Response to the

Affordable Housing Working Group Issues Paper

Council on Federal Financial Relations

Australian Government

11 March 2016

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Response to the Affordable Housing Working Group Issues Paper

Ian Hanger AM QC

"Before Government intervenes in a market in which it has previously had almost no involvement, it needs first properly to understand the industry. .. [and] end users or deliverers."[1]

Introduction

The opportunity to input and comment on this Affordable Housing Issues Paper is significant and welcomed.

Hopefully it heralds not just a much needed practical discussion about growing rental housing supply that is affordable but also provides a catalyst for introducing innovation across governments, the private sector and not for profits to contribute to a fairer and just society in which Australians are well housed, better able to contribute to a more dynamic and productive economy and where no one is left out in the cold.

The Sydney Morning Herald reported on 5-6 March 2016, 'Separate analysis by the Housing Industry Association shows it now takes 2.04 average full time salaries to "comfortably service" a standard mortgage on a median priced detached house in Sydney. That implies a couple each earning an average full-time salary in Sydney- which equates to a combined income of more than $180,000 a year - would struggle to afford a typical mortgage on a median priced detached house.[2]'

Affordable rental housing is now needed more than ever. If produced at scale, it can play a new role in making Australia the clever country.

There is currently a mismatch between financial products and the needs of social enterprises seeking to grow the supply of affordable housing. Access to adequate, and well-structured financial resources for growing affordable housing supply will enable greater financial resilience and independence. Support however through the start up and transition phases will be of critical importance.

The core attractiveness of bringing affordable housing investment together with institutional investors lies its ability to provide an steady low risk indexed return to the investors while offering affordable housing providers a lower cost source of patient capital.

This opportunity offers a critical pivot to sustainably engage and embed the private sector in the expansion of affordable housing

This paper addresses a number of formative contextual issues that should shape any response to this practical issue. There is peril in overlooking them as the quote from Ian Hanger suggests. The paper provides some commentary on the four models put forward in the Issues Paper and then offers some suggestions for moving forward and trialing proposals.

There is an inevitable tension between having strong evidence for an option and testing truly innovative thinking. Even tried and proven models can have different quite different outcomes in new contexts where the political, cultural and socioeconomic landscape dramatically alters the opportunities and constraints and chances of long-term success.

Some calculated risk taking will be inevitable. Investing in some well supported trials can mitigate some of these risks and, if they prove to genuinely scalable, carefully take us forward to a new era in which Australians can again claim a future in which we will all be affordably housed as homeowners or as renters.

Research

This paper expresses the views of the author drawing on over 30 years experience in the social and affordable housing sector.

It does not however purport to constitute original research. There is a great body of very current research and evidence developed in the Australian context, notably by AHURI and City Futures.

Some key reference documents include:

Milligan V, Pawson H, Williams P, Yates J (2015) Next Moves? Expanding affordable rental housing in Australia through institutional investment, UNSW Technical Report

Lawson, J. Berry, M. Hamilton, C & Pawson, H (2014) Enhancing affordable rental housing investment via an intermediary and guarantee, AHURI Final Report no.220, Melbourne: AHURI

Newell, G, Lee C L, Kupke, K. (2015) The opportunity of residential property investment in enhancing affordable rental housing, AHURI Final Report no. 249, Western Sydney University: AHURI.

Our Context

Facing up to market failure

Currently, there are not enough dwellings (i.e. a supply-side deficit) for low income renting households. **AHURI research** reveals that, in 2011, only 76 000 dwellings were affordable and available to the 347 000 Australian **Q1 households** who rented in the private market. As a result, 78 per cent of Q1 households who rented were in **housing affordability stress**..

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What's clear

It is a moot technical point whether there is market failure for housing that is affordable. In nearly all markets there are will be consumers who can't afford the entry price of purchasing goods and services. However missing out on stable housing has dire consequences.

It makes no economic or social sense for even a relatively small proportion of a nation's citizens to be homeless or be unstably or marginally housed. High costs are imposed as society is required to pay for higher health costs, pay for avoidable services (police, justice, mental health homelessness and child protection etc.), stimulate long periods on welfare and shoulder the inter-generational cost of poorer educational outcomes.

It is a worldwide phenomenon in advanced post-industrial states that the private housing market has failed to adequately meet the needs of many of those most in need on the lowest incomes and those with the least family support. Working people on lower incomes are at risk of being detrimentally affected. The commercial returns on investment have been too low and risky for assisting those dependent on welfare payments and for a growing segment of the marginally and intermittently employed.

This story is profoundly true in Australia. While housing markets vary significantly nationally statutory incomes are by and large uniform across the nation. Rent relief in the form of CRA is capped and the proportion is steadily growing with a large proportion of recipients are now receiving the maximum payment but remaining in housing stress. The problem is becoming more pronounced particularly in our capital cities, as they are impacted by our global economy.

The market has in the past met much of the need for low cost accommodation based on returns from older (depreciated) assets, where the return has been made up of full market rents, rent assistance, tax concessions (negative gearing) and speculation on eventual capital gains along with the capacity to quickly remove (evict) and replace non-performing rent paying tenants.

Supply responses have been too slow, erratic and insufficient - relying on a trickle down or 'aging' of older low-cost housing stock to reach those with the least ability to pay at a price point they can afford. The supply of dedicated social housing has been declining and the growth of affordable housing stalled. Urban renewal projects see much of the remaining low-cost housing being replaced by newer stock far outside their means to rent and the vulnerable displaced to areas of poor transport and diminished employment prospects. While more relaxed development and tenancy standards could potentially drive down rents it would have many undesirable consequences that have been rejected by communities and local councils.

The private sector alone will be driven by risk related returns on their investment. It falls first to government to own and respond to this growing problem of its citizens and find partners and new solutions in this cause.

It is an illusion that market driven increases in housing supply will ever make housing affordable for low-income households in our lifetime. Due to the shear size of the problem market based supply growth is most unlikely to continue long enough, and be large enough to generate a sustainable supply demand equilibrium at the bottom end of the rental housing market that produces housing that low income people can afford to rent.

Targeted affordable housing is the most realistic and assured route.

Could Affordable Housing give Australia an advantage in our increasingly competitive and

global economy?

- Could significant affordable housing supply hold part of the answer for how a high wage country like Australia is to remain cost competitive globally without reducing our standard of living?

- Can it help to ameliorate a growing inequality gap for the next generation while increasing the nation's prosperity?

- Can affordable housing produced at a much larger scale and proportion of the housing stock become a driver for the nation's growth and help offset pressures for Australian living standards to decline?

- Can it relieve some of the pressure on social housing at a lower cost to tax payers?

What's clear

- Housing costs are a major Australian household cost and this cost feeds into both our living standards and the cost of producing goods and services in Australia (wages).

- Affordable rental housing at scale can provide a natural cost advantage - through embedding a lower cost structure for a proportion of lower income working households that can't easily be eroded.

- Housing costs are major cost and driver for higher wages in the economy.

- Affordable rental housing is a proven model operating in many global cities, like London and New York. It has been an integral part of Hong Kong's and Singapore's success stories. Key workers are enabled to make their contribution to the economic and social vibrancy of these cities. There aren't in fact other sustainable working alternatives in first world global cities.

- Affordable housing currently exists and operates alongside market priced housing without unduly harming or distorting the rest of the private housing market. (Australia currently has one of the most expensive private housing in the world). If anything it may help dampen over heated housing markets, enhance labour force stability and provide counter cyclical housing supply during inevitable housing market construction down turns.

- At sufficient scale, it could help to moderate rental assistance subsidy growth for government housing subsidies (CRA) ensuring that they are more effective in relieving housing stress. If affordable housing became a widespread component of the Australian housing tenure mix, it could deliver an environment of higher after-housing cost wages and better lifestyle for its consumers while helping to maintain our international competitiveness, in Australian society where fewer people are left behind economically.

- Affordable housing can also provide a stepping-stone into home ownership through stair-cased shared equity arrangements. Integrated with social housing, affordable housing promises to provide a viable pathway out of social housing and greater flexibility for social housing providers matching services to clients according to the duration of their need.

Below market housing requires subsidies in one form or another

While there is a spectrum of choices we can make to attract institutional investment, there is also a strong industry consensus that some form of ongoing government subsidy or equity injection must accompany any new financial models to bridge the investment gap and sustainably attract private finance to below market value rental housing.

While financial vehicles and effective models are critical, they alone will not be enough.

The indexed 25 year subsidy streams to be provided under the Social and Affordable Housing Fund in NSW, the indexed multi-year *User Cost of Capital* subsidies for supporting National Disability Insurance Scheme clients requiring special purpose housing under NDIS, the indexed 10 year National Rental Affordability Scheme financial incentives all underline and illustrate this critical point.

Instigating a new recurrent subsidy or upfront capital subsidy and/or targeted tax concessions must be a priority to ensure new infrastructure successfully attracts serious institutional investment to a pipeline of affordable housing.

Government budget constraints for the immediate future, mean this subsidy requirement may need to also come from a number places to spread the financial burden, avoid seriously worsening the government's deficits and lowering investor risk. However leadership and clarity for funding responsibilities will be a prerequisite for gaining investor confidence.

Making better use and enhancing existing government funding, tax levers and housing stock present some sustainable opportunities that can be scalable, bolster investor confidence and stimulate growth.

These include direct and indirect 'subsidy' measures that work to provide the necessary yield to institutional investors, based on market based risk return benchmarks:

Commonwealth

- Provision of a Commonwealth Government loan guarantee of last resort to bond holders (underpinned by the borrower's credit rating and/or Registration status under NRSCH).
- Provision of a new subsidy stream dedicated to increasing the supply of affordable housing
- Provision of bridging finance on attractive or nominal terms or an equity injection by way of upfront cash for development and construction costs
- Creating an affordable housing asset class recognised by the Australian Taxation Office, that is eligible for tax relief credits – potentially as a refundable tax offset or payment where the subsidies are treated as tax-free
- Reform of Commonwealth Rental Assistance (CRA) to increase/remove the caps to make it more cost reflective in higher cost rental markets
- Enabling alternative options for using the National Affordable Housing Agreement funds as a long-term social housing capital subsidy stream for new supply.

State and Territories

- Use of unencumbered indexed rental streams – the net revenue after costs - associated with social housing transferred by states and territories under long term leases to community housing providers, along with continued and expanded access to the CRA
- Use of indexed rental streams associated with social housing where title has been transferred to community housing providers by states and territories, along with continued access to the CRA to strengthen borrowers balance sheets and opening up opportunities for

value capture from the rezoning of land to higher densities
- Provision of discounted land contributed by state and territory jurisdictions to reduce the cost of new property development.

Local Councils (support by States and Territories)
- Use land contributed from inclusionary zoning requirements
- Discounts to rates and exemptions

Potentially the Commonwealth could use incentive payments made under the National Competition Reform agenda to States and Territories to lock-in a minimum level of state based contributions through mechanisms such as the title transfer assets to CHPs and mandating a proportion of affordable housing via a jurisdiction's planning mechanisms such as inclusionary zoning for funding affordable housing.

The introduction of the NDIS provides a unique opportunity. The NDIS has a funding subsidy stream (around $700 million per annum) to meet the needs of 27,700 people with disability who have the highest support needs – those who require assistance regularly throughout the day. Potentially there is an opportunity to support housing related borrowings. (Refer also to the section on co-operatives for further discussion of this opportunity). Up to 12,000 new housing places are needed immediately.

Regardless of the specific approaches, the subsidy generating measures employed will profoundly shape the focus, governance and structuring of financial vehicles to foster affordable housing supply. The inevitable government rules and tax treatments for eligible parties will mold not only the financial entity but also the services markets and investor expectations.

Until the subsidy issue is determined the financial model analysis exercise will prove hard to progress. Some commitments around at least time limited subsidy arrangements will be required early on in the planning process for funding tranches of affordable housing supply in any proposed trial(s).

What kind of affordable housing future and market do we want to create for Australia?

What will be the inheritance, after the change initiatives are implemented?

- What structural reforms are we aiming to achieve through innovative, transformative and implementable financing models[4] beyond 'facilitating large scale investment in an affordable rental market' (Australian Government Council of Federal Financial Relations, 2016)[5]?

- How well will it serve Australians into the future and specifically assist low-income disadvantaged households sustainably?

- What will drive growth in supply, improved performance and customer service over time (Competition principles) and avoid the pitfalls of monopolistic provision and the misuse of market power?

It is not simply a technical question of viable options but also one of market and product design.

Is there an existing affordable housing market?

What changes would be helpful for fostering one?

- As part of the Australia's housing market, what are the flow-on effects of operating in a dominant private market for the nascent affordable rental housing market?
- How will it fit in with the homeownership and private rental markets? Is there a distinguishable not-for profit affordable housing asset class?
- How does it intersect with the Australian capital market?
- What are the drivers for Australia's largely private housing market? What are the drivers for an affordable housing market beyond the provision of government subsidies? And how do they interact?

What's clear

- Housing stress is a fundamental issue for low-income households. It is the most crucial predictor of poor quality of life for elderly Australians who are pushed to the fringes of the nation's cities, according to the first index of wellbeing for people aged over 65' based on analysis by the National Centre for Social and Economic Modeling[6].
- Special rules and tax treatments for categories for social and affordable housing assets and providers of these services already exist although in a rather disparate and piecemeal fashion.
- Nationally there isn't a readily identifiable 'affordable housing asset class' aimed at attracting private investment in affordable housing through concessional treatment of taxes and charges at Commonwealth, State and local government levels.
- Large investors require large and diversified deals in tradable products. Deal sizes of $50m to $250m for an institution and at least $250m in aggregate would be expected to create liquidity and establish a sustainable market.[7]
- There is a clear need to establish a national market for long-term investment and trading in a residential asset class to spread risk and achieve scale.
- Longer term investment in rental housing by arm's length investors is likely to have flow on benefits for consumers by providing greater tenancy stability.[8]
- New markets in affordable housing delivery and institutional investment are likely to evolve concurrently. Each building on the existing 'industry' infrastructure, market regulation and good practice.
- Current laws, rules and regulations are helpful for giving certainty to government funders and to housing providers. However a further review of these rules will potentially help institutional investors and consumers better engage with new affordable housing supply.

- A national housing strategy that better delineated an affordable asset class would provide clarity and transparency of purpose. In particular it would provide clarity to investors in terms of the assets' tax treatment, eligible government subsidies that are available to support it, and information about any overriding financial constraints and limitations on rents and asset sales that might attach to it.

Market Design: Should it be a competitive market?

- Competition is seen as 'the invisible restrainer of our capitalist economy and essential to ensuring consumers get a good deal.'[9] However competition can also have its drawbacks[10]. Competition and scale of economies are often in conflict.
- Interactions between the two emerging markets will shape government's market stewardship roles and require a growth in communication and understanding between their regulators.

What's clear

- The aim would be to create a competitive and sustainable market in residential investment drawing on multiple sources of funding, both national and international.
- A diversity of well functioning providers is good long-term strategy for government as an 'investor of public funds' and for consumers exercising choice, provided that diversity is accompanied by transparency around performance. Diversity is particularly important where it is hard for consumers and investors to 'move their feet'.
- This approach is consistent with a key principle adopted in the Reform of Federation White paper for assessing reform options. Services 'should support local and diverse approaches to service delivery across the federation that foster innovation and allow services to be tailored to the communities that use them.'
- Avoiding monopoly provision will avoid the possibility of high degree of regulatory intervention (particularly if rents become further deregulated in the future).
- Market design also involves managing the growth in private sector debt as opposed to public debt. It needs to include the design of financial regulation and consideration of the adequacy of current settings for a new asset class.
- Interactions between the two emerging markets of institutional investment in affordable housing and affordable housing provision will shape government's market stewardship roles and require a growth in communication and understanding between their regulators.
- The Competition Policy Review Final Report[11] known as the Harper Review (March 2015) recommended broad reforms promoting greater competition and contestability to raise living standards and increase productivity. The review made 56 recommendations nominating human services (recommendation 2) as a priority area for attention. It helpfully proposes some reform principles that can usefully be applied to shaping an emerging

competitive affordable housing market. They can also assist in evaluating the merits of different models of fostering institutional investment.

- The Review's guiding principles for human services[12] propose that:
    - User choice should be placed at the heart of service delivery.
    - Governments should retain a stewardship function, separating the interests of policy (including funding), regulation and service delivery.
    - Governments commissioning human services should do so carefully, with a clear focus on outcomes.
    - A diversity of providers should be encouraged, while taking care not to crowd out community and volunteer services.
    - Innovation in service provision should be stimulated, while ensuring minimum standards of quality and access in human services.

How important a driver is an affordable rent?

- There is a clear connection between rents and poverty, as housing costs are usually one of the largest household expenditures.

What's clear…

- We need low-cost supply at a range of rental price points with limited predictable rent rises
- We need to avoid pricing households out of low rent social housing
- Different models are needed for different markets

What new models will best deliver effective collaboration and innovation between the private and not-for-profit sectors?

- Who can access affordable housing is a very important question. Where government subsidies are involved there are expectations that they go to people they are intended to help. Potentially the greater the subsidy the greater this expectation.
- The Australian news paper (20 November 2015) reported that the Auditor-General Grant Hehir found that no assessment was ever done on the impact the National Rental Affordability Scheme policy actually had on affordability and half of the $3,600 per dwelling subsidies secured by universities were occupied by wealthy fee-paying foreign students[13].
- According to the Australian (3 December 2015), the audit also found savvy developers gaming the scheme by exploiting flaws to in the scheme to stockpile and trade entitlements claiming a bounty up to $30,000 per entitlement.

What's clear

- The system should work hardest for the people who need it most[14].

- Clarity is required about who gets assistance and that appropriate mechanisms are in place to ensure the expectations translate into assistances.
- Clarity is also required about what investors and developers can legitimately do and profit from.

Are we seeking to establish new commercial businesses or social enterprises?

> *'Social enterprises are organisations that exist to fulfill a mission consistent with public or community benefit, trade to fulfill that mission, and reinvest a substantial proportion of their profit or surplus in the fulfillment of that mission.*[15]*'*

What is clear…

- New models of doing business are required to participate in a world that supports the expansion of affordable rental housing through institutional investment.
- Businesses and their NGO partners need to collaborate to create shared value. This may entail re-conceiving products and markets, redefining productivity in the value chain, or enabling local cluster development.

Some of the challenges are for businesses working for social change. The first is strong alignment on the mission of the NGO and the purpose of the company. When a company has not yet articulated how it can address social problems for profit, partnerships between social enterprises and corporates can become ad hoc and less significant to solving a particular social problem or barrier. [16]

How to ensure asset outcomes (like more supply) aren't preferred over client outcomes (such housing stability)?

At what point does an arrangement become detrimental, if client outcomes are subordinate to those of investors?

What is the overriding driver for these decisions? How can the proposed models manage these at times competing needs?

These questions and issues will be explored in the review of the models.

Model Analysis

The four models being examined are quite diverse. Each of the models has a different focus in terms of the attracting investment resources (institutional and other sources), accumulating capital and delivering outcomes and services for clients. The diagrams of the four models (following) illustrate some of the key differences and emphasis between their roles, focus and scope.

- This makes robust comparisons difficult and more arbitrary
- It also highlights the need to have a consistent set of measurable criteria for assessing a model's success that goes beyond the ability to attract institutional investment in affordable housing.

- Many of the positive examples of models in the paper reflect their specific overseas operating environments. The Australian policy, taxation and market context can be significantly different and the models' direct translation to our circumstances may need to be treated with some caution and care.

Building, Building-to-let, or Building to let affordable housing?

- It is important to clarify what is the problem: is it insufficient supply, insufficient housing supply that is available to rent; or insufficient housing that is affordable (at below-market rents) and available to rent by low income earners? Or is it a combination of all three**?**

- If the fundamental problem is that desirable property is scarce, an obvious answer is to lift planning constraints and build more houses. But more construction is no panacea: Ireland's relaxed planning rules did not prevent a devastating property boom and bust.

Proposed Success Criteria

A set of success criteria is proposed for judging the merit of the models. They aim to balance three key attributes: quality; quantity; and effectiveness. Ideally a model will:

- Establish a sufficiently large and continuous stream of funding, for increasing the provision of affordable housing for those on low incomes, which would be predictable, sustainable and responsive to demand.

- Assure long term (permanent) affordability

- Enable consumer choice and improve client outcomes and help to break entrenched cycles of disadvantage

- Provide stability, service continuity and manage risks, protect consumers and investors alike

- Engender a vibrant supply side, in which affordable housing providers and institutional investors can and do enter the market, where there is healthy competition in the market on desired dimensions and a business environment where providers can and do exit in an orderly way[17]

- Enable government to move from direct provision to a reframed role of strategic direction setter, investor, market steward and regulator of providers.

- Promote innovation in service delivery.

Measures of success

To ensure the effective evaluation of the models and potential trials, these success criteria can then be translated into a number of measures that correspond with the key functions being undertaken. Some suggested measures include:

Capital Formation

- Attracting large scale investment to affordable rental market
- Long term accumulation of capital (equity and borrowings) within system
- Provision of attractive long term returns to investors for the investment risk profile
- Increased net revenue for supporting borrowings
- Level of equity leakage to outside the social housing system that occurs over time

Asset management

- Growing affordable housing portfolio accessible to low income disadvantaged clients

Tenancy and property management

- Affordable rents for tenants
- Growing service capacity
- Avoidance of discontinuities of services to tenants and communities
- Numbers of successful transitions to employment accompanied by shifts to lower housing subsidies

Systemic measures

- Scalable finance model to fund new supply
- The number of new ideas and innovative products that enhance performance of the sector and result in improved client outcomes

Auditor-General's foreword to NRAS Performance Audit (November 2015)

The Auditor-General's advice is instructive for taking the financial models to trial phase and avoiding past mistakes.

> The implementation of NRAS has highlighted the need for effective planning and sound administration, if Government programs are to be successfully implemented and are to achieve their objectives and expected outcomes. In considering the findings of the report several key learnings emerged, these include the importance of:
>
> - effectively planning for the implementation of programs, including allowing sufficient time for the administrative design features and any supporting legislative and regulatory frameworks to be settled prior to commencing formal implementation;

- integrating risk management processes into the overall design, governance, strategy, planning and administration, to effectively manage risks to the achievement of the objectives and outcomes of programs;
- identifying the required mix of essential skills, experience and capability to assist with the efficient and effective design, implementation and administration of programs, in accordance with broader government policy and any underlying legislative and regulatory frameworks;
- conducting application and assessment processes in a manner that accords with policy, legislative and regulatory requirements, including establishing robust probity and sound decision making processes, and complying with procedural fairness and other administrative law requirements;
- evaluating programs with a focus on understanding their impact, whether the policy objectives and expected outcomes are being achieved, and whether the underlying policy approach is an effective intervention;
- departments drawing to the attention of the Government, as early as possible, key risks and shortcomings in policy design and the likelihood that related programs may not fully achieve their intended objectives or outcomes; and
- creating and maintaining a minimum standard of documentation in relation to administrative processes and decisions in order to support accountability and transparency[18].

Other commentators have noted that Australia's NRAS experience was problematic in that the technical scheme design was ill suited to institutional investor requirements. 'More fundamentally now, without a subsidy or incentive of some form, competitive yields on lower rent residential assets are not achievable.'[19]

Overview of the Financing Models

The diagrams following seek to show both the scope and functional focus of the four financial models. The highlighted functions aim to show the key areas of activity associated with the financing model.

The diversity of the different models and their related functional reaches illustrates the scope of the challenge in comparing the models (along with their quite different risk profiles) and hints at the potential challenge of trialing the models with multiple stakeholders.

While the focus is on *capital formation* for affordable housing, the diagrams aim to show the extent that each model extends into other parts of the affordable housing business with key impacts on housing asset management and client outcomes.

Other respondents will be able to provide more detailed descriptions of the arrangements informed by related financial model simulations of yields and other metrics. This analysis aims to provide high -level analysis and commentary on the other fundamentals.

Key precursors for this analysis involve better defining the destination - what should be demonstrated through any trial(s) and how this can inform the eventual end-state? –what time period will be required to achieve results from a working trial, and what can be left to evolve in a next stage?

Geography and related regional housing markets will also play a part in shaping where specific models work most effectively.

Do the models better suit different types of clients, in different financial circumstances?

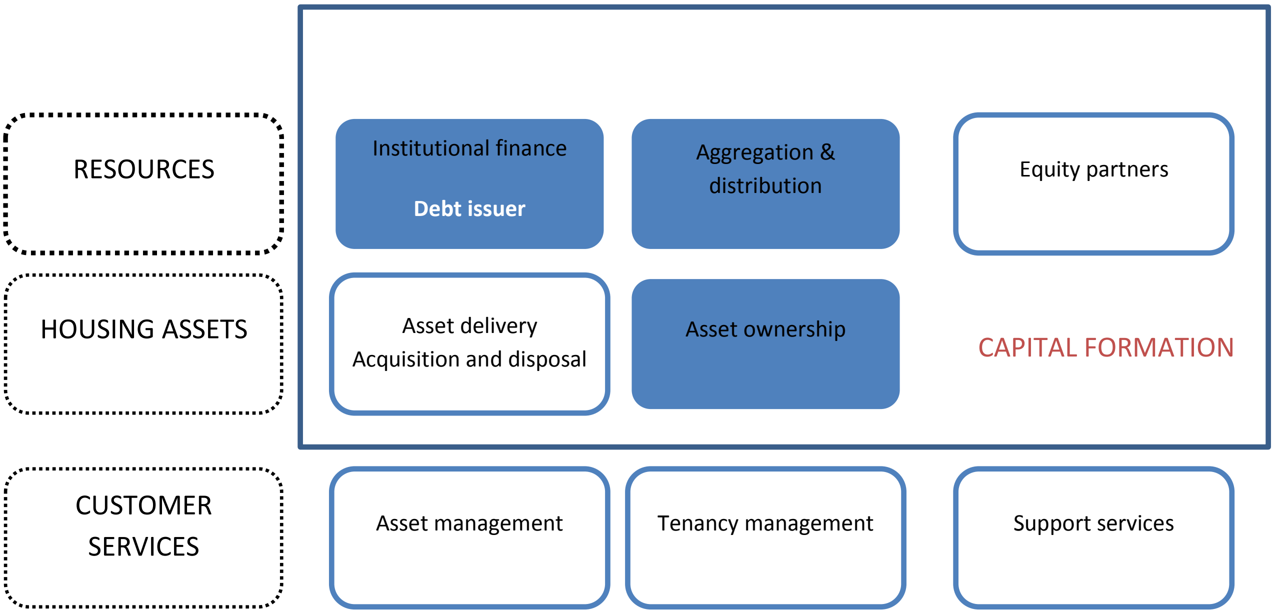
- Will there be an inherent bias to 'cherry pick' those households on higher, more stable incomes to maximise investor returns, as overtly occurs within the private rental market where agents seek to find the 'best and least risky' tenant? Will this undercut the social purpose of providing affordable housing?

- How effectively do the four models address these issues? Do some models lend themselves to certain client niches or cohorts? Will this vary in different housing markets?
- Should the extent of client targeting be geared to the level and depth of the subsidies provided?
- What rent models should (can) apply within the models?

What's clear

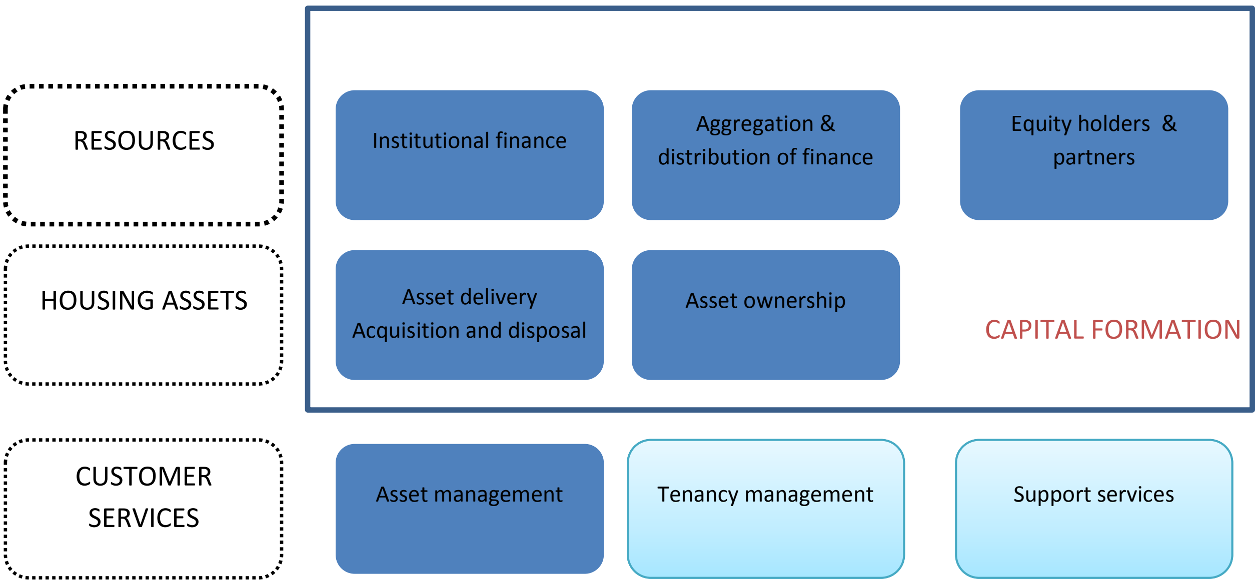
- AHURI research has showed that many people on higher incomes effectively trade down and take up low cost private rental properties to save money and this frequently happens at the expense of people with reduced means.
- The party who chooses the households to be assisted will be important under all of the models, as it is critical for achieving the objectives of improving the housing affordability and ensuring government subsidies go to where they are most needed, while expanding supply.
- In most jurisdictions registered community housing providers are well placed to undertake this access task possessing established systems and policies and expertise to ensure equity of access, especially where a mix of income groups is involved. Tier 1 and 2 providers have mechanisms to distinguish different levels of housing need and a review process for use when household circumstances change.
- Effective targeting of clients should match the level of subsidy (assistance) provided. For example deeply subsidised social housing will usually involve stringent needs based eligibility criteria while market housing with very low subsidy levels would have minimal requirements with few access barriers akin to the private rental market.
- Targeting measures however need to be balanced to ensure there is sufficient revenue to consistently meet commitments for stable investor returns.
- Targeting of clients, systemic and client related subsidies, rent models, local housing markets and revenue surpluses to support investor returns are all interlinked. The policy rules need careful thought through and designed.

Model 1: Housing loan /bond aggregators



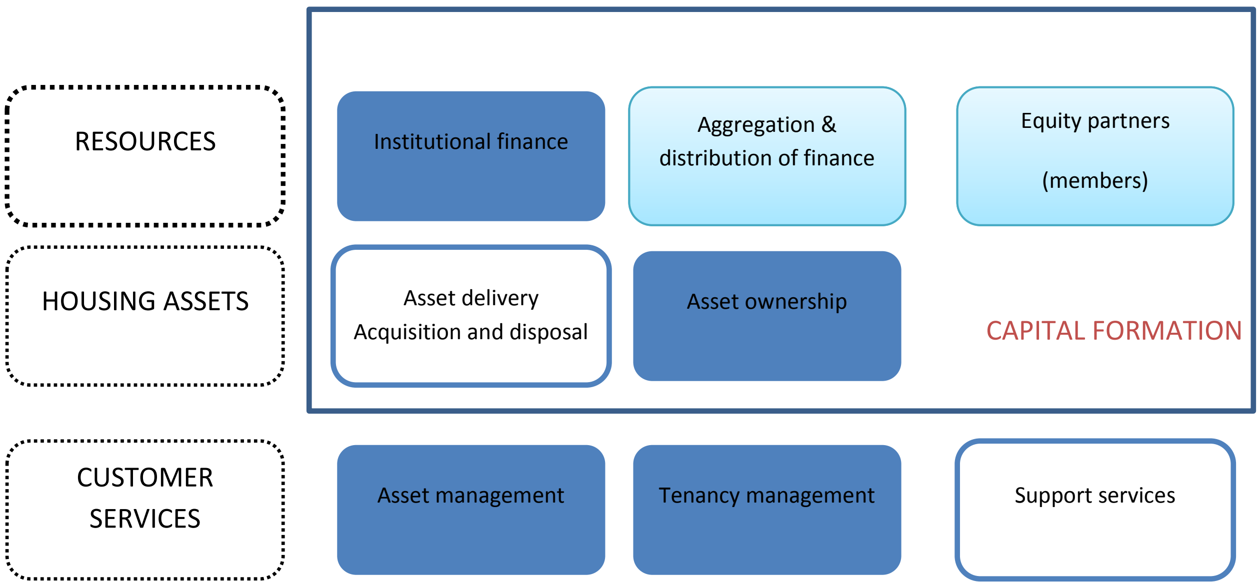
Investor entry points: Financial Intermediary e.g. Housing Finance Corporation via a housing bond issue

Model 2: Housing trusts



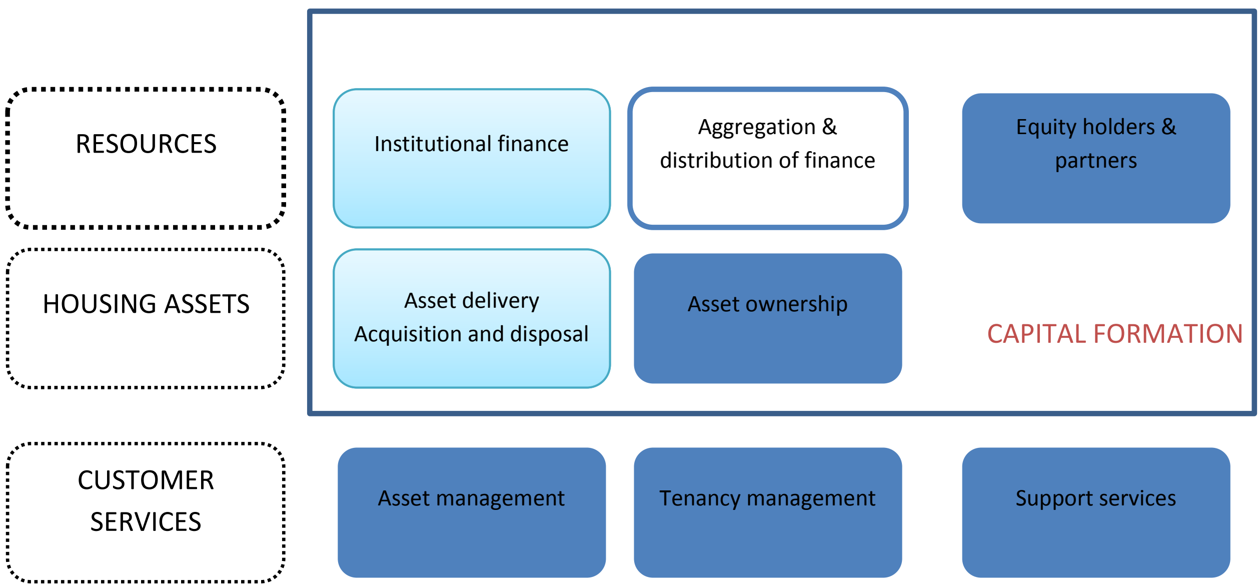
Investor entry points: Purchasing units in Property/Housing Trust or via a housing bond issue

Model 3: Housing co-operatives



Investor entry points: Lending to the umbrella housing co-operative (asset owner) e.g. Common Equity Housing Limited or debt finance via a housing bond issue to the asset owner

Model 4: Impact investing models



Investor entry points: Consortia (potentially a special purpose vehicle) or through housing bond issues

Model 1: Housing loan /bond aggregators

'Housing bonds provide a vehicle to aggregate debt financing and allow affordable housing providers to combine their finance requirements to obtain funding from the wholesale market at a lower price than they could individually from banks and other finance organisations'[20]. In essence this model proposes an alternative means of raising funds to the securitised mortgage from financial institutions like banks undertaken on a provider-by-provider basis.

The entities supporting the housing bond raising can take a number of forms. Selecting the most appropriate form or structure will help to determine the success and effectiveness of housing bonds.

Design prerequisites

- A decision about whether the debt aggregator entity should be a government, commercial business or a social enterprise? Should this encompass the role of debt issuer or should this role be undertaken by a financial entity in tandem with the aggregator role?

- Decisions about structuring the bond raising and the nature of the other entities for the trial and beyond:

    - Bond (e.g. term, yield, maturity, redemption, security ranking, key ratios etc.)

    - The debt issuer and its relationship to the loan aggregator and potential guarantor

    - Insurer underwriters

    - Trustee and trust deed

The following section aims to highlight key strengths, limitations, opportunities and risks that the model of housing bonds present. This seeks to inform analysis and discussion of the model's applicability and implications for its trialing.

Strengths

- Housing bonds have been successfully used in the UK to grow their social housing sector. Registered housing providers are able to service debts and grow new supply.

- A housing bond has potential to shift Australian community housing providers from an over reliance on small-scale volatile finance to large-scale, long-term debt finance.

- The stable long-term cash flows used for funding social housing projects are quasi government in nature with a very high proportion of the revenue drawn directly from statutory incomes paid by the Commonwealth.

- The recurrent subsidy to support government backed (guaranteed) housing bonds yields is likely to be lower than the yield gap of an equity based model like housing trusts.

Limitations

- Attracting institutional investment through housing bonds requires a set of concerted actions and commitments that will need to be maintained over an establishment period of two to three years before benefits can be realised.

- As bond finance would only be available for completed projects, some form of bridging finance arrangement will also be required to meet the construction costs, otherwise acquisitions will tend to focus on existing housing supply.

Opportunities

- Australia has the fourth largest superannuation market in the world. Superannuation funds are seeking diversification into alternative asset classes[21].

- Community Housing providers have financial and management capacity to manage significant portfolios. Currently they don't have access to equity markets.[22]

- There is a special opportunity to forge a unique partnership between a not-for-profit aggregator and a finance institution/bank engaged to take a housing bond to market.

- To investigate the suitability of using 'Simple Corporate Bonds' (CSB) for debt funding of affordable housing supply. This could both simplify and standardise processes and as well impose strictures on the bond product being offered. For example CSBs have a maximum term of 15 years. CSBs promise to provide greater institutional acceptance and speed in going to market to raise debt. Further details of CSBs are detailed at appendix 1.

Risks

- While some **i**nstitutional investors consider the community housing sector of tier 1 providers to be fragmented (over 25 nationally) this diversity has the potential to engender competition and reduce risks for government. Under the Harper Competition principles, a significant diversity of capable providers is seen as creating a beneficial business environment in the long term. According to Westpac 'CHPs without scale are leaving the market open to institutional backed entities and the for profit sector'.[23] The complexity of multiple relationships and risks are undoubtedly an issue for institutional investors, which a debt aggregator intermediary could successfully address.

Implications for policy development

- In the UK housing bonds coupled with a financial intermediary have successfully managed a large diversity of registered housing associations in a standard, straightforward and transparent way, reducing due diligence costs and other impacts for investors.

- Initially limiting the number of housing providers in a trial may facilitate a useful but temporary compromise.

- Large-scale transfers of public housing to community housing across a range of jurisdictions can relatively quickly increase a number of individual providers' scale and capacity to deliver to demand.

A key challenge will be bringing a new housing bond to market. When considering the credit rating on a bond, an investor will look at:

- the credit rating of the issuer;
- the complexity of the product (corporate bond); and
- the credit rating of the security.

If a company is unrated, it does not necessarily mean that its interest rate securities are high risk, but it does mean that investors will have to turn to other means to evaluate its financial strength or the security's complexity. *Australia Ratings* assigns credit ratings and product complexity indicators on ASX listed debt and hybrid securities. [24]

Trial

This model of housing bonds may well exhibit the greatest promise for quickly achieving a successful approach to attracting institutional investment, particularly given initial indications of institutional acceptance and its inherent scalability.

Any trial needs to provide a robust national approach that builds the model's reputation and stakeholder interest but avoids becoming delayed in an overly complex, lengthy development phase slowed down by a large multiplicity of new participants across jurisdictions. Incorporating a trial review and evaluation phase along with a representative advisory committee with broad industry membership may help to 'avoid making the perfect the enemy of the good'.

Strategic Proposition

This project whether pursued by government and or the affordable housing industry beyond the trial will leave a lasting legacy of tenanted affordable housing, a functioning financial vehicle and a corporate bond raising.

Ideally it will involve a Commonwealth seed funding commitment to establish and then implement these three infrastructure elements, but all with a view to them becoming more financially independent of government over time as investor confidence is established. It will also need to secure a stable long-term housing subsidy for the life of the housing bond (and ideally beyond). It will require a higher threshold of financial transparency from community housing providers.

As a suggested minimum, the trial should include testing:

- The placement of institutional investment funds into multiple affordable housing projects at scale
- An assured subsidy that addresses the investor yield gap, provided in combination by one or

more spheres of government
- Multi state and territory affordable housing response based on community housing delivery involving providers registered under the NRSCH
- Increased supply of well managed and targeted social and affordable housing
- National loan aggregating entity that successfully provides coupon returns, manages risks and reassures investors that is responsive to borrowers' needs.

Designing the Trial Parameters

The following seeks to provide some key design considerations for a trial and proposes features that, if progressed, will minimise delays to introducing and progressing a trial. These proposals are necessarily preliminary, and would need to be broadly consulted upon and revised before being adopted.

Issue 1: Leadership

Mitigation strategies

- The Commonwealth as the infrastructure 'seed funding investor' takes on leadership of the model development enabling individual States and Territories, housing providers and investment institutions each to opt in through transparent EOI processes.
- Building and disseminating a financial and risk simulation model that demonstrates the viability and creditworthiness of housing bonds
- The Commonwealth provides seed funds and a guarantee/credit support for the trial's housing bond raising, to help overcome concerns about the lack of a track record. The seed funding would involve an initial capital injection (of say minimum $10 million) and three years of operating subsidies during an establishment phase.
- Committing upfront an assured funding subsidy for the trials, potentially differentiated by participating state & territory -investment return gaps
- Deciding whether the trial will engage one or a pool of financiers/ institutions in the bond raising strategy
- Providing proponents with a high-level estimate of timeframes to become operational to give all stakeholders a measure of certainty and confidence.

Issue 2: Determining the scope of client target groups eligible for assistance at the outset

Mitigation strategies

- Agreeing client target groups to be assisted (and projected average incomes) and any exclusions (e.g. non-resident students). This will be critical for modeling both affordability outcomes and financial viability modeling, to avoid the problems identified in Commonwealth Auditor General's NRAS review.

Issue 3: The number of parties and quantum of transactions

Mitigation strategies

- At the earliest point:
  - Determining the size of the bond offer that is sufficient to attract institutional investment thereby limiting the trial size (setting minimum and maximum number of subsidies offered)

-
- Limiting the number of borrowers to a minimum - potentially a couple of registered tier one housing associations per participating state (selected with strong untapped borrowing capacity and a development pipeline that is suitable for financing)
- Identifying a national debt issuer that meets Australian financial regulatory requirements.

Issue 4: Preparedness of participating housing associations

Mitigation strategies

- At the earliest point after the selection of housing providers, fund a ratings agency to establish participating housing associations' individual credit ratings using seed funding provided by the Commonwealth
- Building a modeling and bidding tools for participating housing associations to demonstrate a borrowing plan when key inputs (nature, size and duration of subsidies, housing markets, client groups, rental model) are all known and agreed in a standard format.

Issue 5 Complexity of funding sources and government budget impacts

Mitigation *strategies*

- Simplify and streamline the funding arrangements in the first instance, to obtain a finite financial commitment for infrastructure and subsidies - ideally just from the key parties for simplicity – i.e. the Commonwealth, participating states and territories and community housing providers.

Issue 6: Establishing a bond aggregator vehicle

Mitigation *strategies*

- Agree national governance based in the non-government and financial sectors that will encourage broad participation in subsequent phases
- Contract legal advice to develop the legal framework incorporating an agreed model incorporation rules, a legal structure for ownership and managing significant transitions. Key elements would seek to replicate many of the features of the UK The Housing Finance Corporation (THFC): independent, specialist, not-for-profit, self-funding intermediary. It on-lends debt finance to registered housing providers.
- Develop a business plan (with a supporting financial model) for both the life of the trial and the projected end-state.
- Contracting in specialist expertise and advice, such as from the THFC to advise on structuring of operational systems.
- A diagram from AHURI Final Report no 220 at appendix 2 illustrates a potential structure for an Australian Affordable Housing Finance Corporation (AAHFC).

Issue 7 Undertaking the bond raising

Mitigation strategies

- Determine the bond issuer based on provider, investor and government advice
- Appoint legal advisors to develop the housing bond prospectus – potentially using the simple corporate bond (SCB) legislation introduced by the Commonwealth Government in 2014. Alternatively closely follow the simple corporate bond 'template' to minimise the complexity of the housing bond, but with the AAHFC as the debt issuer.

Issue 8 Information symmetry, transparency and consistency

Mitigation strategies

- Enabling community housing providers in jurisdictions that do not participate in the NRSCH to also register under the national system to facilitate their access to housing bond finance.
- Building on and using existing systems of reporting and accountability for affordable housing developments and construction. Integration of this into public facing information available to investors and other stakeholders- compulsorily for participating Tier 1 providers and other registered providers opting in. Provide a greater level of disclosure by registered housing providers of key financial ratios and balance sheet positions.
- Agree outcomes and evaluation metrics for assessing social and financial outcomes

Issue 9 Manage key trial risks

Mitigation strategies

- Preparing an actuarially based risk plan to enable the Commonwealth and/or states and territories to provide a full or partial loan guarantee for the initial tranche to lower the risk margins and yield requirements
- Appoint probity project and risk managers to support the development of the trial.

Model 2: Housing trusts

Housing trusts are an investment vehicle for the aggregation of equity investments in income producing housing assets. They allow investors to either purchase units generating the income stream from the trust, or the capital assets of the trust, or both depending on their investment profile[25].

The establishment of a housing trust would allow for housing assets to be aggregated at an individual state or territory level, across several states and territories or nationally. A broad geographic spread can lower risk, reduce volatility and avoid exposure to a single geographic housing market.

AHURI research (2015)[26] found that the features most desired in an effective residential investment vehicle are: being managed by an experienced manager; having a diversified portfolio by location; and delivering stable income returns with low debt.

Potential low returns, poor market information and low quality portfolios are key deterrents for investment in affordable housing by institutional investors.

The following section aims to highlight the key strengths, limitations, opportunities and risks of housing trusts. It seeks to inform the analysis and discussion of the model's applicability and implications for its trialing.

Strengths

- To date the trust model has had primarily commercial property application in Australia. However it is a flexible model that can operate for community, private sector or government providers of affordable housing. The trust model has started to be used in Australia for social-commercial enterprises such as the provision of early childcare properties for example the Folkestone Education Trust[27].

> *Folkestone Education Trust is the largest ASX listed real estate Investment trust (A-REIT) that invests in early learning properties. It has total assets of $709 million with gearing (borrowing to assets) of 27.6% and 395 early learning properties in its portfolio.*
>
> *Its biggest tenants are leading childcare centre operators like Goodstart Early Learning, G8 Education Ltd (ASX: GEM), Mission and Kidicorp. Folkstone is a REIT that specialises in childcare centre development and property management.*

- Unlike housing bonds, which are tied to the timing of debt raising tranches, housing trusts can more readily tap into a source of long term, low cost capital to quickly acquire property and enter deals with relative speed and agility as opportunities present themselves.

- Housing trust models can operate across the housing continuum from social and affordable housing to market rental properties. AHURI research led by Graeme Newell suggests there are benefits in separating this into two groups (AHURI Final Report no 249) because of their different risk and return profiles. This work projected (in 2010-2014) that an unlisted wholesale residential property fund would have an annual return of 4.36% for investment in affordable housing, compared to one oriented to a residential property fund with an annual return of 7.93%. The unlisted wholesale affordable housing fund would need a strong corporate social responsibility mandate, improved clarity around risk and government support to be viable[28].

Limitations

- One of a trust's key strengths - its power to facilitate aggregation of assets under single vehicle and harness economies of scale- is also a potential weakness. Depending on the model's application, it could run counter to the Harper Review competition principles by the reducing the amount diversity and competition between housing providers. At the extreme, it could create one large national monopoly landlord of social and affordable housing.

- The relative costs and rental returns in regional housing markets will probably mean a trust will focus its new activities in places where this makes the most economic sense. As a consequence a trust's properties could be poorly matched to areas of unmet need or expressed demand. Instead the trust's operations could become directed to well-priced areas that are experiencing growth, which can produce satisfactory financial returns.

- The extent that the model relies on regular property sales to realise capital gains to produce returns creates some inherent vulnerabilities and risks. There are in-built financial risks to relying on sales revenue in cyclical property markets where house price growth will eventually slow. This combines with continuity to service risks that can result in tenancy insecurity for vulnerable tenants who may be required relocate to alternative premises.

Opportunities

- **T**he United States example of housing trusts, the *Housing Partnership Equity Trust,* provided in the Issues Paper illustrates how this model can be successfully controlled and run for the benefit of its non-profit partners – the Housing Partnership Network- to raise long term, low-cost capital. See appendix 3 for a more detailed description of this model.

Risks

- The complexity of the trust business model and its governance structure tend to place key operational decisions in the hands of the trustees and fund managers who are answerable to investors rather than to consumers. The contracted housing providers potentially become more concerned with efficiency and dividends rather than client outcomes.

- Trust management may be obliged to apply:

- Portfolio and risk management policies to maximise returns and tenancy operating efficiencies.

- Hedging policies to minimise volatility in the cost of debt and increase the predictability of distributions.

- While the commercial imperatives could potentially subordinate the social objectives of affordable housing as the trust management is typically charged with maximising returns for investors, the US HPET demonstrates this risk can be successfully addressed where a mature community housing sector acts as the trust's principal investors and appoints the trustees.

Trial

Strategic Proposition

A trust model could play a critical role in increasing investor involvement and supply of market rental housing that is affordable to low and moderate-income earners.

A housing trust model operating nationally and providing at (or near) market rental housing at scale has the potential to offer longer term stable housing with greater security of tenure to private renters, while also providing stable indexed returns to institutional investors. A large-scale trust operating in Australia's private rental market that includes 2.4 million dwellings and 5 million renters has the potential to increase competition around service and bring benefits to consumers.

For an institutional investor driven trust model, there are some potential risks to realising benefits for people requiring affordable housing. Long-term client outcomes may become secondary concerns to achieving stable financial returns. In this context housing providers are themselves primarily focused on performing tenancy and property management functions, on behalf of their landlord, to the possible exclusion of other services and protections for the most vulnerable. Any housing authorities considering transferring stock into a trust model would need to find mechanisms to effectively address these concerns.

The use of a trust model that relies in part on realising capital gains to meet investor returns may pose unacceptable risks for vulnerable low income households detrimentally impacted by ensuing housing instability.

The potential inclusion of an underlying 'right to buy' at a fair market purchase price for sitting tenants could usefully be explored. Sales to tenants would have the advantage of creating a financing model that used rental income streams but also captured some capital gains in the portfolio without causing negative client impacts.

Favourable tax treatment of the trust or the asset class may be required to 'lock in' these consumer benefits as the timing of sales and longer term leases may not always be advantageous to the trust. Pending longer-term reform, an initial aim could be to level the playing field with tax settings benefitting individual investors and SMSFs through negative gearing[29].

Housing trusts managed by housing providers registered under the NRSCH should be able to secure debt funding raised from housing bonds via the housing aggregator. Once housing bonds are established a distinct community housing trust growth strategy should be investigated.

Model 3: Housing co-operatives

Housing co-operatives are a specific housing form of not-for-profit housing association.

The members in common equity co-operatives do not individually own equity in their housing. Properties may be owned by the government or by the co-operative. If members move from the co-operative, their lease ends and the dwelling is then re-let by the co-operative to another person who needs affordable housing and wants to be part of the co-operative.

Most co-op households pay a reduced rent geared to income. The other household members pay a cost or market rent.

Co-op housing offers security. Their members who have a democratic vote in key decisions concerning their housing organisation. There is in a practical sense no outside landlord.

Shared equity co-operatives enable individuals to contribute their own equity to share the cost of the housing purchase price. This equity can be withdrawn, if and when, the member leaves the co-operative.

The following section aims to highlight some key strengths, limitations, opportunities and risks that housing co-operatives present. It seeks to inform analysis and discussion of the model's applicability and implications for its trialing.

Strengths

- Housing co-operatives have proved to be a successful and sustainable model in Australia and internationally (especially in Canada) and can work to improve the allocation of low cost rental supply to low and moderate-income households.

- Housing co-ops are a major form of housing in Canada. They are often of a modest size with an average of 60 homes. They frequently involve mixed communities with between 30 to 50% of all co-op households receiving direct assistance with their rents. Individual co-operatives cater for distinct groups families, seniors, people with disabilities and new Canadians, in aggregate a diversified membership.[30]

- Delivery through the housing co-operative (mutual) structure allows members to be involved in decision-making and benefit from its activities including through the reinvestment any surpluses. Its viability is generally strong as rents are used to directly cover running costs, upgrades, administrative overheads and training as well as borrowings.

- Housing co-operatives as a legal and administrative structure can take many forms across a spectrum of incomes. There is potential to use this flexibility to create a model that has broad appeal to low and moderate-income earners 'locked out' of the benefits of homeownership.

- Potentially co-operatives may provide a useful model as funding increasingly shifts to i*ndividualised forms of welfare provision.*

- The co-operative structure in which members are simultaneously personalised budget holders under NDIS and aged community care programs, tenants and, also landlords/owners helps to integrate and operationalise the principle of user directed solutions.

- The co-operative organisational structure provides the opportunity for members to effectively participate in and shape their own housing solution. The structure provides a clear line of sight from a housing project back to participants/recipients residing in the house.

- Co-operatives can exhibit a diversity of management models to fit with members aspirations, needs and capacities: some co-ops hire professional staff; others retain management companies; and, some are managed on a voluntary basis with help from a funded resource body.

Limitations

- One of the key strengths of co-operatives – participation by its members - is also a significant limitation. Not all people needing housing can readily participate, or want to, or can sustain this level of engagement.

- In Australia co-ops are often viewed as a niche model that requires a high level of participation and not well suited to a scalable, generalist housing within an increasingly needs based housing system. Co-operatives actively screen and select who may live in the cooperative. This reduces their applicability and the implicit long-term commitment poses some risks to sustainability. However in Canada, rental housing co-operatives require a lower threshold of participation, are more mainstream and popular.

Opportunities

- Co-operatives provide a mechanism that can marry consumer choice measures to the building of new housing supply appropriate for the members of the co-operative.

- Co-operative models can take a number of forms. They can potentially blend rental, shared ownership and outright ownership in one or more structures on a single site. This flexibility may well be ideally suited to NDIS clients and their carers, with the ability to combine access to government funding, individual equity and private finance for members with a variety of financial means.

- A primary advantage of the housing cooperative is the pooling of the members' resources so that their buying power is leveraged, thus lowering the cost per member in all the services and products associated with residential living and housing management.

- Equity co-operative options can provide a stepping stone for some low and moderate-income households who are in, or able to enter the workforce, to save, overcome deposit gaps and eventually access home finance to purchase a share of their housing.

- Equity co-operatives have the potential to bringing in family and other contributions. For NDIS clients, shared-equity co-operatives could enable families to contribute to the long-term security of their adult children. Equity co-operatives could be made more attractive if the equity contributions for the main place of residence formed part of the exclusion of the 'family home' from pension eligibility tests.

Risks

- Disputes between members can require careful management, as they can also affect the performance and smooth functioning of the co-operative.

Implications for policy development

There is a strong alignment between the premise underlying 'individualised forms of welfare assistance' and a re-conceived flexible, localised housing co-operative model that demonstrates that:

- individual welfare recipients are able to choose the type of housing and support they get, who provides the support, and even what mix of support they get.
- they promote personal responsibility and build capacity in the recipient
- they embrace a diverse range of services provided by a range of private and not-for-profit providers and makes government assistance more cost-effective'.
- they promote a self-help approach that can harness the strengths and abilities of members and communities. There is concern in parts of government that 'long term welfare dependence saps people of motivation and erodes personal responsibility and individual capacity'.

Around 250,000 people live in housing co-operatives in Canada with nearly 97,000 units of stock (Cooperative Housing Foundation and CQCH). The new Liberal Party under Justin Trudeau acknowledged the importance of cooperatives to Canadians during the election and has promised them greater support. New developments should be followed closely.

Trial

Strategic Proposition

A key game changer is the flexible individual funding reforms currently empowering recipients of disability and aged services. The co-operative model offers a unique opportunity to complete the service reforms and to facilitate user choice and control in the housing space, based on their members' needs and aspirations.

A national version of Common Equity Housing Ltd (Victoria) provides a model that could potentially work at much greater scale, tapping into institutional investment provided from housing bonds and mediating between individual affiliated user controlled co-operatives of variable sizes that receive management and financial services and loans from CEH. This approach should be market tested for older persons or NDIS clients (or both together) who funded for care packages.

Registered housing cooperatives or their umbrella organisations should be able to secure debt funding raised from a new housing bond via the housing aggregator/intermediary. Once housing bonds are established a co-operative growth strategy should be further investigated.

Model 4: Impact investing model

Social impact investment allows investors to pursue opportunities that provide both social and financing returns.

Impact investing has recently been focused on social impact bonds. This is where government issues a contract with non-government providers with a commitment to pay for improved social outcomes that result in public sector savings. They have not been directed to simply increasing affordable housing supply.

The following section aims to highlight key strengths, limitations, opportunities and risks that the model or models of impact investing presents. This seeks to inform analysis and discussion of the model's applicability and implications for its trialing.

Strengths

- Fosters a strong client outcomes orientation and a cohort focus
- Payments are on the basis of outcomes that reflect reduced social inequality.
- It is leading to the development of more measurable client outcomes
- This approach drives innovation in service delivery
- It can provide profitable business opportunities for private sector investors.

Limitations

- Social benefit bonds are by nature complex, expensive and limited in use[31]
- Projects are costly to establish as much of the establishment work is one-off
- Social impact investment is only applicable in some circumstances, so scalability is limited and is unlikely to provide a model to attract institutional investment on a large scale.
- Client and financial benefits often fall across Commonwealth-State government boundaries and require a significant degree of inter-jurisdictional collaboration around benefits realisation to make them cost effective for government.

Opportunities

- Social impact investment offers opportunities for transitioning from more costly service models to cheaper, more effective models for high-service, high-cost cohorts (e.g. homeless people, prisoners, mental health, chronic disease, residential care)
- Potentially social impact investment could help to accelerate ‘closing the gap’ initiatives using affordable housing as a platform and catalyst for systemic changes for Aboriginal people.

- There are potentially social investment opportunities to assist work-ready tenants to gain employment and successfully transition from social housing to lower subsidy/market options (affordable housing and lower cost market rentals)

- On a larger scale, cities and towns (and their councils) could be rewarded and empowered to integrate employment, skills and welfare to work provision within their local labour markets with the provision of well-located affordable housing.

Risks

- The evolving government policy and a changing services environment can risk undercutting initiatives (and their payment trigger points), especially those initiatives that require longer timeframes to achieve measurable results.

- There is a risk that the 'wrong' clients groups will be targeted to get results.

Implications for policy development

- Social impact investments can produce useful evaluative tools to compare service options. This information then helps direct and drive service improvement and innovation.

- Greater use of payment by results and more clarity around client outcomes will help to improve the contracting of 'mainstream' services.

- There are many opportunities for joint Commonwealth-State impact investment with de-identified information sharing.

Trial

Strategic Propositions

Many impact Investment projects may well include a complementary housing response as a part of their strategy to improve client outcomes. In the future social impact investors may choose to complement a funded human service response with the provision of affordable housing financed by means of a housing bond.

Successfully transitioning work-ready people living in social housing into employment and affordable housing could become the subject of a scalable social impact bond.

A social impact investment trial could be designed with housing clients and housing provision being central to its change strategy. This could involve a consortium that included affordable housing providers as the leads coordinating employment and other support services. In this proposition the government would guarantee a return if certain employment and financial independence outcomes were achieved by the tenants and their household members.

Conclusion and recommendations

A new affordable housing market is emerging based on clear, large and growing housing demand (657,000 households, with private renters in housing stress). Expressed demand has been demonstrated by 187,500 households that are currently sitting on social housing waiting lists[32]. Tapping this demand and providing the full capital requirement could require hundreds of billions nationally.

The four models considered in the Issues Paper aren't necessarily separate or mutually exclusive but can be conceived as layers that can be applied separately or in combination. The choice of the layers can enable the available funding to be tailored to meet the specific needs of different services, geographic areas, and client groups.

For example, social Impact Investment projects may well require a housing response (funded by way of a housing bond) and complementary services funded by proponents to bring about social and behavioural change results and social impact bond payments. Similarly housing co-operatives and housing trusts could also finance some or most of their housing acquisitions and/or refinancing through the use of well structured housing bonds.

The size of this developing affordable housing market is potentially huge and unprecedented. It could usefully sustain the trialing of all the models under investigation, particularly as they are complementary rather than mutually exclusive. Each has shown its merit in particular contexts.

We first need to think more deeply about our long-term policy goals and how we measure their achievement. Inequality should concern us as well as investment in productive uses.

A multi-pronged approach would enable the potential capacity of each of the models to be co-designed and then tested in a diversity of markets for households with a range of income levels over time.

This approach avoids picking a winner, with the best and sustainable options emerging and evolving in a contestable financing environment, based on proven performance. This promotion of model diversity will avoid generating just one solution that is 'too big to fail' that requires an implicit government guarantee that undermines strong prudential behaviours.

While the end-state will hopefully embody this diversity, there are sequencing issues that need to be considered, whereby the enabling and capacity building elements are established ahead of other components. This paper proposes that priority should first be given to establishing and testing housing bonds as a foundation for the other models.

Commonwealth and State and Territory Governments will need to develop their roles and capacities to perform as market stewards, strategic priority direction setters, regulators and investors of public funds and subsidies for vulnerable households.

In an environment increasingly driven by commercial returns to private investors, jurisdictional governments will need to lead and shape provider thinking about community needs, driven by strategies that reward client needs-based and outcomes-focused solutions and ultimately being an arms-length guardian for society's most vulnerable.

An integral element of the strategy should be to promote and further develop an entrepreneurial, high performing, housing and community development non-profits, capable of using public and private resources to drive innovation and achieve large scale housing impacts. Having control of many of the levers (access to housing, tenancy and asset management services, alternative housing products and support services) is a necessary component of effectively exercising this role and taking on a significant measure of accountability for client outcomes.

The value placed on this leadership hinges on these providers' mission to assist vulnerable low-income people: working to improve client outcomes and where possible break the cycle of disadvantage.

Even socially minded financial institutions will not necessarily share this as their prime objective and will continue to be motivated by returns and risks to investors.

The provision of start up funding will be a critical catalyst for opening up new financing opportunities for growing affordable housing while supporting the Commonwealth Government's broader commitment to develop 'a deep and liquid corporate bond market'.

Recommendations for Possible Trials & Next Steps

A costed and concerted national plan for affordable housing is needed to underpin and build investor confidence in Australia. The following actions are proposed as a suite of priority investments and projects for the Commonwealth Government:

- A budgeted commitment is made in the Commonwealth forward estimates to an affordable housing recurrent subsidy designed specifically for institutional investors, with tranches commencing and made available from 2018/19.
- Provision of seed funding for 2016/17 and 2017/18, to partner with NGOs and financial institutions to establish a national, non-government, specialist, financial intermediary with the capacity to support the aggregation of affordable housing projects, the delivery and servicing of new housing bonds designed to provide debt financing for registered community housing providers and other eligible entities.
- Provision of seed funding for 2016/17 and 2017/18 to establish a housing bond (potentially structured as, or similar to, a 'Simple Corporate Bond') for debt funding of affordable housing supply and related activities.
- Development of a costed proposal during 2016/17, for establishing some form of Commonwealth Government guarantees to facilitate institutional investment in housing bonds nationally, along with recommendations for its implementation. The guarantees would be designed to provide comfort to 'new' investors and therefore minimise the cost of funds at the same time structured to minimise any call on the guarantee (the Commonwealth's contingent liability).

- Introduction of Commonwealth incentive payments for States and Territories to flexibly undertake transfers of public housing to community housing ownership and/or management in 2016/17, along with a request for community housing providers to contribute to a pipeline of affordable housing projects for financing from 2018/19. Potentially these incentive payments could also be tied to the adoption of the NRSCH - at least for those community housing providers in jurisdictions outside the system wanting to gain access to the finance raised by the new housing bonds.

- Consideration of favourable tax treatments for an affordable housing asset class to lower the cost of direct Commonwealth subsidy payments - potentially offsetting broader tax changes.

- Provision of development funding to review and enhance the collection, publication and maintenance of up-to-date financial, debt and housing management information of the participating registered community housing providers, all potentially made available under the National Regulatory System for Community Housing (NRSCH). This is likely to require the NRSCH to strengthen its regulatory reporting requirements to satisfy the disclosure needs of the financial investment industry.

- Commission more detailed investigations of the viability of housing trusts sponsored by community housing providers, co-operative housing and social impact bonds models that made use of a new Australian housing bond, once it was established.

- Commission a more detailed feasibility study of establishing a national housing trust model providing at (or near) market rental housing that offered longer-term, stable housing (greater security of tenure) to private renters and stable indexed returns to institutional investors. The potential inclusion of an underlying ‘right to buy’ on fair terms for sitting tenants could also be explored.

Simple Corporate Bonds

The recent introduction of Commonwealth legislation (passed in August 2014) to enable simpler fund raising may offer important opportunities to quickly establish the first Australian affordable housing bond, using its facility for a 'vanilla' bond with its simpler, less onerous (less red tape) and less complex prospectus process and a resultant lower establishment cost. Potentially bonds can be established in a relatively short 12-month period. It would, however, have the downside of limiting the bond term to a maximum of 15 years, but also the promise of building a regular pipeline of new supply and refinancing.

Australian Unity launched the first 'simple corporate bond' in November 2015.

Australian Unity is a Melbourne based health insurer and mutual fund. It is not listed but its bonds trade on the Australian Securities Exchange. It is a diversified business across healthcare, retirement living and financial services. National Australia Bank helped launch the bond with Australian Unity. NAB was the joint arranger and book runner for this deal.

The bond raised about $230 million of five-year bonds, with $100 million new money. It is based on 280-290 basis points above the 90-day bank rate for an initial yield of about 5.0-5.1 percent.

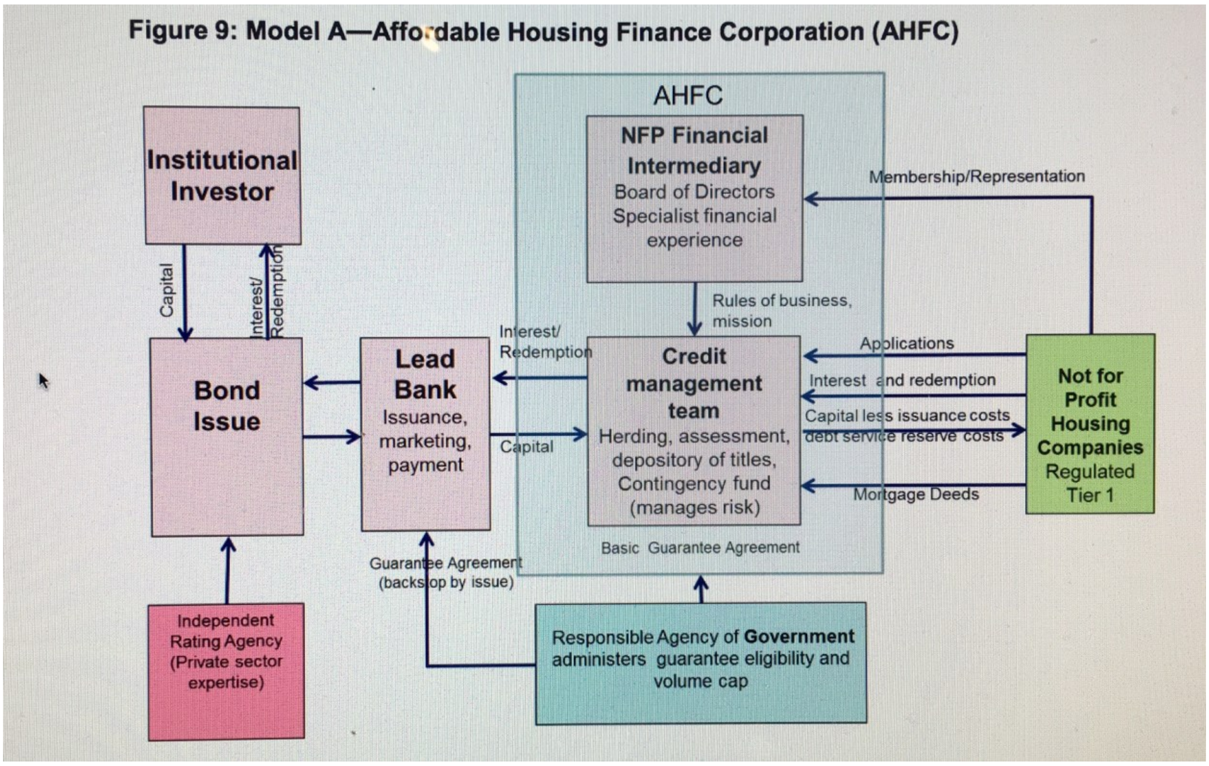
Australian Ratings placed a BBB+ rating on the debt. The proceeds were used in part to procure the NSW home care business.

The legislation allows for less disclosure and the removal of director’s liability associated with the prospectus. (Australian Financial Review, November 9, 2015).

Pre-requisites for complying with legislation:(Kings & Wood and Malleson):

- Bonds must qualify (unsubordinated, except to secured debt)
- The issuer must qualify (good track record of compliance with ASIC) and includes banks credit unions and mutuals
- The offer must qualify
- The disclosure must comply.

Potential Affordable Housing Finance Corporation Structure



Source: Lawson, J. Berry, M. Hamilton, C & Pawson, H (2014) Enhancing affordable rental housing investment via an intermediary and guarantee, AHURI Final Report no.220, Melbourne: AHURI

Appendix 3

Background to the Housing Partnership Equity Trust (HPET) and the Housing Partnership Network (HPN)

The Housing Partnership Equity Trust (HPET)

The Housing Partnership Equity Trust (HPET) is an enterprise sponsored by the Housing Partnership Network (HPN).

It is the first social venture real estate investment trust (REIT) owned by nonprofits and devoted to preserving affordable rental housing in the United States.

Established in 2012, HPET is a venture that enables members to act with the same speed and flexibility as for-profit buyers looking to purchase rental properties. By aggregating capital from private markets, foundations and members, HPET participants can quickly bid on properties without needing to first assemble complex financing packages.

HPET was launched as a social-purpose real estate investment trust with an initial investment of $100 million from Citi, Morgan Stanley, Prudential Financial, the John D and Catherine T MacArthur Foundation and the Ford Foundation.

HPET was formed as a social-purpose Real Estate Investment Trust (REIT), sponsored by the Housing Partnership Network (HPN). HPET provides a ready source of long-term, low-cost capital, enabling the 12 mission-driven nonprofits it partners with – who are also HPN members - to quickly and efficiently acquire apartment buildings and other multi-family properties that can (or can be adapted to) provide quality homes for families, seniors and others with modest incomes.

Board members include representatives of the Housing Partnership Network, the National Housing Partnership Foundation, Chicanos por la Causa, Prudential Impact Investments, Citi Community Capital, Bridge Housing, and others.

Investments

HPET invests strategically in medium- to large-sized Class B and Class C multifamily properties, including non-core, secondary real estate markets that are currently at or below-market rents (average 80% of area median income or less) and are typically unsubsidized, unrestricted rental properties. HPET may also acquire portfolios or notes for similar assets in order to move them into the hands of its members.

HPET members have identified three main asset types as targets for acquisition:

- Market-rate, value-add acquisition opportunities;
- 15-year (and over) low income housing tax credit opportunities;
- Asset disposition opportunities with the GSEs and Special Servicers.

Services to residents

HPET offers a wide range of services to their residents. Programs are tailored to each property and its residents, and are designed to expand residents' educational opportunities and financial security, provide access to health and wellness resources and services, build community, and connect them to safety net resources.

These include programs for children and teens, adult programs, senior programs, childcare centres, and the provision of recreational and educational facilities, and retail centres.

The Housing Partnership Network

The Housing Partnership Network (HPN) is a collaborative of nearly 100 of the leading housing and community development nonprofits in the United States.

It was founded in the 2000s by a coalition of entrepreneurial nonprofit organisations that combine their social objectives with private enterprise to develop solutions to the shortage of affordable housing in the US, which it recognises as one of the most challenging problems facing our country.

The HPN approach is based on members sharing best practices through Peer Exchange from which new ideas emerge for innovation in the housing and community development sectors. The result is a platform of high-impact social enterprises that inform HPN's policy recommendations and enhance members' sustainabililty.

Impact

- 9.8 million people assisted
- 373,600 affordable homes developed
- over $100.9 billion in community investment

- HPN members employ 17,250 people
- There are 97 HPN members, in 50 States
- 10 social enterprises have been created.

Members

The HPN is governed by a 17-member board, and employs four officers: Chair and Vice-Chair, President and Treasurer.

Funders and Investors

Funders include the Bank of America Foundation, Credit Suisse, Fannie Mae, Federal Home Loan Banks, the Ford Foundation, Goldman Sachs, JP Morgan Chase, Merrill Lynch Community Development Company, The Prudential Foundation, The Rockefeller Foundation, the US Department of Housing and Urban Development and Wells Fargo.

Investors include most of the above, plus the Calvert Foundation, HSBC Bank, US Congress, the US Department of Education, the US Department of Housing and Urban Development, and the US Department of Treasury.

Mission

The Housing Partnership Network mission is “to build affordable homes, better futures and vibrant communities for low- and moderate-income people through partnerships with our member organisations, the business sector, government, and philanthropic institutions.”

To that end the Housing Partnership Network supports and forms partnerships with its members. These members include 100 leading US housing and community development nonprofit organisations, that work locally, regionally and nationally to ensure that people have the opportunity to live in decent homes in vibrant communities.

HPN facilitates peer exchanges among members that produce new and innovative solutions to shared problems; researches and tests ideas for feasibility; raises the necessary capital to launch new business enterprises; and manages the initiatives on behalf of participating members.

HPN's member-driven activities are supported by a Boston-based staff with a satellite office in Washington D.C. HPN is governed by a Board of Directors comprised of senior leaders from member organisations.

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