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National Housing Finance and Investment Corporation

Cbus welcomes the opportunity to provide feedback on the establishment of a National Housing Finance and Investment Corporation to attract institutional investment for affordable housing.

Background

Established in 1984, Cbus is the industry superannuation fund for the built environment. Cbus recently received recognition for its 11 years as a platinum rated fund by independent ratings agency *SuperRatings*. Cbus is run only to benefit members, and doesn't pay commissions to sales agents or financial advisers.

Cbus also invests back into the construction and building industry, which not only provides strong long-term investment returns, but helps boost our economy and create jobs within the industry.

Cbus has over:

- 750,000 members
- 136,000 employers
- $40 billion in funds under management

Housing

Access to secure and affordable housing is an important part of ensuring a dignified and comfortable retirement. Cbus believes that superannuation funds can, and should, play a role in helping to improve the supply of affordable housing for Australians through funds investing in this area. Super funds could provide an important source of capital to partner with government to help resolve this longstanding policy issue which affects so many Australians.

In our view, housing affordability cannot be addressed without tackling issues around supply and as the population of Australia increases we need to build more houses and more infrastructure.

As a large-scale investor Cbus is interested in playing a role in helping to deliver positive housing outcomes for Australia. Cbus is a patient provider of capital with a strong focus on the sustainability and innovation of the investments we make, with a particular emphasis on the built environment.

Cbus is also somewhat uniquely placed to finance and deliver assets that contain a mix of infrastructure and property characteristics through the ability to partner with wholly-owned property developer Cbus Property.

Cbus has been active in discussions around affordable housing area for many years and has been an active participator in a range of research forums,[1] public discussions[2] and reviews on the topic.

Cbus has been a strong advocate for a financing model that would allow for greater institutional investment in affordable housing and we welcomed the Budget announcement regarding establishment of a National Housing Finance and Investment Corporation and a Bond Aggregator.[3] While only one step in the broader affordable housing solution, we see strong merit in the Bond Aggregator, noting similar models have had significant success in offshore markets.

Return for risk

Given its nature, investments in 'affordable housing' do not generally generate the same risk-adjusted returns as investments in other types of real estate given their role in the broader social and economic policy framework. Some form of Government contribution is typically required to bridge the gap between non-commercial and commercial returns.

Cbus would encourage a degree of Government support, and views positively the potential for a Government Guarantee to be attached to issuances of the proposed Bond Aggregator. This could provide a mechanism to deliver more competitive and longer-term financing to the affordable housing providers, thus allowing them to operate more effectively and to generate greater levels of housing stock through time.

Our detailed comments regarding the Bond Aggregator and the National Housing Infrastructure Facility are attached. Please contact James Bennett, Public Policy & Media Advisor on (03) 9910 0218 if you have any queries in relation to our submission.

Yours sincerely,

David Atkin
Chief Executive Officer

[1] http://www.nhc.edu.au/wp-content/uploads/2015/12/NHC_2015_program_grid.pdf

[2] https://www.cbussuper.com.au/about-us/news/media-release/cbus-calls-on-government-to-build-investment-structures-for-affordable-housing

[3] https://www.cbussuper.com.au/about-us/news/media-release/Cbus-welcomes-action-to-attract-super-investment-in-affordable-housing

National Housing Infrastructure Facility Consultation: Cbus Infrastructure Submission

The Australian Government's plan to address social housing includes, among other measures, establishing a $1 billion National Housing Infrastructure Facility ("NHIF") which will use tailored financing to partner with local governments ("LGs") in funding infrastructure to unlock new housing supply.

The purpose of this paper is to respond to the issues raised in the Commonwealth Treasury's ("Treasury") consultation paper released in September 2017.

Issues for consideration

Treasury welcomes feedback on the issues raised in Section 3, including on:	
1	**Infrastructure** — Noting the examples identified in **Table 4**, what types of infrastructure do LGs fund, deliver and own? What types of infrastructure could be prioritised to address infrastructure bottlenecks?
2	**Design features** — Are the design features appropriate, including the considerations that the NHIF could take into account when assessing projects?
3	**Financing options** — Are the types of tailoring potentially available under the NHIF's three types of finance sufficiently flexible?
4	**Metrics** — What metrics could enable assessment of infrastructure bottlenecks and housing supply and affordability pressures?
5	**Financing arrangements** — Could the NHIF expand 'eligible applicants' to include a consortium of investors, such as institutional investors, social impact investors, CHPs and other stakeholders (for example, state and territory governments)? In addition, what could a partnership with LGs involving a NHIF equity injection look like? Are there further opportunities for aligning the interests of investors and other stakeholders to create incentives for co-investment to accelerate housing developments? Given the long lead times associated with the infrastructure construction, what are the appropriate repayment timeframes (on the loans and equity)?
6	**Complementarity** — Given existing state and territory lending facilities, how can the NHIF position itself so that it complements state and territory financing schemes and private sector finance options?
7	**Affordable housing** — Should the NHIF also focus on facilitating the supply of affordable housing, including for key workers? If so, what is the most effective way to achieve this objective?
8	**Value uplift** — How should the NHIF factor value uplift and associated value capture schemes into its investment decisions?

Background

Cbus has invested $4.03 billion in infrastructure assets globally on behalf of members, which represents circa 11% of the investment portfolio under the Growth (Cbus MySuper) default superannuation option. The infrastructure portfolio is well-diversified by sector and geographic location, with 38 assets including roads, airports, seaports and water and electricity utilities.

Australian assets represent almost 60% of the Cbus infrastructure allocation, with the balance invested in international core infrastructure managed by IFM Investors and Hastings. Cbus also has co-investments with IFM Investors on the NSW Ports assets and the Indiana Toll Road in the United States. Examples of investments in Australia include Southern Cross Station, Port of Melbourne, Port of Brisbane, Melbourne Airport, Perth Airport, Eastern Distributor and Brisbane Airport.

Cbus has implemented several recent internal changes as a result of its Next Generation Investment Framework. For infrastructure, this included the establishment of a direct investment strategy for both greenfield assets (defined as assets that are yet to be constructed) and brownfield assets (assets that are in the operational phase). Investing in domestic greenfield projects creates strong alignment with the Cbus membership base in the construction industry and will generate jobs.

This direct investment approach will complement our existing fund investments and co-investments under what Cbus refers to as a hybrid infrastructure strategy. In anticipation of ongoing growth, Cbus is expanding its internal investment resources and expertise in the infrastructure area. Managing a portion of our infrastructure assets in-house is expected to drive higher net returns over the long-term, providing Cbus with greater control over how members' super is invested and reducing costs.

Cbus has been actively involved in the social and affordable housing space. The fund is currently considering potential opportunities through the NSW Government's second phase of the Social and Affordable Housing Fund initiative, as well as the Victorian Government's proposed $1 billion Social Housing Growth Fund. Superannuation can potentially play an important role in contributing to a social housing solution, particularly in terms of improving supply. Cbus is also somewhat uniquely placed to finance and deliver assets that contain a mix of infrastructure and property characteristics through the ability to partner with wholly-owned property developer Cbus Property.

Responses

Specific responses from Cbus in relation to the questions posed in section 3 of the September 2017 NHFIC Consultation Paper are outlined below.

1. **Infrastructure** — *Noting the examples identified in Table 4, what types of infrastructure do LGs fund, deliver and own?*

LGs typically provide and own the following types of infrastructure assets:

- Certain regional airports.
- Local roads.
- Local bridges and culverts.
- Water, storm water and wastewater infrastructure (may be shared with State-owned water utilities such as Sydney Water in urban areas, varies between States).
- Parklands.
- Community recreation, cultural and sporting facilities.
- Some electricity infrastructure (e.g. undergrounding of power lines, new connections) funded through contributions to utilities.
- Other types of buildings.

LGs also have planning responsibility for new infrastructure including rezoning of land, subdivision approval, town and environmental planning, development assessment and building regulation.

What types of infrastructure could be prioritised to address infrastructure bottlenecks?

The following are types of essential infrastructure that could potentially be prioritised to address infrastructure bottlenecks:

- Local road upgrades and/or new roads to ensure access to new community hubs.
- Water, storm water and wastewater services.
- Site remediation to remove hazardous waste or contamination.
- Certain electricity/connection infrastructure.

2. **Design features** — *Are the design features appropriate, including the considerations that the NHIF could take into account when assessing projects?*

Some comments on selected design features are outlined below.

Total financing available

Cbus considers that the total available finance appears to be reasonable.

Eligible applicants

While LGs are eligible applications, the NHIF should consider expanding this definition to allow for options where the LG forms part of a consortium with CHPs, private sector capital providers/institutional investors.

By way of example, LGs could play a role alongside private sector consortia to deliver additional social housing supply under the NSW Government's Social and Affordable Housing

Fund Phase 2 initiative. It is understood that the NSW Government is keen to encourage LGs to potentially provide surplus land to private sector consortia of CHPs, not-for-profits, financiers, equity investors and advisors.

Quantum of funding for projects

The proposed approach to avoid specifying minimum and maximum funding requirements will ensure flexibility for NHIF. In order to provide some further guidance to applicants, it may be useful to include information on the types of projects that may be better suited to other forms of Federal, State or LG assistance.

Further detail on the proposed evaluation criteria for applications would be useful.

3. Financing options — *Are the types of tailoring potentially available under the NHIF's three types of finance sufficiently flexible?*

The financing options under the NHIF's three types of finance appear to provide an adequate amount of flexibility. Further detail on the proposed terms of debt, equity and grants would be required to get a better understanding of how these products would interact with traditional financing options.

4. Metrics — *What metrics could enable assessment of infrastructure bottlenecks and housing supply and affordability pressures?*

Government agencies such as Department of Family and Community Services in NSW publish a variety of statistics on the agency's website that highlight social housing demand across various regional areas. Likewise, housing affordability data should also be readily available.

Ideally, available data on local government areas with a high demand for social and affordable housing should be overlaid with data on available essential public amenities such as roads, schools, and hospitals. This will assist in identifying priority areas where new housing developments can be located, or conversely, where infrastructure bottlenecks and backlogs need to be addressed in order to facilitate supply. LG planning data and records should be available to help identify potential infrastructure issues that may affect potential development sites.

Various audit reports are also available that could shine additional light on potential infrastructure bottlenecks, such as the 2013 Office of Local Government review of infrastructure backlog of NSW councils.

5. **Financing arrangements** — *Could the NHIF expand 'eligible applicants' to include a consortium of investors, such as institutional investors, social impact investors, CHPs and other stakeholders (for example, state and territory governments)?*

As per the response to question 2 above, Cbus considers that the definition of eligible applicants should be expanded to include institutional investors, development partners, and CHPs.

Social housing is an area of focus for superannuation funds such as Cbus. Superannuation can potentially play an important role in contributing to a social housing solution, particularly in terms of improving supply. Cbus is also well placed to consider assets that contain a mix of infrastructure and property characteristics through the ability to partner with wholly-owned property developer Cbus Property.

Potential Cbus investments in appropriately-structured projects in the social and affordable housing sector would provide:

- much-needed affordable housing for key workers and the Australian community;
- jobs for the construction industry; and
- a commercial rate of return for members.

However, as opposed to not-for-profit and charity participants in social and affordable housing projects, Cbus and other superannuation investors require a commercial rate of return for members. Social and affordable housing projects are unlikely to meet investment hurdle rates without some form of appropriately structured government assistance.

In addition, what could a partnership with LGs involving a NHIF equity injection look like?

Consideration would need to be given to how equity is repaid to NHIF. Additional work would be required to consider governance arrangements if the eligible applicants definitions was expanded to include institutional investors.

Are there further opportunities for aligning the interests of investors and other stakeholders to create incentives for co-investment to accelerate housing developments?

Consideration could be given to models that have been successfully deployed overseas (e.g. UK, Germany), although the social housing landscape and relative industry size differs considerably to the domestic market.

Given the long lead times associated with infrastructure construction, what are the appropriate repayment timeframes (on the loans and equity)?

The appropriate repayment timeframes will vary for different asset sub-classes.

6. Complementarity — *Given existing state and territory lending facilities, how can the NHIF position itself so that it complements state and territory financing schemes and private sector finance options?*

Given that the NHIF is a national scheme, a comprehensive review of the relevant state-based schemes for social housing related infrastructure development needs to be undertaken in order to guide the key parameters.

7. Affordable housing — *Should the NHIF also focus on facilitating the supply of affordable housing, including for key workers? If so, what is the most effective way to achieve this objective?*

Consistent with the comments above, if the eligible applicant's definition was expanded to include institutional investors, it would be necessary to ensure the NHIF complements rather than competes with state-based programs aimed at increasing the supply of key worker accommodation, such as the Social and Affordable Housing Fund in NSW and the Victorian Social Housing Growth Fund.

8. Value uplift — *How should the NHIF factor value uplift and associated value capture schemes into its investment decisions?*

Value capture is an emerging source of funding available for the development of new infrastructure projects. For example, it is understood that the NSW State Government is considering value capture on the Parramatta Light Rail project.

However, this is a complex area, with many key policy questions to address e.g. who benefits from the infrastructure and importantly, who has the capacity to pay?

Addition work is required to address these issues.

Cbus Submission - The affordable housing bond aggregator

The purpose of this paper is to respond to the issues raised in the Commonwealth Treasury's consultation paper released in September 2017. This document provides feedback from Cbus in relation to the proposed Bond Aggregator.

Section 4: Issues for consideration
Treasury welcomes feedback on the issues raised in Section 4, including on:

1. ***Eligibility:*** *It is currently envisaged that the bond aggregator will only provide loans to Tier 1 and Tier 2 CHPs. Could there be benefits to expanding the eligibility criteria to include other stakeholders involved in the provision of affordable housing?*

2. ***Purpose of loans:*** *The bond aggregator's loans are expected to be primarily used for funding housing maintenance and turn-key purchases. Do stakeholders agree with this focus? Is there scope for the bond aggregator to provide construction finance or should the bond aggregator be prevented from providing such finance?*

3. ***Security for loans:*** *What forms of security should CHPs be asked to provide to access bond aggregator loans? Are there any circumstances where such loans could be unsecured? If security is provided, to what extent should it be collateralised against other assets owned or operated by the CHP? What forms of financial covenants from CHPs should exist alongside any security? If a CHP has multiple secured creditors, how should the security in favour of the bond aggregator rank?*

4. ***Complementarity:*** *How could the Government ensure that the bond aggregator complements and partners with existing private and public sector investment into CHPs?*

5. ***Bond issuance:*** *Could affordable housing bond issuance be expanded to the offshore market or the retail bonds market? What are the potential benefits and costs?*

6. ***Bond issuance size:*** *What is the likely preferred issuance size for large-scale institutional investors?*

7. ***Contracting out functions:*** *Are there potential benefits from contracting out bond issuance and back-office functions? What are the potential costs?*

8. ***Government guarantee:*** *How would a potential Government guarantee on NHFIC bond issuances impact the NHFIC's ability to raise and price funds? What are the risks associated with applying a guarantee and how could those risks be mitigated?*

Introduction

Cbus' adopts a total portfolio approach whereby there is less emphasis on individual asset classes and more on maximising total portfolio outcomes. The Cbus debt sector is currently split across Cash, Fixed Interest (Global & Australian) and Alternative Debt. Within the cash and Fixed Interest sectors, liquidity and defensiveness are key considerations. As a consequence, these sectors are heavily biased to highly rated securities and in the case of Fixed Interest are primarily exposed to Australian and offshore government bonds. Within the Alternative Debt sector, the Fund can accept lower rated securities and a lower level of liquidity, so long as it is adequately compensated from an expected return perspective.

The provision or not of an explicit Commonwealth Government Guarantee is likely to influence where these securities may sit within the Cbus portfolio. If issued with an explicit guarantee we would see the securities potentially forming part of the fixed interest sector and being viewed from a relative value basis against other existing Government securities (recognising liquidity differences until the bond aggregator established sufficient scale). Without some form of guarantee these securities would likely be assessed against the merits of investments within the Alternative Debt sector. We expect that most funds approach assessing such securities in a similar way.

Cbus has approximately $2.7 billion invested in the Alternative Debt sector and $2.6 billion in the Fixed Interest sector as at 30 September 2017. We note that the current allocation to Fixed Interest is low compared to the long-term targeted allocation, reflecting current very low bond yields and a preference away from this sector from an asset allocation perspective.

We comment more specifically on pricing, scale and maturity tenor of potential bond aggregator issuance throughout our submission below, with particular focus on providing feedback around questions posed in section 4 of the September 2017 Consultation paper by the NHFIC.

1. **Eligibility***: It is currently envisaged that the bond aggregator will only provide loans to Tier 1 and Tier 2 CHPs. Could there be benefits to expanding the eligibility criteria to include other stakeholders involved in the provision of affordable housing?*

   We are comfortable with the Bond Aggregator (BA) only being available to Tier 1 and 2 CHP's. We would expect that the CHP's are best placed to ensure social and affordable goals are met, including the provision of new stock for the sector.

2. **Purpose of loans:** *The bond aggregator's loans are expected to be primarily used for funding housing maintenance and turn-key purchases. Do stakeholders agree with this focus? Is there scope for the bond aggregator to provide construction finance or should the bond aggregator be prevented from providing such finance?*

   In regard to the permitted purposes for the lending, we would support the Bond Aggregator's role being extended to provide construction finance, noting that, according to the Ernst & Young report, 62% of CHPs indicated the preferred purpose for borrowing is construction, and we consider that if appropriately resourced and skilled, the NHFIC should be able to undertake construction loans.

   A Warehouse Facility could be extended for a tenor of up to 3 years and allow the CHP's to access funding on a progressive basis to fund refurbishments or construction.

3. **Security for loans:** *What forms of security should CHPs be asked to provide to access bond aggregator loans? Are there any circumstances where such loans could be unsecured? If security is provided, to what extent should it be collateralised against other assets owned or operated by the CHP? What forms of financial covenants from CHPs should exist alongside any security? If a CHP has multiple secured creditors, how should the security in favour of the bond aggregator rank?*

Please see our comment under question 4 in relation to Complementarity. If CHP's have need for funding separate to the Bond Aggregator close ties with the debt financing community will be required.

In relation to security we make the following observations:

1) In normal circumstances, if the Bond Aggregator is providing ongoing general corporate debt, it would want to take security over all the assets of a CHP. However, if other lenders are required for other facilities – and especially for construction debt it may need to limit the security it takes.

2) If the Bond Aggregator takes 1st ranking security (GSA) or mortgages over the CHP's assets the CHP may face difficulties raising other debt including working capital facilities or even payroll lines of credit. Construction debt would become very challenging for the CHP's to raise, as generally lenders would take into consideration and receive the benefit from existing assets and income of the CHP when providing construction debt facilities. The NHFIC could consider:

    a) A security sharing arrangement with the NHFIC / Bond Aggregator determining the total amount of debt that the CHP could borrow from any party. Banks or other lenders would need to obtain an acknowledgement or consent from the NHFIC / Bond Aggregator for the creation of any new debt.
    b) No security held by any party (and negative pledge not to grant any security), but again an agreed maximum debt level would need to be determined.

3) Standardised covenants may be difficult to define as even Tier 1 CHP's have different balance sheet positions and different revenue sources. Input from CHP's will determine if standard covenants are practical. If the goal is to create additional affordable housing any covenants put in place should be structured to enable CHP's to undertake new construction on assumptions that the new properties will lead to additional revenue sources for the CHP's.

Moody's, whose rating methodology is referenced in the Ernst & Young report, or S&P, should be able to assist the Bond Aggregator in relation to covenant ranges that would meet their respective criteria.

4. Complementarity: *How could the Government ensure that the bond aggregator complements and partners with existing private and public sector investment into CHPs?*

We consider that to answer this question the Government / Treasury would need to understand the granular details of how debt funding is currently provided to the sector. At present funding could include various sources of federal, state and local funding; support from religious or other charitable organisations as well as loans from banks and other debt providers.

We would encourage approaches that facilitate and promote the development of new stock for CHP's, as well as those that lower the overall cost of debt for CHP's.

5. Bond issuance: *Could affordable housing bond issuance be expanded to the offshore market or the retail bonds market? What are the potential benefits and costs?*

There is certainly potential for the issuance to be expanded. With regards to offshore markets it is extremely important to be a "well known entity", if attempting to raise funds globally. This is where a Government Guarantee can be most beneficial, as the Australian Sovereign backing is well understood in global wholesale capital markets. Without a guarantee, there would be additional marketing and a longer lead time to showcase the new issuer to the broader network of investors. This would increase the cost of issuance. Offshore issuance is primarily attractive to the issuer due to the potential scale benefits, particularly with regards to issue size and a longer maturity profile.

Accessing the US corporate bond market can provide funding in average sizes of $500 million to $1 billion. Most recently Australian banks have utilised this market. They have been able to secure 30-year funding in volumes well in excess of $1 billion.

Retail bond markets are obviously at the other end of the scale. Retail investors tend to need more education around new issuers, but once an allocation is made their investment tends to be more "sticky' when compared to wholesale market investors. Retail demand stems from listed bond offerings and the cost of listing a retail offering rarely compares favourably against wholesale issues. A government guarantee would likely be attractive from a retail perspective, but appropriate enquiries would need to be made in relation to the appetite for long tenor paper from retail investors.

6. Bond issuance size — *What is the likely preferred issuance size for large-scale institutional investors?*

Institutional investors tend to gain comfort around issuers and issues that are ultimately included in broadly accepted benchmark index. The main Australian index in the Australian fixed interest sector is the Bloomberg Composite Bond Index All Maturities. The Bond Aggregator should explore the requirements for inclusion in such indices as this will likely provide access to a broader investor base with increased scale.

We understand that $100M is the minimum size to be included in the primary indices, however a preferred issuance size would be expected to be in the order of $200-$300M, as this would allow greater potential secondary market activity.

7. Contracting out functions — *Are there potential benefits from contracting out bond issuance and back-office functions? What are the potential costs***?**

We don't have any strong recommendations in this area. However, we would encourage the Board of the NHFIC to consider optimising cost efficiencies, closely managing reputational risk, leverage of expertise and allowing greater focus on core business practices of delivering affordable housing.

8. Government guarantee — *How would a potential Government guarantee on NHFIC bond issuances impact the NHFIC's ability to raise and price funds? What are the risks associated with applying a guarantee and how could those risks be mitigated?*

We are supportive of the role of a Government Guarantee, believing that this will provide more attractively priced debt for the CHPs, and thus allow these entities to operate more effectively and ultimately create greater housing stock.

The positive impact of a Government Guarantee should be felt in two main ways:

- Firstly, through a lower cost of funding when compared to an unguaranteed NHFIC issue. Based on our high-level analysis, without a Government Guarantee the interest costs savings to the CHP's may not be sufficiently worthwhile when compared to other sources of financing available to them.
- Secondly, through access to greater size, tenor and frequency of issue.

There is a risk that once a guarantee is applied, it would be difficult to remove. A possible "period of guarantee" could be feasible, which would give the entity time to establish itself from a ratings and overall track record perspective. To further mitigate this risk the ability to access a guarantee could be written into the legal documents of issuance, which would give the entity some surety of re-finance should there be disruptions in wholesale funding markets.