



# National regulation of the not-for-profit housing sector: Submission to FaHCSIA

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Submission by Access Economics Pty Limited on behalf of  
PowerHousing Australia to  
The Department of Families, Housing,  
Community Services and  
Indigenous Affairs

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## Glossary

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AHURI	Australian Housing and Urban Research Institute
APRA	Australian Prudential and Regulation Authority
CBA	Cost benefit analysis
COAG	Council of Australian Governments
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
KPI	Key performance indicator
LIHTC	Low Income Housing Tax Credit
NAHA	National Affordable Housing Agreement
NFP	Not-for-profit
NPA	National Partnership Agreement
PHA	PowerHousing Australia
PHI	Private health insurance
PPP	Public-private partnership
SHA	State Housing Authority

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## Executive Summary

Governments at all levels in Australia are faced with the challenge of an inadequate supply of affordable housing. The most recent Demographia survey of housing affordability<sup>1</sup> (2010) rated 22 of the 23 Australian cities surveyed in 2009 as “severely unaffordable”, noting that:

*[a] median income household would be required to pay more than 50 percent of its income to service a new mortgage on the median priced house in Sydney or Melbourne.*

Australia has primarily (but not exclusively) approached housing policy from a demand-side focus, providing financial assistance programs for both renters and owners. More recently however, the approach has begun to refocus on supply-side policies, and in particular ensuring adequate provision of rental accommodation for low to moderate income earners and disadvantaged groups.

This change in policy emphasis has given rise to the opportunity to implement **a national system of regulation for the not-for-profit housing sector** (and specifically for growth providers), as outlined in the Discussion Paper “Regulation and Growth of the Not-For-Profit Housing Sector” released by the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) in April.

The following submission has been prepared by Access Economics in response to the Discussion Paper, at the behest of PowerHousing Australia (PHA), which represents growth Not-For-Profit (NFP) housing providers.

Access Economics supports FaHCSIA’s view that housing NFPs can play a vital role in augmenting the supply of affordable rental housing, by improving competition and efficiencies among existing providers and by increasing use of private sector funding.

However, current state and territory regulatory systems and practices covering public housing have resulted in significant barriers to growth for NFPs. These barriers need to be addressed if the sector is to fulfil the role governments are now keen for it to play, in particular:

- a lack of consistency in state approaches to regulation, funding support, reporting and prudential requirements places a large burden of compliance on providers, effectively requiring providers to incorporate separately in each jurisdiction;
- varying reporting requirements and methodologies for calculating service costs, especially between state housing authorities (SHAs) and NFPs mean that outcomes are not able to be accurately compared, impeding the efficient allocation of resources; and
- SHAs both allocate and compete for funding, creating a potential conflict of interest which is exacerbated by the lack of transparency in reporting standards.

Each of these obstacles could be successfully addressed through the development of a consistent national regulatory framework that incorporates a harmonised approach to service delivery and reporting standards through accreditation of providers seeking federal funding.

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<sup>1</sup> Affordability is measured as the median house price divided by gross annual median household income. A multiple of 3x or less is considered “affordable”; 5.1x or higher is categorised as “severely unaffordable”.

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Funding from commonwealth to states would continue to be based on demographic needs; however levels of support would be standardised across jurisdictions and allocations for identified projects would be monitored by the regulator to ensure financial efficiency and transparency.

While growth NFPs and large providers, including SHAs, would be incorporated under the national scheme, smaller local providers could opt to remain under state-based regulations. This would create two tranches of providers and regulation, but would ensure that small-scale providers – many of whom are closely aligned to local special needs groups – were not disadvantaged by support for growth providers.

Regulation will also need to address the increased fiduciary risk that will inevitably accompany an increase in private sector funding. Australia's strong record on prudential regulation, and experience in sectors such as private health insurance, will ensure that these risks are minimised. Harmonised treatment of assets across jurisdictions will lead to a spreading of operational risks for growth organisations.

Reaching agreement on treatment of assets in the event of organisational failure of a nationally operating NFP provides a challenge, but should be achievable, given the broadly aligned objectives of state governments to support NFPs and the accrued benefits (economies of scale, diversified risk) of doing so. The potential that states and territories might have to cross-subsidise in the event of such failures is the price that will need to be paid to achieve all the benefits resulting from a truly national market.

The transition to a national regulatory system will be a lengthy process and, as the housing NFP sector grows, adaptation from the initial framework is likely to be required.

Access Economics recognises that state authorities will continue to play an important role in the provision of affordable housing in a number of ways including planning strategies and land release programs.

This response to the FaHCSIA Discussion Paper does not purport to provide a comprehensive solution to all the issues arising from implementation of national regulation for NFPs. Rather, it provides support for a national system and addresses questions raised by FaHCSIA in relation to key objectives and risks associated with the regulation and its implementation. Access Economics and PHA would welcome the opportunity to discuss any of the issues raised in this submission. (PHA advises that they are also happy to provide additional information regarding their operations in support of this submission directly to FaHCSIA.)

**The NFP sector has the potential to augment the supply of affordable housing in Australia, improving choice and affordability for all Australians and to improve competition among providers of government-funded social housing, through increased efficiencies derived from economies of scale, and through a more open and transparent monitoring of providers' performance. With growth and the ability to attract additional funding from private investment, the sector also has the potential to reduce the burden born by public sector funds, producing welfare gains for all.**

**Access Economics**

## 1 Background

In recent years growth in demand for housing in Australia has not been met by a matching increase in supply, leading to a shortage of available and affordable housing stock for purchase or rental. Lack of available land in particular has made obtaining affordable housing difficult for many in urban centres and especially disadvantaged and special needs groups including Indigenous Australians and low-income households<sup>2</sup>.

State and federal governments therefore face increasing pressure to devise effective policies to augment affordable supply<sup>3</sup>, including social housing, and COAG has placed the issue on its agenda. Traditionally, policies have been demand-driven through measures such as rental assistance or the First home Owners Grant.

The National Affordable Housing Agreement (NAHA) commenced in 2009, under which “Australian governments have agreed to work together to ensure people have access to affordable, safe and sustainable housing that contributes to social and economic participation”. NAHA will provide \$6.2 billion in housing assistance for low and middle income Australians in its first five years.

NAHA is an important first step towards increasing supply, but there is also widespread acceptance among policy makers of the potentially important role that can be played by the non-government sector, and in particular the not-for-profit housing (NFP) sector, which is engaged with those to whom policy is primarily targeted.

Indeed, strong endorsement for the sector came with the announcement in 2009 of the Social Housing Initiative of the Nation Building Economic Stimulus Plan. This program will provide more than \$5 billion in funding over three and a half “for the construction of new social housing and a further \$400 million over two years for repairs and maintenance to existing public housing dwellings.” A large proportion (up to 75% of stock constructed in the second phase of the program) will go to NFPs.

Australian Housing Ministers agreed in May 2009 that jurisdictions and the Commonwealth develop, over time, a **large-scale not-for-profit sector comprising up to 35 per cent of social housing by 2014**.

Social housing comprises less than 5% of all housing stock in Australia (ABS, 2009), although this figure varies markedly both between states and within the larger cities. If the sector were to expand to levels seen in those countries where social housing is strongly supported by government (such as the UK and the Netherlands), this figure over time could double or even treble.

However, to fully realise the potential of this sector, there is a need to address the significant barriers to growth for NFPs that result from the widely different principles and procedures in

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<sup>2</sup> Low-income in this submission is taken to mean within the lowest two quartiles of levelised household incomes.

<sup>3</sup> We note that there are several definitions of “affordable” in the context of housing. COAG uses the most common definition for home ownership affordability i.e. where rent or mortgage repayments require no more than 30% of gross household income.

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operation in each state regulatory systems, (noting that Western Australia, Tasmania and the Northern Territory have no formal regulation of the sector).

In recognition of housing NFP's potential, in April this year the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) released the Discussion Paper "Regulation and Growth of the Not-For-Profit Housing Sector", which acknowledges the importance of NFP providers and the need to address barriers to growth through a national system of regulation.

*Regulatory systems now in place cannot on their own support a national, not-for-profit housing system that will contribute significantly to national supply (2010).*

We now have the opportunity and obligation get the policy settings right, and to ensure that a new national system of regulation for NFPs achieves clear benefits with minimal compliance costs and restriction of competition, while protecting government investment and the rights of tenants.

Against this background, Access Economics was engaged by PowerHousing Australia (PHA) to prepare this submission to FaHCSIA on the future regulation and funding of the Not-For-Profit housing sector in Australia, in response to the Discussion Paper.

This submission addresses some of the issues raised in the FaHCSIA discussion paper, including:

- balancing the needs of growth organisations without penalising smaller operators;
- the provision of appropriate prudential standards, with monitoring and sanctions;
- the role of State Housing Authorities (SHAs);
- removing cross-jurisdictional barriers while respecting incumbent mechanisms; and
- attracting private sector finance while protecting government investments.

This submission is not intended to provide a detailed template for regulation of the sector, but rather to contribute to the debate by responding to key issues raised by FaHCSIA and others. Such issues are likely to warrant further consideration, consultation and quantitative analysis where possible. As a starting point, this paper discusses the objectives of regulation and possible means of implementation. Access Economics notes that any new regime will take time to implement and will need to take into account existing structures.

International experience in social housing, including regulation and funding options, are also canvassed as well as domestic sectors that might provide some insights such as aged care and private health insurance. The submission also draws on earlier work undertaken for PHA by SGS Economics, extensive research undertaken by the Australian Housing and Urban Research Institute (AHURI) as well as domestic and international academic and policy centres.

The structure of this submission is as follows:

- Section 2 provides an overview of current regulatory practice and shortcomings and inefficiencies which need to be addressed by any new regulation. It also looks to international experience as well as lessons from regulation in the Australian aged care and PHI sectors.

- The benefits and risks of a national regulatory scheme for growth NFPs are then outlined in Section 3.
- Section 4 identifies the objectives of a new, national regulatory framework, while Section 5 discusses options for the implementation of regulation, and identifies an optimal approach.

PHA is an industry association representing not-for-profit community and affordable housing providers and training organisations across Australia. PHA members are independent organisations with the objective of providing affordable housing and related services to people on low or middle incomes, or whose needs are not met by housing markets.

PHA members<sup>4</sup> are “growth” organisations – that is, they are committed to achieving significant growth in the quality and quantity of affordable housing held by the sector. Together, they own or manage a significant proportion of housing held by the non-profit sector across Australia. They will be the recipient of a large amount of the housing constructed under the Nation Building Economic Stimulus Plan. Indeed, the Progress report to COAG (2009) from Commonwealth, State and Territory Housing Ministers notes their agreement (p18) that up to 75% of housing stock constructed under Stage Two of this program would be transferred to community housing providers.

PHA seeks to foster a collaborative culture in the sector which enables member organisations to improve current practices and to seek out new opportunities through the sharing of best practice ideas, learning and innovation and the development performance standards and benchmarks. This also includes a readiness to collaborate with other members to identify and develop affordable housing opportunities.

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<sup>4</sup> A list of PHA members can be found on the PHA website at <http://www.powerhousingaustralia.com.au>.



## 2 Current regulatory approach

Australia has primarily (but not exclusively) approached housing policy with a demand-side focus, providing financial assistance programs for both renters and owners. More recently however, the approach has begun to focus on supply-side policies, and in particular ensuring adequate provision of rental accommodation for low to moderate income earners.

### 2.1 Domestic policy

From July 2003 to December 2008, Australia's main program for providing housing assistance was the 2003 Commonwealth-State Housing Agreement. The purpose of the agreement was to provide funding support for those whose housing needs could not be met by the private market. Under this agreement, funding support was provided for:

- public housing;
- community housing;
- crisis accommodation;
- Aboriginal rental housing;
- private rental support; and
- home ownership support.

On average, the Commonwealth government provided two-thirds of the funding for this program and the States and Territories provided the remaining one-third.

From 1 January 2009, the National Affordable Housing Agreement (NAHA) was implemented as a whole-of-government approach to address the issue of housing affordability. NAHA identifies the responsibilities of each level of government and creates a performance framework to measure the key outcomes of the agreement. It provides a framework for all levels of government to cooperate in improving housing affordability and assesses their contribution to a number of outcomes, including:

- achieving sustainable housing and social inclusion for people who are homeless or at risk of homelessness;
- enabling people to rent housing that meets their needs;
- enabling people to purchase affordable housing;
- providing access to housing through an efficient and responsive housing market; and
- providing Indigenous people with improved housing amenities and reducing overcrowding.

The NAHA is also supported by National Partnership Agreements (NPA) on social housing, homelessness and Indigenous Australians living in remote areas.

The NPA on Social Housing facilitates the Commonwealth Government's provision of funds for the Social Housing Growth Fund. These funds are for the states and territories to increase the supply of social housing and provide opportunities for the not-for-profit housing sector to grow, subject to the fulfilment of several key requirements. Furthermore, this NPA outlines

options for the Commonwealth and State and Territory Governments to address housing supply shortfalls.

While current policy and funding practice goes some way to addressing governments' housing objectives, it appears that additional affordable housing units could be made available via the NFP housing sector if certain constraints were removed and a more favourable regulatory environment were established.

FaHCSIA observes that while current state and territory regulatory systems are “fundamentally sound” they are “insufficient on their own” to support a national NFP sector.

The principal shortcomings of current practice are:

- a lack of harmonisation of regulation, which deters efficient cross-border NFP operations thereby impeding growth and the potential for private sector investment in the sector;
- limited benchmarks and performance monitoring, which may contribute to inefficient allocation of resources; and
- critically, SHA responsibility for both funding allocations and provision of services, which may lead to a conflict of interest and inefficient allocation of limited resources.

## 2.2 International practice

Housing affordability is an issue being addressed on a global scale, and there are important lessons that can be drawn from the wide range of international practice and applied in an Australian economic and social policy context.

International experience can provide broad guidance on approaches to addressing the provision of affordable housing, including through regulation, as well as the role and limitations of the NFP sector. Indeed, there is a strong message that the NFP sector can be a powerful tool in the provision of social housing.

Table 2.1 summarises key features of several international housing schemes.

**Table 2.1: International housing schemes**

Country	Sector coverage	Major funding sources	Regulatory regime
France	43% social housing made up of 18% public, 15% private, 10% partnership	Off market loans, subsidised by demand side subsidies, guarantees and tax incentives. A 'savings booklet' scheme to provide low cost building finance through short term deposits.	Covers project codes, housing construction codes, rent and allocation regulations, private profit limited to 4%
United States	4.2% social housing, public housing supplemented by NFP sector	Low Income Housing Tax Credit (LIHTC) for institutional investment, bank debt, bonds, private landlord subsidies	No regulation of the NFP sector. Business recipients of LIHTC must be managed at a project level

Country	Sector coverage	Major funding sources	Regulatory regime
Switzerland	14% social housing, comprising limited-profit associations, NFP cooperatives and municipal companies	Primarily private finance, supplemented by instruments including revolving fund, bond issuing cooperative and mortgage guarantee cooperative	Bound by 2004 charter outlining core principles including no speculative profits, good-quality affordable and sustainable housing
United Kingdom	20% social housing, mostly NFP housing associations, and also through local authorities (some of which are managed by NFP sector)	Social Housing Grants for NFP sector, private finance including debt and bonds, and The Housing Finance Corporation (THFC) for medium sized associations	Audit Commission has inspection powers, Tenant Services Authority regulates the sector
Netherlands	32% social housing, of which 99.5% is run by housing associations	Capital market loans, Central Housing Fund (independent public body) for weaker associations, some external finance, no direct subsidies	National minister oversees sector under the Social Rented Sector Management Decree, Central Housing Fund regulation, perception that greater regulation is required
Austria	Provided through limited-profit housing associations, cooperatives, municipal housing companies and private landlords	A typical housing project is funded by a mix of 30-40% public loans; 40-60% capital market debt; and 10-15% equity	Compulsory membership to Federation of Limited Profit Housing Associations which conducts audits, supervises profits and enforces business rules

Source: AHURI (2010)

International practice is most helpful in understanding different models for the provision of private sector finance, rather than offering specific guidelines for regulatory practice. The UK model, despite having separate regulators for financial prudence and service provision, is probably the most helpful to look to when framing domestic policy.

An integral part of the UK system is the funding model which incorporates both public and private sectors. In fact, 10 years after it was introduced in to UK social housing, private funding to the sector (chiefly through traditional commercial loans and a small amount of syndicated bonds) was on a par with government grants. Importantly for Australia, margins on loans fell from 150 – 200 basis points over commercial loans in 1990 to around 25 basis points over, up until the global financial crisis (Gilmour, 2010).

The US system provides an example of equity-based funding through the Low Income Housing Tax Credits (LIHTC) scheme, introduced in 1986. A secondary market for the tax credits grew rapidly over the ensuing decade and up until the global financial crisis at which point the price of credits fell dramatically.

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## 2.3 Australian regulatory practice in other sectors

Australia's federalist system of government throws up numerous challenges to policy makers. The COAG now plays a central role in attempting to harmonise policy and improve efficiencies between and across jurisdictions and in all portfolios. Despite significant progress on many fronts, there is still often a tension between state and federal governments in funding allocations and policy implementation. Nevertheless, some useful lessons can be gleaned from observing regulatory and prudential practice elsewhere in Australia. For example, both Aged Care and Private Health Insurance (PHI) regulations allow for the transfer of assets in the event of organisational failure.

Regulation of the NFP sector would incorporate two broad arms – prudential oversight and service standards – but could be overseen by a single national regulator.

It should also be borne in mind, however, that delivery of social services is often handled most efficiently at a local level, and there is clearly still a role for state authorities in the administration of services and also for smaller providers that do not wish to grow to continue to be accommodated. The administration and funding of health and education services may provide some useful guidelines as the social housing sector evolves from a state-based to a more national focus.

### 2.3.1 Private Health Insurance

The Private Health Insurance Administration Council (PHIAC) maintains Capital Adequacy and Solvency Standards for the private health insurance industry, and provides direction to the industry on compliance with these Standards. PHIAC enjoys “a strong working relationship with the PHI Industry” and works closely with insurers.

Current prudential standards are principally the Solvency and Capital Adequacy Standards, but also include the Governance Standard and the Appointed Actuary Standard. The following outlines broadly the regulatory standards of the PHI sector, which could be used as a basis for the NFP housing sector.

#### **Solvency (applies to each fund operated by an insurer)**

- A solvency reserve is required to ensure that the insurer will be able to meet the liabilities of the fund in the event that the fund is terminated: the value of the capital of each fund must be equal to, or exceed, the solvency reserve for the fund, as calculated under this standard at the valuation date.
- The insurer must disclose in its financial statements the solvency reserve for each of its funds.
- The insurer must take account of asset and investment risks related to the insurer in applying the standard.

### Capital Adequacy

- A capital adequacy reserve is required to ensure the financial strength of the fund as an ongoing operation, in particular its ability to remain solvent for at least the next three years.
- The insurer must at all times maintain adequate capital within its health benefits funds by ensuring that the value of the capital of each fund equals or exceeds the capital adequacy reserve for the fund calculated under the standard at the valuation date.
- The capital adequacy margin - used in the calculation of the capital adequacy insurance liabilities amount and renewal option amount – is set at 12.5% or more. While there is no upper limit for the margin, 30% would be considered a high value.

### Appointed Actuary

- Insurers must notify the actuary about notifiable circumstances, and provide to the actuary all relevant information and documents about that circumstance, as soon as practicable.
- A private health insurer is required to request after the end of each financial year that its appointed actuary prepare a financial condition report and provide a copy of that report to the Council within three months after the end of the financial year, which is by 30th of September each year.

The actuary presents this information to the fund's auditor, who is then required to determine whether information contained in the Annual Return (Schedules 1 – 9) for the year to 30 June complies with the requirements of the solvency and capital adequacy standards.

Where the auditor is unable to provide an unqualified opinion that the PHIAC 2 Annual Return reflects the provisions of the above legislation, a qualified audit report must be provided to PHIAC, which details the nature of the qualification.

Under the *Private Health Insurance Act 2007* PHIAC is authorised to:

- seek explanations;
- commence investigations;
- accept written undertakings; and
- initiate legal action in the Federal Court.

PHIAC takes a proactive stance, seeking early identification of risks and giving direction to insurers to prevent breaches of standards.

### Sanctions

- For failing to notify the Council, as soon as practicable, if it becomes aware of a breach of prudential standard or any other matter or occurrence that materially affects its financial position: Fine = \$22,000 (200 penalty units @\$110 per unit).
- For failure to comply with Council directions to comply with the standard or take specified action within a specified time: Fine = \$6,600 (60 penalty units @\$110 per unit).

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### **2.3.2 Aged care**

The aged care sector in Australia, like the social housing sector, is characterised by the number of relatively small provider organisations with limited Commonwealth funding and a capped fee structure. There is a strong prudential framework in place to minimise risk to the Government's Accommodation Bond Guarantee Scheme, which covers some \$8 billion in bonds held by providers.

Aged care deals with a particularly vulnerable section of the community and as a result is heavily regulated. However providers argue that there is an imbalance between consumer protection and the regulatory burdens imposed on operators. There are many inconsistencies in regulations across jurisdictions and burdens imposed by duplication of processes such as reporting requirements and certain safety procedures (CHA, 2009).

In contrast, public housing would be best served by light-handed regulation which balances the compliance costs of operators against the needs of tenants.

### **2.3.3 Australian Prudential and Regulation Authority**

Access Economics notes that FaHCSIA has already received preliminary advice from the Australian Prudential and Regulation Authority (APRA) (Discussion Paper, Section 3.5) on the key elements of prudential regulation.

As policy makers are well aware, the Practice notes of APRA on issues such as Capital Adequacy provide guidelines for financial regulation which will be broadly helpful when defining standards for the NFP housing sector.

The PHI industry provides a powerful example of successful industry regulation, and a useful starting point for developing national regulations for housing NFPs. Given the expected development of the sector over time, a close working relationship between providers and the regulator would be especially beneficial to all parties.

### **3 Benefits and risks assessment**

A cost benefit analysis (CBA) will play an integral part in the development of any new regulatory system. However, a full quantitative analysis of costs and benefits is not possible until a more detailed scheme is developed, and in any event is well beyond the scope of this submission. Nevertheless, it is important to identify potential benefits and costs that may arise as a result of implementing regulation at a national level and this section presents a high-level discussion of the issues.

The NFP sector has the potential to augment the supply of affordable housing in Australia, improving choice and affordability for all Australians and to improve competition among providers of government-funded social housing, through increased efficiencies derived from economies of scale, and through a more open and transparent monitoring of providers' performance. With growth and the ability to attract additional funding from private investment, the sector also has the potential to reduce the burden born by public sector funds, producing welfare gains for all.

#### **3.1 Benefits**

##### **3.1.1 Economies of scale**

The NFP housing sector is characterised by a large number of small providers, fragmented across states, a significant number of which are seeking to grow to gain efficiencies through economies of scale. Some have already achieved some success through both organic growth and merger. The Social Housing Initiative of the Nation Building Economic Stimulus Plan will add another 12,000- 15,000 units to the NFP sector in the short term.

Efficiency gains will occur through both physical economies of scale as well as greater skills development and utilisation within providers. The latter will result in a lower marginal cost of service management.

Significant efficiency gains can also be achieved by a national system of regulation which allows for NFPs to operate across all jurisdictions under a single corporation. Currently regulations mean that a separate entity needs to be established for each state, which not only diminishes economies of scale and imposes duplication and other burdens of compliance, but also forces providers to negotiate separately with industry partners such as finance providers and construction companies.

This trend is already evident among members of PHA who are larger than average NFP providers – typically owning between 700 and 2,000 housing units – and who report management and efficiency gains accruing from the increase in organisational size.

The cost advantage enjoyed by these larger organisations provides the case for encouraging further support for growth providers. An assessment of the scale of benefits that may be achieved through economies of scale could be achieved by additional research in this area, and in particular a quantitative cost benefit analysis.

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### **3.1.2 Leveraging private investment**

The ability to attract private finance at commercial rates is an integral step towards increasing the supply of affordable housing in Australia while simultaneously freeing up public sector finances (without diminution of service) for other purposes.

Internationally, large-scale private investment in affordable housing is well established. Well-developed markets include the UK, where debt financing dominates, and the US, where equity financing is more prevalent (as discussed in the previous section). In both of these countries, however, the global financial crisis has significantly impeded the provision of private sector finance.

Some degree of private financing, albeit limited, already exists in Australia and, while data are not publicly available, it is likely that the current scale of providers means debt is financed at a significant risk premium to market lending rates. However, involvement by institutional lenders is growing rapidly. For example, Housing Choices Australia has recently raised \$50 million in debt. Further investigation of current financing practices and the degree to which funding costs could fall as a result of national regulation (as occurred in the UK) will yield more concrete analysis of the potential benefits of attracting additional private sector finance.

UK experience suggests, however, that a strong regulatory environment that reduces financial risk is likely to attract more financing to the sector at more competitive rates.

It should be noted that social housing, by its very nature, is unable to provide high returns to equity investors. To attract greater equity financing, for example from philanthropic funds, some form of government incentives (as occurs in the US) are likely to be required. Access Economics notes that NFPs already receive substantial tax exemption benefits (e.g. GST, payroll and land taxes). Further consideration of such incentives is outside the scope of this discussion.

### **3.1.3 Reinvestment of surplus assets/income**

By definition, NFPs reinvest surplus assets and income into the acquisition and maintenance of additional affordable housing. The level of reinvestment will vary across different providers, according to objectives and practices that are individual to the provider and it is therefore difficult to quantify.

State authorities in theory are also able to reinvest, and to some extent do, however the overwhelming trend at present has been for SHAs to sell assets to fund capital and operating liabilities.

The implementation of regulation supporting the NFP sector may therefore lead to greater reinvestment in the sector resulting in welfare gains for the economy as a whole.

### **3.1.4 Reduced financial stress**

An increase in the supply of affordable housing to low-income and disadvantaged groups will reduce the financial burden that housing places on many in the community. Definitions of financial stress vary widely, but the level of stress in the economy can be gauged from actual

defaults on rent and mortgage repayments as well as rates of homelessness. Increased provision of low cost housing options will contribute to a reduction in all three variables.

### **3.1.5 Transparency**

Operating and reporting requirements vary widely between jurisdictions, making a comparative assessment of efficiency and outcomes all but impossible. This differential is further exacerbated by different treatment of housing NFPs and SHAs, with the former subject to Corporations Law. A harmonised regulatory system for housing NFPs and SHAs would improve transparency.

### **3.1.6 Diversification of risk**

A regulatory system that supports a truly national market for housing NFPs will allow for a more diversified portfolio risk profile. This entails a degree of sharing of risk across jurisdictions, for which state government agreements do not at present allow that states and territories with an inherently lower risk profile may be reluctant to take on. However, in the context of dealing with organisational failure, the benefits of supporting a national framework, as outlined in this submission, are likely to more than offset the risks.

### **3.1.7 Greater levels of choice**

NFPs are often able to provide more customised tenancy support, as services are directed towards specific groups with whom the NFP organisations have close association, in comparison with SHAs which address social housing needs for the full cross-section of groups accessing public housing. This specialisation can provide advantages in the form of innovation and productive efficiencies, through different management structure and greater ability to target the needs of the community.

A greater degree of flexibility particularly allows for variations in design and construction, based on local intelligence, opportunities and tenant requirements such as modification for wheelchair access. Where the public housing sector provides more generic opportunities, the NFP sector can address needs more directly, and further growth will encourage this as providers learn from each other.

Increased choice in affordable housing will also occur as a result of the increase in overall supply. Importantly, it may also go some way to addressing the stigma that is frequently associated with social housing.

Greater involvement of NFPs in the sector is therefore likely to lead to greater utility from increased choice of affordable housing options. However increased choice resulting from more specialised provision of services may come at a cost of increased rents, and the objectives of choice and affordability need to be carefully balanced.

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## 3.2 Risks

### 3.2.1 Protection of small scale operators

A key risk of regulation is that, in supporting growth providers, there is a risk of discriminating against smaller operators. FaHCSIA acknowledges the important role played by many providers and therefore regulation needs to be carefully implemented to avoid this outcome. An opt-in system for larger and growth providers is one means to achieve this.

### 3.2.2 Security of government investment

While providing regulatory support for alternative business models and funding sources will enable the NFP sector to innovate, utilise their assets more effectively and better attract private investment, it may also expose the sector to risks which, if left unchecked, could threaten the credibility of any genuine innovation.

An increased reliance on NFPs to provide, maintain and administer social housing services involves a transfer of (financial) risk from public to private sector, via use of debt financing. Risks arise due to:

- the combining of public funding with private equity or debt, which places public monies at risk; and
- perception by investors of an implicit guarantee of the investment in housing that is enabled and progressed through government policy and possibly involves joint funding.

In both instances, the government has some role for monitoring and managing the risk in the regime.

This is not to say that such a risk is inappropriate, in fact, it is an innovative way of expanding housing stock as the underlying property serves as security for a bank loan. Indeed, this risk can be mitigated through close prudential supervision and monitoring of financial operations, and setting of standards for financial health assessment tools such as interest cover and debt equity ratios. The private health insurance sector provides a helpful template for establishing appropriate tools and management of the prudential supervisory role, as discussed in Section 2.3.1.

In summary, a national system of regulation and accreditation has the potential to promote growth, efficiency and innovation in the NFP housing sector, providing a backdrop for the expansion of the NFP sector's role in the provision of competitive, service-oriented and affordable housing in Australia. Key risks can be mitigated with appropriately structured regulation.

The extent to which regulation can and should address tenants' rights, which is raised in the Discussion Paper, is not covered in this submission. However Access Economics notes and supports the observation in the Discussion Paper that an expanded sector may be best served by rent differentials that reflect the household's level of income and/or the location of housing facilities. In designing such features of the regulation, equity and simplicity must be carefully balanced against the required rate of return to generate future investment in the sector and an optimal means to preserve government investment.

## 4 A new regulatory regime

As noted in Section 2, there is a need and desire among governments to stimulate growth in the NFP sector as a means of meeting current and future affordable housing targets; implementing a national regulatory framework is seen by the NFP sector and FaHCSIA as a crucial step towards achieving this goal. The current regime, while providing some degree of affordable housing, falls short of achieving identified targets, lacks efficiency and flexibility and imposes barriers to growth for NFPs.

Office of Best Practice Regulation guidelines for implementing regulation state that, whatever the form of regulation (explicit, quasi-, self-, or co-regulation):

*In all cases, the methods adopted to deal with a perceived problem should ideally have the following characteristics: administrative simplicity; flexibility; and efficiency and equity (OBPR 2007, p96).*

In a sector traditionally dominated by state-based public authorities, a new regulatory regime should seek to expand the supply of affordable housing through support of the NFP housing sector. The NFP sector sees the regulation as a means promote competition between current providers by providing a level playing field for all participants and to support further growth of the sector, operational capability and innovation.

Specifically, national regulation of the sector should:

1. be consistent with the objectives of national affordable housing policies;
2. address inconsistencies within and across existing state based regulatory regimes;
3. lead to the most efficient allocation of public sector funding and promote greater competition between all participants, including SHAs;
4. define appropriate Key Performance Indicators (KPIs) for accreditation, including measurement of performance standards;
5. develop prudential standards including monitoring and sanctions;
6. not discriminate against smaller providers;
7. stimulate additional private sector investment (through debt, equity or partnerships) by supporting a sustainable sector with an appropriate balance between risk and prudential regulation; and
8. not be administratively complex.

These objectives are discussed in more detail in the following sections, which also address questions raised by FaHCSIA in its discussion paper.

Access Economics observes that the NFP sector in Australia is currently in its infancy and that any regulatory framework is likely to require modification over time as the industry increases in size. An initial framework should therefore be subject to review after an appropriate period.

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## 4.1 Consistency with affordable housing objectives

Under the NAHA, the overarching objectives of national and state governments to increase the supply of affordable housing are aligned, despite marked differences in current regional policy and implementation. An expanded role for the NFP sector is also an agreed objective. However, because each state and territory is currently operating within a different regulatory framework, moving to a national system that incorporates the best practices in each jurisdiction – and indeed which adopts new practices - will be challenging.

## 4.2 Consistency between multiple jurisdictions

As discussed in Section 2, there are a number of problems with the current state-based regimes, which constrain alternative providers – and in particular the NFP sector – from operating interstate at present. (In fact, WA, Tasmania and the Northern Territory have no formal regulations for the sector).

For example, the state based regulatory schemes establish different treatment of the provider's assets if an organisation fails.

In Victoria, the regulator of registered providers under the Victorian scheme has (in certain circumstances) the power to instruct the governing body of the provider to:

- order a transfer to one or more registered providers of some or all of the land of a registered provider in which the state has an interest;
- order a merger of one or more registered providers;
- appoint persons to the governing body of a registered provider;
- appoint an administrator to control and direct the registered provider; or
- wind up and distribute the assets of the registered provider.<sup>5</sup>

In contrast, the powers of the regulator of registered providers under the New South Wales regulatory scheme extend only as far as the cancellation of a provider's registration.<sup>6</sup> A community housing agreement between the SHA and the registered provider (under which a registered provider receives state funding or assets) may separately include conditions relating to any land held by the provider concerned (and in which the authority has an interest) that have effect if the registration of the provider is cancelled.<sup>7</sup>

The ability to operate at a national level, such that funding of cross-state operations becomes viable, presents a difficult challenge for regulation in the treatment of assets in the event of organisational failure. States and territories implicitly support the principle of a national market and the benefits to be gained from a greater role for housing NFPs. It is therefore in the interests of all to align funding support mechanisms, reporting requirements and prudential oversight and to share the risk of organisational failure proportionately.

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<sup>5</sup> Housing Act 1983 (Vic) section 132

<sup>6</sup> Housing Act 2001 (NSW) section 67G

<sup>7</sup> Housing Act 2001 (NSW) section 67K

Agreement among states and territories on appropriate national standards will need to take account of existing regulatory practice and the structure of SHAs, while improving the transparency and accountability of all providers.

### **4.3 Efficient allocation of resources among providers**

Genuine competition between providers for finite public sector funding promotes optimal economic outcomes in the affordable housing market. This requires that all funding (subject to jurisdictional considerations) is fully contestable. This is not the case under current state-based systems, where a potential conflict of interest is inherent by virtue of the fact that SHAs “compete” with other providers for funding. The inability of NFPs to operate in more than one state under the same organisational structure also further impedes competition.

To achieve contestability on a level playing field for NFPs, private sector providers and SHAs, it is therefore necessary to replace SHAs as the primary allocators of funding to the sector as a whole, and to introduce standardised performance measurements.

Allocation decisions made by a national regulator would still need to take into account the particular demographic requirements of each state and territory, balancing these needs with an accepted approach to redistribution of government sector revenues.

SHAs must also be held to the same performance standards as non-government providers. At present it is difficult to accurately measure outcomes such as average cost of services as reporting standards for all aspects of operations vary both within and across states.

### **4.4 Key performance indicators**

To determine optimal funding allocation, an administrative body needs to be able to assess various providers’ capabilities, including past and expected performance. This suggests that providers need to comply with minimum standards, whilst also being required to evidence performance in the providing services and utilising Commonwealth funding.

There is agreement among officials and academics that consistent performance data for the sector are very limited. The NAHA goes some way towards beginning to address this problem, but establishing a solid database will take many years.

To effect policy in the sector, the regulator will need to establish a range of KPIs for service delivery and financial risk which will then need to be monitored by the regulator. Standards should be enforceable and sanctions effective.

A process of accreditation should be used to regulate service delivery minimum standards and determine approved providers.

An annual reporting requirement should be complemented by mandatory reporting of breaches of standards within a specified timeframe. Fostering a close relationship between providers and the regulator will also strengthen industry performance and confidence in the sector.

Specific indicators will need to be developed over time, in consultation with all industry stakeholders, and a consistent method of reporting imposed on providers. Current state-

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based requirements, as well as standards from other social service providers (aged care, child care, health) can be drawn on to provide solid means of assessing provider outcomes over time.

Financial KPIs for the sector should therefore draw on current regulatory practice and institutions such as APRA.

#### **4.5 Development of prudential standards**

Australia has a strong reputation for its ability to develop and implement prudential requirements across a broad range of industries. Financial sector standards, for example, are such that Australian institutions navigated the global financial crisis relatively unscathed.

As discussed in Section 2, industries such as PHI will also provide a useful template for developing a strong system for monitoring of financial risk among providers, and minimising the risk of organisational failure.

Regulation should give consideration to the treatment of partnerships between individual NFPs and to Public-private partnerships (PPPs).

#### **4.6 Protection of smaller providers**

Given the small size of many players in the NFP sector, imposing regulation on all providers may in fact impede competition through disproportionate compliance costs. PHA members support an opt-in system of regulation, under which smaller providers can continue to operate under current systems.

Industry consultation suggests that targeted size of operation over a period of time (such as 5,000 units over 5 years) may be more useful as a means to determine a threshold for compulsory inclusion under national regulation. A minimum level for mandatory inclusion of around 700 units was suggested by some PHA members, as long as no smaller organisations would be prevented from opting-in if they so chose.

The requirement for competitive neutrality is an important principle which should be reflected in any future regulatory regime. However, as economies of scale are also essential to ongoing viability a balance must be struck, at least in the short term, which would allow NFP providers to build scale, while at the same time transitioning the affordable housing sector to a more open and transparent regime. This would suggest that in the interim a staged approach to implementation may be desirable.

#### **4.7 Attraction of private sector funding**

The development of appropriate prudential standards and accreditation requirements, in addition to the fostering of increased scale for NFPs, will lead to an indirect benefit by way of increasing the attractiveness of the sector for private finance including large-scale investors.

However, direct regulation to attract private finance, such as tax breaks or concessional loans, are not anticipated.

## 4.8 Administration and implementation

One of the most challenging aspects of developing a national system of regulation will be the process of moving from current state-based systems that are built on markedly different approaches, without introducing undue complexity and burden of compliance.

If undertaken well, however, new regulation could in fact lead to a reduced compliance burden for providers, especially for those who wish to operate across jurisdictions.

Nevertheless, any regulatory framework must have regard for the starting point from which it is to be developed. The most desirable framework from a systemic viewpoint may not necessarily be the most appropriate if the process of implementing and complying with the new regime outweighs the potential benefits. This is not to suggest that regulatory reform should not be undertaken simply because it involves change and/or the need for additional obligations. Instead, it is simply to say that approaches that can leverage off existing institutions and administrative arrangements may be the most efficient.

In addition to taking into account existing regulatory structures, future compliance requirements should not involve undue compliance costs.

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## 5 Implementation options

This section comments briefly on the five implementation options outlined the FaHCSIA Discussion Paper and on how well each option fits with regulatory objectives.

Given the large number of small players in the sector who may not wish to grow, there should be opportunity to stay under current state system regulation. As noted earlier any system would ideally be, at least in its early stages of development, based on an opt-in process.

- A minimum threshold for mandatory participation under a national regulatory framework could be set (and possibly adjusted over time). Inclusion might alternatively be based on growth targets over time.
- Large state-based providers (i.e. SHAs) should be subject to the terms of national regulation, competing with NFPs on a level playing field.

If the NFP housing sector is successful in growing and establishing a significant role for itself as provider of social housing, initial regulations and the implementation framework may need to be adjusted over time. A review process should therefore be incorporated into legislation.

FaHCSIA has identified primary options for a regulatory scheme. Details of each are available in the Discussion Paper and have not been reproduced here. While each of the options presented is broadly consistent with the objectives of regulation and has some advantages as well as drawbacks, **Option 2 – when combined with the ability to opt-in to preserve competitiveness for smaller industry providers – presents the most practical and flexible solution.**

Of course, at this stage, many details still need to be worked out, but this option presents a sensible starting point in broad terms. For example, such a regime addresses the perceived lack of independence and accountability in current funding arrangements. Accreditation is a positive and necessary step that will allow for accurate monitoring and assessment. Access Economics notes that this is the preferred option of PHA.

Table 5.1 below provides a comparison of key features of the options presented in the FaHCSIA discussion paper. Each option will be affected to varying degrees by the need to transition from one system to another and to obtain consensus from all jurisdictions on objectives and standards.

**Table 5.1: Comparison of implementation options**

<b>Option</b>	<b>Advantages</b>	<b>Disadvantages</b>
1. National accreditation combined with state/territory regulation	Relative ease of negotiation and implementation.	Most cumbersome and complex and likely to increase compliance costs. Does not address cross-border barriers to growth from regulatory inconsistencies.
<b>2. Commonwealth regulation of National Housing Associations</b>	<b>Uniformity. Simplicity. Targeted action for growth providers. Advances competition and flexibility (with ability to opt-in).</b>	<b>State-based systems will continue, albeit with a reduced role.</b> <b>Needs to allow for transition from small-scale state based to large-scale national provider.</b>
3. Referral of all regulatory powers to Commonwealth	Overly complex. Consistency from a single national system that supported all providers unlikely.	Ignores benefits to be gained from regional government involvement and separate requirements of small-scale providers. A short run outcome is unlikely.
4. Harmonised state and territory regulation	Continuity and gradual harmonisation of key principles.	Ignores benefits to be gained from regional government involvement and separate requirements of small-scale providers. A short run outcome is unlikely.
5. A state-hosted national regulator	Greater State and Territory role in delivery of regulation.	Difficult to achieve agreement of all states/territories.

Past experience has shown that Options 3 through 5 would be very difficult to achieve and an outcome in the short term would be unlikely. Option 1, while easier to negotiate, would be particularly cumbersome and likely to increase compliance costs.

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## Conclusions

The availability of affordable housing, especially for disadvantaged Australians, provides a difficult policy challenge for all levels of government.

Not-for-profit housing providers – including PowerHousing Australia and its membership – provide one of a number of complementary solutions that can make a significant contribution to an increase in supply of affordable housing across Australia. At the same time, NFPs offer a number of additional economic and social spill-over benefits to government and the broader community, such as reduced costs through economies of scale, improved efficiencies and innovation in service provision and increased choice. NFPs are also able to leverage private investment, reducing the burden on public funding, but will be best able to do so at competitive lending rates if they are able to operate at scale.

Risks that may arise as a result of an increase in private sector debt funding of social housing can be ameliorated by the design of a regulatory system of provider accreditation and prudential regulation.

In order for NFP providers to be able to grow, barriers to cross-jurisdictional operations need to be removed. A level playing field for growth NFPs and SHAs – including a sufficient level of outcomes-based funding allocations – that allows for the most efficient allocation of resources is also necessary for be required. A national regulatory system is essential to these outcomes.

## Access Economics

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