HOUSING INDUSTRY ASSOCIATION

Submission to the
Federal Treasury

Consultation Paper - National Housing and Investment Corporation

20 October 2017

1. INTRODUCTION

HIA welcomes the opportunity to provide a submission on the proposed establishment arrangements for the National Housing Finance and Investment Corporation.

The delivery and pricing of urban infrastructure to support housing production has bedevilled the delivery of more affordable housing for decades. The shifting of responsibility for the delivery of infrastructure from governments to developers, and ultimately the home owners, has brought with it affordability challenges.

Capital constrained governments have moved away from recouping the cost of infrastructure that they provided over time through local rates and other taxes and charges. This approach enabled home owners to pay for their infrastructure over time as their circumstances improved, providing a significant benefit for affordability.

Over the last two decades state and local governments have shifted responsibility for the financing and delivery of much of the infrastructure needed to support residential development (and in many cases social infrastructure that is only loosely related to a development), to the development proponent. This has shifted the financing challenge for both residential developers and their clients, home buyers, to have to incorporate the up-front charging for this additional infrastructure, creating implications for the affordability barriers that home owners face and the financing challenges faced by developers.

This shift in both the delivery and the financing of infrastructure has seen the residential development industry consolidate into larger entities better able to manage these up-front cost imposts. It has also seen the increasing use of "infrastructure agreements" between development proponents and governments which have pushed even more infrastructure into the "up-front" category.
It is against this background that HIA's submission on the Consultation Paper is framed.

2. NHFIC STRUCTURE AND OPERATIONS

Having a single board overseeing the two quite distinct functions of the infrastructure facility and the bond aggregator has both strengths and weaknesses. The strengths that HIA can foresee are increasing the potential to support projects that draw from both the bond aggregator and the infrastructure facility, and some administrative savings. There might also be some increased potential for the co-location of the functions to drive institutional investment into the infrastructure facility as well as the bond aggregator.

The main potential drawback of the one board is that its membership may not be able to effectively manage the quite distinct objectives of the bond aggregator and the infrastructure facility: the skills of a director to oversee the bond aggregator function are likely to be very different from those needed for the infrastructure facility, leading to inefficiency in the day to day functioning of the board.

Moreover conflict of objectives could emerge, especially with the Consultation Paper's suggestion that the NHFIC may need to operate in a competitively neutral way. This goal may be appropriate for the bond aggregator as it performs a purely intermediary function, but may not be appropriate for the infrastructure facility as its goal of bringing forward investment that would otherwise not take place will inevitably require some level of non-market government support.

HIA's preference would be to have the bond aggregator and infrastructure facility governed by two separate boards, but with a common Minister. This approach would have the added advantage of better focussing the engagement efforts of NHFIC: the target markets for participation in the bond aggregator and the infrastructure facility are quite different.

3. THE INFRASTRUCTURE FACILITY

The single biggest challenge for the facility will be the identification of projects to support that will bring forward residential production that would otherwise not have occurred, or would not have occurred for an extended period, without the support of the facility. In other words, the biggest risk for the facility is that it will simply replace other government or private sector sources of funding.

To minimise the potential for this substitution to occur and leave the facility delivering little or no additional residential development, HIA would recommend that the facility should only support those projects that have:

- The involvement and support of a private sector developer, a local government and a state government: that is, it should be a "mini city deal" as the Consultation Paper suggests.
- The capacity to overcome short term financial barriers that the private proponent cannot overcome without state or local government infrastructure support that would otherwise not be forthcoming. (This will be difficult to assess but should be at the core of the facility's operations).
- Medium (and short) term viability of increased residential development; that is, no need for long term financial support
- The capacity to deliver lower up-front infrastructure costs to residential developers and their clients.
- Productivity trade-offs from the local and state governments involved, for example through streamlined approval processes for the ensuing residential development.
- The potential to have demonstration effects from trialling innovative financing solutions. For example, an equity investment by the facility could be paid dividends from the resulting increase in local rates and other tax revenues; akin to tax increment financing.

The project selection guidelines should also make funding equally available to relatively small scale development, especially in infill locations. The facility should not be the province of large master-planned developments alone.

Through a lowering of the up-front infrastructure costs, the facility also has the potential to produce more affordable housing outcomes across the board that do not rely on inefficient and self-defeating market interventions such as the inclusionary zoning suggestion in the Consultation Paper. All inclusionary zoning achieves is making housing more costly across the board. Those who occupy the affordable component of the development are being cross-subsidised at the expense of all the other housing in a specific project. More concerningly, the artificial inflation of costs for some housing creates a draft effect on other nearby housing, which perversely raises the price of all housing. This is the opposite of what the NHFIC is trying to achieve from both mechanisms.

Similarly, using the facility to support the delivery of key worker housing closer to where they work should not be an objective for the facility. This type of market intervention is best left to better targeted housing programs. The objective of the infrastructure facility to produce additional housing should not be complicated and confused by overlaying social housing policy objectives as this will only make the facility less commercially viable and reduce the number of potential projects. The facility’s core business should be to provide financial support where it can deliver the biggest impact on future housing supply, unconstrained by broader, albeit important, social policy goals.

The Consultation Paper also questions whether value capture mechanisms should be applied to the facility’s investment decisions. HIA would recommend strongly against the use of the NHFIC facility as a test-bed for value capture. HIA would argue that at this stage in the development of value capture policy, the concept is poorly understood, complex to apply and potentially adds to project cost, defeating one of the facility’s objectives; producing more affordable housing. Value capture is best targeted at transformational infrastructure, primarily being transport infrastructure, which sits outside the types of infrastructure required to ‘bring on’ residential development and support the improved timeliness of land and housing releases in all locations.

HIA suggests that if it is to be truly innovative the NHFIC facility should not attempt to constrain the types of infrastructure that it supports. Limiting the scope of infrastructure to particular types of infrastructure could exclude otherwise innovative and productive proposals from consideration. Similarly, eligible applicants should not be constrained beyond the requirement suggested above for all applications from developers to have the support of local and state governments. The scope of infrastructure funded and the characteristics of applicants could be refined after the NHFIC has some experience under its belt.

It is worth noting that the former national Housing Affordability Fund was used to provide similar support for local infrastructure projects that would lead to the early delivery of residential developments. That Fund operated solely as a grant funding source which turned out to limit its potential and made project selection complex. The proposed NHFIC model with the capacity to deliver grants, loand and equity investment there should be improved potential to deliv infrastructure that is genuinely required to support residential development, rather than infrastructure that should otherwise be funded by state and local governments.

In summary, HIA recommends that the Government should not attempt to confuse the NHFIC's objectives beyond infrastructure delivery by seeking to use the facility to achieve other policy objectives. Going down this path runs the very real risk of the infrastructure facility turning into a poorly targeted and ineffective social policy tool. The facility should "stick to its knitting".

4. THE AFFORDABLE HOUSING BOND AGGREGATOR

The Consultation Paper and the Ernst and Young report underestimate in HIA's view, the unique characteristics of the community housing sector. One such area is the extent to which the operations of the community housing sector, and therefore the risks faced by lenders to the sector, are underpinned by government programs and policies. The sector is exposed to a considerable degree of sovereign risk.

The regulatory framework around community housing includes

- the eligibility and extent of Commonwealth Rent Assistance payable to the sector's tenants;
- the extent to which governments re-assign government owned housing stock to the sector and whether it is on a title transfer or leasing arrangement;
- the extent to which governments support the sector via the transfer of government owned land;
- local rate and other concessions;
- the charitable status of the providers and their consequent exemption from income tax and GST; and
- the registration arrangements for providers.

Government changes to any of these factors add risk to the community housing sector and anyone lending to them, including via a bond aggregator. In view of these additional government controlled risks that are additional to those faced by any lending to a housing investor, HIA considers it appropriate for the bonds issued by the aggregator to have an explicit government guarantee, especially in the early formative years of the bond market.

Another way of mitigating some of these and other risks for the bond holder, but not the community housing provider, would be to issue the bonds as a mortgage backed security, even if were just for a tranche of the funds available. This approach would provide more security for the bond holder and potentially lower the cost of funds to the provider. The interest-only and ten year features of the bonds could be preserved and apply to both the bond holder and the loans that the aggregator makes to the providers. It is not at all clear to HIA why the Ernst and Young report and the Consultation Paper have dismissed this approach.

It is also not clear why the potential for the bonds to carry a variable rate has not been more fully explored as providers may prefer this type of loan. Not only would this potentially provide a less costly loan to the provider, especially in the early years of the loan, it would also provide some security for the bond aggregator against the risk that the provider repaid the loan to the aggregator before the bond reached maturity. If the rate is variable in these circumstances the aggregator would be better able to reinvest the early repayment at current rates. If the bond aggregation process is to mimic the current commercial lending arrangements that providers face, it would not be useful to have the providers carry the early repayment risk.

Another risk for the aggregator which does not appear to have been addressed is the proportion of the lending pool that the aggregator is prepared to lend to a small number of providers.

Not surprisingly HIA is concerned that the Consultation Paper recommends that the loans from the aggregator not be used for constructing dwellings. This appears at odds with the Paper's recommendation that the loans to the providers not be secured by mortgage and be available for "general corporate debt". The construction loans do not face some of the risks that lenders would face in lending to a commercial investor as the entity for whom the dwelling is being built is not speculating on selling the property on completion. So for a community housing provider borrowing to construct a dwelling would be regarded as a "general corporate" activity.

In its infancy the bond aggregator may need considerable financial support from the government to manage the timing of the aggregation of the lending requirements of providers prior to a bond issue. The community housing providers will not all need financing at the same time and there will be instances where market opportunities mean that the providers could not wait for a sufficient pool of funds to be needed by the sector to warrant a bond issue. In these circumstances the aggregator would need the capacity to advance loans to providers ahead of the next bond issue.

The Consultation Paper does not address the potential scale of bond issues that would be needed to generate a functioning market. It is not clear to HIA that the $3-400m mooted for the aggregator initially would be sufficient to achieve this goal.

5. CONCLUSION

The causes of Australia's poor housing affordability are many and complex and there is no panacea, but HIA supports the development of both the Housing Infrastructure Facility and the Affordable Housing Bond Aggregator as important tools in the government's housing affordability armoury.

HIA's comments and recommendations in this submission have been intended to be constructive to improve the prospects for these initiatives. Properly designed and well executed these two initiatives will make a positive contribution and hopefully demonstrate to governments at the state and local level that progress can be made in meeting our affordability challenge.