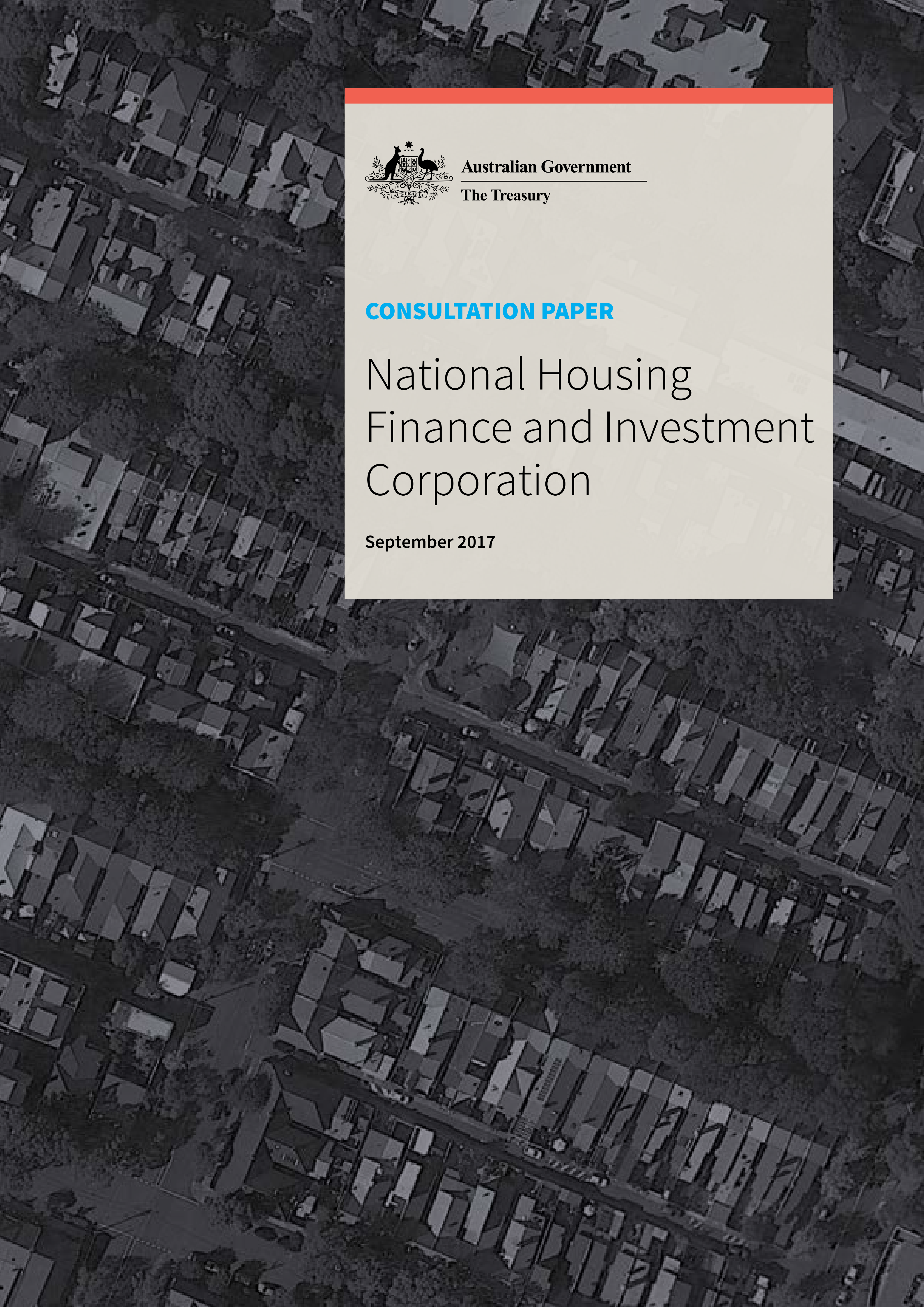
Australian Government
The Treasury

CONSULTATION PAPER

National Housing Finance and Investment Corporation

September 2017



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Notes to participants

The purpose of this document is to seek feedback on the objectives of the National Housing Finance and Investment Corporation (NHFIC).

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The Consultation Paper seeks feedback on the potential structure and governance of the National Housing Finance and Investment Corporation and the operation of the National Housing Infrastructure Facility and affordable housing bond aggregator.

Consultation process

Request for feedback and comments

The purpose of this Consultation Paper is to seek feedback on the establishment of the National Housing Finance and Investment Corporation (NHFIC) as part of the Government's 'Comprehensive housing affordability plan for all Australians' announced in the 2017–18 Budget. The Consultation Paper seeks feedback on the potential structure and governance of the NHFIC, and the operation of the National Housing Infrastructure Facility and affordable housing bond aggregator.

Interested parties are invited to lodge written submissions on the matters raised in this Consultation Paper by **Friday, 20 October 2017**.

All information (including names and addresses) contained in submissions will be made available to the public on the Treasury website unless the party making the submission indicates that all or part of the submission is to remain confidential. Automatically generated confidentiality statements in emails are not sufficient for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* for access to a submission marked confidential will be determined in accordance with that Act.

Submissions should include the name of the organisation (or person if the submission is made by an individual) and contact details including an email address and telephone number, where available. While submissions may be lodged electronically or by post, electronic lodgement is strongly preferred. For accessibility reasons, please email responses in a Word or Rich Text Format. An additional PDF version may also be submitted.

The proposed structure and governance arrangements for the NHFIC and its functions are subject to change. Before finalising its plans for the NHFIC, Treasury intends to consider the feasibility of the options outlined in this Consultation Paper, taking into account the feedback it receives as part of the consultation process.

Closing date for submissions: Friday, 20 October 2017

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Housing plays a critical role in the social and economic wellbeing of Australians and the economy as a whole. Housing is fundamental to employment, educational and health outcomes. It is also a significant driver of investment, productivity and participation, as well as representing the main savings vehicle for the majority of Australians.

SECTION 1

1 The Government's plan to address housing affordability

Growth in years needed to save a 20% home deposit

OVER THE PAST DECADE

HALF OF LOW-INCOME RENTAL HOUSEHOLDS SPEND MORE THAN

30%

of their household income on housing

80,000

Current number of community housing dwellings

Around 40,000 Australians currently are on waiting lists

Australians' ability to access secure and affordable housing is under pressure

Housing supply has not kept up with demand, particularly in our major metropolitan areas, contributing to sustained strong growth in housing prices. This is impacting the ability of Australians to purchase their first home or find affordable rental accommodation.

The average time taken to save a 20 per cent deposit on a house in Sydney has grown from five to eight years in the past decade, while the time taken to save a similar deposit in Melbourne has grown from four to six years over the same period.[1] Half of all low-income rental households in Australia's capital cities spend more than 30 per cent of their household income on housing costs.[2]

Meanwhile, across Australia, community housing providers (CHPs) currently provide 80,000 dwellings to low-income households at sub-market rates, and around 40,000 Australians are currently on waiting lists for community housing and an additional 148,000 are on public housing waiting lists.[3]

The National Housing Finance and Investment Corporation is central to the Government's plan for housing affordability

In the 2017–18 Budget, the Government announced a comprehensive housing affordability plan to improve outcomes across the housing continuum, focused on three key pillars: boosting the supply of housing and encouraging a more responsive housing market, including by unlocking Commonwealth land; creating the right financial incentives to improve housing outcomes for first-home buyers and low-to-middle-income Australians, including through the Government's First Home Super Saver scheme; and improving outcomes in social housing and addressing homelessness, including through tax incentives to boost investment in affordable housing.[4]

The Government's plan includes establishing:

- the National Housing Finance and Investment Corporation (NHFIC) — a new corporate Commonwealth entity dedicated to improving housing affordability;
- a $1 billion National Housing Infrastructure Facility (NHIF) which will use tailored financing to partner with local governments (LGs) in funding infrastructure to unlock new housing supply; and
- an affordable housing bond aggregator to drive efficiencies and cost savings in CHP's provision of affordable housing.

These measures are important but can only go so far in improving housing affordability. As noted by the Affordable Housing Working Group (AHWG), further reforms to increase the supply of housing more broadly have the capacity to improve housing affordability and alleviate some of the pressure on the community housing sector. To this end, they would be complemented by the development of a new National Housing and Homelessness Agreement with an increased focus on addressing housing affordability.

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1 The Australian Government, *Guaranteeing the essentials for Australians*, 2017.
2 ABS 4130.0 Housing Occupancy and Costs, 2013-14 – Table 15. Available on the ABS website, www.abs.gov.au.
3 Productivity Commission, 2017, *Report on Government Services 2017*, Vol G, Chapter 18: Housing.
4 The Australian Government, *Guaranteeing the essentials for Australians*, 2017.
5 The AHWG released its report, *Supporting the implementation of a housing bond aggregator* on 22 September 2017 (the AHWG bond aggregator report). The report is available on the Commonwealth Treasury website at www.treasury.gov.au.

SECTION 2.1

2 The National Housing Finance and Investment Corporation

Table 1: NHFIC's objectives

Being credible in financial markets and ensuring its investment decisions are soundly based.	Addressing financial constraints by providing innovative and tailored finance.	Operating in conjunction with commercial lenders and state and territory governments.
Through the NHIF, partnering with local governments to fund the infrastructure needed to bring forward the construction of new homes in areas experiencing particular supply and affordability pressures.	Through the bond aggregator, catalysing institutional investment into the community housing sector and improving the financial strength of this sector by assisting it to grow in scale and sophistication.	

The Government's objectives for the NHFIC reflect its priorities to improve affordable housing outcomes for Australians. The NHFIC intends to grow the community housing sector, and increase and accelerate the supply of housing where it is needed most.

Governance of the National Housing Finance and Investment Corporation

Entity structure

The NHFIC is expected to be established through legislation as a corporate Commonwealth entity. It will be a body corporate that has a separate legal personality from the Commonwealth, but will be subject to an investment mandate prescribed by the Treasurer that reflects the Government's objective of improving housing outcomes. It is currently envisaged that both the NHIF and the affordable housing bond aggregator functions would be established as separate business lines within the single corporate entity (see **Diagram 1** opposite for an indicative structure).

The final structure of the NHFIC will be determined in accordance with the Commonwealth Governance Structures Policy administered by the Department of Finance.[6] The Governance Structures Policy provides an overarching framework to ascertain fit-for-purpose governance structures for all entities established by the Government.

The NHFIC Board may also engage third-party providers with the requisite expertise to provide treasury, loan administration and other back-office support for its bond aggregator and/or NHIF business lines.

NHFIC Board

The Government intends to appoint an independent, skills-based Board to govern the NHFIC. Board members are expected to be selected by the Government on the basis of expertise in finance, law, government, housing, infrastructure and/or public policy.

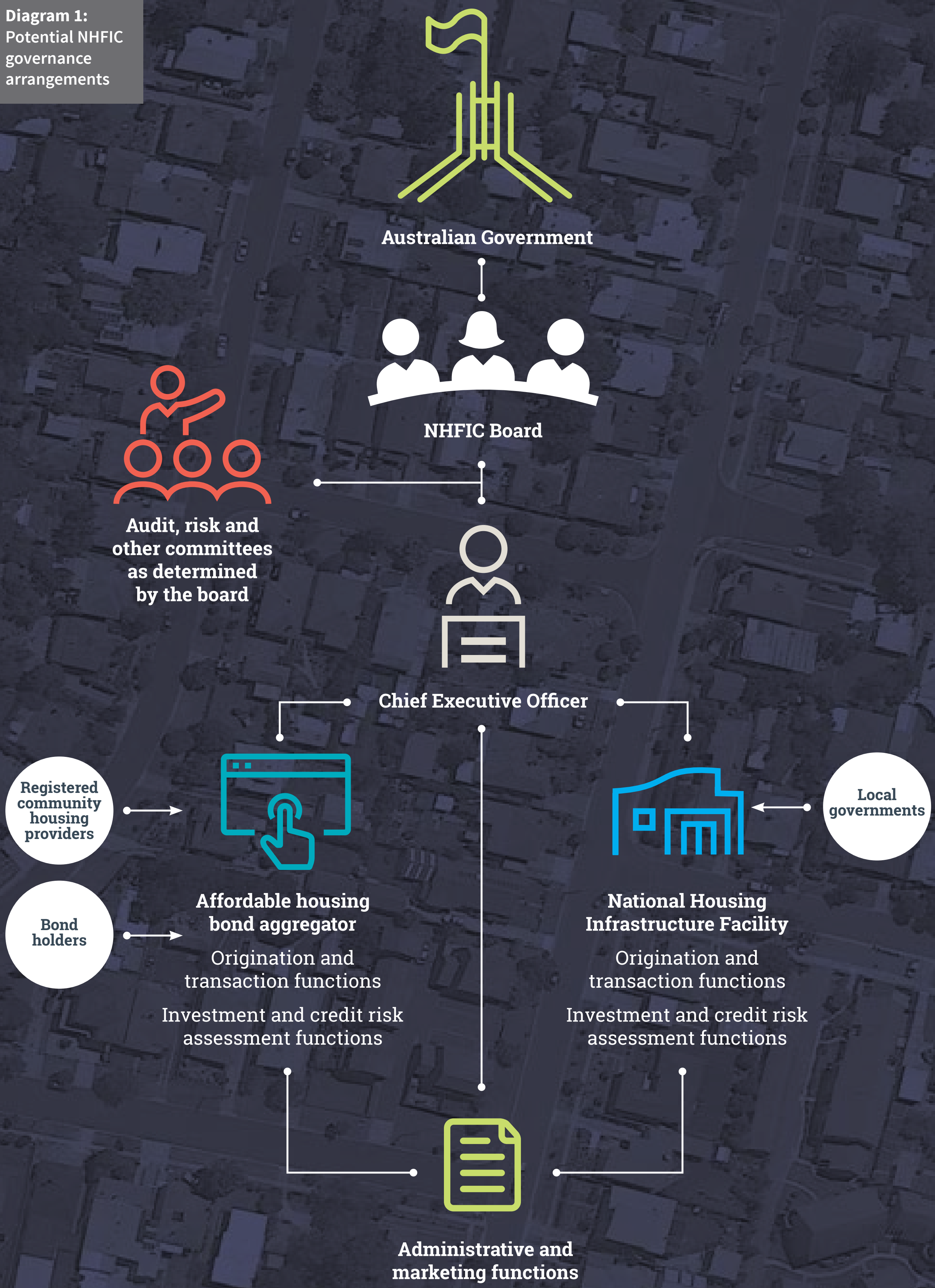
The Board will be responsible for the entity's corporate governance, overseeing its affairs and operations. This includes establishing a corporate governance strategy, defining the entity's risk appetite, monitoring performance and making decisions on capital usage.

The Board will be responsible for ensuring that investment decisions made for the NHIF and the bond aggregator comply with the NHFIC investment mandate.

The Board will also ensure that the NHFIC is governed according to best-practice corporate governance principles for financial institutions, including compliance with the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

6 The Commonwealth Governance Structures Policy is available on the Department of Finance website at www.finance.gov.au/resource-management/governance/policy/.

Diagram 1:
Potential NHFIC governance arrangements



SECTION 2.2

The National Housing Finance and Investment Corporation's operations

Table 2: Ministerial responsibilities	
Appointment of the Board	It is intended that the responsible Minister will appoint the Chair and other Board members.
Investment mandate	The NHFIC will be required to make investment decisions for both the NHIF and the bond aggregator in accordance with an investment mandate set down in writing by the responsible Minister. It is envisaged that the investment mandate will cover eligibility for NHFIC financial assistance, matters of risk and return, any limits on financing mechanisms and other matters that the Board must consider before making investment decisions.

Ministerial responsibilities

As noted earlier, the NHFIC will be a corporate Commonwealth entity. The operation of the NHFIC will be at arms length from the Government and consistent with the investment mandate.

However, consistent with other Commonwealth entities, the Government is expected to retain certain responsibilities relating to the operations of the NHFIC (see **Table 2**).

The Government also announced in the 2017–18 Budget that it will retain the ability to direct the NHIF to invest in particular projects where doing so would address a significant affordable housing issue. The Government is currently considering how this direction may be implemented and will articulate its position as part of the enabling legislation to establish the NHFIC.

Funding and staffing

The Government has committed $53.5 million in operational funding for the first three years of the NHFIC. It is anticipated that the NHFIC will be established by 1 July 2018. In addition to the Board, it is envisaged that the new entity will comprise approximately 30 staff members, including a Chief Executive Officer.

It is expected that the financing of all NHFIC functions would be self-sustaining over the medium term, with investment returns covering the NHFIC's operating and borrowing costs, at a minimum.

The NHFIC may be required to pay to the Commonwealth amounts determined by the Minister to meet competitive neutrality requirements.

Section 2: Issues for consideration

Treasury welcomes feedback on the issues raised in Section 2, including on:

1 **Structure** — The proposed 'one entity, two functions' structure for the NHFIC, including how the NHIF and bond aggregator functions can be designed to ensure that they are delivered effectively?

2 **Governance** — The proposed NHFIC governance structure, including: the role of the independent board; what issues may be reflected in the investment mandate; and the potential role of the Government in decision making?

3 **Resourcing** — Whether 30 staff members split across the NHIF and bond aggregator is likely to be sufficient; the potential outsourcing of some NHFIC functions; and whether the self-funding objective for the NHFIC is attainable and if so, over what timeframe?

4 **Engagement** — How can the NHFIC effectively engage with stakeholders across Australia to ensure that viable projects are identified?

SECTION 3.1

3 The National Housing Infrastructure Facility

The NHIF will seek to address impediments that LGs face in building the infrastructure that is critical to unlocking new housing supply. These can take the form of financial constraints — such as mismatches between future rate revenue streams and the upfront costs of infrastructure — and coordination issues relating to the different layers of government regulation and responsibilities.

The NHIF will catalyse projects linked to new housing supply by offering innovative financing options such as equity and blended finance, tailored to the needs of projects. The NHIF will work in partnership with LGs and other stakeholders to accelerate infrastructure projects, including 'micro-city' deals.[7]

The NHIF will need to be flexible in its financing arrangements and partnerships with LGs, and ensure that it engages with other stakeholders involved in the development of housing-related infrastructure.[8] This reflects the varying roles of LGs in providing housing-related infrastructure and the range of existing state and territory financing schemes available to LGs.

Table 3: NHIF's objectives

Boosting and accelerating the supply of housing through investment in housing-related infrastructure. A key concept is additionality; that is, the NHIF only funds projects that otherwise would not proceed or face undue delay.	Providing a collaboration platform that brings together governments, developers and other stakeholders to develop targeted responses that boost housing supply.
Complementing, not competing with, other sources of financing available for housing infrastructure.	Offering innovative financing options that are tailored to the needs of new housing projects and potentially leveraging additional investment.

As **Table 4** demonstrates, in some jurisdictions LGs can be responsible for very little of the direct provision of housing infrastructure, while private developers and state and territory governments (or their corporations) may be largely responsible. Responsibility for infrastructure provision also varies within jurisdictions. For example, Sydney Water (a state-owned corporation) is responsible for providing water and sewerage infrastructure in Greater Sydney and the Illawarra region, and also has a role in stormwater infrastructure in some locations. In regional NSW, local water utilities — owned and operated by councils — are generally responsible for providing water supply and sewerage services to NSW non-metropolitan urban communities. In some regional areas, LGs provide water and sewerage services.

7 The Hon Scott Morrison MP, Budget Speech, 9 May 2017

8 See Table 5 for an explanation of proposed 'housing-related infrastructure' for the purposes of the NHIF.

Table 4: Examples of LG responsibility for infrastructure, and state-based infrastructure facilities and programs			
Jurisdiction	**LG responsibility for housing infrastructure**	**Examples of state-based financing facilities for LGs**	**Description of state-based financing facilities**
Queensland	In Queensland, LGs are typically responsible for planning and providing 'connecting infrastructure' that is shared between different developments, This includes water supply, sewerage, transport, stormwater management, parks and land for community facilities.	Catalyst Infrastructure Program (Queensland Department of Infrastructure, Local Government and Planning)	The Catalyst Infrastructure Program (CIP) involves the Queensland Government partnering with LGs, water distribution retailers and select developers to co-invest in urban and housing infrastructure such as roadworks, water supply reticulation, and major sewerage and treatment plants. The project proponent is expected to invest between 10 and 50 per cent of the total cost of the infrastructure and repay the interest-free loan over a period of no greater than 10 years for loans between $5–10 million and 15 years for loans greater than $10 million.
New South Wales	Responsibility for infrastructure varies across NSW. LGs typically provide local roads, stormwater infrastructure, open space and community facilities (noting the variation in stormwater infrastructure referenced on the previous page).	Halving the cost of borrowing for LGs for eligible projects (NSW Government's housing affordability package)	To bring forward the delivery of local infrastructure, the NSW Government is offering LGs rebates on their interest expenses on borrowings of up to $500 million (in total) through the New South Wales Treasury Corporation (TCorp) or commercial banks. To be eligible for the rebates, councils must use the loan for infrastructure that enables new housing supply, and have Local Environmental Plans with sufficient residential zoning to meet Greater Sydney Commission growth targets. In addition, LGs can only apply for borrowings from TCorp if they meet 'Fit for the Future' loan scheme conditions.
		Housing Acceleration Fund (HAF) (NSW Department of Planning and Environment)	The HAF is a grant program that funds essential infrastructure, including water, road and electricity networks to speed up the supply of new housing. The HAF works collaboratively with key government stakeholders, LGs and private industry.
Victoria	Responsibility for infrastructure varies across Victoria. In a number of cases, developers fund and construct infrastructure such as local roads and water infrastructure.	Local Government Funding Vehicle (LGFV) (Municipal Association of Victoria)	The LGFV is a funding vehicle for LGs that aggregates their borrowing needs and enables them to directly access wholesale capital markets. LGs can borrow for general purposes, including infrastructure investment. The inaugural bond issuance for the LGFV was $240 million in November 2014 across five- and seven-year fixed rate, interest-only loans. A second bond issuance of $100 million was undertaken in 2015–16, across 10 years.

SECTION 3.2

Proposed design features of the National Housing Infrastructure Facility

Table 5 sets out proposed key design features to guide the provision of financing under the NHIF.

Table 5: Proposed key design features	
Total financing available	The $1 billion NHIF will provide up to: » $600 million in lending; » $225 million in equity investments; and » $175 million in grants.
Eligible applicants	Applications for financing under the NHIF will be accepted from a local governing body as defined by the *Local Government (Financial Assistance) Act 1995* (subject to further consideration as outlined in Section 3.3).[9] Applications from multiple LGs may also be accepted.
Eligible projects	The NHIF would give preference to 'greenfield' and 'urban infill' infrastructure projects that can demonstrate 'additionality' and which target those geographic areas experiencing particular supply and affordability pressures. Additionality in this context refers to projects that otherwise would not proceed or would face undue delay without NHIF assistance, and the extent to which NHIF assistance would accelerate or increase housing supply. Examples of housing-related infrastructure include: » new or upgraded infrastructure for services such as water, sewerage, electricity or transportation; and/or » site remediation works including the removal of hazardous waste or contamination. It is proposed that the NHIF will examine infrastructure proposals on a case by-case basis, using cost-benefit analysis. The NHIF is not intended to be used to refinance existing projects.
Quantum of funding for projects	It is not anticipated that there would be an explicit minimum or maximum funding criteria but the scale of the project should justify the NHIF's costs.
Financing terms	The NHIF is expected to provide finance from January 2019 (allowing time for the NHFIC to be established) and will be open to applications from 1 July 2018 until 30 June 2023. Applications for financing will be accepted at any time and will be considered on a merit basis. Repayment timeframes for NHIF finance are to be finalised following the consultation period.
Tailored finance	Finance would be tailored to assist in making projects viable. Tailoring may be available in a range of forms including loan tenor, repayment holidays, subordination in debt structures and interest rate margins. Applications seeking a blend of financing options will also be possible. It is proposed that NHIF payments to LGs be made through state and territory governments (subject to further consideration as outlined in Section 3.3).

9 For the purposes of the NHIF, eligible applicants include the Australian Capital Territory and the Australian external territories.

Early feedback

Given the varied ownership structure of housing-related infrastructure and the range of existing state and territory funding facilities for LGs, some stakeholders have suggested giving the NHIF more flexibility in its partnership and funding arrangements. In particular:

» **Fund infrastructure for new housing developments conditional on a certain proportion of the new housing being set aside for affordable and/or key worker housing.**

– Inclusionary zoning[10] already features in some jurisdictions' housing policies (see **Table 6**). There also appears to be an emerging interest in 'multi-family' housing developments that have a combination of affordable and standard housing, as evidenced by the recent announcements by Ivanhoe Estate in Macquarie Park, NSW.[11] There could be a role for Government in assisting this nascent sector to develop further and to leverage other sources of finance, such as from superannuation funds.

– Escalating housing prices have resulted in some key workers (such as nurses, police officers, firefighters, teachers and early childhood educators) not being able to afford to live in the communities that they serve.

– Given the large estimated undersupply of affordable housing, an affordable housing or key worker objective could also make it easier to demonstrate the NHIF's additionality objective.

» **Explore other potential innovative financing and partnership arrangements (subject to constitutional considerations).**

– A number of LGs have established special purpose vehicles (SPVs) for attracting investment to develop housing precincts. The NHIF could potentially provide finance directly to such SPVs. This may also enable a simpler, more streamlined transaction, with funds being directly provided to the SPV, rather than through state and territory governments.

Table 6: Examples of inclusionary zoning

South Australia	New South Wales	Australian Capital Territory
» 15 per cent of new dwellings in all significant development projects must be affordable, including at least 5 per cent for high-needs groups.	» 2 per cent of housing in specified zones must comprise affordable housing. » Developers must include affordable housing within developments or pay an affordable housing levy.	» 20 per cent of all new estates must include affordable housing

Image courtesy of Logan City Council

Invest Logan, Queensland

Logan City Council's independent investment corporation, Invest Logan, partners with private organisations such as developers to make better use of underutilised government land. Partnerships can take on different forms, including joint ventures.

Through LG investment corporations such as Invest Logan, the NHIF could provide an equity injection into housing projects, with subsequent housing sale proceeds and/or rental income providing a return to the NHIF.

10 "Inclusionary zoning aims to deliver a supply of affordable housing through the private sector requiring new developments to consist of a certain percentage of affordable housing for sale or lease to eligible households below certain price points", AHWG, *Innovative Financing Models to Improve the Supply of Affordable Housing*, October 2016.

11 Redevelopment of Macquarie Park's Ivanhoe Estate, Fraser's Property, 14 August 2017, http://www.frasersproperty.com.au/Media-Centre/News/2017/08/14/IvanhoeAnnouncement_14Aug2017.

- Another option is to provide NHIF finance to CHPs (as part of a consortium) developing projects that offer both market-rate and affordable housing options, or Build to Rent properties. LGs would still be an important partner in such a transaction, as they could provide the necessary zoning, land and/or supporting infrastructure. It has also been suggested that a blended finance option for such projects, provided by the NHIF, could generate enough yield to be potentially attractive for investment by superannuation funds.
- NHIF financing could also partner directly with state and territory governments and/or their Government Business Enterprises, given that they often own some of the enabling infrastructure for housing development.
- It is not anticipated that NHIF financing will be directly available to developers.

» **Another issue that has been raised concerns the potential implications of NHIF investments for value uplift.**

- The NHIF will be partnering with LGs to assist housing developments to become viable, potentially increasing the value of those developments and the potential gains enjoyed by their owners. Governments use a range of value capture methods to recoup some of these gains, and it has been suggested that consideration be given to how the NHIF may interact with such schemes. Doing so would be consistent with Infrastructure Australia's recommendation that governments routinely consider value capture opportunities in all future public infrastructure investments.[12]

12 Infrastructure Australia, 2016 *Capturing Value: Advice on making value capture work in Australia.*

Ivanhoe Estate, New South Wales

The redevelopment of Ivanhoe Estate in Macquarie Park NSW is part of the NSW Government's Communities Plus program that will deliver a new integrated community of private, social and affordable housing. The project is a partnership between the NSW Government and the Aspire Consortium, consisting of the CHP, Mission Australia Housing, and private developers. The project will deliver 3,000 dwellings including at least 950 social housing units (replacing the existing 259) and 128 affordable rental units, supported by infrastructure such as schools, pre-schools or community hubs. The NSW Government will provide the land for the development and Mission Australia Housing will manage the social housing dwellings. The private sector partner will fund, manage and build the project.

Section 3: Issues for consideration

Treasury welcomes feedback on the issues raised in Section 3, including on:

1 **Infrastructure** — Noting the examples identified in **Table 4**, what types of infrastructure do LGs fund, deliver and own? What types of infrastructure could be prioritised to address infrastructure bottlenecks?

2 **Design features** — Are the design features appropriate, including the considerations that the NHIF could take into account when assessing projects?

3 **Financing options** — Are the types of tailoring potentially available under the NHIF's three types of finance sufficiently flexible?

4 **Metrics** — What metrics could enable assessment of infrastructure bottlenecks and housing supply and affordability pressures?

5 **Financing arrangements** — Could the NHIF expand 'eligible applicants' to include a consortium of investors, such as institutional investors, social impact investors, CHPs and other stakeholders (for example, state and territory governments)? In addition, what could a partnership with LGs involving a NHIF equity injection look like? Are there further opportunities for aligning the interests of investors and other stakeholders to create incentives for co-investment to accelerate housing developments? Given the long lead times associated with the infrastructure construction, what are the appropriate repayment timeframes (on the loans and equity)?

6 **Complementarity** — Given existing state and territory lending facilities, how can the NHIF position itself so that it complements state and territory financing schemes and private sector finance options?

7 **Affordable housing** — Should the NHIF also focus on facilitating the supply of affordable housing, including for key workers? If so, what is the most effective way to achieve this objective?

8 **Value uplift** — How should the NHIF factor value uplift and associated value capture schemes into its investment decisions?

4 The affordable housing bond aggregator

The NHFIC will also operate an affordable housing bond aggregator designed to provide cheaper and longer-term finance to CHPs.

CHPs are an important part of the Australian housing system. They provide accommodation services for social housing, managing public housing on behalf of state and territory governments. They also own their own stock of housing, which they offer to eligible tenants at below market rents. CHP tenants range from people on very low incomes with rents set at a proportion of their income (generally 25 to 30 per cent) to tenants on low to moderate incomes with rents set below the relevant market rates (usually set at 75 to 80 per cent of market rents).

Many CHPs (over 300) are registered either under the National Regulatory System for Community Housing (NRSCH) or other state and territory regulatory regimes (which is the case in Victoria and Western Australia).

Although the community housing sector has grown over recent years, it remains relatively small at around 80,000 properties (less than 1 per cent of all residential dwellings) in 2016.[13] This is compared to more than 2.8 million properties (around 10 per cent of all residential dwellings) in the United Kingdom in 2015.[14]

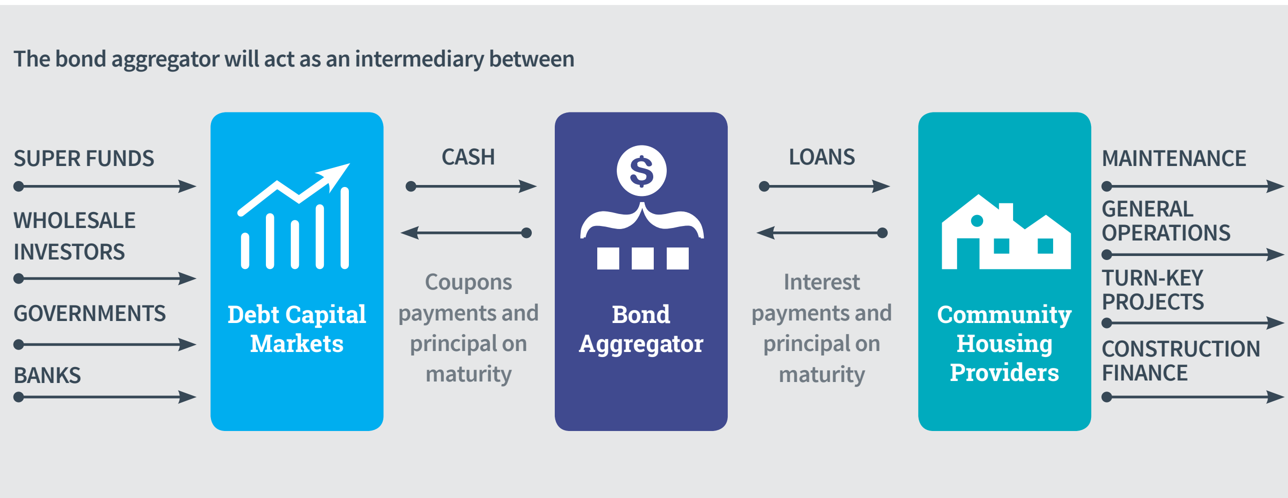
There are substantial barriers to the community housing sector achieving the scale and capability necessary to meet current and future demand for affordable rental accommodation. These include the fragmentation of the sector, its limited financial capability (including the degree of financial sophistication), and the funding gap — the inability of sub-market rental revenues to cover the costs of providing affordable housing — which constrains the extent of services that CHPs can offer.

Bond aggregator model

The bond aggregator aims to assist in addressing the financing challenge faced by the CHP sector. It improves efficiency and scale by aggregating the lending requirements of multiple CHPs and financing those requirements by issuing bonds to institutional investors.

The bond aggregator will act as an intermediary between CHPs and wholesale bond markets, raising funds on behalf of CHPs at potentially lower cost and over a longer term than traditional bank finance (which generally offer three to five-year loan terms). This structure will provide CHPs with a more efficient source

Diagram 2: Potential bond aggregator structure



13 Australian Housing and Urban Research Institute, 2017, *Ready for growth? Inquiry into Australia's affordable housing industry capacity*. Australian Bureau of Statistics, 2017, *Residential Dwellings: Values, Mean Price and Number by State and Territories*.

14 UK Department for Communities and Local Government, 2017, Housing Statistics, Table 102: By tenure, Great Britain (historical series); Table 108: By tenure, Northern Ireland (historical series) (extrapolated).

of funds, reduce the refinancing risk faced by CHPs and will reduce their borrowing costs. This should enable CHPs to invest more in providing social and affordable rental housing.

However, the bond aggregator alone will not close the funding gap experienced by CHPs. This will require ongoing support from all levels of government. In their respective reports, the AHWG[15] and Ernst and Young[16] (EY) both highlight the important role of the bond aggregator, while noting that it is only a partial solution to closing the funding gap for CHPs.

Key findings of the EY report

Analysis undertaken by EY for the Affordable Housing Implementation Taskforce in 2017 found that an affordable housing bond aggregator is a viable prospect in the Australian context and recommended a number of design features (see Box 1). EY found that a bond aggregator could potentially provide longer tenor and lower cost finance to CHPs. The interest savings could be in the order of 0.9 to 1.4 percentage points for 10-year debt (depending on the level of Government support).

Furthermore, EY estimated that the CHP sector will need to access around $1.4 billion of debt over the next five years, which should provide the necessary demand and scale needed to support affordable housing bond issuances.

Box 1: Summary of key recommendations of the EY report, *Establishment of an Australian affordable housing bond aggregator*[17]

1. **Eligibility** — The bond aggregator should be established as part of the NHFIC, noting CHPs are likely to be the primary agents to maintain and expand the stock of affordable housing.
2. **Domestic wholesale bonds** — The bond aggregator should issue wholesale bonds, as opposed to retail bonds, into the Australian domestic capital market. This is the most efficient approach and will create the greatest investor demand.
3. **Bond issuance size** — The minimum size for an initial wholesale bond issuance should be around $100 million.
4. **Pass-through model** — The bond aggregator should operate on a 'pass-through' model where CHP borrowing requirements are matched to the funding sourced through the wholesale bond market. (A similar pass-through model has operated successfully for many years in the United Kingdom.)
5. **Loan purpose** — The bond aggregator should provide CHP borrowers with general corporate debt finance.
6. **Government guarantee** — Subject to the outcomes of potential regulatory changes concerning security arrangements over affordable housing in the event of a default, it may not be preferable for the Government to guarantee the bond aggregator's issuances. Alternatively, an explicit guarantee would provide greater investor confidence and also deliver an enhanced pricing advantage for CHPs.

15 AHWG, 2017 *Supporting the implementation of a housing bond aggregator.*

16 Ernst and Young developed the report, *Establishment of an Australian affordable housing bond aggregator*, for the Affordable Housing Implementation Taskforce (AHIT), which comprised an Expert Panel. The AHIT was established on 10 March 2017 following the recommendations of the AHWG Innovative Financing Models report which was endorsed by Treasurers at the Council on Federal Financial Relations in late 2016. The EY report is available on the Commonwealth Treasury website.

17 The full version of the recommendations is available on page 9 of the EY Report *Establishment of an Australian affordable housing bond aggregator*.

SECTION 4.2

Proposed design features of the bond aggregator

Drawing upon the EY analysis, Table 7 sets out proposed key design features to guide the lending and borrowing practices of the bond aggregator.

Elaborating further on some of these design features, it is envisaged that CHPs would be registered and assessed at the Tier 1 and Tier 2 levels under the NRSCH[18] (and their equivalents in Victoria and Western Australia) in order to be eligible for a bond aggregator loan. As EY noted, this is because Tier 1 and Tier 2 CHPs are more likely to have the scale and financial capability to utilise debt to expand their operations. While it is expected that the bond aggregator will only lend to registered Tier 1 and Tier 2 CHPs, this does not preclude other not-for-profit or private entities that access alternate forms of government assistance from partnering with CHPs to indirectly utilise the bond aggregator. For example, Treasury is aware of situations where Specialist Disability Accommodation recipients have partnered with CHPs to fund property construction and provide property management services.

Table 7: Proposed key design features of the bond aggregator	
Lending	
Terms of loans	The bond aggregator would have the flexibility to offer a range of financing options to CHPs. It is expected that the preference would be for medium-to-long-term tenor, interest-only loans with fixed interest rates. As an interim measure, EY also suggested the possibility of the bond aggregator offering a 'warehousing facility'. This facility would provide short-term finance (up to one year) at variable rates. The interest rates on loans would be consistent with a pass-through model, with rates reflecting the bond aggregator's borrowing costs plus a margin to cover administrative costs. A risk premium would also be applied to higher-risk loans at the discretion of the NHFIC Board.
Purpose of loans	Loans would be for 'general corporate debt' facilities. The NHFIC Board would have the discretion to determine what the loans are used to fund, but the expectation is that bond aggregator funds would primarily be used for refinancing and turn-key (i.e. post-construction phase) projects. The aim would be to complement and partner with existing private and public sector financiers.
Eligibility	Loans would be provided to CHPs that are registered as Tier 1 or Tier 2 providers under the NRSCH (or their equivalent in Victoria or Western Australia). Eligible CHPs would also have to meet the bond aggregator's cash flow and security requirements. These additional requirements would be determined by the NHFIC Board.
Security	Loans to eligible CHPs would be provided on a secured basis over the CHPs assets. Security arrangements would be determined by the NHFIC, consistent with existing security arrangements between CHPs, state or territory governments and private financiers. Inter-creditor arrangements may be required when a CHP has other borrowings.
Bilateral contracts	Loans to CHPs would be offered on a bilateral basis.

Table 7: Proposed key design features of the bond aggregator (continued)	
Borrowing	
Wholesale issuance	The NHFIC would issue bonds to wholesale investors. Wholesale bond markets are deeper and have different regulatory requirements than retail bonds, which lowers potential costs.
Domestic issuance	The NHFIC would be expected to issue bonds in the Australian market. Domestic market investors are most likely to purchase affordable housing bonds and issuing bonds in Australian dollars reduces potential transaction costs. However, the NHFIC would wish to retain flexibility to undertake offshore bond issues if this provided necessary additional benefits.
Tenor	The NHFIC Board will determine the tenor of its bonds subject to prevailing capital market conditions. EY analysis indicates a 10-year bond may be appropriate in the current Australian market context.
Repayment terms	Interest-only 'bullet' bonds are conventional in the Australian debt capital market. Amortising bonds are uncommon.
NHFIC credit rating	NHFIC would obtain its own 'standalone' credit rating from a recognised international ratings agency to provide assurance to investors and assist in enhancing the pricing of NHFIC bond issuances.

It is envisaged that bond aggregator loans to CHPs would be for 'general corporate debt' facilities. This would enable CHPs to use the loan funds for a range of purposes, including 'take-out' or 'turn-key' finance, maintenance and business administration costs. The potential longer-term loans offered by the bond aggregator will enable CHPs to better match their liabilities with their housing assets and management services.

Bond aggregator lending could also potentially be used to finance construction of new affordable housing stock by CHPs. However, given that construction-phase finance is generally higher risk, this would require the CHP to ensure appropriate security was available. Construction-phase finance also tends to be for a shorter period and banks would appear to be better placed to provide such finance given their existing expertise in assessing and managing construction credit risk.

The Australian Government has not taken a decision on whether to provide a guarantee on bonds issued by the bond aggregator. In coming to a decision, it will take into consideration feedback from stakeholders, the EY bond aggregator report and advice from the Expert Panel to the AHIT.

18 In all Australian states and territories except Victoria and Western Australia, CHPs are registered under the NRSCH in one of three tiers of registration. According to the NRSCH, registrars determine a CHP's tier by assessing the level of risk, by reference to the scale and scope of activities. The registration tier determines the performance requirements and intensity of regulatory engagement by the NRSCH. Victoria and Western Australia have separate regulatory and classification arrangements for CHPs. It is anticipated that Victorian Housing Providers and Western Australian Growth Providers and Registered Providers would be eligible for bond aggregator loans. While registration would be a relevant consideration of the NHFIC in determining whether to make a loan to a CHP, it is expected that the NHFIC will apply additional methods of credit assessment and due diligence as part of its processes.

A guarantee would mitigate much of the uncertainty for investors and also deliver a lower borrowing rate to CHPs. EY analysis suggests that a Government guarantee could reduce by up to 50 basis points the interest rates that CHPs would otherwise pay from the bond aggregator (subject to competitive neutrality considerations). However, the guarantee would transfer financial risk to the Australian Government.

The bond aggregator has the potential to attract large-scale institutional investment in the CHP sector. However, as noted by the AHWG bond aggregator report, in order to fully leverage this potential it is important to ensure that the community housing sector has the necessary financial, asset and risk management expertise.

As part of its initial establishment phase, there could be scope for the NHFIC to use other Commonwealth services (such as advisory support services delivered through the Department of Industry, Innovation and Science) to help build the financial capability of CHPs.

This could complement the proposals of the AHWG bond aggregator report to develop a uniform national CHP regulatory framework (including strengthened financial regulation) and update the existing National Industry Development Framework for Community Housing.

Section 4: Issues for consideration

Treasury welcomes feedback on the issues raised in Section 4, including on:

1 **Eligibility** — It is currently envisaged that the bond aggregator will only provide loans to Tier 1 and Tier 2 CHPs. Could there be benefits to expanding the eligibility criteria to include other stakeholders involved in the provision of affordable housing?

2 **Purpose of loans** — The bond aggregator's loans are expected to be primarily used for funding housing maintenance and turn-key purchases. Do stakeholders agree with this focus? Is there scope for the bond aggregator to provide construction finance or should the bond aggregator be prevented from providing such finance?

3 **Security for loans** — What forms of security should CHPs be asked to provide to access bond aggregator loans? Are there any circumstances where such loans could be unsecured? If security is provided, to what extent should it be collateralised against other assets owned or operated by the CHP? What forms of financial covenants from CHPs should exist alongside any security? If a CHP has multiple secured creditors, how should the security in favour of the bond aggregator rank?

4 **Complementarity** — How could the Government ensure that the bond aggregator complements and partners with existing private and public sector investment into CHPs?

5 **Bond issuance** — Could affordable housing bond issuance be expanded to the offshore market or the retail bonds market? What are the potential benefits and costs?

6 **Bond issuance size** — What is the likely preferred issuance size for large-scale institutional investors?

7 **Contracting out functions** — Are there potential benefits from contracting out bond issuance and back-office functions? What are the potential costs?

8 **Government guarantee** — How would a potential Government guarantee on NHFIC bond issuances impact the NHFIC's ability to raise and price funds? What are the risks associated with applying a guarantee and how could those risks be mitigated?

Appendix A: Glossary

Term	Definition
AHIT	The Affordable Housing Implementation Taskforce was established to design a proof of concept for a bond aggregator model. The Taskforce was guided by an Expert Panel and was informed by the EY report.
AHWG	The Affordable Housing Working Group was established by the Council on Federal Financial Relations to identify potential financing and structural reform models that increase the provision of affordable housing (social housing and housing in the private rental market) for those on low incomes. It comprises the Commonwealth Treasury and Department of Social Services, as well as members of the Victorian, New South Wales and Western Australian governments.
AHWG bond aggregator report	The Affordable Housing Working Group report *Supporting the implementation of a housing bond aggregator* was released on 22 September 2017.
Community Housing	Rental housing provided by not-for-profit and non-government organisations to assist people who are unable to access suitable accommodation in the private rental market.
CHPs	Community Housing Providers, not-for-profit and non-government organisations that provide community housing.
EY Report	The report prepared by Ernst and Young for the Affordable Housing Implementation Taskforce, *Establishment of an Australian affordable housing bond aggregator*.
Housing-related infrastructure	Examples of housing-related infrastructure include: » new or upgraded to existing infrastructure for services such as water, sewerage, electricity or transportation; and/or » site remediation works including the removal of hazardous waste or contamination.
LGs	Local governments
NRSCH	National Regulatory System for Community Housing. The regulatory system for CHPs in all states and territories except Victoria and Western Australia. CHPs are registered under the NRSCH in one of three tiers of registration. Registrars determine a CHP's tier by assessing the level of risk, by reference to the scale and scope of activities. The registration tier determines the performance requirements and intensity of regulatory engagement by the NRSCH.
PGPA Act	*Public Governance, Performance and Accountability Act 2013*
Public Housing	Rental housing provided by state and territory government organisations to assist people who are unable to access suitable accommodation in the private rental market.
Social Housing	Rental housing provided by not-for-profit, non-government or government organisations to assist people who are unable to access suitable accommodation in the private rental market. Comprises community housing and public housing.
Tier 1 CHP	CHPs that are involved in activities at a higher level of risk. They operate at a large scale, meaning any serious non-compliance has the potential to impact on a large number of tenants and assets. They manage ongoing developments at scale, meaning that any serious non-compliance has the potential to affect the viability of the provider.
Tier 2 CHP	CHPs that are involved in activities that have a lower level of risk than a Tier 1 provider but has the potential to impact on a moderate number of tenants and assets. They manage ongoing developments on a small scale, meaning any serious non-compliance has the potential to affect the viability of the provider.