ARCH

ASSOCIATION TO RESOURCE CO-OPERATIVE HOUSING

ARCH Equity and Affordable Housing Project

2004-2005

Final Report

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Feb 2005

1. Introduction

For the past year ARCH has been investigating the possibilities for housing co-operatives in NSW to secure equity in their current and/or future properties. Having such equity at some stage was the basis under which many co-operatives were established, but over the nearly two decades of the development of the sector, that equity has not been legislated.

Instead, housing co-operatives have been developed within a lease-hold program with the co-operatives taking the role of head lessees of property of the Department of Housing under 5 x 5 year leases. These leases stipulated that co-operatives had to be incorporated as common equity co-operatives and that the leasehold program would only remain until a process for transferring equity had been developed. Up until December 2004 that process remained undeveloped.

Over that time, the issue for many co-operatives has shifted from equity to achieving long-term security through long-term leases on current properties. Younger co-operatives and those with long waiting lists have remained interested in looking at how existing surplus funds could be used as leverage to secure mortgages in the private sector through which to grow their co-operatives. Older co-operatives have been less interested in growing as their residents age and become less inclined and/or able to take on long-term debt financing.

2. Recent Developments

(a) Affordable Housing Pilot

In mid 2004, a proposal was first mooted for a pilot Affordable Housing Scheme to which individual co-operatives could have applied to enter into partnership with The Department of Housing and private lenders to build additional units of accommodation. The contribution expected from the social housing provider is in the order of $500,000.

Financial modeling by ARCH demonstrated that it would be impossible for any single co-operative to enter into this pilot as figures given to ARCH by member co-ops showed that their existing surpluses in no case was above $400,000 (some co-operatives may have more than this, but their figures were not forwarded to ARCH during the time of this study).

ARCH floated the idea of pooling surpluses as a way of securing sufficient to leverage units under this scheme that would grow the sector as a whole, if not individual co-operatives.

(b) Financial leverage modeling

At the same time, ARCH developed a financial model to consider the extent to which existing co-operatives could use their existing surpluses to leverage borrowings on the private market to grow their co-operatives. Again, the model showed that only a handful of co-ops currently had sufficient surplus to use as a sufficiently significant deposit to ensure their long term capacity to repay a mortgage on the loan raised.

(c) The present lease

A detailed study of the current headlease raised a number of questions about the ethics of the Office of Community Housing continuing with 5 x 5 leases while no work was done on developing a process for transferring equity to co-operatives.

Towards the end of November 2004, ARCH also became aware that OCH was about to start only offering 5 year leases, without a guaranteed option of renewal. The long term security of tenure of co-operatives now appeared seriously under threat.

(d) OCH growth funds

At the end of 2004, OCH made ARCH and the sector aware that they had $1m earmarked for sector growth for 2004-2005.

3. Activity to Date

(a) Affordable Housing Pilot.

ARCH has agreed to enter into a partnership with Community Housing Limited (CHL) (Victoria) and Willoughby Council to submit an Expression of Interest in developing units of social housing under this Pilot. Under the partnership, CHL will raise the finance for the social housing contribution, Willoughby Council will provide the land, and ARCH will provide support to develop a common-equity co-operative to manage the properties (with a component of the finances raised being paid to ARCH for this purpose).

The EOI is to be lodge in February 2005.

(b) OCH growth funds

In late December, ARCH met with OCH to discuss the findings of the equity project and raise issues about the current leasing arrangements. At that meeting, OCH agreed that it was willing to enter into agreements with co-operatives whereby OCH provided them with some growth funds in exchange for their surplus, giving the co-operative a degree of equity in their present properties commensurate with the value of their surplus and placing the co-operative on a 49 year lease.

Co-operatives were given a very short time in which to make a decision and as at the time of writing this final report it is unclear whether any will take up the offer.

4. Bargaining for equity for co-operatives

At this stage it is too early to tell what may come from these new directions. Both are very limited options, but both have thrown light on the way co-operatives can continue to work on achieving equity or long-term security of tenure via 49+ year leases.

A January 2005 meeting with ARCH members interested in these developments produced a clear picture of what co-operatives bring to the bargaining table and the scope of equity/security of tenure arrangements they could bargain for. These are summarized in the table below.

What co-operatives have to offer	*What co-operatives can bargain for*
♦ The use of their surplus funds either for individual expansion of your co-op or pooled for expansion of the Sector. A note of caution is necessary here. Co-operatives need to do further work on estimating their real surplus. Issues to be considered here are the long-term maintenance/ replacement costs which they may not have accounted for, and costs that may be involved in conversion and adaptation of dwellings as co-op residents age and become frail, and the costs involved in the next years in	♦ Security of Tenure (a 49 year lease) ♦ Equity in current and future properties ♦ Expansion in their property this year, with equity in any new property ♦ Expansion of their co-op in the future ♦ Expansion of the Co-op sector as a whole ♦ Servicing via a Secondary Co-op for current or future needs of individual co-ops or the sector as a whole eg. accounting services, brokering aged care services.

meeting registration and performance management criteria ♦ Sweat Equity. While this is not as yet an established principle, it is worth considering as a bargaining point in this situation. The issue here is how to cost it. ARCH suggests basing it on a management fee/per dwelling/ per year. CHL, ARCH's partner in the Affordable Housing Pilot, charges $1000 per dwelling/per year, and ARCH believes this is an appropriate fee. ♦ Participation in the Performance Management Framework. This has two elements: (a) the goodwill of co-operatives in entering into the system; (b) the willingness of co-operatives to work towards resolving any performance issues identified. In effect, co-operatives here are in the same bargaining position as individuals undergoing performance appraisals in companies or non-government services, where it is commonly expected that both parties in the appraisal will have both responsibilities and gains from the process.	

5. Options for using surplus funds to expand co-operatives

As discussed above, the number of co-operatives who could consider expansion of their co-operative through debt financing through the private market based on their surplus and on-going income alone is very limited. Appendix 1. presents some of the modeling undertaken for the equity study. In essence, it indicates that for a co-operative to enter into debt financing of its own it needs to have:

(a) A surplus sufficient to provide upwards of 30% leverage (deposit) on the cost of a property they are looking at purchasing ($100,000 on a $300,000 prospective property).
(b) An annual rental income in the order of $40,000 - $60,000, and an annual rate of expenditure at no more than 50% of their annual rental incomes.

While at present co-operatives operate primarily within the program of the Office of Community Housing, this will be difficult under the present terms of the lease whereby the ratio of tenants must by 65% low income (say below $28,000) and 35% other income groups.

It may be possible for a co-operative with sufficient surplus to meet 30% leverage to enter into debt financing if it uses the surplus to expand its co-operative outside of the OCH program. In this situation, the co-operative would still need to be able to raise annual rental income in the order of $40,000 - $60,000 and hold its costs at 50% of this. This would be achievable if the co-operative was to operate these new premises under an affordable housing model whereby the ratio of tenants would be in the order of 30% low income, 40% - 50% moderate income (say $28,000 - $46,000), and 20% - 30% higher incomes.

Discussions between ARCH and OCH suggest that OCH would not be favourable to using surpluses generated through its program to develop accommodation under an affordable housing model, however.

Still, there are options where the co-operative is willing and able to enter into partnerships with other social housing providers in order to secure debt financing.

(a) Affordable housing program of the Department of Housing

The extent to which this is a viable option will depend on the success of the pilot projects to be conducted over the next 4 years. If the expectation remains that a social housing provider will contribute in the order of $500,000 (roughly a third of what is required to construct 10-12 units, then most co-operatives would need to partner with another social housing provider with investment or surplus funds sufficient to reach that figure.

This is still possible where co-operatives are willing to pool their resources to grow the sector as a whole. It is also possible where a social housing provider investor such as CHL enters into a partnership with the co-operative(s).

In the latter situations, the new units would need to be developed within an affordable housing model of tenant income ratios.

There may also be an opportunity here with a social housing provider investor for co-operatives to bargain their management of the property as sweat equity with the investor in lieu of a financial contribution towards raising the deposit for the financing.

Equity in the property would be determined based on the initial and continuing contributions of the parties in amortising the debt finance. The possibility exists for the co-operative to achieve 100% equity.

The issue here will remain whether OCH is willing to release surpluses for affordable housing.

(b) Social housing investors

CHL has indicated that it is interested in being a significant investor in the development of the sector in New South Wales. A strong relationship has developed between ARCH and CHL in recent months. This may afford the opportunity for the sector to work through ARCH with CHL to achieve growth independent of any government scheme.

Here there are two options:
(a) Individual co-operatives could enter into partnership with CHL to grow their own co-operatives. The individual co-operative may put forward its surplus or bargain for crediting its management of the property(ies) as sweat equity in lieu of a cash contribution.
(b) A group of co-operatives could pool their surpluses through a secondary structure with in ARCH, with that secondary then entering into partnership with the CHL.

In both these situations the CHL would then be the agency which enters into the debt financing with the private lender.

Equity in the property would be determined based on the initial and continuing contributions of the parties in amortising the debt finance. The possibility exists for the co-operative to achieve 100% equity.

The income ratio of tenants here will depend on the specifics of the partnership arrangement between the social housing investor (such as CHL) and the co-operative. CHL for example has indicated that it would consider investing in housing that was targeted for a 65% low: 35% other income. In such a situation, OCH is likely to look more favourably at releasing the surplus for investment.

(c) Partnering with Local Government

The proposal being developed between CHL, ARCH and Willoughby Council can also serve as a model for future growth. Here, the advantages to be gained are through a reduction in the overall development costs where Councils are willing to:

- Contribute land
- Re-zone land
- Reduce or remove Council charges in relation to the development.
- Use of developer contributions under an Affordable Housing Policy.

For example, it is possible that the proposal being developed by CHL, ARCH and Willoughby Council could proceed outside of the Affordable Housing pilot. To do so, CHL would need to increase its contribution to cover the amount that would have been provided through the pilot, or ARCH could approach co-operatives to pool their surplus. The issue here would remain the attitude of OCH to using these surpluses for an affordable housing model.