

Sustainability of the social housing system and options open to the Department of Housing

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I have been asked to speak on the topic of 'sustainability of the social housing system and options open to the Department of Housing'. This is an issue that the Department has given the highest priority to over the past 2 years. It is of huge importance to all State Housing Authorities and everyone with a connection to social housing.

What is a sustainable social housing system?

A sustainable social housing system would achieve the following outcomes:

- i. First, total revenue is sufficient to meet operating costs, depreciation on assets, and to fund recurrent programs.
- ii. Second, there would be sufficient resources to upgrade and maintain assets to community standards, reconfigure the stock profile to reflect changing patterns of demand, and to regenerate housing estates.
- iii. Third, the social housing system would deliver high level housing outcomes to clients. Existing programs would be enhanced and new programs developed to assist the growing number of clients with complex or special needs.
- iv. Fourth, there would be an increased capacity to meet demand through growth in social housing and other programs where required.

Within this, lies the overall theme for this conference: why is private financing an increasingly important topic for social housing and how can it contribute to its future.

I will therefore concentrate primarily on the financial aspects of sustainability: how can we improve the level of resourcing available. The focus is not only on private finance, but also other key mechanisms that can affect sustainability.

What will become quickly evident is that it is difficult to separate one solution from others. There are no simple answers and no quick fixes. The sustainability of the system has been affected by many factors and each needs to be addressed if social housing is to have a solid future.

Current position – summary

These factors are social, political and economic. They are not unique to New South Wales, but operate throughout Australia and in most western countries. They are made especially challenging in New South Wales, however, by the rise of Sydney as a global city and the impact this has had on the profile of the community and the wider housing market.

The last decades have seen a major shift in the core business of social housing providers. Housing needs have both grown and become increasingly diverse. In response we have changed who we house, yet the products offered have not altered to keep pace.

Like all government systems we are trying to do more with less, even as community expectations increase.

In its simplest terms, the heart of the financial sustainability problem is the growing gap between revenue and the cost of providing the range of services needed by clients. For instance, a recent study conducted by the Australian Housing and Urban Research Institute found that between 1990/91 and 2001/02, operating incomes in New South Wales declined by 15.2% in real terms, or by \$600 per dwelling. This decline was the highest for any State Housing Authority.¹

NSW public housing has the second lowest average operating cost per dwelling in Australia.² Yet, each tenancy makes an average loss of over \$2,000 per annum, or around \$40 per week.

There are some 125, 640 public housing tenancies, amounting to a loss of around \$5 million each week. On current trends the cash position will be negative some time next year.

The causes of this include:

- Commonwealth–State Housing Agreement (CSHA) funding continues to decline in real terms, and long-term funding beyond the present CSHA is uncertain. Rent revenue is constrained by the high level of subsidies to clients, which effectively link revenue with tenants' income.
- Demand for housing assistance remains high, and the complexity of client needs have increased, impacting on both the type of social housing required and operating costs.

¹ J Hall and M Berry, *Operating Deficits and Public Housing: Policy Options for Reversing the Trend*, Australian Housing and Urban Research Institute, Melbourne, October 2003, page 28.

² Australian Institute of Health and Welfare, *Commonwealth–State Housing Agreement National Data Reports 2001–02*, The Institute, Melbourne, April 2003, Table 4.2.6.

- An aging stock base and a legacy of under-investment in asset management.
- The provision of CSHA funds as loans for almost 4 decades, resulting in a large debt to the Commonwealth.

Without major structural reforms to the way the Department conducts its business and the securing of alternative forms of funding, the social housing system will become financially and socially unsustainable.

Purpose of this presentation

What then are the options available to the Department of Housing to improve its financial viability? They include the three areas being covered in other sessions today – debt, equity and rents.

My comments on each of these are intended to aid today's discussion rather than pre-empt it. I think it important to give you some background to the sustainability issue, and examine various options available to the Department for improving its financial position.

Commonwealth CSHA funding

For the past 60 years any discussion of the viability of social housing has been inextricably linked to a discussion of the CSHA. Indeed, it has generally been seen as a subset of that discussion. I am not going to break all of that tradition, but I will signal that this is probably one of the last occasions when I will begin by talking about the future of social housing in this way.

As most of you are aware, Commonwealth CSHA funding has declined markedly in recent years. These reductions have amounted to a cumulative loss in real terms of around \$357 million over the past 7 years for New South Wales. This decline is serious and is having major long-term impacts on the Department's capacity to provide the level of services needed to clients and to improve and grow its assets.

A new CSHA has commenced which gives a level of funding certainty until June 2008. States and Territories successfully negotiated for that funding to be indexed over the five years of the Agreement. However, the Commonwealth has continued to impose an efficiency dividend of one percent per annum, and has discontinued GST compensation.

The immediate impact of this is that Commonwealth funding to New South Wales for this financial year is \$27 million less than for the 2002/03, and will be less in real terms each year of the new Agreement, than it was in 2002/03.

The bottom line is that Commonwealth CSHA funding will continue to be constrained over the next five years, placing further pressure on already limited social housing resources.

Beyond 2008, when the present Agreement expires and fiscal equalisation will occur, there is a major uncertainty. We cannot base our planning on the assumption that CSHA funding will continue as our major funding source. Not only because of the GST, but also because even if it were to continue, its shrinking size means that it cannot provide the level of funding needed for a viable system.

State government funding

The State Government, has shown a strong commitment to maintaining and strengthening the viability of social housing. During this financial year alone it provided an additional \$47 million over and above its CSHA matching contribution for asset improvement in Aboriginal and community housing; \$10 million for initiatives that offer people more choices and improve services to vulnerable families and \$22 million in GST compensation.

The State Government cannot sustain this level of assistance to social housing in the medium to long term without affecting other programs and services. As a result, opportunities for addressing the funding gap through increased State Government payments are very limited.

How then can additional resources be secured? Besides grants, the options available fall into just a few categories. At the highest level, we can increase our rent revenue and/or secure debt and equity funding.

These measures featured prominently in the negotiations leading to the present CSHA and five percent of base CSHA funding - around \$12 million per annum - is linked to reforms in these areas. They are also part of national work that has recently begun to explore options for future resourcing under Principle 11 of the new Agreement.

Identifying and implementing some or all of these options will be a central focus for all jurisdictions over the life of the Agreement.

Rent revenue

Let me turn first to rent revenue.

Rents are the social housing system's crucial source of recurrent income. Like other States and Territories, New South Wales sets public and community housing rents according to household income. This provides affordable housing and equity in after-housing income for tenants and is relatively transparent.

At present, over 90% of social housing tenants in New South Wales receive a subsidy. This compares to 30% thirty years ago.

The subsidy is provided in kind, and its cost is borne entirely by the housing provider. In the Department of Housing around 43% of the total value of market rents is forgone as subsidies to tenants. This is by far the highest level of any

State or Territory. Other jurisdictions typically forgo between 20 to 30 percent of the market value of their rents in rebates to tenants.³

Under the new Agreement States and Territories, are required to reduce workforce disincentives by addressing the link between earned income and rent. This is to support Commonwealth welfare reform objectives. But it should also be linked to wider aims around rent reform.

Income based rents have numerous strengths, but they also have limitations:

- They are expensive to administer.
- They do not reflect the standard, size or location of the house in the amount paid. There is therefore equity in after-housing income, but not of housing outcomes.
- There are marginal tax rate issues which can be seen to penalise someone for increasing their income.
- Rent variations can be hard to predict for tenants and providers, which makes it difficult to plan expenditure with certainty.
- When the vast majority of clients are small, pensioner households, at 25% of income, rent revenue does not cover the tenancy or property costs for the landlord.

Above all, when over 90% of tenants pay an income based rent it means that there is no reflection of the real cost of providing housing. As I said earlier – every rebated tenancy in New South Wales is loss making.

Rent reform must be considered if we are serious about increasing viability. There are three main ways rents can be calculated – income, market and cost based. The latter two take into account – at least to some degree - the costs of the product.

What then are the questions confronting us in rent reform? Here are just a few examples:

- If 25% of income does not provide enough revenue should the rate simply be higher? Say 30%? Would that be affordable? Would it be enough?
- Should one percentage apply to everyone, or should a sliding scale of income based rents be introduced as used by the City West Housing Company?
- As single person pensioner households have the least ability to pay, should we target more couples and families, whose statutory incomes are higher?
- Taking up the Commonwealth's concerns, should there be different rent policies for tenants who have left the workforce (e.g. the aged and disabled)

³ Australian Institute of Health and Welfare, Table 4.2.1.

and those whom the Commonwealth describes as ‘work ready’? Would this help sector viability by increasing the number of tenants with jobs?

- Should there be an extra amenity charge for newer, or better located properties?
- Is there scope for the Department to base its rents on the market or a proportion of market rent? How would we deal with properties in very high cost areas? Would there be an artificial ceiling?
- Should the Department be changing the mix of tenants, deliberately including moderate income earners who can afford to pay higher rents? Would it be reasonable to expect the moderate income earners to cross-subsidise very low income earners?
- If we moved to cost rents, would they be based on the price of providing a specific house, houses in a particular area, or across the whole portfolio?
- Are there social as well as financial reasons for moving to any other rent models or to targeting other income groups?
- Should any changes to rent policy be applied retrospectively? If we only introduced them for new tenants it would take at least seven years to significantly impact? Do we have that long?

None of these options is simple. Each must be considered from a range of perspectives including their impact on revenue, affordability, equity, transparency and ease of administration for such factors affect outcomes for both the housing providers and tenants.

Not to consider them, however, cannot be an option. We must explore these together if social housing is to have a sustainable future.

Debt

I’d like to turn now to the topic of debt.

Prior to 1989, Commonwealth–State Housing Agreements provided funding in the form of loans, which created large debt burdens on State Housing Authorities. It was estimated that at June 2001, State and Territory Housing Authorities owed a total of \$3.9 billion in CSHA debt to the Commonwealth. Recurrent servicing of this consumes around \$250 million per annum - of which \$176 million is interest payments.

New South Wales has given priority to reducing its debt level to a more manageable level as this is one strategy it can actively employ to improve the Department of Housing’s financial viability. As shown in the AHURI study referred to earlier, in 1990/91 interest payments accounted for 26% of the Department of Housing’s average operating expenditure per dwelling (excluding rebates). By 2000/01, this had been reduced to 7%.

What this experience means is that any loan based product – for example a stream of superannuation funds, or a bond issue – only aids long term viability when the repayment components are fully factored into the equation for the life of the loan. As residential property in general, let alone social housing, does not

produce a competitive commercial rate of return we must examine ways to increase revenue through rent reform and secure an appropriate subsidy stream if debt funding is to remain part of the social housing system.

We have one relatively recent example of such an approach. Under the Social Housing Subsidy Program (SHSP), funds were provided in the mid 1990s to procure additional stock. A fixed rate, interest only, 20 year loan of \$40 million was raised through the Treasury Corporation to acquire around 250 properties. The NSW and Commonwealth Governments each committed to an annual subsidy of approximately \$2 million each toward the repayments. This is supplemented by surplus rental income collected on these affordable housing units. At the end of the 20 years a portion of the properties will be sold to clear the remaining debt.

This program illustrates the key features of the most obvious loan based models: a competitive loan rate, a decent rent stream, a defined government subsidy and the need to sell down some (or all) of the dwellings at the end of the loan period.

The prospect of low-cost borrowings is less now because governments, for a range of reasons, are loathe to borrow directly. This has led proponents of social housing to look at other debt sources. Recently housing bonds have been suggested as one way of obtaining funds for new housing.

One particular bond model has been proposed by the Affordable Housing National Research Consortium, a national committee with representatives from industry, unions, peak organisations and State Government agencies. It shares some of the features of the SHSP.

In the Consortium's model, the Commonwealth would issue a 25-year bond with a guaranteed minimum after-tax return. Funds would be distributed to States on a per capita basis. Dwellings would be owned and managed by state housing authorities, who would be responsible for repaying the interest and principle, less the subsidy amount. At the end of the 25 year period, States would need to pay back the bond principle or equity owned by private investors.

States, including New South Wales, did not support this particular model because the risks were not shared appropriately between the Commonwealth, States, investors and providers - far too much of the risk was to be borne by States.

These models do, however, remain on the table as a potential source of income. The challenge to us is to identify the appropriate balance of risk between the parties but most importantly to have clear objectives of what is to be achieved.

To what degree would the funding source be to improve existing stock – an issue that is deeply affecting viability of all State Housing Authorities – versus for new stock. What portion of the repayments can be made through rent revenue; what rent policies would be effective in making this a secure stream of funds; what role would the Commonwealth and States play; what proportion of stock could or should be sold at the end of the period; how long should that period be?

Private sector partnerships

I would now like to briefly discuss issues relating to partnerships between the private and public sectors.

As I mentioned earlier, 5% of new CSHA base funding is linked to drawing in additional resources from outside the social housing sector, and to reducing workforce disincentives.

The Department has long recognised the potential benefits and opportunities for increasing social housing through joint ventures with the private sector.

In 2002 the previous Minister for Housing announced a number of projects designed to attract private sector investment to help improve the quality and availability of social housing. These projects were based on redeveloping existing public housing on sites in Minto and Redfern. Recently, the Department also announced the successful negotiation of the sale of a vacant site in Randwick through which the Department will obtain a portion of the units to be built on the site. Very recently, Minister Scully also announced a preliminary review of the viability of redeveloping certain public housing estates through privately financed-project (PFP) arrangements.

This direction is underpinned by several factors – major reconfiguration of the housing on some estates is essential; there is a need to decrease the proportion of public housing in some areas; the Department has major land holdings and underutilised land in some locations that could be realised to improve viability.

PFPs are familiar to us through road, rail, health, education and other sectors both here and overseas. They are a much newer phenomenon in social housing. And I stress that we are at an exploratory stage. Yet PFPs have considerable potential. They can take many different forms but have certain characteristics that make the arrangements quite different to the loan or borrowing approach I have just described.

The key elements include the fact that there is an active, long term, risk sharing arrangement between the government and the private investor. For example, a developer would not simply build the houses and walk away but instead would commonly be responsible for the asset management, the maintenance of those properties for a set term. They could also provide tenancy management through a consortium of partners. These arrangements are also site specific. Whereas bonds provide a general income stream, PFPs are specific arrangements around designated projects.

The typical arrangement for these types of projects is that private investment is sought to support priority social housing or community regeneration initiatives. The outcomes are that aging housing stock is upgraded or replaced with new, quality accommodation; housing is reconfigured to better suit current demand; and the diversity of tenure that results reduces concentrations of disadvantage.

In England, PFPs (called PFIs – Private Finance Initiatives) are seen as an increasingly important procurement and financing mechanism within a community renewal context. Although there are presently only a small number of PFIs operating in England, they are described as one of the three main tools available to improve housing under the Government's Sustainable Communities Plan. The other two are stock transfer to Housing Associations, and creating Arms Length Management Organisations (ALMOs).

In England PFIs tend to have the following characteristics:

- Principally a form of contracting or procurement
- Involve a long term service contract
- Provision of capital and services by operator
- Integration of design, build, operate, finance by contractor
- Unitary regular payment by public authority
- Best allocation of risk
- Payment based on meeting performance standards
- Finance off balance sheet

PFPs in New South Wales would share most, if not all, of these elements. They are therefore a very different model to anything we have done before in social housing and hence present many challenges. But, as I said at the outset of this talk, these are not challenges we can ignore. To fail to examine every opportunity is to condemn social housing to a slow death.

Concluding remarks

We are undoubtedly at a cross roads in the history of social housing in New South Wales. Before us lie numerous options but each is difficult, new and complex. Moreover, none will work in isolation. We must find a balance, taking the best from each. We must be prepared to take risks but at the same time be very clear about the strengths of the current system we want to preserve.

This is also something that must be developed in partnership. The Department is committed to working with you on these directions and I look forward to hearing feedback from the rest of the sessions as a first step in that process.