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THE CHALLENGES IN TRANSFERRING PUBLIC HOUSING TO THE PRIVATE MARKET

Dr Judith Callanan, Dr Rebecca Leshinsky and Dr Callum Logan

RMIT University

ABSTRACT

The purpose of this paper is to outline the complexities in transferring residential housing ownership from government (state) ownership to a private provider. An analysis of the literature was conducted, including a focus on the drivers for housing stock transfer along with the implications and issues that need to be addressed in that process. In-depth interviews, focus groups and an industry panel were used to formulate the discussion and findings. Data from the focus groups highlights that the quality, accuracy and interpretation of asset data at transfer, combined with the continuation of sound asset management practice post transfer, is critical. Without this full oversight of the assets condition, amenity levels offered, the standard of physical setting and location mismatch then optimal portfolio creation and management will not be possible.

Implications from this research show there are many socio-economic factors that need to be addressed when transferring to private ownership.

Keywords: Asset plans, condition reports, valuation, social housing, land transfer

INTRODUCTION

This paper is based on findings from research commissioned by Australian Housing and Urban Research Institute (AHURI) to identify the key determinants of effective property transfers between the state and community housing providers (CHPs). Housing is complex - each locale has its own set of peculiarities, such as demand-types (i.e., housing demand varying across life stage and composition), space (i.e., public transport serviceability) and supply capacities (overlays and community expectations). A key factor noted in this study is that the principles underlying property transfers vary across jurisdictions and can change in unpredictable ways due (partly) to political forces. It is therefore not possible to recommend a framework of 'best practice' that can be applied across all states and circumstances.

The investigation informed stakeholders of the key features of the property transfers mechanism that impacts on the ability to deliver community benefits along with the technical issues surrounding the land/property transfer. Within this paper we focus on the following three themes:

- legal arrangements
- public housing asset conditions
- valuation methodologies

Each of the identified themes, influences the effectiveness of a property transfer and therefore the extent to which organisations (and the industry as a whole) are able to deliver on community benefits which include:

- A growth in overall supply of housing to be achieved.
- Tenants may be able to enjoy a well-maintained property in good condition.
- Tenants may enjoy appropriate physical setting.

- Tenants may enjoy appropriate (to their needs) residential location.

These 'macro' outcomes are reflective of the 'micro' implications of a property transfer, namely, the capacity of an organisation to deliver community benefit depends (in a large part), on whether its portfolio is financially viable. Further, it will also determine an organisation's ability and decision to retain or expand assets for social purposes.

Public housing in Australia has existed since the early twentieth century. The foundations for the present system within Australia, were established in the mid-1940s when the newly formed Commonwealth Housing Commission (CHC) recommended that the government take an active role in reducing a severe shortage of housing (Yates 2013).

Since 1945, social housing in Australia has been developed, owned and managed largely by state/territory governments, traditionally known as state housing authorities (SHAs) (Pawson, Milligan et al. 2013: 9). Social housing today includes public housing, community housing, as well as state-owned and managed Aboriginal and Torres Strait Islander (ATSI) housing. In 2016, more than 427,700 dwellings provided housing, usually at below-market rents, to low-income households and those with special needs (AIHW 2016b). Rent is highly subsidised (generally set at 25 or 30% of household income) and is determined by tenant income (Yates 2013).

Home ownership in Australia today is increasingly unaffordable for low-income and younger Australians (National Housing Supply Council 2012). In particular, over the past decade there have been large increases in residential property values, and slow development of well-targeted affordable housing. There is not enough affordable private rental housing for low to moderate income households. This is most evident in Sydney, Melbourne and Brisbane. For example, in Sydney there is one affordable and available rental property for every 15 very low-income households (AIHW 2014: 3).

The social housing sector is increasingly under pressure to assist more households to access appropriate and secure dwellings. Current demand for social housing is much higher than supply, and waiting lists and times are extensive. For example, as of June 2013, nearly 160,000 people were on public housing waiting lists nation-wide (Department of the Prime Minister and Cabinet 2014:20), and in Queensland a shortfall of 83,000 dwellings was identified (Kraatz, Mitchell et al. 2015).

In Australia, the transfer of stock from public housing providers to community housing providers was, for a while, the preferred policy tool of state and Federal governments (Gough 2013). According to Pawson, Milligan et al. (2013: 2), there are two main objectives for the stock transfer policy, beyond an overarching aspiration to diversify social housing through an expanded community housing sector. The first aim is to address supply issues and increase the stock of social housing in a financially viable way. This will enable CHPs to leverage their assets and seek finance to build more stock, which is something that governments appear to be unwilling to do. The second aim is to address the structural financial deficit that is a result of the growing gap between rental revenue and the costs of running the portfolio (Victorian Government 2012: 32). Interestingly, CHPs have had access to funding avenues that are not available to government, such as Commonwealth Government tax subsidies, philanthropic donations and CRA (Gough 2013) - however this may no longer be true.

Asset/title transfer involves the transfer of the dwelling ownership to a community agency for use as social housing. Title transfers can generate financial advantage through leveraged private finance, secured against the transferred asset and repaid through projected rental income stream. Greater CHPs independence could maximise entrepreneurialism and innovation, and may bring more responsible, rational and efficient long-term asset management planning (Pawson and Wiesel 2014).

METHODOLOGY

This research was commissioned by AHURI and enabled an investigation into a deeper understanding of the issues related to transferring ownership and management of public housing stock from government control to private housing providers.

An analysis of the literature was conducted, including a focus on the drivers for housing stock transfer along with the implications and issues that need to be addressed in that process. In-depth interviews were then carried out with key staff from government housing agencies along with private CHP providers across New South Wales, Victoria, Queensland, Tasmania and South Australia. The interviews were followed up with focus groups to discuss the emerging issues in more depth and tease out the practicalities of transferring the ownership to private providers. An industry panel, which was assembled by AHURI, was then used to formulate and validate the findings from the interviews and focus groups.

RESULTS

States and territories across Australia have different property and housing legal structures to deal with the transfer of title of government land and properties for the use of social and affordable housing. As a consequence, there are many different models across Australia for the management, maintenance and further provision of social and affordable housing. Some states opt for the transfer of only management rights of government owned housing and related assets. In other cases, there might be the transfer of the land or only development rights, and this might be through long leases or development deeds. From data collected for this report, it appears as though across Australia absolute freehold title transfer is uncommon, with state housing agencies opting to retain an interest on the title of their parcel properties on behalf of the respective Director of Housing. Such diversity in approach to what is effectively management transfer means there are numerous and varied legal models on foot, and this has implications for the governance, finance, accounting and valuation for these properties and parcels of land, impacting in turn on how CHP operate in the various states and territories across Australia.

Whilst the transfer or allocation of management rights to CHPs allows for some independence for CHPs, it also comes with detailed and, at times, onerous obligations. Contracts often stipulate that CHPs are responsible for not only on-going maintenance issues, rates and charges (with no council concessions), but also retrospective maintenance and repairs. As the existing stock can be quite old and fatigued, with some properties being some 65 years old, this can be quite an expensive burden for CHPs. By virtue of weighted contractual obligations imposed on CHPs by housing authorities, there is the expectation that CHPs will leverage their own funding sources from transferred parcel properties, to cover not only maintenance and repair costs, but also new social and affordable development. The interviews identify that maintenance costs can be very high and that the CHPs may have no choice but to turn to other means of finance, including private finance. CHPs are straddled here with further challenges which stem from the housing authority holding an interest in the properties, notwithstanding ‘title transfer’ to the CHP. Such encumbrances on title, including mandatory caveats placed on titles by housing authorities, may dissuade or delay finance companies from lending to CHPs.

CHPs rely on concurrent contractual arrangements with housing authorities so that tenants are in effect, both tenants of CHPs and the housing authority. Such a bypass allows the CHP to rely on assured funds from the CRA. Leveraging from industry or private finance is operational as long as CHPs can rely on these assured funds from the CRA and where this funding source is guaranteed to cover all maintenance and repair costs, rates and charges, as well as any other contractual obligations regarding the development of further social and affordable housing.

We query whether this is in fact too large a burden on CHPs, and we have concerns that there is a real risk that CHPs will struggle to meet their obligations. Where transfer agreements are structured whereby CHP failure returns parcel properties back housing authorities, CHPs have more to lose than state agencies. Ultimately, it is the tenants who will be affected, causing them inconvenience and distress.

Housing providers are opting for transfers to CHPs via management agreements and limited title transfer arrangements. There is an expectation for CHPs to allow the housing authority to retain the interest on all titles. This detracts from the control CHPs may have to raise finance. CHPs, via concurrent contracts with housing authorities, are able to rely on the Commonwealth Rent Assistance (CRA) for assured funding but with high expectations on CHPs to cover current and often retrospective maintenance and repair costs. Some transfers also require the CHP to leverage for further social and affordable development. Many transfer contracts have strict termination clauses which can see CHPs losing absolute control over parcel properties. There is still scope to consider rates and charges concessions as well as further tax concessions for CHPs and maintenance contractors.

Asset Management

Public housing asset features relate to the built assets, land and associated infrastructure. These physical characteristics include building fabric, dwelling size, age, type, communal areas, land development capacity and dwelling location. Understanding the condition, compliance, alignment with demand, and functionality of the assets is an integral part of public housing asset management. The long-term viability of an investment class asset such as real estate should include regular reviews of future cash flow. Integral to this process is the accuracy of maintenance forecasts, backlog maintenance and depreciation to ensure the rate of return from the investment is sustainable. Equally important is the shared understanding by transferor and transferee of maintenance standards, shortfalls in maintenance, obligations, costs and contracting practices.

Issues were raised by panelists about asset condition maintenance forecasts, backlog costs, differences in definitions of an 'ideal home standard' and how these issues impact cash flow projections for determining investment value. A fundamental understanding of the process behind these cash flow numbers should feature strongly as a due diligence element during the stock transfer process.

The quality, accuracy and interpretation of asset data at transfer, combined with the continuation of sound asset management practice post transfer, is critical. Without this full oversight of the assets condition, amenity levels offered, the standard of physical setting and location mismatch then optimal portfolio creation and management will not be possible. Without this fundamental understanding of the assets and financial foresight that develops from that, the ability to transform the portfolios over time with sound financial stewardship is impossible. However, with full oversight, and asset management expertise, portfolios can be transformed through various strategic, tactical and operational means to an ideal state where condition standards are acceptable, asset typology matches demand, location is matched to need, and amenity levels and physical settings are appropriate. Furthermore, a well managed portfolio will deliver optimised net revenue and asset value thereby allowing leveraging to meet growth through new supply of community or affordable housing.

Valuation

The transfer of government land and/or buildings requires a value to be placed on the asset at the time of transfer. The determination of that value and the issues that may arise in the process is the focus of this section of the research. The value placed on the asset will vary dependent on whether the purpose is to determine a market value (for sale or purchase), rating value, insurance value, financial reporting value, or for security against debt finance.

At present, there is no consensus on the type of value that must be reported for assets held by CHPs in Australia during a particular financial year. Different states report different types of values for assets (land and buildings) which means that different valuation methods are also used to determine the values that are reported at the end of each financial year (Productivity Commission 2012, Table 16A.85). The problem is compounded when the purpose of valuation is for the transfer of the assets to a third party because the transfers within social housing have been limited, until recently.

The valuation of social housing raises a few additional issues that are not as evident in the valuation of other property asset classes. The predominant basis of valuation is based on either the principle of substitution, or the principle of anticipation. The principle of anticipation is based on the benefit of the future cash flows. When considering the valuation of social housing, this principle will hold risks, which needs to be considered in the final determination of value. The principle of substitution is based on the assumption that a buyer would not pay more for a property than what they could obtain an equivalent alternative. This principle is the basis of the sales comparison valuation approach.

The key issues with any property transfer is determining the value mechanism for the transfer; is it to be financial reporting value, market value or an alternative value? Although there are difficulties in determining the factors of risk, market rent and free market conditions, there are still accepted valuation industry practices that are followed. The issues to be identified and accounted for in the valuation are predominantly measurable, although perhaps not with an exact science.

Public housing in Australia has historically been valued for the purpose of obtaining a financial reporting value for the government's assets, rather than as a market value to sell or transfer the title of the asset. In some states the financial reporting value is calculated as a depreciated cost value, based on average condition of the asset, this is highly likely to differ in value from the market value, which is generally based on direct sales comparisons or an income value. In Victoria the financial reporting value is based on the direct comparative sales approach for residential properties on residential zoned land.

In summary, there are challenges in determining the value for property transfer, however these are not insurmountable if clear methodologies are put in place. At present there is no consensus on the type of value that must be reported for assets held by SHA in Australia in relation to market value. The value placed on the property, on transfer will have a large impact on the ability of the CHP to maintain the property condition, and also raise debt against existing stock to build their portfolio. In Australia the SHA has generally been transferring the properties at zero dollars to the CHP. It would be expected that If the public housing asset title is transferred at zero dollars, that there is a corresponding social benefit recognised within the SHA books. Where there is a long-term lease in place with CHP this generates a Lessee interest in the property asset and subsequently a value is attached to this. As the CHP is limited in its ability to borrow funds, to its cash-flow, the lessee value is predominantly useful in providing the security to the debt. It is important to note that the asset value of a long term lease is considerably less than the freehold (title transfer) value.

The valuation can enable the delivery of community benefit through a growth in overall supply of housing. CHP can also take advantage of the cashflow generated or added asset value, to ensure tenants are able to enjoy a well-maintained property in good condition.

CONCLUSION

The research results show that the building condition assessment is a critical element of asset management practice and forms the building blocks for advanced asset management practice. Good asset data leads to the creation of forecast maintenance requirements, current backlog maintenance, capital requirements and identification of non-compliance items. Without this information during the pre-tender submission process and the transfer process it becomes problematic for CHPs to develop confidence in feasibility projections for the purposes of tendering for the assets being transferred.

The standards and requirements are specified for achieving good oversight of assets and without good asset condition data, and other asset data such as amenity data, good oversight of the assets cannot be achieved which jeopardises an organisation's ability to make sound asset management decisions. Such decisions include whether to demolish and rebuild, package capital renewal work, defer lumpy expenditure, redevelop sites, retain and maintain, reconfigure, or, sell and reinvest elsewhere. The use of these standards and the audit of their use should enhance the level of asset oversight, custodianship leading to optimised decision making. However, their use does not resolve the issues related to the absence of a common national standard for social housing.

It is also clear from the interviews and focus groups that each state has developed their own system of condition assessment and standards over the course of time and that these systems are the result of a great investment of time and resources. However, the dissemination of this data during the tender process to CHPs becomes problematic due to the conversion process that needs to occur so that it becomes interpretable and meaningful. For example, one of the national CHPs uses a 1–5 condition rating scale but NSW use a 1–10 scale within their Property Assessment Survey (PAS). It becomes even more problematic when a national CHP operates within multiple states and need to interpret the many different condition assessment and standards of other states. Similarly, the terms of contracts can also vary between states and vary whether the transfer is by lease or title, which again requires a degree of interpretation and variations in the level of portfolio management by CHPs.

Interviewees clearly indicated the creation of an agreed national standard for social housing is needed to address these issues. Aligned with this, is a requirement for personnel training in managing and developing housing assets for the purpose of providing social housing and expanding the stock.

The provision of public housing (affordable housing) is critical to the development of Australia in ensuring that the damaging social consequences of unaffordable housing can be avoided. However, many public housing dwellings in Australia are fundamentally rundown buildings due to the severely underfunded nature of the agencies managing them. The lack of funding has placed substantial burden on state housing authorities / agencies (SHA) to establish other forms of housing provision either in the private sector or through the non-profit sector (Jacobs, Marston et al. 2004). As a result, funding for SHAs currently comes from ongoing sale of some of the assets and deferral of essential upgrading and maintenance works (Berry, Whitehead et al. 2006). Due to these problems of underfunding leading to dilapidation, the new trend emerging is partly the attempt by Federal government to transfer tenancies and tenanted properties to NFPs housing organisations to both manage and develop new dwellings (Pawson and Wiesel 2014).

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Email contact: Judith.callanan@rmit.edu.au