



Revisions To The Capital Framework For Authorised Deposit-Taking Institutions

Submission to APRA from St George Community Housing Ltd (SGCH), NSW's largest Community Housing Provider

31st October, 2019

CONTENTS

1. Summary of this submission
2. About SGCH
3. SGCH funding and finance
4. SGCH risk management and governance
5. Impact of proposed changes to Capital Framework on SGCH
6. Risk management considerations
7. Summary

Appendix 1

1. Summary of this submission

This submission has been prepared by SGCH to focus on the potential impact to our business of the current review of the Capital Framework for Authorised Deposit Taking Institutions.

SGCH provides homes for around 11,000 people in 6,400 properties across Sydney metropolitan areas. SGCH manages housing worth an estimated \$2.8 billion, and either owns or is developing 2,200 properties valued at an estimate in excess of \$765m.

Finance for our current portfolio and our pipeline of projects underway has been secured with APRA regulated and non-APRA regulated financiers. SGCH currently has committed facilities with APRA-regulated lenders of \$225m, of which \$69 million, 31% has been drawn as at 30 September 2019. SGCH understands this is the largest facility an Australian Community Housing Provider (CHP) has with an APRA-regulated lender. This makes us the borrower most impacted by the proposed changes.

This submission has been drafted to highlight our concern for the current proposed APRA direction and the risk level assigned to our business, and indeed the whole sector as outlined in the response from our industry bodies. This risk assessment does not accurately reflect the true risk of SGCH. Moves to apply the same risk treatment to SGCH as 'other residential mortgages' has the potential to adversely impact our ability to deliver on our purpose, and disadvantage our business by around \$1million annually based on an estimated interest rate differential of 45 bps between owner occupier and 'other mortgages'.

There is an enormous opportunity cost for SGCH of inaccurately priced bank lending. An additional \$1 million per annum would allow our business to provide a housing subsidy to about 100 low income families / build an additional 3 dwellings each year. Or, this restricts our ability to provide support and services for the residents in our housing. A higher and inaccurate risk rating also has the potential to impact SGCH's ability to attract institutional investment, be it APRA-regulated debt, non-APRA regulated debt or equity. Our five year strategy to attract institutional investment funding will be adversely affected if institutional investors are influenced by inaccurate risk ratings implicit in the APRA response, and use these to evaluate potential investment in this sector.

In its discussions with our industry bodies APRA has acknowledged it is unfamiliar with our industry, the stringent regulatory environment that organisations such as SGCH operate in, nor had it considered the consequences of the changes.

We request that APRA now makes a more fully informed decision around its risk considerations and engages with the sector to better understand our risk management. It is our expectation that armed with accurate information about the true risk, we will be able to achieve the following:

- A considered set of risk consideration criteria that better measures the risk profile of CHPs and therefore ascribes a lower risk weighting under APRA's changes to the regulatory Capital Framework than is currently proposed
- An exemption or a new classification for NFP housing providers like SGCH that assigns a risk rating in line with standard owner occupier mortgages.

2. About SGCH

SGCH is the largest community housing provider in NSW. SGCH has expanded from our roots in the St George area, and we now operate across metropolitan Sydney. With 35 years' experience, SGCH provides a place to call home for around 11,000 people in over 6,400 properties across Sydney. Of this portfolio, SGCH owns or is developing over 2,200 properties valued at an estimate \$765m. Our equity in these properties is about 80%.

In addition to the properties we own, SGCH manages tenancy for a total portfolio of property assets worth \$2.8 billion.

SGCH is responsible for providing 18% of all community housing in NSW and 7.2% of all community housing dwellings in Australia. SGCH has worked with a range of partners to attract over \$400 million in investment since 2014 to deliver more social and affordable housing.

The activities of SGCH have a profound economic impact. People who are safely housed are able to work and contribute to the economy. A proportion of SGCH tenants only require support and assistance temporarily to return to employment and the private rental market.

SGCH market share

- 1 in 460 people in Sydney is housed by SGCH
- 18% of all community housing in NSW provided by SGCH
- At a national level, SGCH represent 7.2% of all community housing dwellings

3. SGCH finance and funding

Finance for our current portfolio and our pipeline of projects underway has been secured with Australian banks and CEFC. SGCH currently has total borrowing facilities of \$410m, \$225m of which is from APRA-regulated banks.

SGCH is currently working with our partners to develop a pipeline of 1,070 social and affordable homes valued at over \$500 million by the end of 2022 (See appendix 1 for more detail on the stages of this pipeline). Bank and non-bank lending has been secured for this pipeline.

In addition to this pipeline of development activity, SGCH's long-term strategy is to expand our property portfolio over the next 5 years, as demand for social infrastructure continues to increase. To meet our long-term strategy, we hope to see funding continue from Australian APRA-regulated banks. In addition to this, we are currently developing a compelling structure for institutional investors such as superannuation funds to invest in social infrastructure to take advantage of its stable long-term investment characteristics.

As an asset class, social and community housing is more closely aligned to infrastructure than property. It is not subject to the same cyclical nature of the residential property market – it is rarely sold and occupancy rates are not volatile. We expect this to have strong appeal to larger equity investors.

The importance of social housing infrastructure was acknowledged for the first time this year in the Infrastructure Australia 2019 Audit that guides Australia's infrastructure decision-making - an important validation and an acknowledgement of the crucial contribution this housing makes to the community, the economy and our environment.

This audit also highlights social and affordable housing infrastructure as a nascent but growing investment opportunity, which will help to address funding shortfalls.

SGCH is working closely with the International Housing Partnership (IHP), comprising like organisations in the UK, US and Canada, with the aim of collaborating and unlocking efficient and favourable capital solutions that will enable the delivery of more homes and better outcomes for residents. McKinsey Global Institute have estimated that building necessary social and affordable housing globally will require expenditure of up to \$16 trillion.

As outlined in our industry bodies' submission, Australia's need for housing solutions is immense. SGCH is working with global stakeholders such as the IHP to gather international insights and to combine this with our Australian experience to inform the policy and funding settings that will embed a social and affordable housing asset class to encourage a broad range of investors to build scale and capacity in Australia. The Australian Infrastructure Audit sets out an ambitious vision for the country that works towards the current and future needs. Including social housing in this Audit, and in the allocation of government investment, is crucial.

There is enormous potential for private investment to develop social infrastructure into a large-scale asset class, provided the investment conditions are compelling.

4. SGCH governance and risk management

SGCH is a Tier 1 provider under the National Regulatory System for Community Housing in recognition of the high level of performance requirements and regulatory engagement it complies with under the scheme. It is this rating and endorsement that reinforces SGCH's capability to develop new social and affordable dwellings.

SGCH has a strong culture of risk management having relaunched its risk management framework in the last 12 months. As part of this process SGCH engaged Institute of Internal Auditors–Australia (IIA–Australia) to perform an independent Quality Assessment of our Risk Management function.

In assigning a rating of 4 out of 5, the highest it has awarded any organisation, IIA-Australia noted the SGCH Risk Management function is operating professionally and SGCH generally conforms with the international Risk Management Standard. The report confirmed that SGCH policy conforms to the risk management standard AS/ISO 31000:2018.

SGCH is overseen by the Directors of SGCH Group Boards, who are elected for service based on their expertise in finance, accounting, business, management and corporate governance.

“ It is always refreshing to work with an organisation that is doing a good job – this is the highest score I have ever given anyone”

**Michael Parkinson,
Senior Consultant,
The Institute of
Internal Auditors
Australia and
Australian delegate to
ISO Committee TC262
(responsible for ISO
31000)**

5. The impact of proposed revisions to the Capital Framework on SGCH

We acknowledge that revisions to the Capital Framework are being undertaken with the objective of reducing risk in Australia's financial system. We support regulatory changes that achieve this objective if they are based on fair, considered and accurate information. As they currently stand, the ill-considered treatment of SGCH under a revised framework will have a number of detrimental impacts on our business.

i) Financial impact

Our modelling suggests that under the proposed changes to the Capital Framework, SGCH would be \$1m worse off each year on our current lending facility of \$225m if lending is not offered at the same rate as owner occupied mortgages. This is based on a projected 45 basis point difference between owner occupied mortgages loans and higher risk categories under which SGCH would fall if changes are implemented.

ii) Impact on our reputation with institutional investors

It is our view that APRA's intention to apply a higher standard than Basel 3 does not acknowledge the stable, long-term characteristics of this category of infrastructure investment and will send a signal to potential investors that this is a higher risk investment. At a time when SGCH is focussed on highlighting the appeal of this area as an emerging asset class that is characterised by stable long-term returns, any changes will undermine the work we are doing to drive investment into the area.

iii) Impact on our ability to deliver social and economic improvements

We recognise that a robust financial system is the primary goal for APRA, however social good is the backbone of SGCH and consideration should be given to the broader social and economic impact that an ill-considered risk assessment will have on our ability to deliver great outcomes for tenants. APRA has not considered the social returns and benefits that may accrue from concessional regulatory capital settings which grant a minor interest-rate reprieve for the good and relatively safe cause of social and affordable housing.

To expand with an example, SGCH participates in the NSW Government's Social and Affordable Housing Fund (SAHF) initiative to provide access to social and affordable homes together with coordinated access to tailored support services that empower people to improve their lives and achieve greater security and independence.

In addition to SAHF, SGCH is committed to ensuring great places to live for all communities. In just one of our communities in Bonnyrigg, highlights over the last 12 months included:

- 11 community events attended by more than 1,400 people
- 68 Strive scholarships awarded to Bonnyrigg students
- 25 Bonnyrigg residents accessed Catalyst program
- 81 people each week participate in health and wellbeing programs run by SGCH and our partners
- Our tenants reported a 96% satisfaction rate with SGCH customer service.

On top of the support it is contractually obliged to provide residents, SGCH also offers additional support that benefits these communities. These highly valued 'nice to haves' will be impacted if SGCH does not benefit from concessions under the APRA changes.

iv) Impact of alternative funding

If bank funding is not able to be secured at competitive rates, this will drive providers like SGCH away from APRA-regulated lenders to principally the National Housing Finance and Investment Corporation (NHFIC), increasing the reliance on its government guarantees. This changes the shape of the sector and reduces opportunities for APRA-regulated lenders as they will be less able to compete with non-regulated lenders.

6. Risk considerations

In its response APRA simply says, “Under the IRB approach, APRA does not consider that retail treatment is justified based on risk considerations”. As highlighted in the introduction, we request that APRA makes a more fully informed decision around its risk considerations by building knowledge and understanding of our sector.

For SGCH a considered set of risk consideration criteria would take into account the following factors:

i) Government as the funder of repayments and source of cashflow stability

For SGCH (and other providers) high risk levels are mitigated because government is the ultimate funder of repayments with tenants welfare dependent in more than 95% of cases. Our material dependency on rent payments is not like ‘mum and dad investors’. Repayment risk rests with government but with demand for social and affordable housing already exceeding supply, policy change to reduce access to welfare and therefore housing is extremely unlikely.

ii) High levels of governance and risk management

The governance and risk management procedures and processes employed at SGCH replicate those required by ASX listed companies. SGCH has been assigned the highest rating awarded by independent auditors to reflect the strength of this function.

iii) Assets under management and track record

The estimated value of SGCH’s property portfolio is \$765m. Over 35 years SGCH has built the portfolio conservatively and sustainably with a focus on the long-term viability.

7. Summary

Changes to the Capital Framework for Authorised Deposit Taking Institutions have the ability to negatively impact the bottom line of community housing providers like SGCH. It is important that any changes are undertaken with a full understanding of the impact on our sector.

With a body of evidence from SGCH now supplied and open lines of communication to work together, we request that APRA gives further attention to the assumptions it has made around risk considerations of CHPs.

--ends--

Appendix 1: SGCH pipeline of development

