**Infrastructure and Project Financing Agency comments on the National Housing Finance and Investment Corporation (NHIFC) consultation paper.**

Infrastructure and Project Financing Agency (IPFA) welcomes the opportunity to provide comment on the National Housing Finance and Investment Corporation (NHIFC) Consultation Paper (the Paper), dated September 2017. The Paper seeks feedback on the potential structure and governance of the NHFIC. The NHFIC is proposed to be independent of Government, with a Board making investment decisions pursuant to a mandate set by government, but potentially subject to Government direction in relation to investment in certain projects.

The Paper also seeks feedback on the proposed operation of the National Housing Infrastructure Facility (the Facility) and affordable housing bond aggregator (the bond aggregator). The Paper notes that the Facility will work in partnership with local governments and other stakeholders to remove barriers to building housing-related infrastructure, particularly targeting geographic areas experiencing particular supply and affordability issues. The bond aggregator will provide cheaper and longer-term finance to community housing providers (CHPs), by aggregating the lending requirements of multiple CHPs and financing those requirements by issuing bonds to institutional investors.

Some of the below comments were also raised in the consultation session of 29 September 2017. We note that these comments may be subject to FOI, but would request that this submission be treated as in-confidence.

*The HHFIC model, governance and policy objectives*

Careful consideration should be given to the status of NHFIC as a GBE or statutory corporation, and possible governance and fiduciary tension between a corporate board and a government directive. The Department of Finance should be consulted with respect to the Governance Structures Policy, which helps Government to manage risk which arises from governance structure design.

Infrastructure funding for new developments and funding for affordable housing are two different things, with different requirements and likely transaction participants. Separation and clearer objectives would be desirable, including for the purpose of developing the (different) products and support NHFIC and the Facility might provide.

The model of project identification needs careful consideration. For example, how will NHFIC (and the Commonwealth Government) be assured that a particular project in a particular Local Government Area (LGA) should be pursued rather than, say, encouraging the release of land for development in another LGA which the private sector (or the LGA) will fund itself?

A risk for this entity, if it is established outside of government, is that its independence hinders relationships with policy developers in Commonwealth line agencies, particularly in city shaping and infrastructure planning. An explicit requirement to work in collaboration with other Commonwealth entities should be part of the mandate of the Board, and/or the entity should be subject to the PGPA Act which would impose on the Board a duty to collaborate with others.

Leveraging and integrating with the work of the Cities Division in the Department of the Prime Minister and Cabinet, and Infrastructure Australia and Department of Infrastructure and Regional Development (DIRD) pipeline forecasting, will be critical to ensuring sound project selection. We would recommend that, at least in the first 18 months, investments be focussed around geographic areas identified by these entities, to leverage existing relationships with states and local governments, and maximise Commonwealth policy outcomes. A broader submission/ application process for projects (such as direct with local governments) could be deferred until pilots have been done that allow the entity to work through and refine Commonwealth, state and local government governance issues, and internal processes.

Noting that the role of the Facility is to boost housing supply, explicit consideration should be given to the value capture and developer contribution opportunities for the Commonwealth, local governments, and, as required, States. Value capture should be considered as a component of business cases for these proposals.

Establishing a new entity is a time consuming and resource intensive process. It should not be under-estimated how long it would take to operationalise broad directives and legislative mandates, as well as establishing a full entity structure. Further, the extent of policy engagement and collaboration across the Commonwealth (such as with the Cities Division, DIRD, Treasury and Finance), as well as with States and Territories, local governments, and property developers, will be significant. 30 staff appears to be too small for the task of both the Facility, aggregator, and running the entity. IPFA recommends that the staffing levels of the Clean Energy Finance Corporation, Future Fund Management Agency, and Cities Division be investigated as forming useful benchmarks.

We note that the Northern Australia Infrastructure Facility has outsourced some of its back office functions to EFIC, retaining credit assessment functions. IPFA has outsourced its accounts payable/ receivable and payroll functions to a private sector accounting firm. A similar arrangement may reduce the total staff required by a marginal amount.

*Design challenges*

Assuming, as suggested, that NHFIC and the Facility should earn an acceptable return and become self-sustaining, complementarity and thus the utility of the proposal itself, may become a real issue. After all, if there is an acceptable return on acceptable risk involved, why wouldn't the private sector (or the LGA itself) undertake the project itself? Clearer guidance might be useful around the (minimum) terms and hurdle rates NHFIC and the facility will require: e.g., that it is expected the Facility will be on below market terms. We note, however, that this should not be overly restrictive, but rather principles based to enable the Board to work within a general mandate aimed at achieving affordable housing. The mandate and controls on the NHFIC and Facility should draw on the lessons learnt from the Clean Energy Finance Corporation and the Northern Australia Infrastructure Facility, and should be sufficiently flexible to enable maturing as the model develops.

It would also be useful to understand the position on LGA borrowings: the Victorian solution is instructive in this context and raises the question of why LGAs themselves can't do more of what it is proposed NHFIC undertake.

A few specific comments on design:

- How will revenues (including via value capture) be captured and their availability for repayment (or return on equity) be assured, without hypothecation to a project entity in which NHFIC has an interest, either as equity holder or secured lender? This may depend on the constitutional basis.

- Repayment timeframes and other terms may vary, depending on the type of project involved. This should be explicitly recognised in the guidance.

- It is not just construction timeframes which push out loan or investment tenor: here, it will be the availability of revenues (assuming it is rates from the development which will be used, rather than LGA general revenues) which will also push out repayment.

- Thought should be given as to how assets acquired by NHFIC might be disposed (i.e., what sort of strategy should NHFIC adopt in exiting from loans it might make or arrange?). For example, if construction risk is an issue, should there be an ability to sell down, require refinancing or securitise a loan made based on hypothecated revenues post-completion? With a wider base of receivables, the question of why LGAs don't do more of this themselves to raise finance should be asked. Are there particular regulatory or structural impediments which should be reviewed, ahead of a Commonwealth financial commitment like this one?

- Almost by definition, unlocking and encouraging financing arrangements, which ensure additionality (and complementarity) will require NHFIC concessional contributions to make other investments "work". This may mean a more junior position for the organisation in any consortium, and a need to be very clear on minimum terms.

- Aside from loans and grants, should NHFIC and the Facility also involve the giving of guarantees (e.g., to "wrap" a particular risk) or provision of derivatives (e.g., to take floating rate risk out of a project)? An explicit government guarantee, whether for an entire debt (such as the first loss guarantees offered under the UK government's affordable housing guarantee programmes) or a particular risk, would increase volume, reduce bond price and flow through to lower cost of debt for the CHPs. This would be a Commonwealth liability, and not one the Government may wish to absorb, particularly if a general "wrap" is being required. If the guarantee is focussed on a particular risk (e.g. construction, floating rate or, in the case of offshore issuance, foreign exchange) or capped at a particular level for a pool, this may be more acceptable and deliver some reduced pricing benefits.

- It may be useful to consider the possible use of real estate investment trusts in this space, particularly, perhaps, as a device to encourage super fund investment. Assuming the low rentals involved, and consequent inability to achieve a market return without significant enhancement, this might be ruled out, but Treasury should consider this as part of the options analysis.

*Bond aggregator*

IPFA believes the "bond aggregator" providing construction finance could also be an acceptable model, provided it has access to an acceptable pool of CHP receivables over which this risk might be spread. This also goes to the security issue: if more money, for different risks, is required, then access to a wider base of assets on secured terms should be required. Without this, it may be harder for the aggregator to issue bonds on acceptable terms – unless it was prepared to split these riskier assets out and offer differentially priced bonds backed by them.

A model akin to this is the collateralised loan obligations which were structured in the past, and paid different bondholders different returns based on their priority of recovery should the loan pool prove insufficient for repayment or service (see Figure 1).

**Figure 1. Collatoralised Bond Obligations Model**

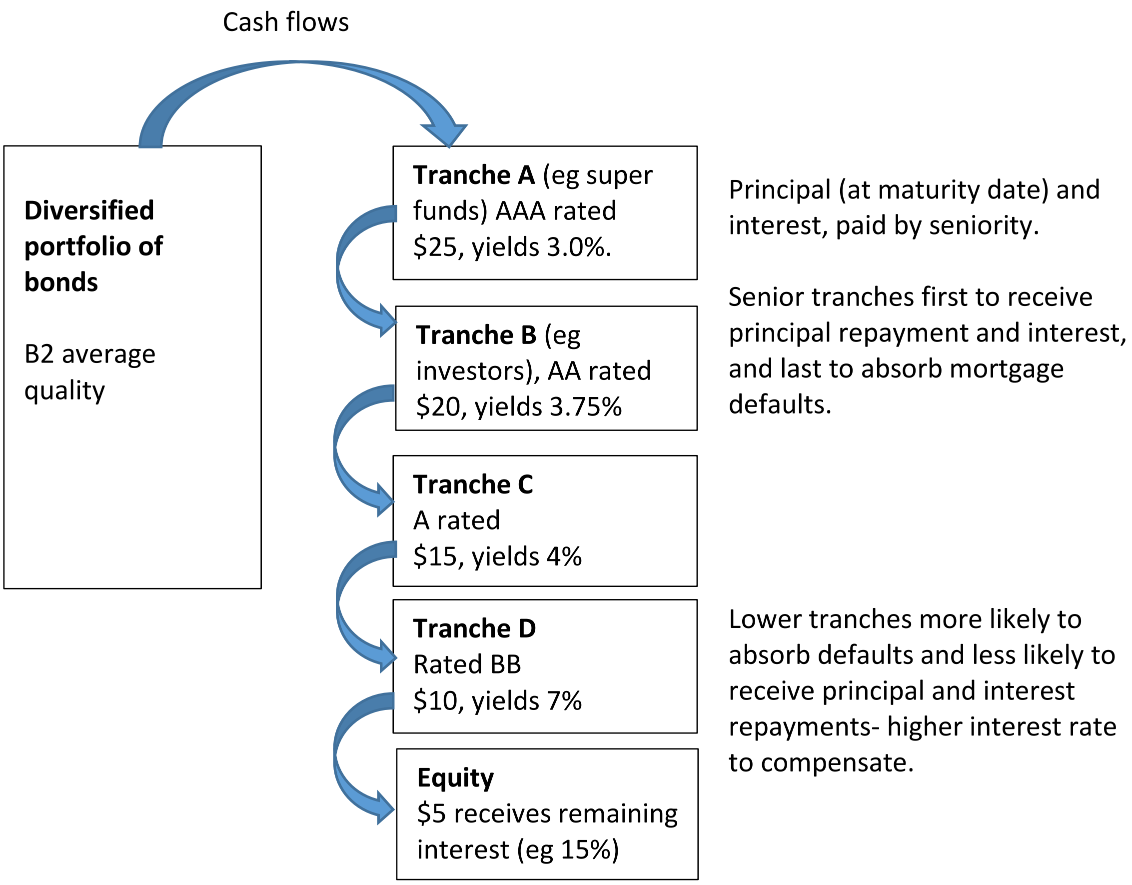
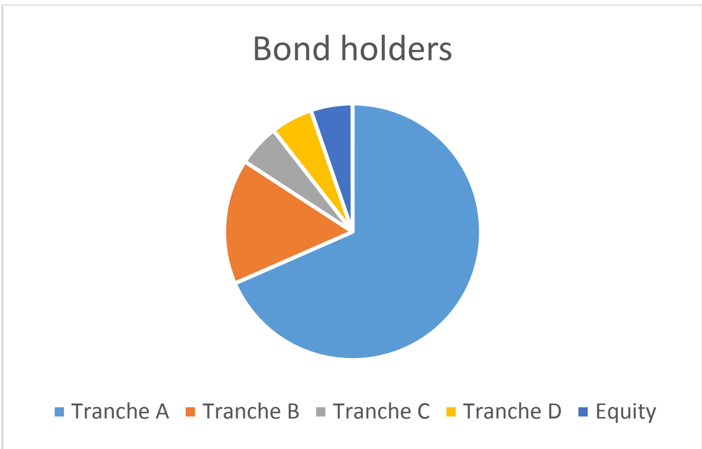



**Figure 2. Collatoralised Bond obligations model: proportional share of the bonds issued**




- The aggregator could charge the CHPs a blended rate on their loans sufficient to cover this. “Complementarity” and the unlocking of additional private sector funding could also be encouraged if the aggregator’s debt owed by the CHPs were to sit lower in priority to the debt of others, or if it were offered on looser terms, such as longer tenor.
- Aggregator bond holders would require a higher return on their debt, were it to form part of their pool. The more these sorts of debts are “diluted” by better assets, the less the price payable on bonds backed by the pool.

- Depending on the market being targeted, an acceptable rating (or series of ratings, depending on risk position) will be required. This will require rating agency engagement, and influence on aggregation and issue structure. Walking through this process would typically involve one or more banks and payment of fees.
- Depending on pool size, it would be usual to contract out debt management to a "servicer" or similar.

*IPFA assistance*

IPFA has been established to provide a centre of expertise within the Commonwealth, to assist agencies and advise Ministers and the Government on the development of innovative funding and financing solutions, and to increase private funding of public infrastructure. We are staffed with commercial experts with significant experience in financial markets, PPPs and infrastructure and other project financing. We would welcome the opportunity to discuss these comments in more detail in person, and to support Treasury in its policy development. The initial point of contact for IPFA on this proposal is Margaret Makeham-Kirchner (6215 5421, Margaret.makeham-kirchner@ipfa.gov.au).

John O'Neil, Acting Chief Executive
Infrastructure and Project Financing Agency
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