Part 4

Sector Financial Performance

Annual Report 2020-2021

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

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Contents

About this document

This Report provides an overview of the financial performance of the community housing sector.

This is the fourth and last part of a series of reports issued for the NRSCH reporting period 2020-2021. The Annual Overview has been delivered in four discrete parts.

Part 1 NRSCH Overview

Published August 2021

Part 2 Regulator Performance Report

Published September 2021

Part 3 Sector Performance – Non-financials

Published October 2021

Part 4 Sector Performance – Financial

Published December 2021

Scope of this report

This report provides data and analysis for participating NRSCH jurisdictions only. The data contained in the report is provided by registered community housing providers as part of their scheduled assessment to demonstrate their compliance with the National Regulatory Code.

The financial analysis carried out in this section is based on the most recent financial information submitted by Tier 1 and Tier 2 registered community housing providers. Where possible, we have compared the current information to the previous financial data submitted. Due to the time difference between NRSCH compliance activities and the official reporting of financial results by community housing providers (CHPs), financial results may be from financial year 2020 (FY20) or earlier.

To learn more about the status of the NRSCH in a particular state or territory, 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 and how Registrars deliver their functions under the NRSCH please visit https://www.nrsch.gov.au/publications/nrsch-framework.

A financially viable sector

Financial viability is the ability to generate sufficient income to meet operating payments, debts commitments and, where applicable, to allow for growth, while maintaining service levels.

Financial viability is one of seven performance outcomes specified for housing providers within the National Regulatory Code.

The assessment of financial viability is an integrated process involving a review of audited financial statements, financial performance report which includes the budget and forecasts, business planning documents such as operational and strategic plans and other information that supports financial analysis.

Financial viability 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 financial performance indicators. 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.

Key Findings

- The community housing sector has shown resilience and agility responding to the challenges and seizing opportunities during the COVID-19 pandemic.
- The community housing sector continues to demonstrate a strong financial position and performance with the majority of CHP's results at or above key financial thresholds.
- Rent revenue increased solidly over the comparative periods as a result of the transfer of stock from public housing to community housing sector and acquisition of new stock.
- Whilst total housing debt rose there is no evidence of financial stress.

Sector financial performance

This report contains financial information for all Tier 1 and Tier 2 providers based on the most recent financial data submitted to NRSCH Registrars.

The label Current in Tables 1 and 2 refers to the most recent financial information held by the NRSCH. The label Previous in Table 1 and 2 refers to the financial results submitted prior to the most recent or current report. This data is provided for comparative purposes.

Table 1: Revenue Snapshot

	Rent Revenue	Operating Grants	Operating EBITDA
Previous	$814,244,582	$1,179,650,809	$293,256,253
Current	$963,404,777	$1,204,252,618	$367,973,709
% change	18.32%	2.09%	25.48%

Table 1 shows the sector experienced a solid increase of over 18% in rent revenue over the periods examined. This can largely be attributed to state-based stock transfers from public housing to the community housing sector and new stock generated by National Housing Finance and Investment Corporation (NHFIC) funding.

As a result of accounting changes some providers managing programs were advised by their auditors to re-categorise lease payments, previously recorded as operating expenses, to interest or amortisation expenses. These by definition are excluded from EBITDA. While this does alter the financial risk it has the effect of increasing Operating EBITDA in the current period.

The recognition of a right of use asset and a lease liability, for some other providers, lead to depreciation and interest expenses. This also contributed to the increase in EBITDA.

Table 2 – Asset snapshot

	Housing Assets - written down value	Total Housing debt	Net Assets	Total Assets
Previous	$8,222,461,082	$1,059,242,154	$8,946,473,539	$14,553,021,453
Current	$8,895,919,397	$1,613,238,743	$9,179,335,042	$16,257,318,126
% change	8.19%	52.30%	2.60%	11.71%

Table 2 shows a significant movement in total housing debt. This movement can be attributed to two factors; the adoption of new accounting standards specifically AASB 16 Leases which replaced AASB 117 Leases and increased lending through NHFIC.

The AASB 16 Leases introduces a single lessee accounting model where all leases are accounted in a similar manner to the way in which finance leases are currently accounted.

The Affordable Housing Bond Aggregator (AHBA) provides low cost, long-term loans to registered CHPs to support the provision of social and affordable housing. During 2020-2021 the NHFIC approved more than $1billion of loans and grants to community housing providers supporting 5,800 dwellings[1]

[1] https://www.nhfic.gov.au/media-resources/media-releases/nhfic-annual-report-2020-21-released/

Understanding the graphs

Current and previous

The label Current in following figures refers to the most recent financial information held by the NRSCH. Due to the time difference between NRSCH compliance activities and the official reporting of financial results by community housing providers (CHPs), financial results may be from the financial year 2020 (FY20) or earlier. This approach has been taken to give a complete view of Tier 1 and Tier 2 providers.

The label Previous in the following figures refers to the financial results submitted prior to the most recent or current report. This data is provided for comparative purposes.

Quartiles, median and thresholds

The following Figures have been displayed in quartiles (or percentiles) dividing the data set into four equal groups represented by whisker lines to show the values within the 25th, 50th and 75th percentile. The median is reflected in the 50th percentile.

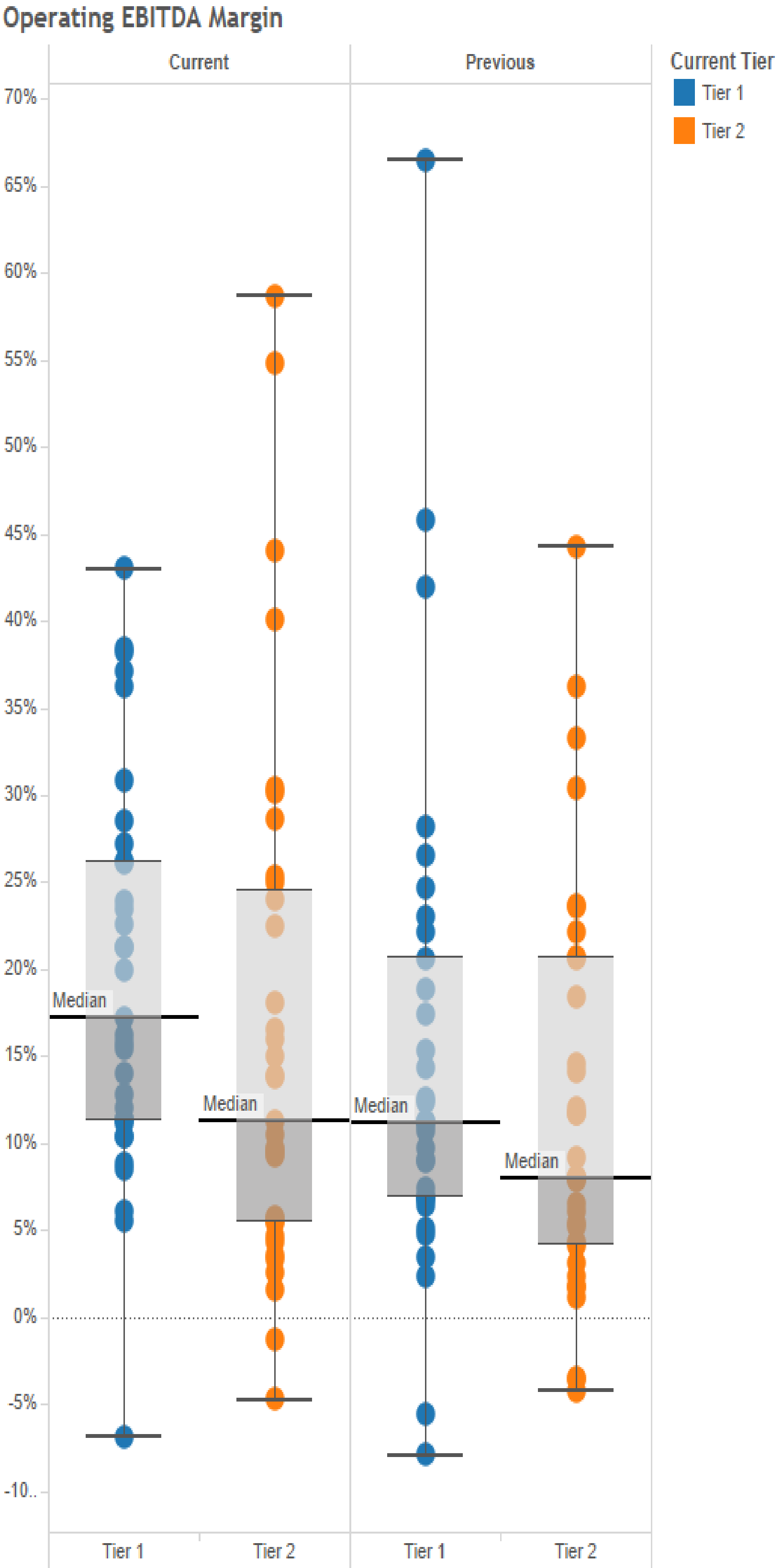
Regulators use a suite of indicators to assess financial performance. The financial measures include performance thresholds for some requirements as an indicative guide to assessing performance results. The thresholds do not determine capacity or compliance per se. Rather they provide a transparent level of performance as a starting point against which results can be assessed. Thresholds have been identified in the narrative associated with each figure.

Performance results that are below or are trending below a threshold or a combination of thresholds will raise a flag that there may be a performance concern to be addressed in the assessment of the provider's capacity or ongoing compliance. Registrars will seek to understand whether the provider is not complying with the performance requirement or whether the level of performance relates to particular risk and/or circumstances.

Exclusions

Some Tier 1 and Tier 2 providers have been excluded from the following plot graphs. These include providers who are subsidiaries of a parent entity which is also registered. The parent reports to the Registrar on consolidated numbers which also includes the subsidiary numbers. Some newly registered entities were also excluded as they were not yet operational, effectively meaning they have no historical numbers to report.

Figure 1:



Operating EBITDA Margin

Operating Earnings Before Interest Tax Depreciation and Amortisation (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.

The performance threshold for Tier 1 providers is 8%-15% and 3%-10% for Tier 2 providers.

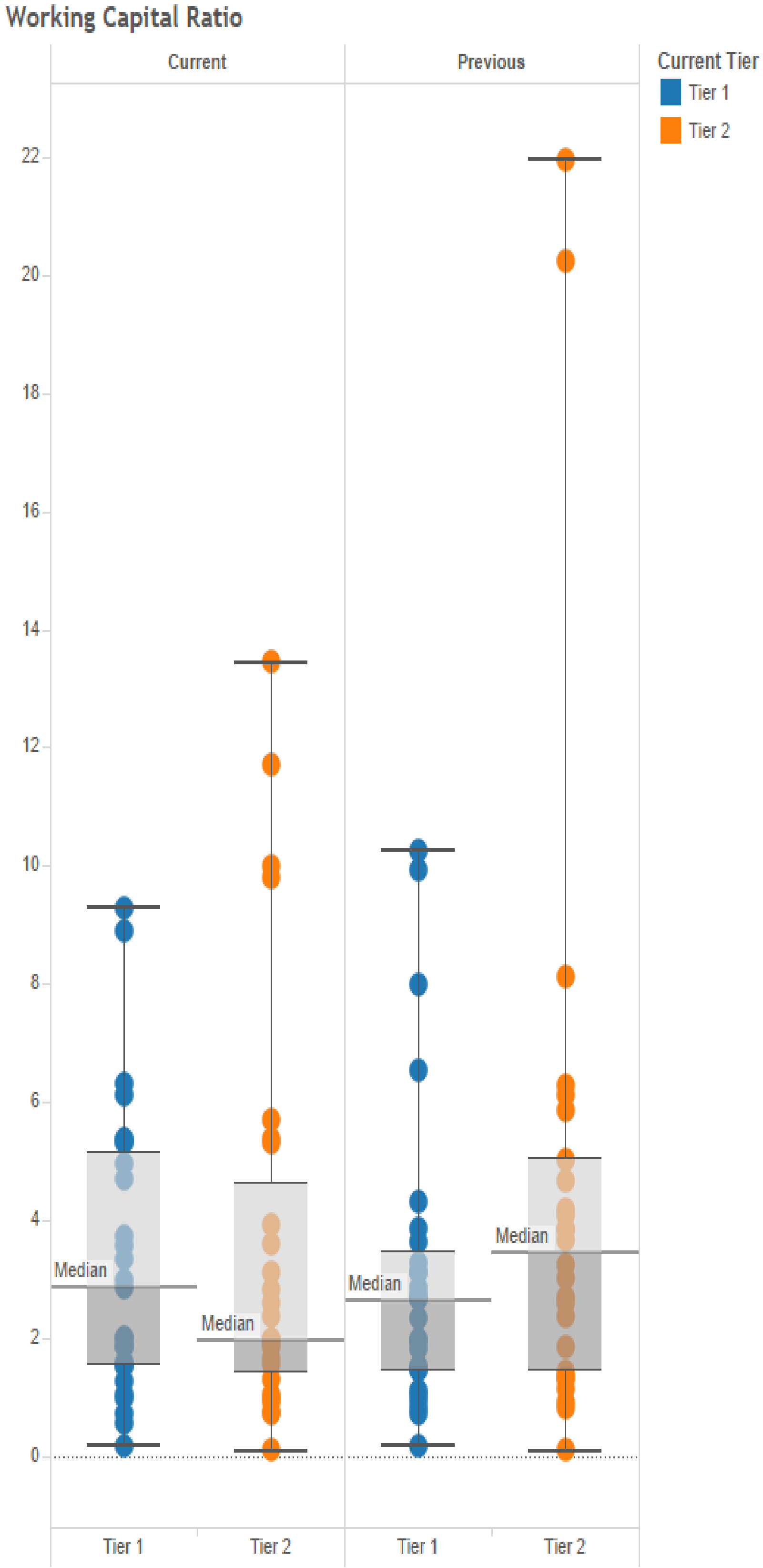
Based on Figure 1 the average operating margins for Tier 1 and Tier 2 providers indicates a good level of profitability with only a small number of CHPs operating on negative margins. Some providers are unviable solely based on their operations but have demonstrated a sufficient guarantee from a viable parent organisation.

Some providers have unique structures which produce unexpected results based on inclusions. For example, one provider has a unique funding stream. While monies received under this program are used to fund development activities they are actually classified as operating income in its financial statements. This has the effect of inflating the provider's Operating EBITDA Margin.

One Tier 2 provider recorded a high operating margin due to receipt or transfer of land from the state government which should have been recorded as a non-cash income.

Some provider results are not shown in Figure 1. One newly registered provider filed a Financial Performance Report but did not have any historical data to report.

Figure 2:



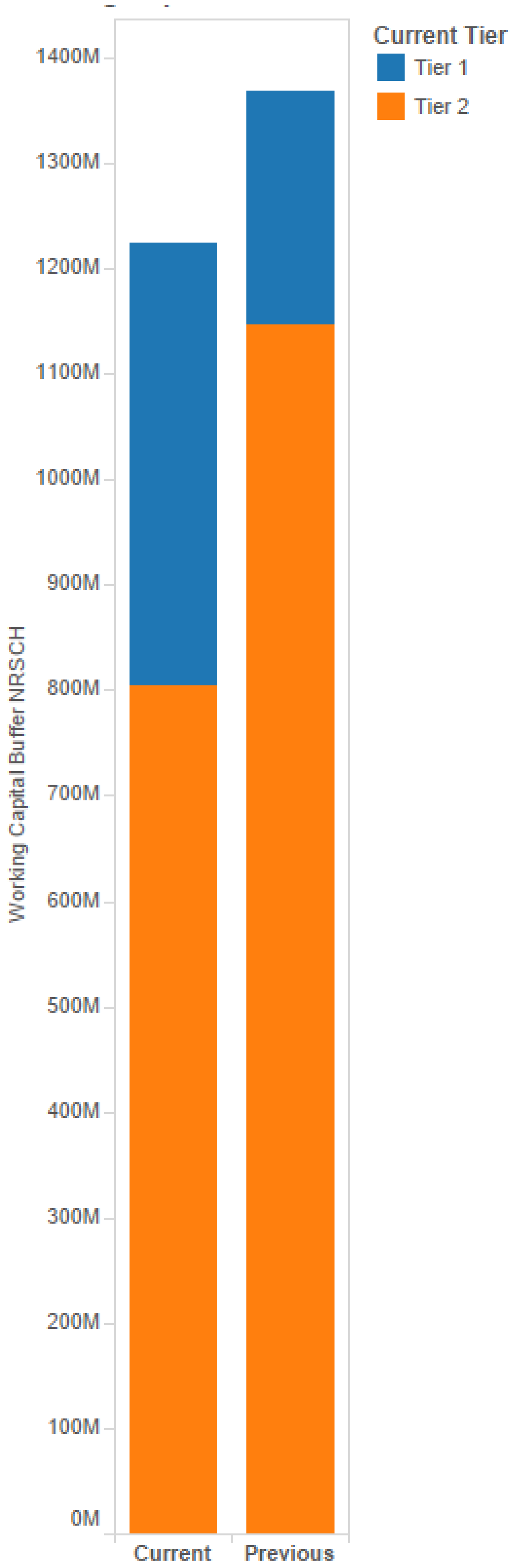
Working Capital Ratio

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. It indicates whether the provider has enough current assets to meet its short term obligations when they fall due.

The performance threshold for working capital ratio is greater than 1.5 times for all registered providers.

As presented in Figure 2 most Tier 1 and Tier 2 CHPs were above the NRSCH threshold demonstrating capacity to support and pay for currently maturing obligations.

Figure 3:

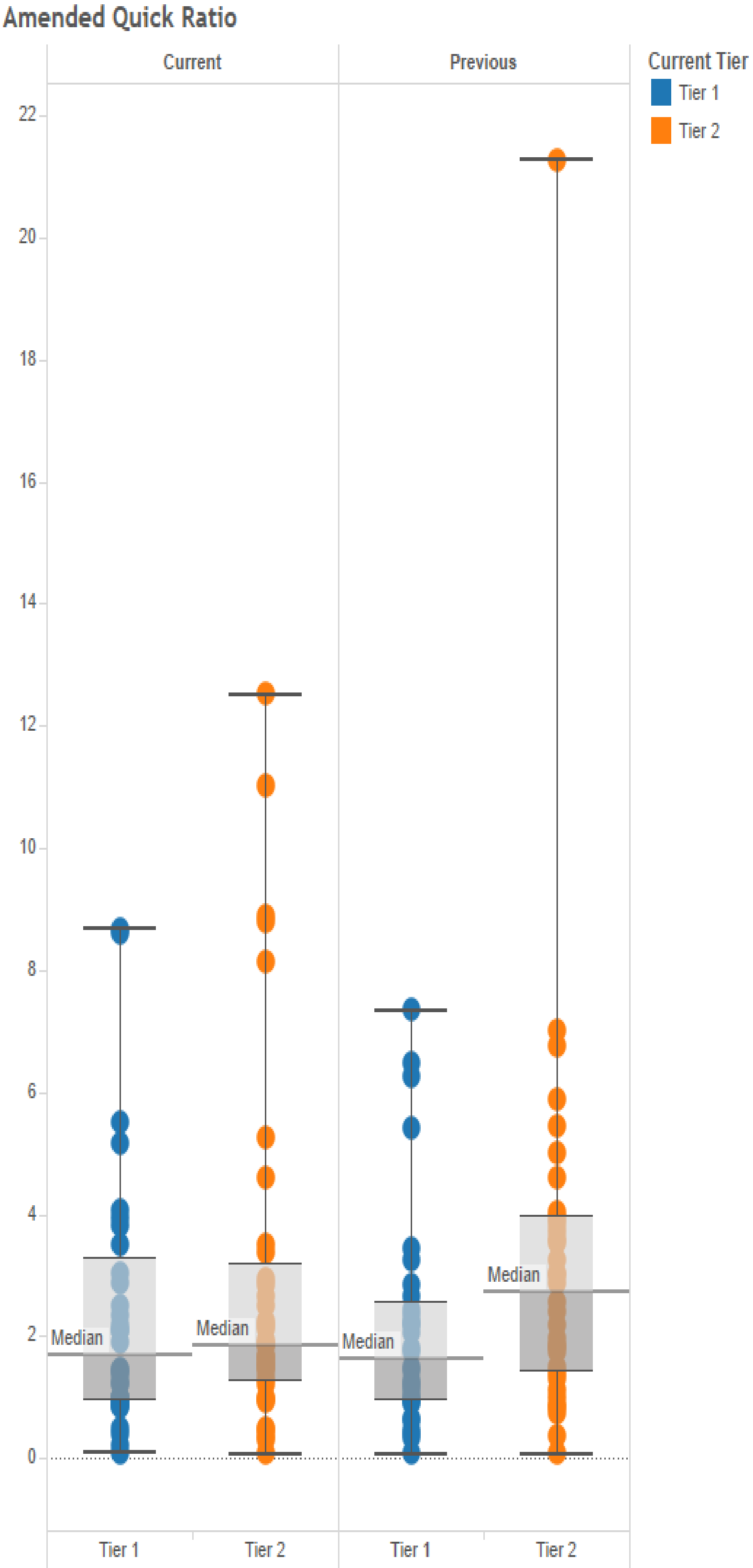


Working capital position

The working capital position shows current assets minus current liabilities providing the financial buffer for unexpected events.

Figure 3 shows that Tier 2 providers have a larger liquidity buffer than Tier 1 providers. This is a result of several large Tier 2 aged care providers that inflate the figures. While the Tier 1 liquidity position has improved in the most recent period Tier 2 has declined. This does not represent a concern to ongoing viability and is mainly the result of those large aged care providers utilising their cash reserves to fund community housing development activities.

Figure 4:



Amended Quick Ratio

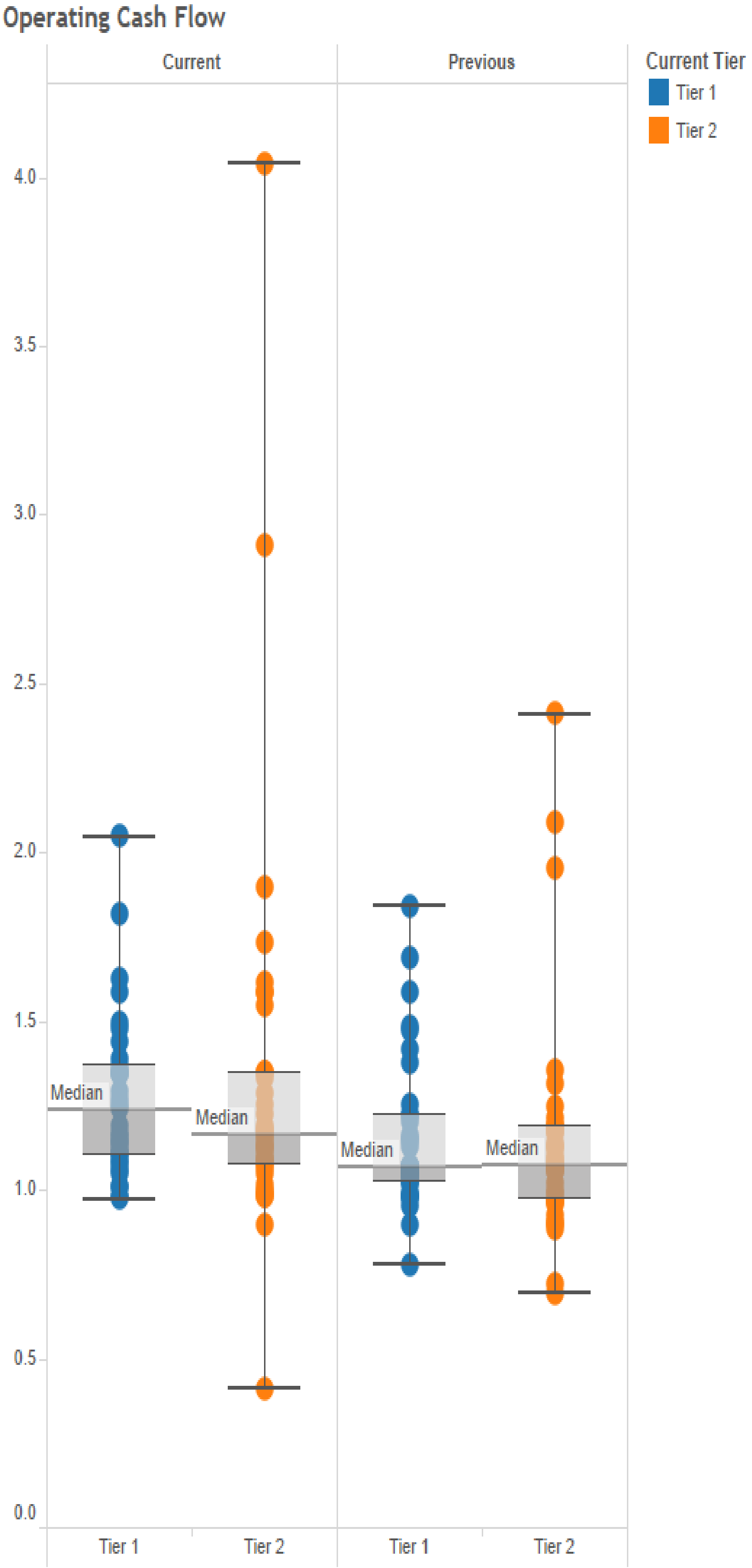
Amended Quick Ratio is calculated as cash plus short-term investments plus unused overdraft divided by total current liabilities less accommodation bonds less unspent capital grants. This is a more conservative measure of short-term liquidity than the working capital ratio and is also monitored by Registrars to ensure CHPs have sufficient liquid assets to cover current liability obligations.

The performance threshold for amended quick ratio is greater than 1.2 times for all registered providers.

The graph (Figure 4) shows that most Tier 1 and Tier 2 CHPs recorded above the NRSCH threshold; demonstrating high levels of liquidity with few providers below the 1.2 times mark.

Registrars engage closely with providers who fell below the threshold as this may present a liquidity risk. Providers in this category were asked to demonstrate capacity and/or develop strategies to mitigate any potential risk to business operations.

Figure 5:



Operating Cash Flow Adequacy Ratio

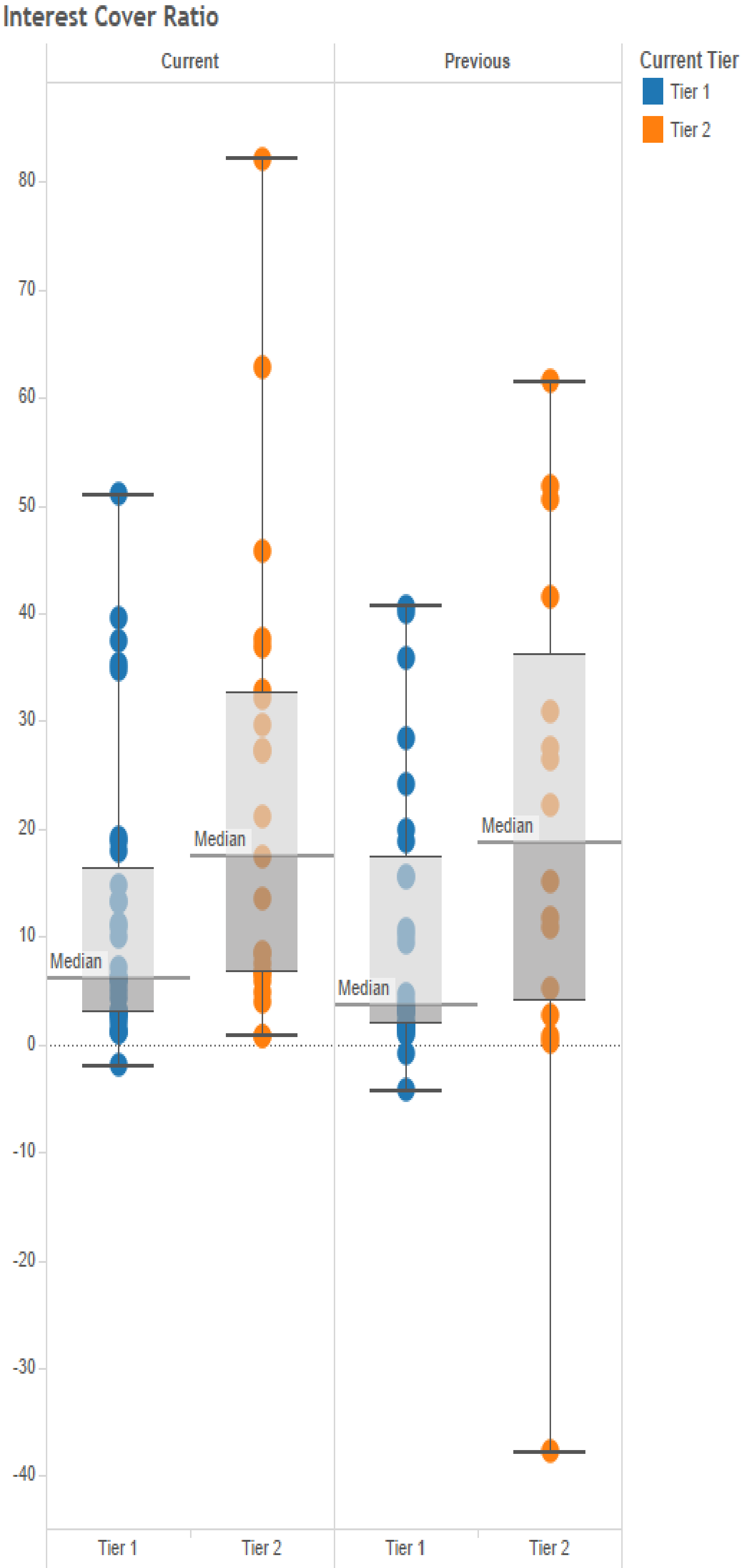
Operating Cash flow Adequacy is calculated as operating cash inflows divided by operating cash outflows. This is a key measure of financial performance and is monitored by Registrars to ensure CHPs are generating sufficient cash flows from operations to achieve business goals.

The performance threshold for operating cash flow adequacy ratio is greater than 1.2 times for Tier 1 providers and greater than 1.05 time for Tier 2 providers. It indicates whether cash flows generated from the provider's operations are enough to pay for its ongoing expenses.

Figure 5 indicates that Tier 1 and Tier 2 providers have generated sufficient cash flow to support current on-going operations.

Outlier results were primarily as a result of grant payments that distort the ratio calculation. One provider received a significant operating grant of $1.2m and another received $4.9m SDA funding from NDIS. The funding from NDIS is currently recorded as a liability as there is no agreement at this time in relation to the repayment of the funds.

Figure 6:



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.

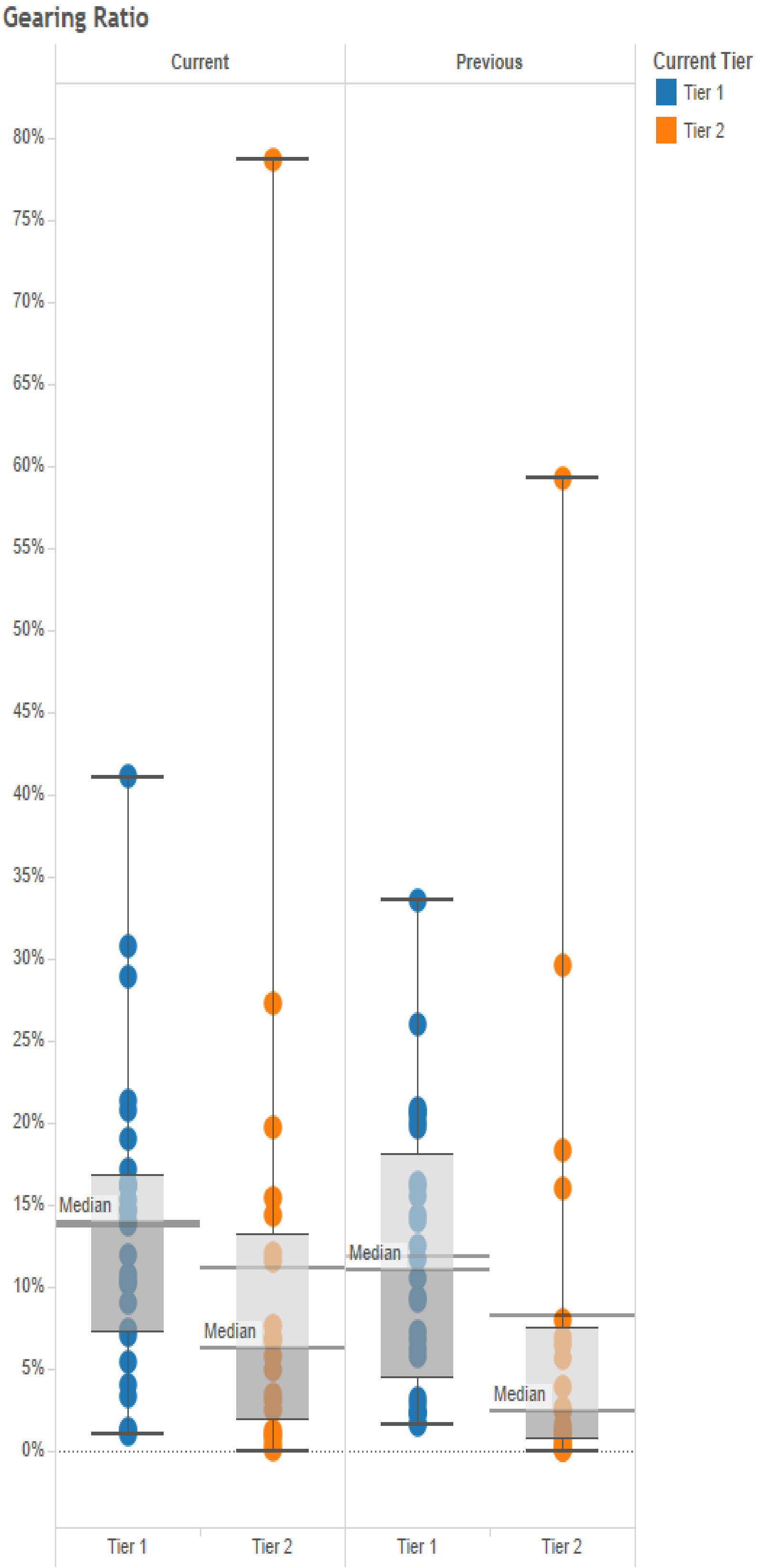
The performance threshold for interest coverage ratio is greater than 1.5 times for all registered providers.

Figure 5 shows that most CHPs were operating well above or within an acceptable range of the threshold.

The negative results in the previous reporting period reflected one provider's deficit financial performance as it prepared for the NDIS rollout with significant expansion and investment in staff and systems. Since then, the provider has delivered cost saving strategies with a strong turnaround in financial performance generating positive operating cash flow and an improved liquidity position

Two providers had a very small amount of debt (with very small interest expenses) which distorted the ratio calculation.

Figure 6:



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.

The performance threshold for gearing ratio is <30% for all registered providers. It indicates how much a provider owes compared to how much it has invested.

Debt levels are increasing in some jurisdictions and on the evidence presented thus far providers are satisfactorily managing the risk. Some jurisdictions expect debt levels to continue to rise sustainably as provider's access low cost, long term loans through NHFIC. Registrars will continue to monitor the situation.

The year ahead

The next 12 months will bring further challenges and opportunities for the community housing sector relating to financial reporting and viability.

Emerging from the COVID-19 pandemic The community housing sector demonstrated resilience and agility adapting quickly to the COVID-19 pandemic. Registrars will focus on how providers' financial performance is impacted as government subsidies, such as Job Seeker, cease.

Improved guidance To support consistent reporting Registrars will consider the need for additional guidance material for providers in relation to the definition and application of restricted cash due to the impact on the liquidity ratio.

Special Purpose Vehicles Registrars have observed an increasing appetite for Special Purpose Vehicles (SPVs). The use of SPV's to deliver housing projects introduces a new set of risks that need to be appropriately identified and managed. Registrars are currently developing an agreed approach to the registration and assessment of SPVs to ensure a consistent approach across jurisdictions.

Improved reporting During 2020-2021 NHFIC approved more than $1 billion of loans and grants to registered CHPs. Financial Analysts will focus on the sector budget and forecast to provide a future outlook for Tier 1 and Tier 2 provider's financial standing and viability.

Impact of NRAS cessation The impact of NRAS cessation on the community housing sector's financial performance and their affected tenants will continue to be a focus for the next 12 months.

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