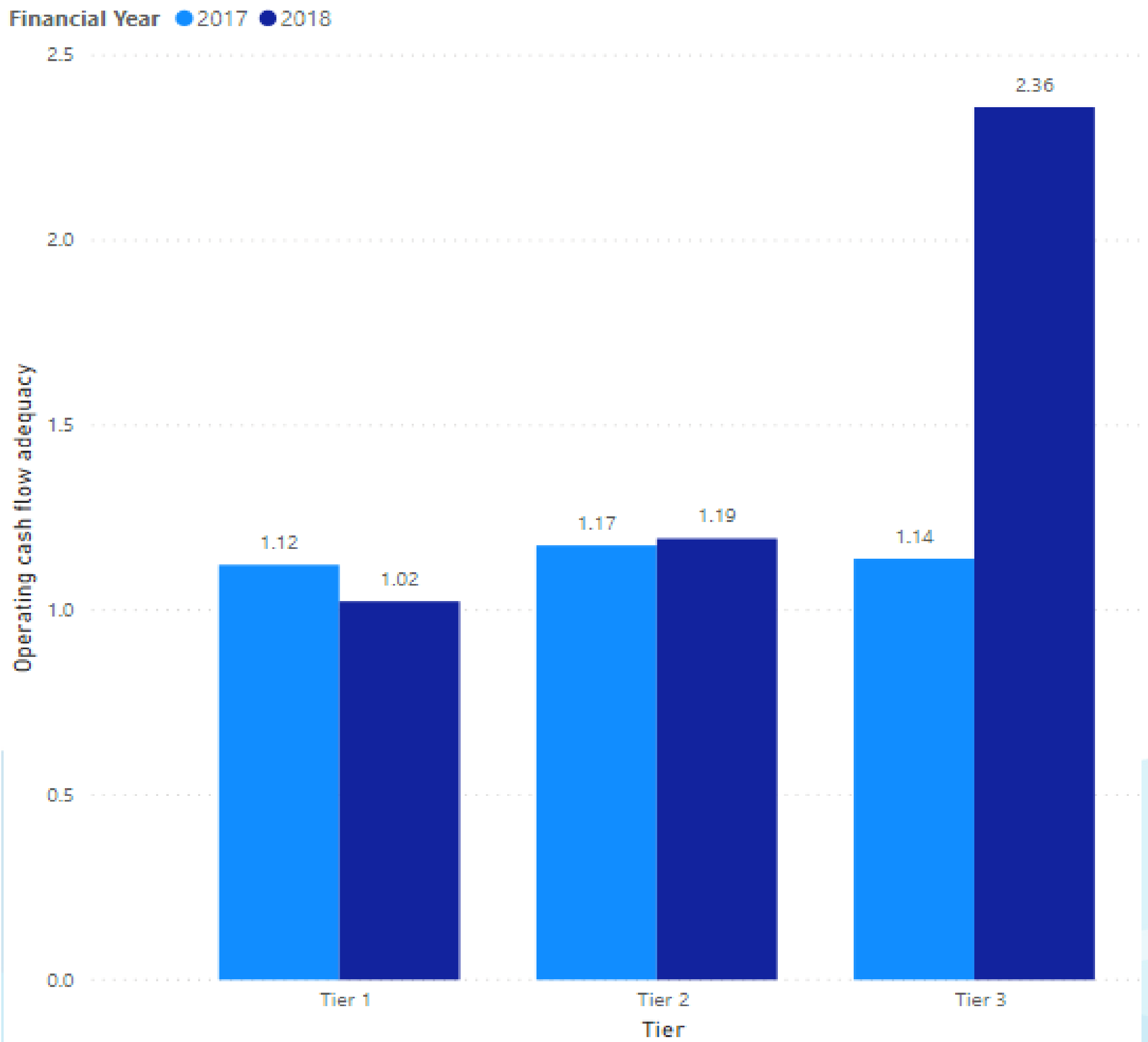
Figure 7: Operating Cashflow Adequacy Ratio – FY18



Markers in **BLUE** represent median values. Those in **RED** represent weighted averages. GREEN arrows represent NRSCH thresholds.

Figure 7 indicates that on average, Tier 1, Tier 2 and Tier 3 CHPs have generated sufficient cash flow to support on-going operations.

Figure 8: Operating Cashflow Adequacy Ratio- historical simple average comparison

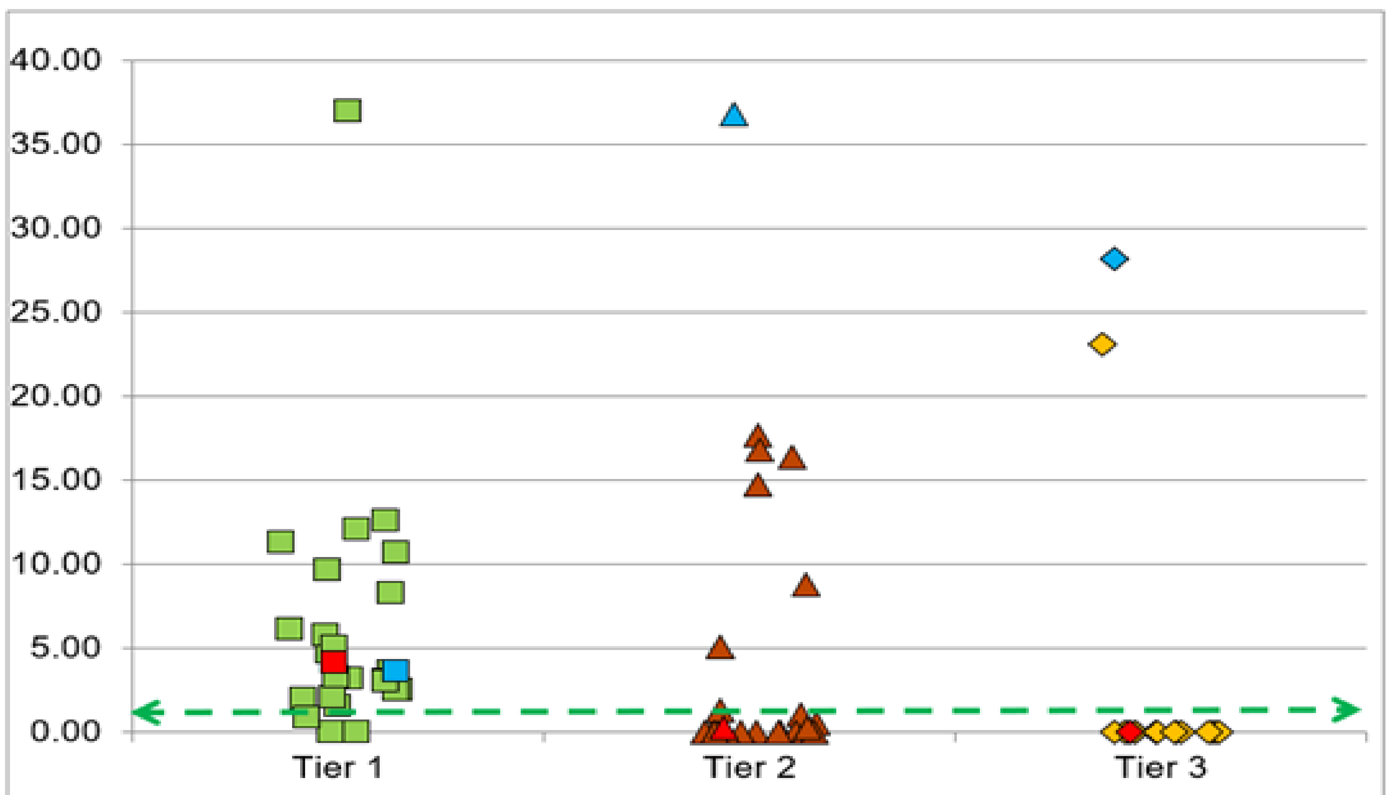


Interest Coverage Ratio

Interest Coverage Ratio (ICR) is calculated as operating EBITDA divided by total interest expense. This is a key measure of the ability to service debt obligations and is monitored by Registrars to ensure CHPs are generating surplus funds to service financial commitments.

As mentioned earlier, context is a critical factor in assessing this ratio. For example, those CHPs with a high ICR may simply have a small amount of debt (credit card balance, single vehicle loan) and a reasonable operating EBITDA- this will result in a very high ICR but is not necessarily an indication of financial health. CHPs with low ICR's (e.g. below threshold) could have significant debt relating to the construction of new housing stock (i.e. income generating assets) and a long-term plan for reducing debt and improving financial stability.

Figure 9: Interest Coverage Ratio – FY18



Markers in **BLUE** represent median values. Those in **RED** represent weighted averages. GREEN arrows represent NRSCH thresholds.

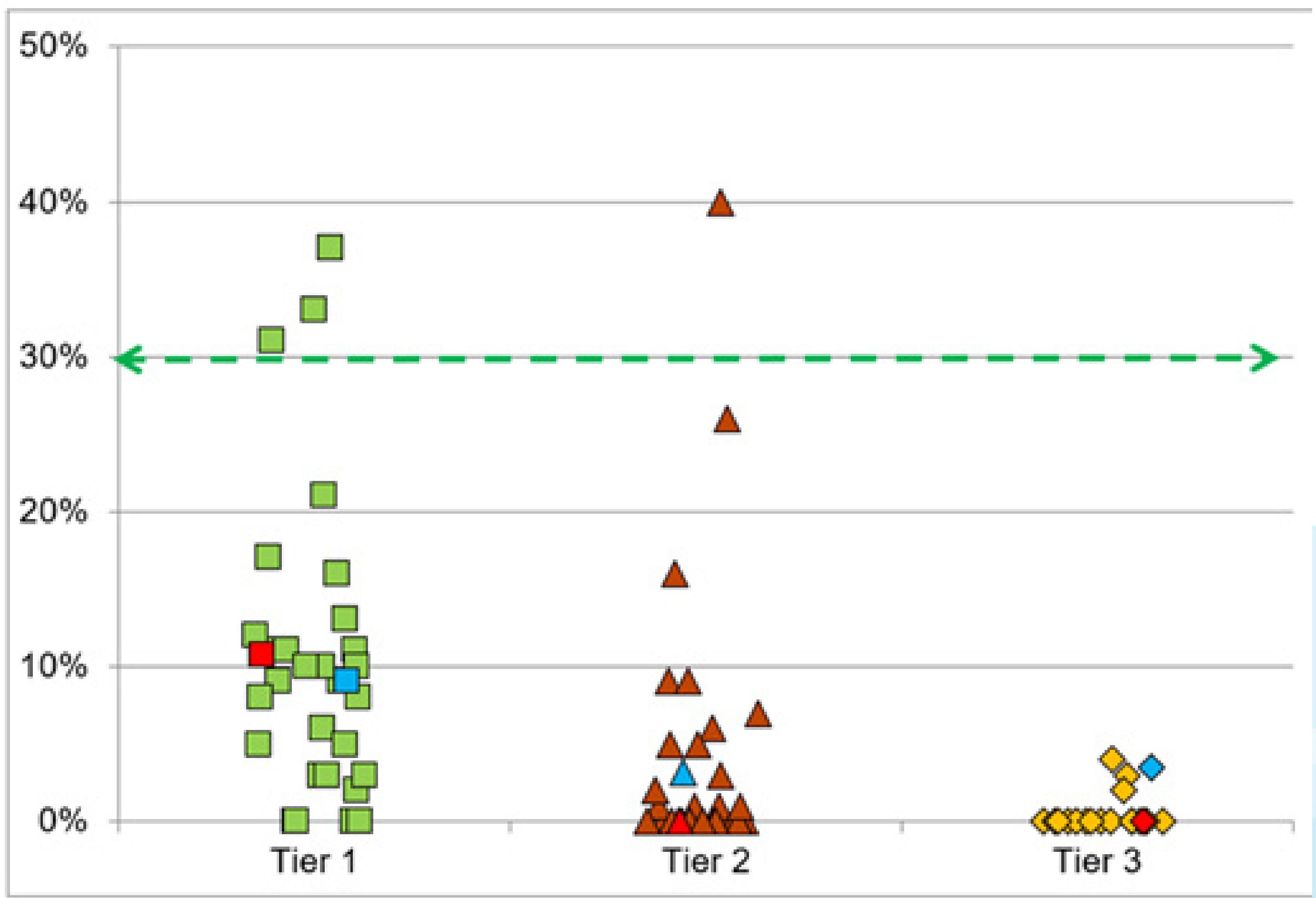
Figure 9 indicates that the vast majority of CHPs with debt demonstrate an ICR at or above threshold. All other things remaining equal, the interest rate reductions in FY19 are expected to impact positively on these results.

Gearing Ratio

Gearing Ratio is calculated as total repayable debt divided by total assets. This is used to determine sustainable debt levels and is monitored by Registrars to ensure the provider's capital structure is viable in the long term.

This ratio is typically considered along with the ICR (above) to form a more complete picture of a provider's financial situation. Combining information from the ICR and gearing ratio allows analysts to undertake basic sensitivity analysis and ascertain the effect of interest rate changes, or changes in gearing on a provider's overall financial position.

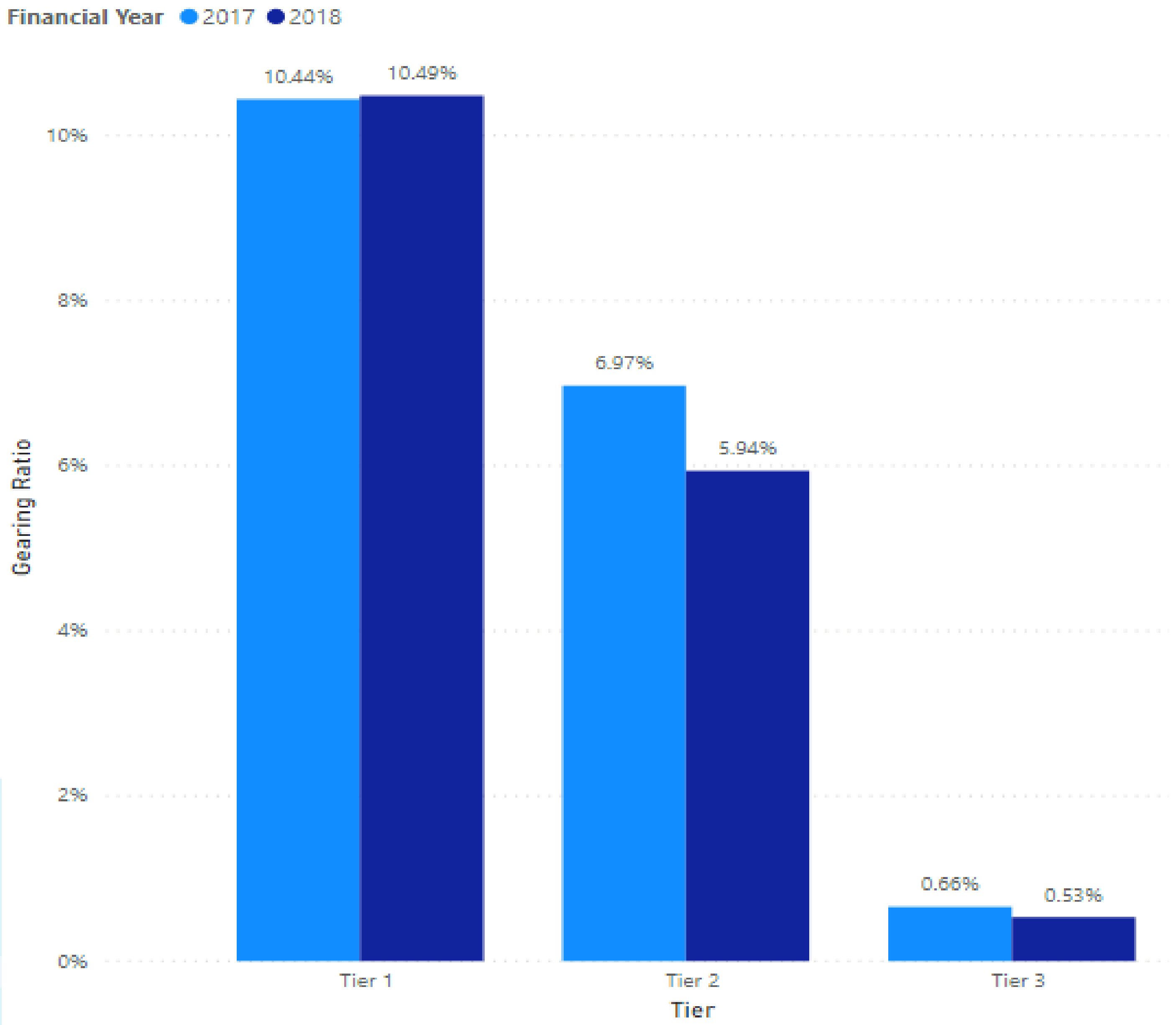
Figure 11: Gearing Ratio – FY18



Markers in **BLUE** represent median values. Those in **RED** represent weighted averages. GREEN arrows represent NRSCH thresholds.

Figure 11 indicates that the vast majority of CHPs have debt at levels well below the 30% NRSCH threshold. Despite being a sector-wide trend, the reasons behind this result can be varied and include risk appetite, strategic objectives, ability to source or repay debt and investment opportunities. Gearing ratios are expected to increase over coming years due to the implementation of jurisdiction programs and access to competitively priced finance options.

Figure 12- Gearing Ratio - Historical simple average comparison



For more information

For more information on the National Regulatory System for Community Housing, please visit: www.nrsch.gov.au