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Establishment of the National Housing Finance and Investment Corporation

The Westpac Group (**Westpac**) appreciates the opportunity to provide submissions to the Government's public consultation on Establishment of the National Housing Finance and Investment Corporation (NHFIC).

General comments

Westpac believes that all Australian's should have the right to access affordable housing and supports the proposals to accelerate housing supply and diversity of housing choice.

As Australia's oldest company and lender Westpac understands the Australian dream of home ownership and is committed to helping more Australians into their home. Every day we see the joy and security that home ownership brings to Australian households as well as the benefits it provides to the wider community. This is also important for a fair distribution of wealth in society.

Social and Affordable housing is a critical part of the housing continuum. Ultimately, efforts at this point of the continuum help all Australians. The shortage of social and affordable housing in Australia is a significant challenge. We want to bring our skills and financing to bear on this priority community need. For this reason we have made $2 billion available in lending and investment to help people gain access to social and affordable housing.

We note that in the consultation paper, the Government acknowledges that the NHFIC "can only go so far in improving housing affordability"[1]. We agree and urge a national, consistent policy response is necessary to provide the kind of investment certainty required. We therefore endorse all efforts towards a National Housing and Homelessness Agreement. We also agree that the development of a uniform, national Community Housing Providers (CHP) regulatory framework, requiring a higher level of financial sophistication[2] should be a priority.

Section 2: Structure, Governance, Resourcing and Engagement

In order for the two functions (that of the bond aggregator and the infrastructure facility) to be delivered effectively, the Government must set a clear scope for what the NHFIC will deliver to the market. Further, the board must have a clear and independent mandate. Ideally, the investment mandate should encourage

[1] *Consultation Paper – National Housing Finance and Investment Corporation*, Sept 2017, page 7
[2] As outlined in the Affordable Housing Working Group report (2017), *Supporting the implementation of a housing bond aggregator* available at www.treasury.gov.au.

situations where the private sector and the NHFIC are able to work in partnership to address the social housing need, having regard to existing private sector investment so as not to 'crowd out' the private market. This will encourage investment growth in the sector beyond the financial capacity of the NHFIC.

With regard to resourcing, 30 staff members split across the NHFIC and bond aggregator should be feasible but remains dependent on the volume of bonds issued and cash flows. The bond aggregator in the UK, for example, has not been a heavy issuer. Rising operational costs could make the structure unviable and it may be appropriate to outsource some functions to the market where there is greater expertise, *e.g*. bond issuance.

Critically, the NHFIC must be an active market participant, attending market events, collaborating with financial entities, developers and jurisdictions, and demonstrating a clear pipeline of opportunities for the private sector. This will ensure that the NHFIC is viable player, aligned to investor appetite. A key challenge is addressing the mismatch in understanding between the sector and the barriers to investment faced by private investors. For this reason, we recommend a detailed market sounding phase.

Section 3: Design and Financing Options

We agree that the features and options should be sufficiently flexible to allow the NHFIC to optimise the Social Housing outcome. For example, the design terms should include the use of special purpose vehicles (SPVs) and also the ability to 'staple' the finance provided with a private provider. For example a private provider could provide competitive short dated finance and the NHFIC could focus solely on long dated finance.

In relation to financing arrangements, to the extent the relevant infrastructure is competitively financed the NHFIC could also be seen as a catalyst for broader funding in the sector and could simply 'fill the gap' required to secure private sector finance. Therefore, the NHFIC will need to understand the required rate of return from the investor base and their investment criteria and then fill the gap to deliver that required rate of return. This support is likely to be required at a submarket rate of return to make the projects viable for investment from the private sector.

Many potential investors are keen to participate in the sector but unable to achieve the returns required under their investment mandates. Superannuation funds, for example, are typically required to hold up to 70 per cent of assets in highly liquid securities to meet redemption requirements. These securities are likely to be highly rated and tradeable but will be relatively low yielding. By necessity, the less liquid part of their portfolio needs to be invested in higher yielding assets to achieve the required returns for the funds. Without a government guarantee, social and affordable housing securities will form part of the remaining 30 per cent and as such will require returns in excess of 10 per cent to clear those hurdles. Government support can therefore take the form of either a guarantee of the securities or a payment that improves the cash flows.

From the banking sector's perspective, the biggest issue is reputation risk. Realistically banks would find it difficult to recoup their debt by selling the underlying social and affordable housing security and moving some of the most vulnerable people in our society out of their housing to recover their exposures. Accordingly, the only way for banks to be repaid is through amortisation of the loan which, due to the very low rate of cash flows, extends the amortisation period. Increasingly, we are finding that CHPs are requesting facilities that do not fully amortise within a 20 year time frame, leaving a residual exposure that presents elevated risks for banks. This is a clear market gap that the NHFIC could close.

In addition, some states are currently focusing more on the development of social housing, as opposed to affordable housing for key workers. This leaves a gap in the market, which the NHFIC could address. The cash flows in affordable housing are much higher than social housing where the level of support and grants are lower, therefore the level of subsidy required to lift returns to market will be lower.

For example, there is a high level of interest from developers in build-to-rent models but they are struggling to make this work from a return perspective. Again, NHIFC could provide a level of subsidy to help close this funding gap and ensure the delivery of these projects.

Section 4: Loans, Bonds and Government Guarantees

As this will be a new, untested style of bond issuance for the Australian market, relative value considerations will remain the most pertinent consideration for investors. We therefore recommend establishing a track record of bond issuing utilising the government guarantee, along with a stand-alone credit rating, to ensure strong primary and secondary bond outcomes. After developing a number of years of successful issues and a broad set of investors, the guarantee could potentially be removed (accepting an initial adjustment to expected pricing) with the ambition to continue to build out the program without this defined support. We believe this guarantee will be required to allow this entity to scale up quickly but could potentially have some form of sunset clause, subject to performance, over time.

Presuming the NHFIC proceeds with the guarantee, if there is a desire to remove this over time then the quality of issues will depend on the quality of the underlying loan. Potential risks exist in dislocating the track record and reputation of the program if funding is extended beyond proven Tier 1 and Tier 2 CHPs, in the early stages, to providers of lesser credit quality. The ability to demonstrate a strict credit profile will be integral to the success of the NHFIC's bond issuance. Having said this, it is important that in supporting the CHP sector, the eligibility criteria are not drafted too narrowly so as to exclude appropriate investment vehicles, such as property trusts or similar.

In terms of purpose, again on the presumption a guarantee is to provided, there is no reason to exclude construction risk. The banks have appetite for senior debt (with appropriate cash flow support from governments) and will focus on funding housing maintenance, construction and turn-key projects, but the area of greatest market failure lies in the lack of long dated (and potentially subordinated) debt. Market forces should ensure funding is directed to the program in the most efficient way. Noting the aim of the bond issuance will be to achieve superior pricing, potential tenor extension and a reliable funding source, this will provide an additional investment source to fill the funding gap, increasing housing supply by increasing the number of viable projects.

Security should be provided against the underlying land and property covered in the housing bond issue. However, given investors will price this security at a discount due to the inherent risks and reputational issues, we recommend funding is managed as discrete pools for each issue, ensuring there is no additional cross default risk.

At a minimum, we believe investors will require a covenant regarding maximum spending limits for the CHP. We believe funding can be achieved on an unsecured basis if a government guarantee can be provided, which would be our preferred approach. However it would be worth having the relevant investment and security requirement criteria in place at inception, to facilitate the potential removal of the guarantee over time. NHFIC needs to hold security although this does not mean that it needs to offer collateralised loans to the extent that a government guarantee is available.

In relation to bond markets, we recommend targeting a minimum A$100 million line per issue to ensure the bond is index eligible and to promote some degree of liquidity for investors. However, as this vehicle develops other investor markets should be considered. We further suggest that there should be scope for private placements at the option of the business. The government could explore the possibility of aligning the issuance program with a sustainable lending framework to capture additional funds. This would allow the bonds to be marketed specifically to the growing segment of sustainable and responsible investors.

With regard to contracting out services, we recommend that the NHFIC focus on its core objectives and outsource unnecessary infrastructure and services that currently exist in the market and accordingly can be more efficiently provided by third party providers. By way of example, bond issuance is a complex task, with back-office functions requiring critical support systems. This could be outsourced either to Treasury or the banks. In terms of agency and potentially aspects of portfolio management, these could potentially be handled within existing infrastructure of the banks and/or other market providers.

For further information in relation to any of the matters raised in this submission, please contact Jaimie Lovell, Senior Manager, Government Affairs on 0450 132 858 or jaimie.lovell@westpac.com.au.