HomeStart Finance

HomeStart Finance - Submission to Affordable Housing Working Group

March 2016

Government of South Australia

HomeStart FINANCE

Contents

Executive Summary

HomeStart Finance believes access to suitable finance is a key ingredient of the overall affordable housing debate. Although mainstream lenders may argue otherwise, our 27 years of experience is that there is a segment of the market largely unserved and this group – essentially our core customer base – are those for whom home ownership of any description is often most out of reach. HomeStart's lending experience over multiple interest rate cycles and various economic shocks demonstrates this segment of the community can be successful home buyers.

In considering initiatives to improve supply and accessibility of affordable housing the Working Group should apply the following high level policy principles in assessing ideas:

- Capital, including land, should be recycled wherever possible to ensure it remains within the affordable housing system
- Assistance should be targeted across the housing continuum and designed to facilitate movement, not to promote stagnation. This will help increase exit rates from each step in the continuum, balancing load across the system
- Home ownership represents a policy gap that is not widely or explicitly recognised. It has a proven and significant role to play in creating an exit strategy for households from assisted housing, and can act as an incentive for many.

In particular, HomeStart recommends:

1. That the working group adopt the three principles identified above in assessing affordable housing proposals
2. If a community housing sector financial intermediary is to be considered, then a home ownership financing vehicle should be established alongside it. HomeStart is willing to assist in the development of this concept.
3. Land available for affordable housing should be retained within the affordable housing system. Sale outside the system creates a one-off affordable housing outcome which is undesirable given the value of well-located land. Instead, using mechanisms such as the Home Foundation concept under development in South Australia, it is possible to preserve and recycle this land within the system
4. Shared equity, particularly where the equity is held by a not for profit entity with a long term interest in affordable housing, can also help retain and grow capital for future investment in the sector.
5. The "Home Foundation" concept described in this submission be considered as a model for retaining and recycling land within the affordable housing system.

Background information on HomeStart

HomeStart was established by the SA government in 1989 with the purpose of operating a home ownership assistance program. In its 27 year history HomeStart has now helped an entire generation of South Australian home buyers to purchase a home (over 67,000 households), generated a profit in every year of operation and returned more than $450M to the SA government. It is estimated that more than 80% of customers would have been unable to get a loan from a mainstream lender at the time they purchased a home. The organisation's current loan portfolio is approximately $1.8bn, supported by net assets in excess of $170M.

HomeStart's reason for being is to "make home ownership a reality for more people in more ways" and this is achieved by:

- Accepting lower deposits for certain groups of customers, such as people with formal qualifications (Certificate III or above), creating access for key workers and trades
- Accepting a wider range of customer income sources for loan servicing than the commercial banking sector, including Centrelink benefits
- Increasing customer borrowing power without increasing monthly instalments, through subsidised rate home loans or innovative structures such as shared equity
- Reducing upfront costs through self-insuring the credit risk on its mortgage portfolio, enabling customers to avoid paying lenders mortgage insurance (LMI) and instead pay a loan provision charge which for most borrowers is significantly smaller than LMI

Legislative context and governance

HomeStart is a statutory corporation established under the South Australian *Housing and Urban Development (Administrative Arrangements) (HomeStart Finance) Regulations* pursuant to the *Urban Renewal Act 1995*. HomeStart is empowered to:

- Facilitate home ownership in South Australia by lending and providing other forms of financial assistance, including finance on concessional or special terms for low to moderate income earners.
- Provide, market, and manage home finance products and facilitate schemes to encourage home ownership, including mortgage relief schemes, as well as facilitating finance for the development of aged care facilities and rental accommodation in regional areas.

A Board of seven members oversees the performance of the organisation, with members appointed by the State Governor. The organisation reports to the Minister for Housing.

HomeStart operates as a financial institution and complies with relevant consumer credit legislation including the *National Consumer Credit Protection Act 2009 (Cwlth)* which governs the licensing and supervisory regime for brokers and lenders.

The organisation is also subject to a range of other legislation including the *Privacy Act 1988 (Cwlth)* and the *Anti Money Laundering and Counter Terrorism Financing Act 2006 (Cwlth).*

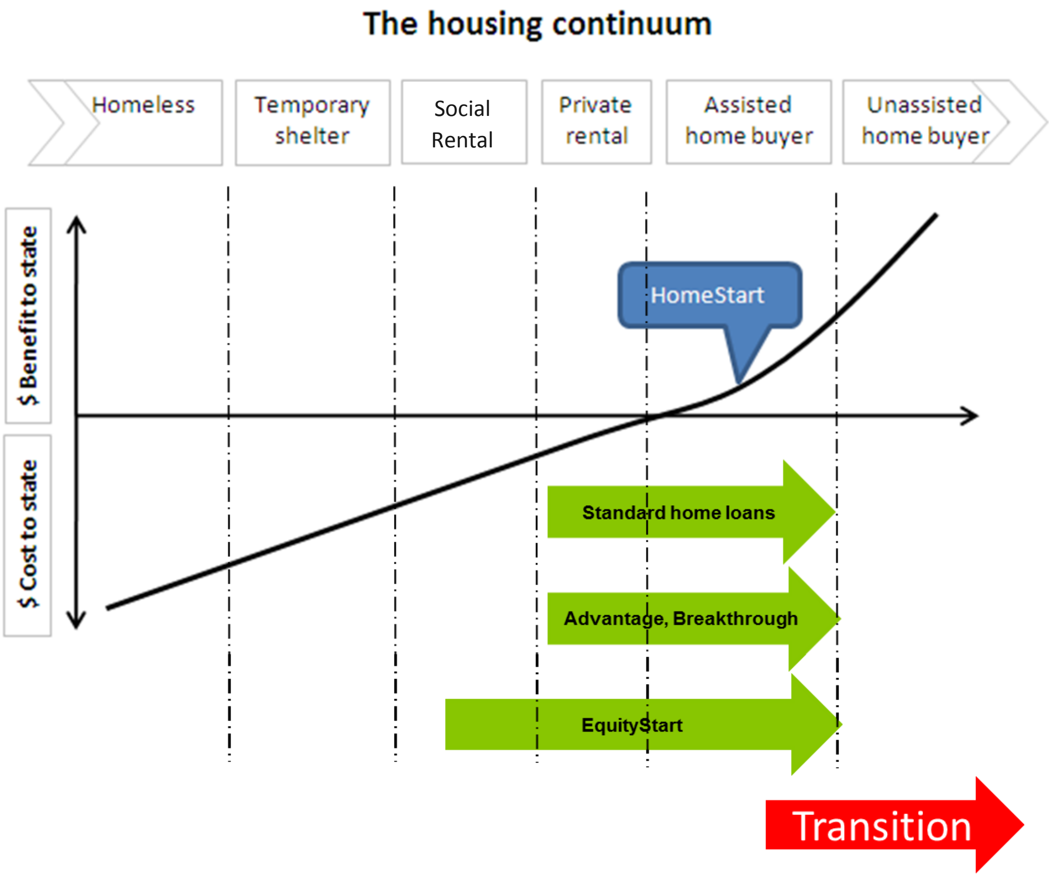
Competitive neutrality

Lending activities are financed by the South Australian Financing Authority (SAFA) at market rates and HomeStart operates within an overall borrowing limit agreed with the SA government. Consistent with the principles of competitive neutrality a guarantee fee of 1.60% is paid on outstanding debt and HomeStart's variable interest rate of 5.54% is priced above market average standard variable rates and well above the discounted rate commonly available which at the time of writing averaged 4.85%[1]. HomeStart does not offer any rate discounts.

In this way, HomeStart uses its interest rate deliberately to position itself as an interim solution for customers entering home ownership for the first time or re-entering the market after changes in their life circumstances.

Role in the SA housing finance market

HomeStart's role in the home finance market is best described using the housing continuum diagram below, illustrating the different housing tenures and corresponding cost / benefit to the state.



The diagram shows how HomeStart's products are targeted at people in private or public rental and enable them to shift to the right, moving away from government assistance including Commonwealth Rent Assistance (CRA). It also highlights that home ownership via HomeStart provides a net financial benefit to government, as opposed to the cost of services

[1] Market statistics from Reserve Bank of Australia, Indicator Lending Rates, February 2016

through provision of public rental (e.g. HousingSA), private rental assistance (e.g. CRA) or resulting from homelessness.

A key message from the housing continuum is that HomeStart is a gateway for customers to eventually achieve home ownership via mainstream finance. To this end, HomeStart positions itself as a way to buy a home sooner, and also as an interim step between renting and home ownership.

This means customers who discharge their HomeStart loan (either by repayment or to refinance to another lender) represent successful home ownership policy outcomes.

At times in the past HomeStart has proactively worked to refinance customers to other lenders. Strategic levers – an interest rate higher than market, use of brokers for distribution – are used to achieve this goal in the long run.

HomeStart by the numbers	
Loans settled since 1989	more than 67,000
Current loan portfolio value	more than $1.8 billion
Value of all loans settled since 1989	approximately $6.5bn
Value of credit losses	approximately $36 million
Credit losses as a percent of loan value	approximately 0.55%
Funds returned to SA government	in excess of $450million
Retained earnings	approximately $160 million

Financial relationship with the SA government

Last financial year HomeStart returned $40.7 million to the SA government including:

- Guarantee fee revenue of $27.5 million
- Income tax equivalent of $5.1 million
- Dividends of $7.1 million

HomeStart receives Community Service Obligation (CSO) payments from the SA government in recognition of the non-commercial activities undertaken. These activities include:

- Acceptance of non-commercial credit risk
- Subsidised interest rate loans, such as the Advantage Loan
- Costs of lending to specific customer groups

Customer profile

HomeStart's internal estimates are that approximately 80% of customers would be unable to get a loan from mainstream sources at the time they purchased a home.

Notwithstanding this statistic, at least half of loans made to first home buyers are eventually refinanced which means that once a customer has spent a few years building equity and demonstrating a repayment history with HomeStart they become attractive for mainstream lenders.

This is the essence of HomeStart's role: creating opportunities to give people a start in home ownership and then encouraging an eventual shift to private sector financing. It recycles HomeStart's capital and limits the exposure of the state government.

A snapshot of HomeStart's lending since 2008 shows:

- 51% of loans were to first home buyers
- 36% relied on Centrelink as their primary income source
- 20% were in professional or managerial occupations
- 19% worked part time or casual
- 72% were earning less than $65,000 at the time they took out the home loan
- 15% were single females with children, and 27% were couples with children. 33% were singles without children
- 47% were moving out of private rental to buy a home
- 26% of customers were eligible to receive a portion of their borrowings in the form of a subsidised rate loan, either due to low income or status as a social housing tenant.

First home buyers

Lending to first home buyers is a core part of HomeStart's objectives and this customer segment currently represents over 50% of new loans, although higher at times where government has provided greater levels of incentives such as grants.

Non-first home buyers will typically take out a HomeStart loan as a result of changes to their circumstances, such as divorce or re-entering the property market for a variety of reasons. Although HomeStart does allow customers to refinance their existing bank loan to a HomeStart loan, this is a relatively small part of the business and generally not an attractive option due to the higher interest rate. Refinance activity is higher when interest rates are well above their current levels, typically where monetary policy settings are contractionary.

Employment and income source

HomeStart's acceptance of Centrelink income for loan servicing (subject to certain criteria, such as ensuring it is sustainable) represents a key difference to mainstream lenders. This has been a feature of the organisation's lending since inception although the proportion has substantially declined from almost 60% in 2003 to around 40%. Long term growth is evident in other employment classes including trades/labourers, professional/managerial and clerical/sales & service type roles. This is the result of two factors:

1. Long term house price growth has outstripped inflation, creating an affordability gap
2. Deliberate targeting of key workers (e.g. nurses, trades, and teachers) who are first home buyers with difficulty raising a deposit and covering upfront costs. These people tend to refinance their loans faster than other categories of buyers. For example since 2008, the average age of a loan held by a nurse or teacher when refinanced is 3.8 – 3.9 years compared with 6.7 years for a customer reliant upon Centrelink income.

Customer age

HomeStart exhibits a relatively even split across the major age brackets. Historically, 75 – 80% of first home buyers are aged under 39. A rise in 20 – 29 age bracket in 2009 and 2010 reflects significant first home buyer activity in response to increases to government incentives.

The majority of older customers are either non-first home buyers (typically re-entering the market, often for reasons such as relationship breakdown).

Household composition

Household composition of new customers is generally aligned with the market segments that have the most difficulty with affordability: young singles who represent more than 30% of lending. Single parents with children are also a notable segment. There is also a correlation between changes in household and employment types when viewed over the longer term.

Migrant communities

Approximately 40% of HomeStart lending is to people born outside Australia, with a notable cohort of customers from humanitarian arrival programs.

One example of this is the arrival of Bhutanese refugees to Australia via a UNHCR resettlement program. Adelaide is now home to a significant community of Bhutanese people and HomeStart has worked with them to facilitate home ownership through offering educational seminars and support including interpreter services. The Bhutanese community has worked hard to establish themselves in their new country and see home ownership as an important step in that direction with HomeStart financing 183 households as at the time of writing. Other communities of migrants have also worked hard to build a culture of home ownership including groups from Burma, Burundi, Philippines and Afghanistan.

Credit quality

HomeStart is not a “sub-prime” or “low-doc” lender. HomeStart’s lending policies and credit criteria are strict and full documentation of income is required. Customers with poor credit histories are not eligible for a HomeStart loan. Notwithstanding these guidelines, HomeStart’s customers typically sit outside the criteria for mainstream finance due to deposit or income sources.

HomeStart’s arrears rate sits above that of prime mortgages as would be expected, but it is materially better than that experienced by sub-prime lenders and further reinforces the point that the group of customers serviced by the organisation are capable of receiving and sustaining mortgage finance. Since inception, HomeStart has settled over $6.5bn of new loans, and written off approximately $36M, representing a loss rate of 0.55%.

In considering credit quality it is also important to recognise that HomeStart complies with responsible lending guidelines as set out in the National Consumer Credit Protection Act (NCCP).

Customer deposit

Reflecting the organisation's purpose and place in the market, a large proportion of loans are written to customers with relatively low deposits. Around 30% of new customers have a deposit of 5 – 10% and around 25% of customers commence with a deposit of 3- 5% (HomeStart's minimum is 3% for certain customers such as those with at least a Certificate III qualification, who also meet other credit criteria).

Lenders mortgage insurance (LMI)

It is standard in the mortgage industry for customers with a deposit of less than 20% to be charged what is known as Lenders Mortgage Insurance (LMI). Somewhat disingenuously, the concept of LMI is not to insure the customer, rather it provides a payout to the lender in the event the customer cannot repay their loan and a credit loss is incurred.

The cost of LMI can be many thousands of dollars for even small loans and is not widely understood by customers. HomeStart is unable to obtain LMI for its portfolio and since July 2000 has undertaken a form of self-insurance using an internally managed fund known as the Risk Transfer Vehicle (RTV). Customers are required to make a contribution toward the cost of their credit risk in the form of a fee at the time the loan settles and known as the Loan Provision Charge (LPC). The LPC is charged on the basis of LVR bands and the proceeds are invested in the RTV investment fund. Actuarial assessments are regularly undertaken on the adequacy of the RTV and the fund has always been solvent.

HomeStart's LPC is significantly cheaper than LMI as shown in the table below highlighting the differences for a first home buyer purchasing a $400,000 property and borrowing $380,000.

Lender	Cost
ANZ (LMI)	$13,935.36
Westpac (LMI)	$11,684.00
HomeStart (LPC premium)	$1,875.00

Source: Figures sourced online, January 2016. Assumes $400,000 property, $380,000 loan for a first home buyer

As can be seen, the approach taken by HomeStart delivers a substantially cheaper outcome for most of its customers. LMI providers do, in some cases, allow customers to add the premium to their loan balance and repay it over the life of the loan. This adds to the monthly repayment cost, and also increases the amount of interest payable over the life of the loan.

Geographic concentration and property value

The geographic distribution of HomeStart's loans is representative of the demographics of our customer base, with a large proportion (33%) of the portfolio held in Adelaide's outer northern suburbs including local government areas such as the City of Playford (e.g. Elizabeth) and City of Salisbury. HomeStart has also undertaken a significant proportion (25%) of portfolio in regional towns particularly centres such as Whyalla, Port Augusta and Port Pirie. Adelaide's southern fringe suburbs account for around 14% of the portfolio.

Loans are distributed through a network of brokers and loan managers (including BankSA branches), as well as via the organisation's own internal lending function which includes offices in the city, northern and southern suburbs. Loan managers undertake origination, approval within lending guidelines and post-settlement management of the loan. By contrast, brokers provide origination, with approval handled by HomeStart.

Third party distribution is an important strategic component because it delivers:

- A lender of "next resort" for brokers unable to find a suitable mainstream lender
- Geographic reach

HomeStart's distribution approach is not unusual in the mortgage finance industry, with the major difference being a partnership with BankSA through which a HomeStart Loan can be obtained via any BankSA branch.

Loan products offered

There are four basic types of HomeStart Loans available:

1. HomeStart Loan

HomeStart Loans are available for owner-occupiers in South Australia with a minimum deposit of 5%. The HomeStart Loan is fundamentally different to 'normal' home loans. It is designed to be affordable throughout interest rate cycles and this is achieved by generally only adjusting the instalment once per year, typically in line with inflation. This means that when rates go up, the loan term will increase and vice versa. By contrast, a standard home loan is written with a defined term (e.g. 30 years) and the instalment will go up and down with interest rates so that the loan is always paid off in that time. Variations of the core product include:

- Graduate Loan (maximum LVR of 97%): Limited to holders of Certificate III qualifications or above. Geographic restrictions and specific credit criteria apply.
- Low Deposit Loan (maximum LVR of 97%): Geographic restrictions and specific credit criteria apply. An interest premium of 1% is charged in the first year of the loan.

2. Subsidised interest rate products

These loans are taken in conjunction with one of the HomeStart Loans above. In the case of the Advantage and EquityStart products interest accrues on these loans at a rate generally equivalent to CPI and repayments are not due until the HomeStart Loan has been paid out.

Advantage Loan

A subsidised rate loan of up to $45,000 available to households earning less than $60,000 p.a. The amount available scales downward between net incomes of $37,500 and $60,000.

The Advantage Loan provides a borrowing power boost without increasing monthly commitments.

EquityStart Loan

A subsidised rate loan of up to $50,000 available to public or community housing tenants to purchase their existing HousingSA property or another home.

The EquityStart Loan also provides a borrowing power boost, without increasing monthly commitments.

Wyatt Loan

Delivered in partnership with the Wyatt Trust which provides funding for the loans and HomeStart provides administration, credit assessment, and distribution. Wyatt Loans are interest free and available for a term of up to 5 years to specifically targeted customer groups.

The Wyatt Loan is available to assist with upfront costs associated with purchasing a home. Total funds available are capped.

3. Shared appreciation products

These loans are taken in conjunction with a HomeStart Loan. They are designed to significantly lift customer borrowing power and HomeStart (or another party) receives a share of the capital gain on the property in lieu of interest on the shared appreciation portion.

Breakthrough Loan

This product sits on HomeStart's balance sheet. The customer pays an annual fee of 3% of the Breakthrough Loan value and shares a portion of the capital gain with HomeStart on sale or refinance. HomeStart holds approximately $60M (face value) of these loans and has a limit of $100M. Geographic restrictions apply.

Shared appreciation loans (various)

HomeStart has partnered with local government (e.g. City of Salisbury and Adelaide City Council) to offer shared appreciation products for specific developments. Under these arrangements the shared appreciation portion is retained by Council.

4. Reverse mortgages

Seniors Equity Loans are provided to customers who own their properties outright and are commonly termed "asset rich and cash poor". The maximum loan to value ratio available for the customer is determined by their age. There are no scheduled payments and customers are protected by a "no negative equity" guarantee.

Question 2: How can governments ensure sustainable improvements in the housing outcomes of current affordable housing tenants within the current fiscal environment?

For governments to pursue sustainable improvements in housing outcomes, three core principles should be adopted in considering any assistance program:

1. Capital, including land, should be recycled wherever possible to ensure it remains within the affordable housing system
2. Assistance should be targeted across the housing continuum and designed to facilitate movement, not to promote stagnation. This will help increase exit rates from the various forms of housing assistance, balancing load across the system. A key metric of any assistance program should be the exit rate of recipients from receiving assistance.
3. Home ownership represents a policy gap that is not widely or explicitly recognised. It has a proven and significant role to play in creating an exit strategy for households from assisted housing, and can act as an incentive for many.

Land is a scarce, immobile commodity that, once lost to the affordable housing system, is very difficult to replace. Typically it can be released or redeveloped to create affordable housing outcomes only once a generation, or perhaps even less frequently. It is imperative that injections of land into the affordable housing system are not used to satisfy a single outcome, for a single household. Systems and structures should be in place whereby the land can be reused for affordable housing, or if that is not possible, the eventual uplift in the value of the land can itself be captured (even if the land is lost) within the affordable housing system. There is a need to create the entities or vehicles which are appropriate “safe pairs of hands” in which to hold this equity. Some quarters of the community housing sector may already represent such a holder, but this varies from provider to provider, particularly given the wide spectrum of risk appetites and capabilities HomeStart observes in the sector.

Home ownership represents the point at which a household can remove itself from government assistance. It is also socially desirable for many segments of the community, and creates improved social connections within communities as well as economic security.

For most people the private sector provides adequate support to facilitate the purchase of a home. However, HomeStart’s experience is proof that a segment of the market remains excluded from home ownership, despite being demonstrably suitable (in our experience) to take this step.

The private market does little to ameliorate the barriers that exist to home ownership such as upfront costs, mortgage insurance and acceptable forms of income.

HomeStart both delivers assistance to a targeted group who are otherwise unable to access finance, and also positions itself in the market as a transitionary point for households. Through a variety of policy settings including interest rates and choice of distribution networks, the organisation provides the opportunity for households to purchase their home when otherwise unable to do so, and then can facilitate the refinancing of these loans several years later. In this way, the organisation complements the activities of the private sector, rather than competing.

It also represents a structure where capital is continually recycled over the 4 – 6 year life of an average mortgage, and the majority of households move onwards into unassisted home ownership, financed by the private sector.

Approximately 1800 – 2000 customers discharge their HomeStart mortgage each year. Of these customers, 50% are refinanced to another lender. The remaining reasons for discharge are split between sale of the property and repayment in full.

There exists an opportunity for both state and federal governments to review the home ownership outcomes in South Australia. A similar mechanism could be established as a not for profit, drawing on HomeStart's existing delivery and risk management capabilities, and accessing wholesale funding. While government need not provide the balance sheet to fund the vehicle, it may be necessary for government to support the entity in the early years, perhaps through limited guarantees (e.g. guaranteeing interest on funding, or underwriting a form of "1st loss fund" similar to HomeStart's RTV). The vehicle should be established to be financially self-sustaining such that government support can eventually be withdrawn. Further information on this concept is provided in the response to question 3 (below).

Recommendation:

1. That the working group adopt the three principles identified above in assessing affordable housing proposals

Question 3: How can the cost base of new affordable housing assets be minimised? How can the return generated from affordable housing assets be maximised?

The HomeStart model works because it creates a system which can recycle capital. The concept can be applied and extended in a myriad of ways. When applied to affordable housing, the key item in the value chain to consider capturing and recycling is land, and in particular, access to the long term capital gains arising from holding land.

In South Australia, the process of transferring management of public housing to community housing providers (CHP) is currently underway. Many of the properties to be transferred are old and require significant maintenance. An outcome expected from the transfer is the redevelopment of these properties to deliver new houses that are a better fit for purpose, and offered to a range of tenure types.

Working in partnership with Junction Australia, RenewalSA and other tier 1 providers operating in SA, HomeStart is developing an innovative financing model (the "Home Foundation"). The concept is designed to enable CHPs to raise significantly larger amounts of capital for housing redevelopment than otherwise available through the market, as well as providing a significantly cheaper price point for people to own houses constructed through this process.

Two core activities ('lines of business') are envisaged for the Home Foundation:

- Funding intermediary: raising large scale wholesale funding, and on-lending to community housing providers to enable redevelopment of properties in the absence of a direct mortgage over the property being redeveloped.
- Retail home buyer finance: creating opportunities for target customer groups to purchase homes constructed by community housing providers, using a model based on shared equity and the aged care industry's "right to occupy". Under this right to occupy model, land title is retained by the South Australian Housing Trust, and therefore retained by the overall affordable housing system.

It is contemplated the Home Foundation will be established either as a separate entity or part of HomeStart Finance. This enables the entity to both take advantage of HomeStart's existing systems, structures and processes, and ensures any affordable or social housing assets taken as security for loans cannot be lost to the system. HomeStart could run the Home Foundation through its existing business, subject to negotiation of certain parameters with the SA government.

Innovation arises from the use of the aged care sector's "right to occupy" model. A person buying the "right to occupy" would have full ownership of the property but would not hold title to the land. The right to occupy would be a negotiable instrument and the Home Foundation would share in any future gains / losses as the instrument is subsequently bought and sold by home owners.

Preliminary modelling suggests the initial price of a 'right to occupy' would be in the order of $210,000 as opposed to an estimated market price for a house / land in the same location of $350,000. Based on HomeStart's existing loan criteria, this price point is potentially accessible for a household earning $25,000 as opposed to more than $40,000 required to finance the full price. This creates a significantly deeper pool of potential buyers for the properties, helping reduce development risks for the CHPs.

The concept represents a creative approach to the idea of how available land can be preserved for future generations, with some of the long term uplift in value able to be reinvested in the affordable / social housing space. From the purchaser's perspective, they enjoy almost all the benefits of a traditional ownership model except for the right to deal in the land (e.g. subdivide[2]).

A number of extension opportunities exist for an entity such as the Home Foundation. Ultimately it could build a substantial portfolio of shared equity assets, creating an asset pool that can be reinvested in a range of affordable housing projects or assisting a wider group of home buyers. Other parties holding land with an interest in affordable housing could potentially also look at similar land lend arrangements with the Home Foundation.

Recommendations:

1. Land available for affordable housing should be retained within the affordable housing system. Sale outside the system creates a one-off affordable housing outcome which is undesirable given the value of well-located land. Instead, using mechanisms such as the Home Foundation concept under development in South Australia, it is possible to preserve and recycle this land within the system
2. Shared equity, particularly where the equity is held by a not for profit entity with a long term interest in affordable housing, can also help retain and grow capital for future investment in the sector.
3. The "Home Foundation" concept described above in this submission be considered as a model for retaining and recycling land within the affordable housing system.

[2] The loss of opportunity to deal in the land is not new, for example, many councils have zoning requirements around minimum allotment size which prevents subdivision. These rules have the same effect.

Question 5: What role can the community housing sector play in implementation of new financing models to increase the supply of affordable housing?

Until recently HomeStart was the largest financier of community housing in South Australia. Our view is the sector has taken steps forward in professionalism and capability, with a variety of complex projects delivered in recent times.

Ultimately, the key ingredient for the sector is scale. Work done in the past has helped many providers achieve the size and professionalism needed to be able to truly have a significant impact on the wider community within which they operate.

There is a strong case for the sector to work together and with external partners to develop its own financing mechanisms at scale. In doing so, the sector should give strong consideration to ensuring whatever financing vehicle is chosen has robust and independent governance to avoid undesirable conflicts of interest.

In particular, the sector should look beyond their own financing needs and consider those of their tenants as well. In looking into the creation of a financing intermediary, it is recommended that the sector consider creating a home financing vehicle accessible to both tenants and non-tenants alike. The experience of both HomeStart in South Australia and KeyStart in Western Australia, shows that there are a significant number of households who can benefit from assistance in stepping into home ownership. Both these organisations also show that by and large, these households represent a reasonable credit risk, and that a pool of mortgages to this customer demographic will behave in a similar fashion to a standard pool of mortgages.

By considering the financing needs of their tenants, the CHPs would create a defined pathway out of rental and into home ownership. It would also facilitate redevelopment goals of ensuring new projects contain a mix of tenure types. Lastly, such a vehicle significantly increases the flexibility of CHPs in the development process, with options to provide varying degrees of mortgage assistance, as needed and wrap around other service such as financial education.

The home financing vehicle should be structured to provide standard home loans as well as shared equity investments. It would add substantial scale to the overall sector financial intermediary, and importantly be funded through the private sector using an asset class (residential mortgage backed securities, RMBS) that is already familiar to institutional investors.

A significant barrier to the capability of the sector to deliver such a vehicle will be in its capacity to obtain sufficient credit enhancement to support credit ratings on the RMBS issued. There may be a medium term role to play for government to consider providing credit enhancement (CE) for the securities until such time as the vehicle can stand alone.

The capability to originate and manage mortgages to the target customer groups is also already in existence, for example, through HomeStart. HomeStart also has knowledge on managing the credit and operational risks associated with such a proposal, including mechanisms by which customers can contribute to the cost of their own credit risk (the “loan provision charge” or LPC), with the resulting pool of funds perhaps being used to create a ‘first loss fund’ thereby providing a level of subordination to senior notes.

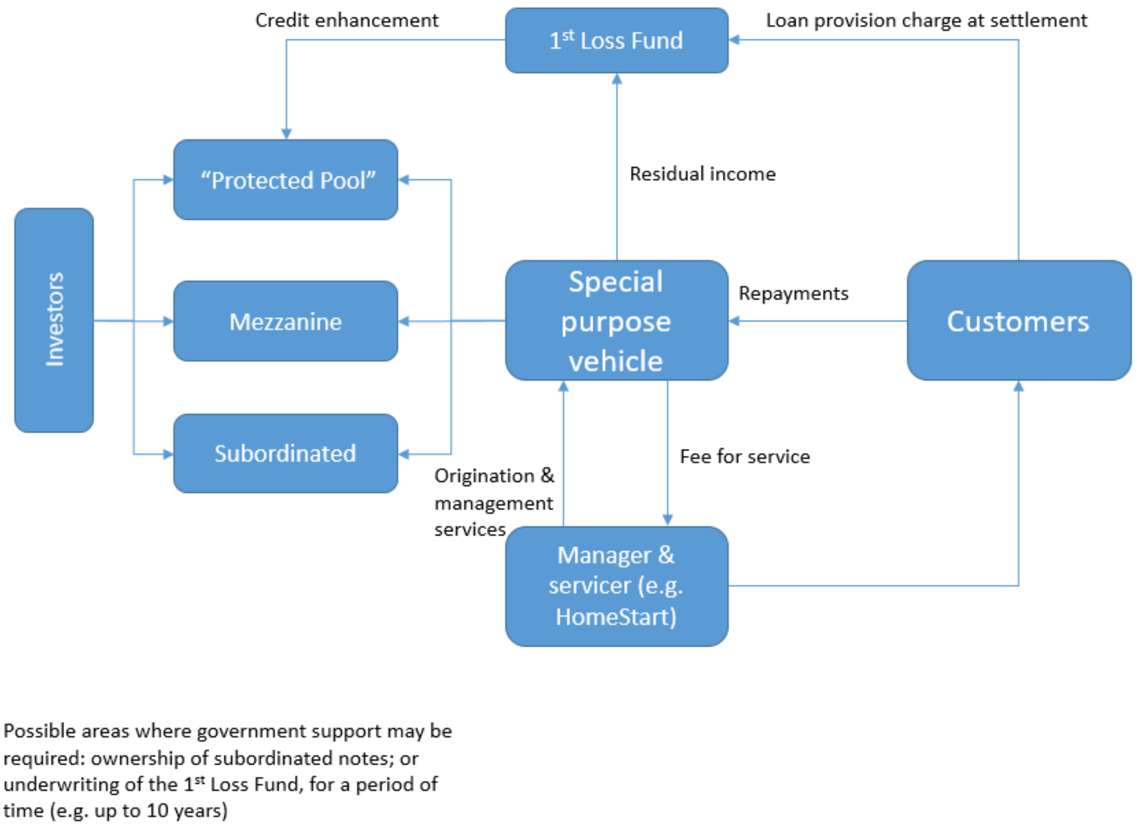
Any securities issued through sector-wide finance initiatives should be rateable, and as close to plain vanilla as possible. The use of overly exotic financing structures creates an undesirable level of complexity, risk and cost.

A possible structure, using the concepts described above, is illustrated below. It shows the resulting home loans being securitised into three high level tranches, being senior, mezzanine, and subordinated. These are indicative based on HomeStart's portfolio experience and any actual structure would depend on the nature of the transaction.

It also shows the 1st Loss Fund providing credit enhancement to the structure, capturing Loan Provision Charge (LPC) income from new customers but also being the beneficiary of any residual income. In time, the 1st Loss Fund should grow in size and be able to operate without any government support. Until then it is considered a role for a government could be to either underwrite the 1st Loss Fund, or purchase the subordinated notes.

Either of these roles would be temporary until the transactions were able to stand on their own.

Diagram 1: Community Housing Sector home financing vehicle – illustrative structure



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Other elements that remain to be determined would include the nature of the home loan product offered (e.g. HomeStart's unique home loan structure, which protects borrowers from rate fluctuations, or a standard credit foncier product), and how subsidies might be offered or financed.

Currently for example HomeStart offers two subsidised loan products (Advantage Loans and EquityStart Loans) to low-moderate income and social housing households respectively. These loans serve similar purposes, in providing a borrowing power boost without increasing monthly commitments. However, they also carry a funding cost.

The final element to consider is that not all loans in the portfolio would be securitisable, requiring separate funding lines not shown above.

Recommendation:

1. If a community housing sector financial intermediary is to be considered, then a home ownership financing vehicle should be included alongside it. HomeStart is willing to share its model and provide other support to help defray setup costs.

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