6 January 2021

VIC and National Office
L22, 130 Lonsdale St
Melbourne 3000
PO Box 24231
MELBOURNE VIC 3001
P: (03) 9910 0200
F: 1300 228 739

Manager – Attention Will Devlin
NHFIC Act Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600
NHFICSecretariat@treasury.gov.au

Dear Sir / Madam

Review of the National Housing Finance and Investment Corporation Act 2018 ('the Review')

Cbus welcomes the opportunity to provide feedback on the Review of the National Housing Finance and Investment Corporation (NHFIC).

Background

Established in 1984, Cbus is the industry superannuation fund for the built environment. Cbus recently received recognition for its 11 years as a platinum rated fund by independent ratings agency SuperRatings. Cbus is run only to benefit members.

Cbus also invests back into the construction and building industry, which not only provides strong long-term investment returns, but helps boost our economy and create jobs within the industry.

As at 30 June 2020, Cbus has over:

- 774,000 members
- 157,000 employers
- $54 billion in funds under management.

Cbus is one of the best performing superannuation funds in Australia, with investment performance of 8.98% per annum since inception in 1984. Annual returns for the Growth (MySuper) option over financial year 2019/20 was 0.75%, compared to -0.92% for the median return in the SuperRatings SR50 Balanced Survey. Annualised returns (to 30 June 2020) for the Growth (MySuper) option was 7.13%, 8.49% and 8.54% over 5, 7 and 10 years, respectively.

Housing

Access to secure and affordable housing is an important part of ensuring a dignified and comfortable retirement. Cbus believes that superannuation funds can, and should, play a role in helping to improve the supply of affordable housing for Australians through funds investing in this area. Super funds could provide an important source of capital to partner with government to help resolve this longstanding policy issue which affects so many Australians.

In our view, to address housing affordability it is necessary to tackle issues around supply and as the Australian population increases, we need to build more dwellings and more infrastructure.

ACT
2 Badham St
Dickson 2602
P: (02) 6103 6046

NSW
L25, 44 Market St
Sydney 2000
P: (02) 8027 3515

NT
L1, 29 Daly St
Darwin 0800
P: 0419 555 261

QLD
L3A, 300 Adelaide St
Brisbane 4000
P: (07) 3638 6123

NORTH QLD
448 Flinders St
Townsville 4810
P: 0419 142 761

SA
Ground Floor,
50 Flinders St
Adelaide 5000
P: (08) 7223 2125

TAS
PO Box 2001
North Hobart 7002
P: (03) 9910 0309

WA
L1, 82 Royal St
East Perth 6004
P: (08) 6430 4201

As a large-scale investor Cbus is interested in playing a role in helping to deliver positive housing outcomes for Australians. Cbus is a patient provider of capital with a strong focus on the sustainability and innovation of the investments we make, with a particular emphasis on the built environment.

Cbus is also somewhat uniquely placed to finance and deliver assets that contain a mix of infrastructure and property characteristics with the in-house investment team having extensive equity and debt expertise in the Australian market and through the ability to partner with wholly-owned property developer Cbus Property.

Cbus has been active in discussions around affordable housing area for many years and was a strong advocate for the establishment of NHFIC and the bond aggregator concept. NHFIC play a role in providing funding to community housing providers (CHPs) for the construction of new dwellings.

Return for risk

Given its nature, investments in 'affordable housing' do not generally generate the same risk-adjusted returns as investments in other types of real estate given their role in the broader social and economic policy framework. Some form of Government contribution is typically required to bridge the gap between non-commercial and commercial returns.

The Government Guarantee provided for NHFIC is an important factor in the success that NHFIC has had in placing bonds into the capital markets. With only a contingent liability on the Australian Government's balance sheet, the NHFIC funding is an important mechanism to deliver longer-term, cheap funding to the affordable housing providers, thus allowing them to operate more effectively and to generate greater levels of housing stock through time.

Investment

Cbus has been pleased to support all three bond issuances made by NHFIC and currently holds bonds of over $88 million. In other activities, NHFIC and Cbus recently announced a joint debt funding package to be made available to support the NSW Land and Housing Corporation (LAHC) in a leading-edge pilot program to deliver new social and affordable housing in NSW.

It is the current intention of Cbus to continue to support future bond issuances by NHFIC and to continue to explore further ways of working with NHFIC and CHPs to deliver new housing supply to Australians, whilst also ensure we are meeting our obligation in respect to the best possible retirement outcome for our members.

Our detailed comments in respect to the items raised in the Review are attached. Please contact Brett Chatfield, Deputy Chief Investment Officer on +61437219671 if you have any queries in relation to our submission.

Yours faithfully,

Justin Arter
Chief Executive Officer

Cbus Submission on the Review of NHFIC

This submission is in response to the Issues Paper released in December 2020 in relation to the operation of the National Housing Finance and Investment Corporation Act 2018 (the Review).

Executive summary

The NHFIC AHBA should be continued under the current arrangements, including the Government Guarantee.

The Liability Cap should be increased to assist the CHP sector to reduce the current shortfall in social and affordable housing.

Cbus envisages continued support for future bond issuances undertaken by NHFIC should the Government Guarantee remain in place.

Summary of Questions raised in the Review

1. Impact of NHFIC on the Community Housing Provider Sector

Consistent with the terms of reference, the Review invites interested parties to comment on the effectiveness of the Bond Aggregator, giving consideration to the impact of NHFIC on:

- the CHP sector's access to finance – including whether NHFIC has generated a more efficient source of funds, reduced refinancing risks, and reduced borrowing costs; and
- the scale and prominence of CHP sector delivery of sub-market rental housing – including through partnerships with the private sector and institutional investors.

Cbus comments

Savings made by CHPs

- NHFIC has stated in their report the savings made by CHPs[1] having access to funding via the AHBA.

Source of funding for CHPs

- We do not believe that the appetite by bank lenders to provide long tenor funding (long tenor being considered a term of longer than five / seven years) for businesses generally, and specialist business such as CHPs, has changed since the EY report[2] was undertaken in 2017. In fact, the recent COVID-19 Pandemic has probably further limited the tenor or tightened the terms and conditions on which funding is provided.

  The combination of economic uncertainty and the requirement for increased capital to be held by banks to support longer tenor funding means that bank appetite, if at all, will be focused on shorter tenor funding.

- We also believe that bank lenders will become more active in the funding market for CHPs

[1] https://www.nhfic.gov.au/media/1434/nhfic-social-bond-report-2019-20-website-version.pdf

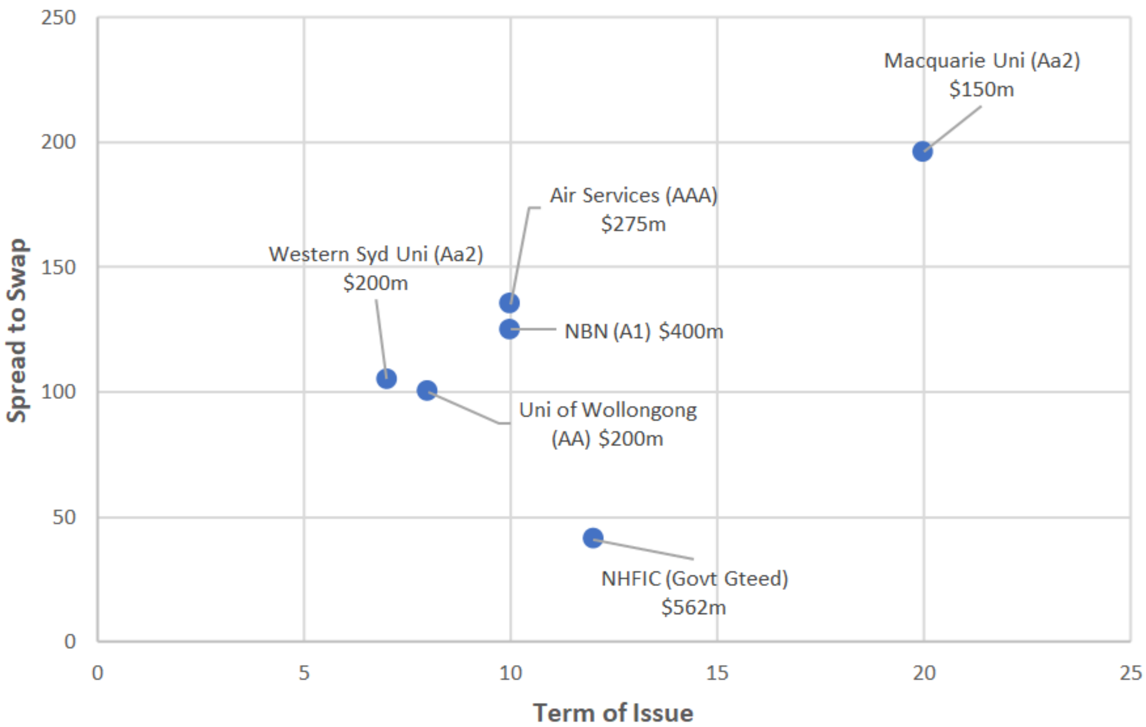
[2] 'Establishment of an Australian affordable housing bond aggregator', Ernst & Young Global Limited, 21 September 2017.

as a result of NHFIC's activities. It is likely that banks will seek to provide construction funding to CHPs with an expectation, or potentially they may seek a firm commitment from NHFIC, to refinance the CHP upon completion of the new dwellings. Whilst we would argue a preference for NHFIC to earn the higher income available from undertaking construction funding, at a minimum, we would like to see NHFIC recognised for its role in providing the take-out finance which makes this bank funding possible.

Reduced borrowing costs for CHPs

- NHFIC last priced a bond in the capital markets on 24 June 2020. The bond was issued for a term of 12 years maturing on 29/6/2032. The all up yield was 1.41% p.a. – this represented a spread of approximately 0.38% p.a. over Government bonds and 0.41% p.a. as a spread over swap.
- In comparison, Airservices Australia – an entity which is AAA rated but does not carry an explicit Government Guarantee, priced a 10-year bond on 19 May 2020 at an all up yield of 2.20%. The spread over swap at the time of issue was 135bps. Whilst the lack of a Government Guarantee is the principal reason for the spread differential, it is also noted that Airservices Australia is an infrequent issuer in the capital markets, which can also have impact on credit spread.
- The following chart shows some highly rated bonds issued during 2020. Tenor has been challenging during 2020, and it was noted that the two universities shown on the following chart did undertake market soundings about longer tenor bonds issuance but ultimately only proceeded with tenors of seven and eight years.

Chart 1: New Issue Spread Comparison



Source: Bloomberg and Westpac data

- Having successfully launched three social bonds, NHFIC is well placed to continue to issue further bonds and achieve both volume and market pricing, at a relatively small spread over Government issued bonds of a similar tenor.

2. Increasing private investment in housing

Consistent with the terms of reference, the Review invites submissions regarding the effectiveness of NHFIC in attracting private investment in housing. In particular, the Review will consider:

- The impact of NHFIC on improving the attractiveness of affordable housing as an asset class for private investment; and
- NHFIC's role in facilitating additional investment in housing, including social and affordable housing.

Cbus Comments

Affordable Housing as an Asset Class

- Affordable housing will continue to be a challenging asset class for private investment unless there is certainly about how the return gap will be met for investors (subsidy / tax credits / NRAS style payments etc.), as well as certainty around the regulatory environment and the ability to scale investments to a material size over time
- We consider that the best place for any subsidies to be directed is to CHPs. CHPs being allowed to cross subsidise social, affordable and market rents in a not for profit environment reduces the volume of subsidies or ensures the maximum benefit of any subsidies is achieved.

NHFIC's role in facilitating additional investment in housing, including social and affordable housing

- NHFIC and Cbus recently announced a joint debt funding package to be made available to support the NSW Land and Housing Corporation (LAHC) in a leading-edge pilot program to deliver new social and affordable housing in NSW. The funding package will see NHFIC providing debt on a senior basis and Cbus taking a mezzanine / junior debt position. The two lenders will share one security package with a priority arrangement between themselves. This package will reduce costs to the CHP by delivering a whole of debt package as well providing long tenor of debt.

  https://www.nhfic.gov.au/media-resources/media-releases/new-social-housing-to-be-delivered-in-innovative-partnership/
- This funding package sees NHFIC providing construction funding followed by term funding. The Cbus facility includes construction funding as well as term funding of 10 years post completion of the construction. It is hoped that the provision of the mezzanine debt facility will address the lack of equity that CHPs have available to contribute to projects of this nature. As the successful CHP will have the right to manage the properties for a 49 year period, the expectation is that the cash flows from the properties will grow and be sufficient such that, the overall debt level that is in place at the expiry of initial term debt funding will be able to be refinanced on NHFIC's standard terms and conditions. The Cbus facility thus provides gap funding during the initial period.
- For Cbus to continue to participate in debt opportunities, the inclusion of full market rental

properties to support cash flow, enabling interest and principal repayments to be made, is seen as critical. In addition, we see strong merit in mixed-use developments, which promote greater social cohesion.

3. The Government's guarantee of NHFIC's liabilities

Consistent with the terms of reference, the Review invites submissions to comment on the suitability of the liability guarantee and the associated Liability Cap, considering its resulting impact on the CHP sector, Commonwealth's finances and the functioning of private capital markets.

Cbus Comments

Government Guarantee

The Government Guarantee provides an efficient funding source and reduced borrowing costs for CHPs, whilst only resulting in a contingent liability to the Federal Government and taxpayers.

Importance of Government Guarantee to investors

- The Australian Government guarantee is an important factor in our ability to invest in the bonds issued by NHFIC. Our fixed interest portfolios consist primarily of Government bonds, or bonds with Government guarantees. We would expect this to also be the case with many other investors. Should the guarantee no longer be available on new issuances, this would likely materially reduce the universe of potential investors.
- Without a guarantee, it would not be possible for NHFIC to obtain the pricing relative to Government bonds that it currently pays on its bonds. Individual CHPs, even with credit ratings, would not be able to achieve the low pricing currently achieved.
- Without a guarantee, NHFIC as an issuer would be considered to be corporate credit risk, not sovereign risk, and from our perspective would only fit in our credit sector. The credit sector has a higher return target (bank bill index plus 2% p.a.) and prudently places limits on exposure to individual issuers.

Low likelihood of NHFIC calling on the Government Guarantee

- The Australian Government Guarantee would only be called upon if a CHP defaulted and NHFIC was unable to fully recover on the loan it had provided to the CHP, and NHFIC held insufficient reserves to cover that loss.
- Default is unlikely due to NHFIC's knowledge of, and strong relationships with CHPs across Australia, its prudent lending criteria and the strong regulatory framework for CHPs.
- In the unlikely event of a default caused by an idiosyncratic event, it is likely that NHFIC would be able to recover its debt via sale / transfer of the assets of a defaulting CHP to another CHP.

Liability Cap – additional funding is needed for new dwellings

The Liability Cap should be increased to enable construction of new dwellings, especially given the stimulus programmes being announced by various State Governments in response to COVID-19. Current debt in CHPs is not the key to determining the cap needed. CHPs need to be encouraged to borrow to build new dwellings.

- Construction funding and cash flow lending being provided by NHFIC is a game changer to get new dwellings into the sector. NHFIC are approaching construction funding in a similar manner to an infrastructure project would be assessed, with the amount of funding available determined by forecast cashflows. Whilst refinement of NHFIC's lending criteria could assist in releasing additional funding to the sector, it is noted that the relatively lower level of funding support for social housing does limit funding available.

- If stimulus projects by State or local authorities eventuate, a lift in the Liability Cap would assist NHFIC to be positioned to support those projects at a time that funding is available.
- A lift in the Liability Cap and a resulting increase in lending to CHPs, will also assist NHFIC to be self-funding by generating sufficient revenue to both recover operating costs but also to build its capital and reserves portfolio to support that lending.
- CHPs continue to be best placed to provide any form of subsidised (below market) housing. In many regards, CHPs are the original Australian 'build to rent' investor. By developing mixed tenure properties CHPs are trying to solve for the low level of funding available for social, and for providing affordable accommodation, by also providing full market rental properties. Some CHPs sell properties at market rates, rather than holding as rental properties to enable them to reinvest funds into social and affordable accommodation.
- Any 'for profit' organisation has responsibilities to members / shareholders and whilst there may be some altruistic investors who will accept a below market return, we expect that they will be limited to token investment.
- We fully support NHFIC funding being only available to registered CHPs and not for other investors. This should ensure 'for profits' don't benefit from the lower funding available to CHPs.

Functioning of private capital markets

Funding appetite for CHPs by the private sector is still constrained by the risk of adverse publicity associated with the failure of a CHP and needing to rely on asset security for repayment of the loan. Other challenges include:

a) Lack of freehold title security;

b) restriction on title around use of property for social housing;

c) constraints due to low level of rental income and available subsidies; and

d) conservatism of the Board of the CHP and reluctance to borrow.

Conclusion

After many years of discussion of the merits of an affordable housing bond aggregator, the Government pleasingly announced the establishment of NHFIC in the 2017-18 Budget. NHFIC launched its first bond in March 2019. To date, NHFIC has issued bonds with a total face value of just under $1.2B, providing important core funding to the CHP sector at a low cost and extended tenor. Importantly, a NHFIC Debt Investor Presentation provided to investors to support the June 2020 AHBA launch noted that 1,700+ new dwellings had been supported by the AHBA in transactions approved by NHFIC Board as at 3 June 2020. This has provided the sector with greater certainty of costs to enable commitment to develop new dwellings. The CHP sector will most certainly provide submissions to Treasury on the shortfall of social and affordable housing and the need for CHPs to find attractive funding to fill that shortfall.

The NHFIC AHBA, having only just started, should be continued under the current arrangements, including the Government Guarantee and the Liability Cap should be increased to enable that shortfall to be constructed.

Cbus envisages continued support for future bond issuances undertaken by NHFIC should the Government Guarantee remain in place.

We do see over time that the Government Guarantee could be lifted on future issuances, similar to what now exists with the equivalent provider in the UK, however, this is some way off with NHFIC needing to build up a longer track record before market participants would have sufficient comfort with the entity on an unguaranteed basis.