UNSW AUSTRALIA

Never Stand Still | Built Environment | City Futures Research Centre

Submission to the Council on Federal Financial Relations Affordable Housing Working Group

Vivienne Milligan, Judith Yates and Hal Pawson

March 2016

Introduction

City Futures Research Centre (CFRC) at the University of New South Wales welcomes the opportunity to make this brief submission to the Council on Federal Financial Relations Affordable Housing Working Group on its recent Issues Paper.

CFRC is a leader in research into affordable housing provision in Australia. CFRC researchers have variously led and partnered in research projects, including for the Australian Housing and Urban Research Institute (AHURI), that have produced a substantial body of research that documents the evolution of Australia's nascent affordable housing industry, investigates the perspectives of private sector financial institutions (especially institutional investors) on affordable housing investment, considers the local applicability of international developments in affordable housing policy and practice, and puts forward financing mechanisms and associated policy and regulatory frameworks to support the growth of the affordable housing industry. The housing loan/bond aggregator model considered in the Working Group's Issues Paper is the result one of these research projects.

Drawing on this body of evidence, this submission sets out:

- some fundamental principles to be considered in developing and implementing an innovative financing regime for the Australian affordable housing industry;
- recommendations to Australian governments that, taken together, have been designed to enable development and implementation of new public and private co-financing arrangements to underpin the growth of affordable housing, especially to attract institutional investors at scale; and
- (as appendices) a digest of research as it relates to affordable housing finance which CFRC has led or participated in with university colleagues and a summary of affordable housing financing mechanisms used by governments across Australia and internationally.

Principles for affordable housing policy and finance

We submit that it is crucial to the success of affordable housing finance reform to first get the wider policy architecture right. From our research, we put forward the following principles for affordable housing policy – of which principles for affordable housing finance are one part:

1. Clear and measurable affordable housing policy objectives and outcomes are legislated or otherwise officially established;
2. A robust housing needs analysis informs government and providers of the range, mix and priority of needs and is used to drive an appropriate range and balance of responses with different levels of subsidy;
3. The various government agencies with an interest in affordable housing are co-ordinated by effective leadership;
4. Planning for affordable housing at national, state-wide and sub-regional levels is well integrated with housing supply and financing plans;
5. Well-governed, well-performing agencies are available to procure and manage housing;

6. Finance mechanisms, including durable subsidy programs and well-regarded specialist agencies, are in place to attract private investment at scale, promote cost-effective fundraising and guide allocation to proven and qualified providers.
7. Government land is made available for affordable housing development either at a discounted price or subject to clearly specified developer obligations regarding affordable housing provision;
8. Affordable housing supply is monitored to ensure transparency and accountability against targets;
9. Preservation of affordable housing is given explicit policy consideration.[1]

Specifically as regards point 6 – affordable housing finance – the research indicates a further set of principles. While both options 1 and 2 in the Issues Paper have the potential to meet requirements for an affordable housing financing system, we submit that there is no single best funding model for affordable housing. Historic policy settings and institutional factors in different countries, along with the particular characteristics of regional housing markets and market cycles, all have a strong influence on the political, financial and practical viability of different financing options. However, some key principles can be suggested to inform the development of a local funding model founded on public and private co-financing:

- The social goals and outcomes required of private affordable housing providers in return for government investment must be established clearly. The social purpose (who is eligible, at what rent, what other social outcomes are required – e.g. reduced social exclusion, increased economic participation etc.) has a key bearing on the appropriateness and viability of different financing options. This relationship between financial viability and social purpose must be clearly understood and determined at the outset. Unless this is clearly resolved, social outcomes may be compromised by viability considerations or governments may be called on to provide additional subsidies. However, expected outcomes should not be so tightly prescribed as to create unreasonable risks for providers or stifle the potential for innovation and entrepreneurship;
- Affordable housing providers need predictability and certainty of funding to operate efficiently, to retain specialised capacity, to optimise strategic asset management planning and to manage risk effectively;
- Similarly, governments (and providers) need to demonstrate to potential private investors that the environment for investment will have scale and will be sustained and predictable (thereby reducing the risks that investors might be left with stranded assets). In the early years this could include governments taking a lead role to support new approaches and build track record;
- Subsidies or other mechanisms that underpin provider revenue streams must be secure and predictable to avoid downstream risks to governments of unfunded liabilities arising or the loss of housing/tenancies. In the Australian context the payment of CRA is critical and suggests the need for Commonwealth Government engagement with any strategy;
- Leakage of subsidies should be minimised through policy design (e.g. offering positive incentives for households to increase their contribution to meeting their housing costs; ensuring retention of affordability benefits etc);

[1] Adapted from Milligan, V., Gurran, N., Lawson, J., Phibbs, P. & Phillips, R. (2009) *Innovation in Affordable Housing in Australia: Bringing Policy and Practice for Not-for-Profit Housing Organisations Together*, AHURI Final Report 134 (Melbourne: AHURI)

- Government investment must be secured in a way that does not constrain private finance (i.e. is acceptable to private lenders);
- Private sources of finance must be driven to the lowest possible cost to minimise subsidies for particular target group. Having efficient fund raising mechanisms –e.g. government guarantees or mortgage insurance – to underwrite lender risk; reducing compliance and transaction costs; having information and financial expertise in /or close to government; and adjusting the weight given to different financial levers under shifting financial and property market conditions – e.g. lower or higher interest rate environments – will be key aspects of effective policy; and
- Investors and providers must be regulated appropriately to reduce risks, ensure accountability for their part in the social program and to promote both competition and innovation. As regards the current status of provider regulation in Australia there is a need for Commonwealth leadership in reviving the establishment of a genuinely national framework and in reviewing the current 'national' model to underpin a refined approach sufficiently robust to command financier confidence.

Affordable housing financing: institutional framework and next steps

Proceeding from these principles, CFRC's most recent research, *Next Moves? Expanding Affordable Rental Housing in Australia through Institutional Investment* (2015), puts forward a practical agenda for Australian governments and industry representatives, which would work towards catalysing a new residential investment market in Australia, underpinned by public and private co-financing arrangements capable of engaging institutional investors at scale.

The 10 recommendations are:

1. Given the economic and social importance of boosting efficiently and effectively managed rental housing supply, governments across Australia should recognise the untapped potential for large scale institutional investment in this sector. They should give priority to stimulating a new financing model to realise this prospect.
2. A cross-sectoral Rental Investment Task Force of key stakeholders and experts with high level policy and financing credentials should be appointed to develop recommendations for achieving target levels of institutional investment in rental housing supply, including an element affordable to low and moderate income groups.
3. An eminent private sector leader should be appointed to head the Rental Investment Task Force.
4. To facilitate the supply of newly-constructed *affordable* rental housing, a new incentive framework designed specifically for institutional players (and replacing the National Rental Affordability Scheme) should be developed for introduction by 2017.
5. State Governments should assemble and offer an initial portfolio of suitable shovel-ready sites for residential development by private and not-for-profit developers which, on letting, can be re-financed through large-scale institutional investment.
6. State governments should offer a land tax waiver for aggregated rental holdings meeting designated regulatory requirements for affordable rental.
7. Consideration should be given to the possible role of government guarantees in facilitating institutional investment in rental housing provision, to provide comfort to backers and, thus, to minimise cost of funds.

8. An independent specialist financial intermediary, such as an Australian Housing Finance Corporation, should be founded.
9. An existing or new agency should be resourced to collect, publish and maintain appropriate financial, asset and tenancy management information that will inform all industry parties about the state of the affordable housing industry and its development.
10. Tax reform options to support institutional investment in social infrastructure including affordable housing should be investigated.

Appendix 1: CFRC affordable housing financing research

Report	Purpose and Findings
Lawson, J., Gilmour, T. & Milligan, V. (2010) *International measures to channel investment towards affordable housing*	Commissioned by the WA Government, this report compared six national affordable housing financing systems (mechanisms, policies and supporting institutional arrangements) – the Netherlands loan guarantee scheme, the Swiss bond issuing cooperative, the UK Housing Finance Corporation (THFC), the US Low Income Housing Tax Credit, dedicated bond issues for affordable housing in Austria and the housing savings deposit scheme in France – chosen because of their potential applicability in Australia.
Lawson, J., Milligan, V. & Yates, J. (2012) *Housing Supply Bonds - a suitable instrument to channel investment towards affordable housing in Australia?*	This in-depth proposal for a fit-for-purpose Australian financing mechanism – Housing Supply Bonds (HSB) –was developed from the successful Austrian approach (documented in the above report). The HSB is a privately-issued, purpose-designed bond to raise long term private finance at low cost. Importantly, itis intended to attract a mixed class of investors – institutions, 'mums and dads' and government. 2012 modelling for the bond assumed NRAS as a subsidy to help address the yield gap. Following release of the report, the proposal gained substantial traction and has garnered wide support among Australian stakeholders, mostly recently in the Senate Economics References Committee report on its Inquiry into Affordable Housing (2015). However, while the yield gap may have reduced since 2012 some level of government support will be required. The HSB should not be confused with a social impact bond. While this may offer potential for supporting some housing and homelessness service aspects of social landlord functions, it is not suited to large scale financing of bricks and mortar.
Milligan, V., Yates, J., Wiesel, I. & Pawson, H. (2013a) *Financing rental housing through institutional investment – Volume 1: outcomes of an investigative panel* ____________ (2013b) *Financing rental housing through institutional investment – Volume 2: supplementary papers.*	In 2012, AHURI convened an industry expert panel to develop recommendations on attracting institutional finance into residential investment at scale in the context of policymaker recognition of the need to expand rental housing supply to accommodate the growing sections of the population excluded from both home ownership and social renting and the related increase in the numbers of households renting insecurely for longer periods. The panel proposed a policy framework and implementation plan for generating an investment market in affordable and market rental housing assets that would meet the expectations of super funds and other large investors for yield, scale and liquidity. A key recommendation was to consider adoption of an infrastructure-style financing product attractive to institutional investors (when compared to a property style investment that relies on more risky capital growth) because of its attributes as a low risk, low yield investment financed from rental revenue (cash flows). The experts further noted that such an approach would necessitate different financing solutions for the construction and operating phases of rental housing supply. A stable policy framework that generates certainty and continuity (e.g. a pipeline of investment opportunities) and the immediate development of a suite of 'proof-of-concept' projects were also considered essential to obtain the interest and confidence of institutional investors.
Lawson, J. (2013) *The use of guarantees in affordable housing investment—a selective international review* Lawson, J., Berry, M., Hamilton, C. & Pawson,	These two contributions focussed on institutional arrangements to support private financing by different investor classes. The 2013 review of seven international guarantee schemes highlighted the extent to which governments are moving into guarantee arrangements that have low budget impact to boost affordable and private rental housing supply. This was followed by a report on how Australia could apply a guarantee scheme and introduce a specialist aggregator (The Australian Housing Finance Corporation) to

H. (2014) *Enhancing affordable rental housing investment via an intermediary and guarantee*	assess and aggregate the borrowing needs of diverse affordable housing providers and to issue bonds linked to that guarantee. The preferred approach was based on the learnings from comparative research and in-depth local industry consultations. The importance of strong monitoring and regulatory practices to ensure borrowers have financial capacity was also highlighted in this work.
Milligan, V., Pawson, H., Williams, P. & Yates, J. (2015) *Next moves? Expanding affordable rental housing in Australia through institutional investment*	This short report provided an updated assessment of industry views on institutional investment in the post-NRAS policy context. While institutional interest remained, the 2014 demise of NRAS was found to have arrested mounting market momentum and heightened industry concerns about policy risk. The report also notes lessons from NRAS, including its design being ill-suited to institutional investor requirements and insufficient time being allowed for market responses to develop.. Up to date evidence on the extent to which the English housing association sector has shifted to capital market financing (away from traditional mortgage financing) post GFC was highlighted – 75% of 2014 lending was raised via bond issues, private placements, equity partnerships with sovereign wealth funds or similar.

Appendix 2: Financing mechanisms for supplying affordable housing

Financing mechanism	Brief Outline	Illustrative example
Grants	Directly able to influence housing supply, but limited to available funds and political commitment to housing. Often used to lever and secure other sources of funds.	UK, Austria, Ireland, Australia
Discounted land price	Traditionally a key vehicle to manage urban development outcomes, where governments are a major land holder. Can be applied specifically to affordable housing goals. Subject to land availability and market conditions.	The Netherlands, Austria, France, Switzerland, UK, US states, some Australian states/territories
Public loans	Traditionally the primary financing strategy for social / affordable housing programs. Cost effective fund raising. Revolving liquidity (through loan repayments) can offer longer term reinvestment potential. Recently, curtailed by public sector borrowing limits and the attractiveness of low private mortgage rates. As so called 'soft' loans, may not require same security as for private finance.	Austria, some US states, ACT Government.
Protected circuits of savings for specified investments	Used to achieve a dedicated flow of affordable credit for affordable housing programs. Sustained in some countries, while others have dismantled to improve competitiveness of local banks amidst foreign competition.	France (Caisse des Depot), Australia (first home savers)
Interest rate subsidies	Useful in early phase of a mortgage to reduce higher relative costs. Containing the cost to government over time relies on steadily rising wages & house prices & stable interest rates.	Widespread until late 1980s
Tax privileged private investment	Used to channel investment to affordable housing & to compensate investors for lower rates of return/profit restrictions.	Austria, Australia (NRAS). US (Low Income Housing Tax Credit)
Government secured private investment	Government backed guarantees to reduce risks to financial institutions investing in affordable housing, passed on in a lower cost of finance.	The Netherlands, Switzerland, UK
Tax privileges for providers of affordable housing	Many countries provide a variety of tax privileges to registered organisations, for example income and investment deductions, depreciation allowances, reduced sales and property taxes, exemptions from capital gains tax. These allowances compensate the efforts of the preferred providers towards achieving the social policy objectives of governments.	Widespread
Use of own reserves and surpluses	Mature housing organisations can leverage their balance sheets, reserves and surpluses to invest in additional housing. Funds raised may be pooled to support weaker organisations or to promote innovation and competition.	The Netherlands, Austria, Switzerland, France, UK
Use of tenants' equity	Some funding models incorporate a small tenant equity contribution. Governments may assist low income tenants to make this contribution. Larger contributions may lead ultimately to tenant purchase of dwellings.	Austria, UK

Source: Milligan et al. 2009, Table 2.1, updated