IMPACT INVESTING AUSTRALIA

Housing Policy Unit Manager
Social Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600
by email: HousingConsultation@treasury.gov.au

20 October 2017

Dear Sir/Madam

National Housing Finance and Investment Corporation Consultation Paper

On behalf of the Australian Advisory Board on Impact Investing (AAB) and Impact Investing Australia (IIA), I would like to thank you for the opportunity to share our thoughts on the National Housing Finance and Investment Corporation, NHFIC. This submission sets out what we believe to be the key impediments around growth in social and affordable housing and our view on how some design aspects of the NHFIC could be enhanced to greater effect. Given the short time frame, we have not provided a fuller examination of the individual questions raised for consultation.

We congratulate the Government for its ongoing commitment in trying to resolve the issues around social and affordable housing. Solutions need action and we recognise the genuine attempts from Treasury across both the Minister's office and the Department to extensively examine the issues and build feedback from key stakeholders into the design framework for the NHFIC.

We are highly supportive of the creation of a "go to" organisation such as the NHFIC to enable growth in social and affordable housing. If executing effectively the NHFIC could form an important hub for strengthening collaboration across the different levels of government, and the community and private sectors. Effective frameworks, regulation and policies around governance, accountability, transparency, measurement and reporting will all be critical to success.

This implies appropriate and nationally consistent regulation for the CHP sector and an NHFIC board composed within the principles of independence, relevant experience and diversity.

The risk appetite of the NHFIC and its initial "owner" is also critical. There is a need to take on enough risk to effectively execute a mandate to help market development around social and affordable housing and strengthen the Community Housing Provider, CHP, sector while not absorbing the full burden of risk.

The multi-dimensional aspects of the social and affordable housing issues mean they are not mutually exclusively. The risk components: by whom and how much, also pervades much of the financing discussion. With this in mind, we have identified four key issues for consideration in the context of the NHFIC:

1. Lack of supply of fit-for-purpose new social and affordable housing stock and its associated infrastructure [roads, sewerage etc.].
2. A need for refurbishment or reconfiguration of existing stock;
3. The funding gap between rental income and associated operating and financing costs;
4. The service overlay which enables initial stability in housing outcomes and facilitates longer term movement along the housing continuum.

Thank you again on behalf of the Australian Advisory Board on Impact Investing and Impact Investing Australia for your consideration of our thoughts in relation to social and affordable housing. We would be delighted to have further conversations with Treasury to elaborate on our points or to provide additional information. Please do not hesitate to contact us.

Yours Sincerely

Sally McCutchan

Executive Director and CEO
Impact Investing Australia

IMPACT INVESTING AUSTRALIA

AUSTRALIAN ADVISORY BOARD ON IMPACT INVESTING

Submission on the National Housing Finance and Investment Corporation Consultation Paper

20 October 2017

National Housing Finance and Investment Corporation Consultation Paper

The Australian Advisory Board on Impact Investing (AAB) and Impact Investing Australia (IIA), thank you, the Government and the Treasury, for the opportunity to respond on the National Housing Finance and Investment Corporation (NHFIC) Consultation Paper. This submission sets out what we believe to be the key impediments around growth in social and affordable housing and our view on how some design aspects of the NHFIC could be enhanced to greater effect. Given the short time frame, we have not provided a fuller examination of the individual questions raised for consultation.

We are highly supportive of the creation of a "go to" organisation such as the NHFIC to enable growth in social and affordable housing. If executed effectively the NHFIC could form an important hub for strengthening collaboration across the different levels of government, the community and private sectors. Effective frameworks, regulation and policies around governance, accountability, transparency, measurement and reporting will all be critical to success. This implies appropriate and nationally consistent regulation for the Community Housing Provider (CHP) sector and an NHFIC board composed within the principles of independence, relevant experience and diversity.

The risk appetite of the NHFIC and its initial "owner" is also critical. There is a need to take on enough risk to effectively execute a mandate to help market development around social and affordable housing and strengthen the CHP sector while not absorbing the full burden of risk.

The multi-dimensional aspects of the social and affordable housing issues mean they are not mutually exclusive. The risk components: by whom and how much, also pervades much of the financing discussion. With this in mind, we have identified four key issues for consideration in the context of the NHFIC:

1. Lack of supply of fit-for-purpose new social and affordable housing stock and its associated infrastructure [roads, sewerage etc.];
2. A need for refurbishment or reconfiguration of existing stock;
3. The funding gap between rental income and associated operating and financing costs;
4. The service overlay which enables initial stability in housing outcomes and facilitates longer term movement along the housing continuum.

Incorporating consideration of the questions raised in the consultation paper, we have examined below the capacity of the NHFIC within its proposed structure to address these critical issues.

1. Lack of new fit-for-purpose housing stock and infrastructure.

Key recommendations:

- *Provide for the National Housing Infrastructure Fund (NHIF) to take a broader catalytic role including around new affordable housing construction to enhance the capacity of the NHFIC to address market gaps.*

- *Review the proposed structure of the capital investment (debt, equity or grant) of the NHIF to ensure it deploys catalytic capital appropriate to the expansion of fit for purpose housing stock and infrastructure.*

According to the EY Report[1], 62% of the 30 responses received from CHPs indicated that the preferred purpose of borrowing was construction. The outline of the Bond Aggregator (BA), in the discussion paper indicates its focus will be to predominantly provide a means of financing, [or refinancing], for existing housing and not new builds. The focus of the BA therefore largely relies on the preparedness of the banks

[1] EY, (2017), 'Australian Treasury Final Report: Advice, modelling, evidence and an implementation plan for the establishment of an affordable housing bond aggregator'

or other financiers to step into this higher risk development end of the housing market to enable new construction. It also implicitly assumes interest savings delivered by the BA and/or providers of equity capital will enable the CHPs to take on the construction related debt and the associated development risk.

In 2012 in the UK, admittedly a more mature CHP market, the government offered financial support to CHPs through the Build to Rent Fund (BRF) to develop new rental units which could then be sold to institutional investors[2]. The extension of the remit of the NHIF to go beyond funding local council related infrastructure may form a similar mechanism to address the lack of new housing stock in Australia. The NHIF could provide catalytic capital to initiatives that involved new housing stock and associated infrastructure. It could build tools, capacity and experience to enable efficient replication of effective capital structures and models across different jurisdictions. In our view, this would be preferable to conflating the role of the BA to also fund construction which may create confusion and/or be less welcome by both investors and ratings agencies in risk assessment of the entity and its bond issues.

In broadening the scope of the NHIF, further consideration could be given to the proposed capital investment of the vehicle. The current indications of $600m debt, $225m equity and $175m grants may not provide the right type of catalytic capital to enable construction, particularly without further subsidisation of debt servicing requirements. Often it is the equity or grant funding that is missing in the capital stack and its provision whether through land or, as could be the case with the NHIF, direct capital investment, is the catalyst to success.

2. A need for refurbishment or reconfiguration of existing stock

Key recommendations:

- *Evaluate the possibility of a fully out-sourced model for the BA to enhance scale and financial sustainability while maintaining a high level of risk control to ameliorate Treasury concerns in this respect.*

- *Adopt a structure that incorporates a Government guarantee at least initially. This would help ensure a high level of credit rating while the BA builds track record and national consistency around regulatory settings particularly in relation to default remediation is pursued.*

The BA under its “general corporate purpose loan” mandate is designed to address the financing requirements for refurbishment and potentially some reconfiguration of existing stock. Its objective is to attract institutional capital with long tenor at a price that is lower than currently achievable by eligible CHPs. The BA’s capability to deliver on this will largely depend on the credit rating it attracts.

Notwithstanding the EY analysis around Shadow Credit Rating, we have concerns with respect to this aspect. As the EY report discusses, the only Australian CHP to have secured a credit rating is the Brisbane Housing Co Ltd (BHC). This CHP is recognised as one of the best in Australia with both the Queensland State Government as a major shareholder and a proven track record around debt servicing. It is rated AA- [S&P] or Aa3 [Moody] which is just above the Shadow Credit Rating suggested for the BA on a standalone basis, despite that entity’s lack of track record and cash-flow transparency. In addition, further clarification is needed at the national level around avenues for remediation in the event of default. On this basis, it would appear that to achieve objectives around rating and associated pricing, a government guarantee would be required at least until appropriate regulation is put in place around default outcomes and/or the BA’s track record around credit assessment and related servicing is established.

---

2 Stevens, B. (2016) ‘Strategic intervention for the economically active? Exploring the role of selected English local authorities in the development of new market rental housing with pension fund investment’, Journal of Housing and the Built Environment, vol 31, no. 1: 107-122.

The other issue that needs to be considered in respect of the BA's pricing advantage is "crowding out" and an associated competitive response from banks. Based on the EY report, only 18% of CHPs have experienced difficulty in soliciting funding offers from lenders. There is a risk that once the BA enters the market [or is close to doing so] the banks become more competitive on pricing particularly to Tier 1 CHPs eroding the marginal pricing benefit of the BA. This could impact: market share of the BA; diversification of its credit risk; the cost impost on government and, in a worst-case scenario, the self-sustainability of the BA itself.

This may be further impacted by a structure that outsources the warehouse facility funding and associated pricing particularly bi-laterally [bank to CHP] ahead of building DCM scale requirements for a bond issue. The risk to the BA's market share may be further compounded by the element of uncertainty around the final pricing and CHP servicing requirements ahead of issuance under a proposed competitive bidding model.

The challenge with an entity like the BA that relies on an interest margin recovery model is the need for scale in assets to cover high fixed costs [principally staff] relative to variable costs. Comparison of BA staffing requirements to those of The Housing Finance Corporation in the UK illustrate the point. The staff requirements of the two entities are not significantly different despite the large differential in the size of the issuances with the BA at a forecast $400m compared with £5.9bn for THFC – the latter of course having a much larger loan book from which to draw margin and cover the costs of its 15 staff[3].

While understanding that Treasury has concerns around maintaining control of risk mitigation, given the likely size of BA bond issues in the medium term, there may be some merit in considering an outsourced model with a government guarantee to realise the potential scale benefits. Clearly, in this scenario a high level of governance and detailed risk and investment policy guidelines would be required to manage risk. We note that The Housing Finance Corporation UK is a non-government entity with shareholders compromising predominantly Directors, the National Housing Federation and the Homes and Communities agency (Social Housing Regulator). It does however have a government relationship through the Affordable Housing Scheme.

Finally, to a review of government cost versus savings to the CHP sector. The EY analysis suggest savings to the CHPs from the BA of $56m over 10 years or $5.6m per annum on issuances of $400m and a subsidised model from government. This falls to $3.6m a year on a full cost recovery basis. While recognising that the budgetary impact of $53.5m and 30 staff over 3 years reflects the full NHFIC entity and not just the BA, and that market development is at the core of the initiative, *ceteris paribus* this does appear to be quite a high cost and level of risk for the benefit derived.

3. The funding gap between rental income and associated operating and financing costs.

Key recommendations:

- *Consistent with Recommendation 1 of the AHWG Report and the recent AHURI inquiry into social impact investment for housing and homelessness [4], that the Commonwealth and State and Territory governments progress initiatives aimed at closing the funding gap particularly in relation to direct subsidy for affordable low-income rental housing.*

[3] The Housing Finance Corporation Limited Annual Report and Accounts (2017)
[4] Muir, K. Moran, M., Michaux,F., Findlay, S., Meltzer, A., Mason, C., Ramia, I. and Heaney, R. (2017) The opportunities, risks and possibilities of social impact investment for housing and homelessness, AHURI Final Report 288, Australian Housing and Urban Research Institute Limited, Melbourne.

Both the Affordable Housing Working Group, AHWG[5], and EY[6] reports, recognise this funding gap is a fundamental issue in growth in social and affordable housing. While EY did not specifically address a question to this issue in its survey, it was reflected in the key priorities for CHPs around financing. They ranked as the highest: interest rate costs [lower servicing requirements], tenor [re-financing risk] and a desire for fixed rate loans [mitigating servicing volatility given the relative fixed nature of rental and CRA receipts].

Recommendation 1 of the AHWG Report "*recommends that the Commonwealth and State and Territory governments progress initiatives aimed at closing the funding gap, including through examining the levels of direct subsidy needed for affordable low-income rental housing, along with the use of affordable housing targets, planning mechanisms, tax settings, value-adding contributions from affordable housing providers and innovative developments to create and retain stock.*"[7] **.**

We see as critical the need to address this funding gap issue in conjunction with any initiatives around the NHFIC. While potential savings of $56m and new avenues for debt finance and infrastructure are a helpful start, on its own in its currently proposed form, the NHFIC is unlikely to drive a significant change in the affordable housing stock. Initiatives like grants and subsidies may be seen as too great a burden on the government budget, however these are likely to be required to stimulate significant change in housing sector outcomes.

4. The service overlay which enables initial stability in housing outcomes and facilitates longer term movement along the housing continuum.

Key recommendations:

- *To consider how to incorporate this important service overlay into the broader mandate of the NHFIC. This may be implemented through explicit Expressions of Interest or deal conditions as observed under the NSW SAHF.* [8]

- *To work with the Australian Advisory Board on Impact Investing and Impact Investing Australia to form a unique partnership between the government and banks, in Impact Capital Australia (ICA). ICA's role as a predominantly wholesale investor with a market development focus will stimulate critical intermediation and demonstrate efficacy of different approaches to addressing both infrastructure related to Affordable Housing as well as a range of inter-related priority policy areas including employment, disability services and health.*

A missing piece in the NHFIC discussion is the service overlay. Asset based investment which focuses on housing stock and associated infrastructure goes some way to addressing a lack of supply. However, long durations of tenancies may constrain the breadth of the investment impact and limit the efficacy and efficiency of government capital in addressing the Affordable Housing issue.

A combined approach providing both Affordable Housing and complementary services such as education and training resulting in better employment outcomes can move individuals to a more economically sustainable position and encourage movement up the housing continuum. There are a number of examples globally, including the Living Cities Catalyst fund [USA] and Real Lettings Property Fund [UK] that combine this service and infrastructure layer providing accommodation or Affordable Housing for the aged, people with disabilities and the unemployed.

---

[5] Council of Federal Financial Relations, Affordable Housing Working Group, (2017) 'Supporting the Implementation of an affordable housing bond aggregator', Report to Heads of Treasuries.
[6] EY, (2017), 'Australian Treasury Final Report: Advice, modelling, evidence and an implementation plan for the establishment of an affordable housing bond aggregator'
[7] Ibid.
[8] Department of Family and Community Services NSW, website: https://www.facs.nsw.gov.au/reforms/social-housing/SAHF accessed 20 October 2017

In previous submissions to the Australian Government, we have outlined the robust planning and design for a collaborative initiative that will be the game changer in the Australian market namely the establishment of an appropriately funded independent wholesale institution, Impact Capital Australia (ICA).

The concept for ICA with the capital ($300m), mission and mandate to drive the impact investment market to scale was developed by a working group of cross-sector senior Australian leaders with support from Big Society Capital. ICA's role as a predominantly wholesale investor with a market development focus will stimulate critical intermediation and demonstrate efficacy of different approaches to addressing societal issues. Investment for ICA would not be restricted to infrastructure related to Affordable Housing but would extend across a range of inter-related priority policy areas including employment, disability services and health. It would promote approaches that deliver better outcomes as well as more capital and stock.

In closing thank you again on behalf of the Australian Advisory Board on Impact Investing and Impact Investing Australia for your consideration of our input in relation to social and affordable housing.

We would be delighted to have further conversations with Treasury to elaborate on our points or to provide additional information. Please do not hesitate to contact Impact Investing Australia Executive Director and Chief Executive Officer, Sally McCutchan or Director of Policy and Stakeholder Engagement, Sabina Curatolo on 0478 544 423.

****