Response to the National Housing Finance and Investment Corporation Consultation Paper

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Executive Summary

Australia does not currently have enough social and affordable housing (SAH) to service the needs of vulnerable people in our communities. This contributes to housing stress, poor health and wellbeing as well as impeding efforts to reduce homelessness. An affordable housing bond aggregator is an important part of the solution as it will enable more capital to flow into the SAH market, resulting in more stock and ultimately better outcomes for people trying to access affordable and appropriate housing.

Social Ventures Australia (SVA) has strongly supported the development of an Australia affordable housing bond aggregator through submissions and engagements with the Government. SVA was pleased that funding was allocated in the 2017/18 budget and steps taken to establish the National Housing Finance and Investment Corporation (NHFIC). It is an important new institution to improve the functioning of our housing system.

The NHFIC's long term success will be determined by the extent to which Commonwealth and State governments use other complimentary 'policy levers' to assist in the provision of more SAH across the country. These should also be considered in parallel to the development of the NHFIC.

SVA welcomes the opportunity to provide comments and feedback on the key design features of the affordable housing bond aggregator as detailed in the Commonwealth Government's *National Housing Finance and Investment Corporation (NHFIC) Consultation Paper* (the Consultation Paper).

SVA has provided specific comment on eligibility, purpose of loans, security for loans, complementarity, government guarantee, and costs to sub-contract the aggregator with recommended changes detailed in the sections below. Based on our comments we make the following recommendations:

- Open up the eligibility criteria once the NHFIC has established a track record of bond issuance;
- Include construction finance in the purpose of the loans;
- Over collateralise the bonds to reduce their risk profile and create greater security of loans;
- To ensure complementarity, the bond aggregator must continue to provide long-term and low-cost funding in order to differentiate itself from other sources of capital;
- The government should provide either a full or partial guarantee for a finite period as the NHFIC scales up and builds a portfolio of stable, predictable and risk-weighted investments;
- Consideration be given to the legal structure establishing the NHFIC in line with the equivalent body in the United Kingdom to ensure a level of independence in its operation and strong links to the community housing sector.
- The government should develop a comprehensive housing and homelessness policy to strengthen the response to the need to increase the supply of SAH stock.

SVA is a non-profit organisation that works with partners to improve the lives of people in need in Australia, including through fostering socially focussed initiatives and developing an evidence base of what drives social impact. Based on our experience, SVA agrees that there is an urgent need in Australia for a new, viable and scalable financing model to assist with the supply of SAH.

1 Introduction

In 2016, SVA in our joint submission with Macquarie Group, recommended that the Commonwealth Government create a privately-operated housing finance aggregator to improve the financing costs and tenure for CHPs developing new stock.[1] The joint submission stated that the model should follow that of the UK's The Housing Finance Corporation (THFC) by establishing an Australian entity that:

- aggregates funding needs for housing providers (including CHPs, Real Estate Investment Trusts and Special Purpose Vehicles);
- undertakes credit assessment of these entities;
- sources periodic tranches of debt from institutional investors in its own name;
- ensures continuous compliance with covenants to ensure SAH providers are solvent and able to pay their obligations with right to procure rectification of compliance breaches;
- sources SAH providers' repayments via free cash flows from secured properties; and
- on-lends debt to SAH providers at cost of debt plus margin to cover costs, with borrowers subject to covenants and their repayment obligations secured.

SVA welcomes the Government's announcement to establish a NHFIC together with the operation of the Affordable Housing Bond Aggregator. The bond aggregator should seek to increase the supply of readily available, long-term and low-cost finance to Community Housing Providers (CHPs), providing them with a more efficient source of funds, reduced risk and reduced borrowing costs.[2]

The aggregator is not the only solution required to increase the supply of suitable and appropriate SAH stock in Australia.

As the Government develops its housing and homelessness policy further it should determine which combination of these levers will optimise the delivery of new SAH stock. Our suggestions are highlighted in Table 1 and were also referenced in our earlier submissions. The aggregator will support the policy levers rows outlined in red but other policy levers must also be addressed.

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[1] SVA and Macquarie Group, Joint Submission to the Council on Federal Financial Relations Affordable Housing Working Group
http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/CFFR%20Affordable%20Housing%20Working%20Group/Submissions/PDF/SVA_Macquarie.ashx

[2] *National Housing Finance and Investment Corporation Consultation Paper,* Commonwealth Treasury, 2017.

Table 1: Levers for new social and affordable housing

Lever	Details and examples	Gov't role	Scale of Impact
Construction or development costs	- Innovative design and build concepts such as modular housing - Large scale development capability of CHPs to reduce project costs	N/A	LOW
Financing costs	- Interest rate subsidy – equivalent of 2-3% as a cash transfer - Government guarantee administered by a financial intermediary	Federal and State	MEDIUM
Financing terms	- Long dated financing tenor up to 15-20 years (funding certainty for borrowers) - Lower debt servicing hurdles where prudent	Federal and State	MEDIUM
Management rights transfer	- Leverage rental income stream to develop new stock - Limited by maintenance liabilities on existing stock	State	MEDIUM
Planning regulations	- Inclusionary zoning – 10-15% based on LGA needs assessment - S.94 contributions waived for CHP residential development projects	State	MEDIUM
Income support	- CRA moved to floating mechanism linked to market rent - Other forms of rent subsidy to bridge income based rents and market rates	Federal/ States	MEDIUM / HIGH
Tax incentive	- Replacement mechanism for NRAS - Tax credit for new SAH	Federal	HIGH
Land costs	- Partnership between NFP, land banks and CHPs with alignment of mission and purpose - Land gifted or leased at peppercorn rent from the State	State	HIGH
Land or stock ownership transfer	- Title transfer of social housing to CHPs with leverage commitments - Medium-long term leases (20-30yrs) of social housing to CHPs with land swap	State	HIGH

2 Proposed key design features of the bond aggregator

Based on SVA's experience investing in the CHP sector and partnering with CHPs, we have provided the following comments on the Government's proposed design.

2.1 Eligibility

Given this is a new entity, SVA agrees that an initial focus on Tier 1 and Tier 2 CHPs would be the best approach to ensure a successful launch of this new funding model. By allowing only well-established community housing providers to apply for loans, this would provide institutional investors with a greater level of comfort with regards to both the longevity and ongoing scale of the aggregator issuance.

Tier 1 and 2 CHPs make up a significant proportion of the total community housing market in Australia and whilst not allowing access to all social housing providers, the aggregator would still enable a significant proportion of CHPs to benefit from lower funding costs and therefore stimulate an increase in SAH supply.

Upon the establishment of a successful track record of bond issuance by the aggregator, there is scope for the eligibility criteria to be expanded. This could also occur once institutional investors have become comfortable with the risk-return dynamics associated with the bonds. As per the UK based The Housing Finance Corporation (THFC), we would expect the aggregator to be staffed with a team of experienced individuals with strong financial and credit skills, who would closely analyse and monitor the financial position of all the borrowers on an initial and on-going basis.

2.2 Purpose of loans

The Consultation Paper proposes that bond aggregator funds would primarily be used for post-construction phase projects. Consideration should be given to following THFC's portfolio approach, which enables proceeds of the bonds to be lent to fund maintenance and turn-key purchases as well as some development activity. This approach reduces the impact of construction risk on bond pricing and ensures that bonds can continue to be issued at low margins to the benefit of the CHPs.

The bond aggregator may choose to focus on maintenance and turn-key purchases as a way to ensure bond pricing can be kept low, in line with the perceived risk profile of the borrowers. However, SVA believes that by excluding construction funding altogether there is a chance that the ongoing scale of issuance required to attract institutional investors may not be met and SAH stock will not be significantly increased.

2.3 Security for loans

In order to stimulate and sustain growth of SAH throughout Australia, the aggregator needs to be able to continue to issue low cost and long-term bonds. Any unsecured capital would be at a higher cost to that capital already available to CHPs given it is "riskier" in nature. As such, this would not be conducive to improving the financial position of the CHPs and ultimately would not increase the supply of suitable housing stock as a result.

SVA suggests that over collateralisation of the bonds may be another option for the Government to consider with regards to the security position. This approach would substantially reduce the risk profile of the bonds and as such would drive down the cost of funding for the CHPs.

2.4 Complementarity

The shortage of suitable SAH stock will not be increased solely by the introduction of new capital into the housing system. SVA believes the aggregator should co-exist alongside other forms of capital such as unsecured debt, Social Impact Bonds, Real Estate Investment Trusts and shorter tenor construction loans so as not to cannibalise these. These sources of capital may sit alongside the aggregator bonds for those CHPs borrowing via the aggregator and but also by other housing providers that do not meet the eligibility criteria and credit worthiness required to borrow via the aggregator.

Providing the sector with a range of capital sources will allow greater optionality in terms of housing stock thus leading to an overall increase. The bond aggregator must ensure that the capital it issues differentiates itself from other sources by continuing to provide long-term and low-cost funding. This will ensure the bond aggregator can complement and partner with other capital providers.

2.5 Government Guarantee

As a newly formed entity with no track record of issuance, the NHFIC will require some initial support from Government in order to attract long term institutional capital. This will also ensure the longevity of the bond aggregator as a funding source for CHPs. It is SVA's view that this needs to take the form of either a full or partial Government guarantee. The guarantee would be for a finite period as the NHFIC scales up and builds a portfolio of stable, predictable and risk-weighted investments.

Establishment of the bond aggregator without any form of guarantee would hinder the ability to issue low cost bonds, especially given the current lack of an effective Commonwealth regulatory regime. SVA would therefore recommend that, in tandem with the establishment of an aggregator, the Commonwealth Government seek to improve the national regulatory framework as this would underpin institutional investor confidence in the underlying risk profiles of the individual CHPs accessing the financing.

2.6 Cost of the housing finance aggregator

In our earlier submission, SVA and Macquarie Group provided indicative costings to establish and operate the aggregator as a private entity.[3] Further information on the costs and assumptions can be found in the submission. If the Government is seeking further information on the costs to sub-contract of tender this function we would be happy to provide further detail.

[3] Ibid

3 Conclusion

SVA makes the following recommendations in relation to the design and establishments of the NHFIC's new housing finance aggregator:

- Open up the eligibility criteria once the NHFIC has established a track record of bond issuance;
- Include construction finance in the purpose of the loans;
- Over collateralise the bonds to reduce their risk profile and create greater security of loans;
- To ensure complementarity, the bond aggregator must continue to provide long-term and low-cost funding in order to differentiate itself from other sources of capital;
- The government should provide either a full or partial guarantee for a finite period as the NHFIC scales up and builds a portfolio of stable, predictable and risk-weighted investments;
- Consideration be given to the legal structure establishing the NHFIC in line with the equivalent body in the United Kingdom to ensure a level of independence in its operation and strong links to the community housing sector.
- The government should develop a comprehensive housing and homelessness policy to strengthen the response to the need to increase the supply of SAH stock.

SVA would welcome further discussions with the Government about any of the feedback provided.

4 About SVA Impact Investing

Social Ventures Australia works to improve the lives of people in need. We are a non-profit organisation established in 2002 by The Benevolent Society, The Smith Family, WorkVentures and AMP Foundation. Our approach focuses on understanding the structural causes behind persistent disadvantage, then finding and supporting the innovative approaches that can create systemic change.

In order to overcome disadvantage in Australia, we have focussed on initiatives designed to provide great education, sustainable jobs, stable housing and appropriate health, disability and community services. By offering funding, investment, and advice we support partners across sectors to increase their social impact.

SVA was one of the earliest participants in the Australian Social Impact Investing market and has been responsible for a number of the largest and most innovative transactions.

In 2009, SVA played a pivotal role in orchestrating the GoodStart syndicate comprising four non-profit organisations - SVA, Mission Australia, The Benevolent Society and The Brotherhood of St Laurence. Through the development of a new social capital model, the syndicate was able to raise $165m to successfully bid for 650 ABC Learning Centres and is now running these centres with business discipline for a social purpose. The transaction was undertaken with the assistance of the Australian Government by way of a $15m medium-term loan from the then Federal Department of Education, Employment and Workplace Relations. This has resulted in improved quality of early childhood education for 73,000 children.

In partnership with Uniting and the NSW Government, SVA launched Australia's first SIB in 2013, the $7m Newpin SBB, which used private capital to fund a restoration program for children in foster care in NSW. This pay for success model allowed Government to measure the outcomes of the program before making payments linked to the anticipated savings arising. It has also generated strong financial and social returns for investors. In the first three years of the SIB: 130 children have been restored to their families; a further 47 have been prevented from moving into out of home care; and as a result of that success the bond has paid a return 12 percent to those investors who took on the performance risk. SIBs have unlocked private capital to fund social services but they have also created a level of rigour around the assessment and measurement of impacts, costs and benefits of social programs that is quite rare.

SVA successfully tendered with Uniting to develop a similar bond in Queensland, has completed the successful capital raising for Australia’s first homelessness social impact bond with Hutt St in South Australia, was part of the successful consortium that tendered to deliver a youth foyer social impact bond in NSW and has partnered with GoodStart Early Learning to develop another bond focussing on increasing participation of vulnerable children in early childhood education and care.

In 2015, HESTA committed $30 million to create a dedicated fund managed by SVA which is the largest single commitment to the local impact investment market made by an Australian superannuation fund to date. SVA and HESTA designed a dedicated fund, the Social Impact Investment Trust, to allow HESTA to make direct and indirect investments in a range of businesses, housing projects and social impact bonds that deliver both financial returns and identifiable and quantifiable social impact. HESTA’s commitment therefore represents a milestone in terms of size, source and social commitment. The fund is also notable for a number of innovations, in particular its impact-based incentive structure. In 2016, HESTA made a $6.7 million investment in Horizon Housing, a community housing provider operating in south east Queensland, which is focused on increasing the supply of SAH and helping low income earners achieve home ownership in targeted areas.

In 2016, SVA was instrumental in raising $6 million of capital from a blend of philanthropy, government, local investors and bank finance to setup Vanguard Laundry Services (VLS) which is a start-up non-profit commercial laundry based in Toowoomba. VLS will employ up to 40 people with mental health issues each year and will also operate an industry-linked career centre for a further 40 people per year by partnering with local businesses. The laundry business is underpinned by a long-term contract with St Vincent’s Health and contracts with other Toowoomba businesses. SVA also provided strategic and commercial advice, brokered pro-bono legal support, recruitment assistance and support to realise this business opportunity.