Submission to the

Council on Federal Financial Relations

Affordable Housing Working Group: Issues Paper

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Introduction

National Affordable Housing Providers Limited (NAHP), formerly NRAS Providers Limited, is a representative peak body whose purpose is to represent the collective interests of NRAS Approved Participants, in the Constitutional Objective of assisting in the delivery of Affordable Housing across Australia. Our members hold responsibility for over 50% of all NRAS delivery. NAHP members are a mix of not for profit housing organisations, commercial and ASX listed entities, representing the broad interests of companies engaged in the field of providing private affordable housing in Australia, including NRAS and other State and Federal Government initiatives. We work collaboratively with our members and advocate on their behalf with Government on proposed legislation and regulations; engage with NRAS officials on NRAS policies and procedures, undertake research relevant to the delivery of affordable housing; and promote the benefits of NRAS and affordable housing investment in appropriate forums. As a key stakeholder group, NAHP acts as a conduit for Government to both disseminate NRAS-related information and provide feedback to Government on NRAS and affordable housing issues.

As Affordable Housing providers and investors, we are in a unique position to comment on proposals that seek to generate private market investment in affordable housing, given our experience with the Government's only Affordable Housing program and our expertise in this emerging investment market. As early participants in the Scheme, we have witnessed the positive impact it has had on the supply of affordable housing, making some 30,000 new homes available to over 66,000 tenants at affordable rents. Collectively we have substantial expertise in attracting private finance into this space and have utilised that experience by securing over $10 billion of private investment into NRAS. We have worked cooperatively with Government to improve the operation of the Scheme as we believe the fundamentals of NRAS are sound but the administration has been plagued with complexities and unnecessary duplication of effort. NAHP has a strong desire to continue in the affordable housing space given the right product and/or appropriate mechanism.

It is our contention that the focus for solutions to improve the supply of affordable housing and maximising the effectiveness of government expenditure must be on a supply stimulus. That is, a mechanism to ensure a continuous, guaranteed supply of private sector investment for social and affordable housing. The four models outlined in the Issues Paper describe various mechanisms for delivering affordable housing but fail to act as a direct stimulus for supply. While the models do have the capacity to increase supply, they would not facilitate large scale market investment in affordable housing and would be limited to specific applications. We provide specific comments on those models below.

It is our view that a *tax credit* provides the best option to stimulate supply by providing a straightforward mechanism within the existing ATO infrastructure to bring institutional investors into the affordable housing market. There is a well -established and proven model operating in the US, the Low Income Housing Tax Credit (LIHTC) that provides a blueprint for a similar tax arrangement in Australia. We provide comment on our preferred option and the LIHTC further in this submission.

It should be noted that if a key goal of this process is to maintain a social housing safety net and ensure that people on low and very low incomes are adequately housed, some form of Government financial support – be it a subsidy, debt support, tax offset, etc -- must be provided to support this population. To achieve the other key goal of facilitating large scale market investment, investors will require an adequate return on their investment which is not possible solely through low rents without Government support.

Clearly, NAHP is supportive of all initiatives which will assist in the generation of affordable housing in this high need sector across Australia. The former National Housing Supply Council in its 2012 Report identified a shortfall of housing across Australia of 228,000 dwellings, and forecast this shortfall to grow to 370,000 by 2016. NAHP views are supportive of all proposed models; however, do not believe that any of these models in isolation will provide the necessary supply stimulus to enable the growing shortages in housing to be arrested.

Proposed models

Housing loan/bond aggregator

This proven financing structure has had great application in the UK. If adopted in Australia, it would provide not for profit housing providers access to debt financing at far more attractive rates and allow them to expand and increase their social and affordable housing portfolios. However, this option is limited to a financing mechanism only for the community housing sector and would not be accessible by for profit affordable housing entities. The same problems that currently confront this sector—lack of scale, limited equity and newly emerging development expertise—would persist.

While this model would aggregate debt financing, it would not generate equity investment. While not for profit organisations would be able to access more debt financing on far more favourable terms, they would still be limited by their revenue streams (largely derived from below market rents) and ability to service the debt. As will be outlined below, the LIHTC brings equity investment into the affordable housing market which would allow community housing providers to better use their surpluses for expansion and growth rather than debt retirement.

This model also requires the establishment of a specialist financing intermediary. A tax credit approach could utilise the existing ATO infrastructure developed to accommodate NRAS and thereby maximise the Government's previous investment for processing a housing-related tax incentive.

Housing trusts

Housing trusts are a good model for aggregating housing assets to provide scale, geographic diversity and liquidity that is often required to attract large-scale or institutional investors into the affordable housing market.

However, this is primarily a mechanism to enable State governments to redevelop underutilised assets and improve the value of their properties while still maintaining control over the assets. It is similar to a stock transfer process whereby the property is transferred for management to a community housing provider, making the dwelling eligible for Commonwealth Rent Assistance (CRA), a needed income stream for the provider to adequately maintain the property. However, the ownership of the property remains with the housing trust which prevents the community housing provider (or other entity who receives housing through the trust) to benefit from the appreciation of the asset and cannot be added to the balance sheet of the provider.

Housing Cooperatives

Housing cooperatives are a successful model for the delivery of affordable housing, especially models like Common Equity Housing Ltd (CEHL) and similarly structured cooperatives around the country. They provide a unique option for social and affordable housing tenants who want to participate directly in the governance of their housing and often evolve from specific communities, e.g. ethic groups, older people, etc. CEHL owns the dwellings of each of the cooperatives, effectively combining the assets of the individual cooperatives and giving it the capacity to leverage a large portfolio for growth and expansion. It head leases the properties to the individual cooperatives which allows them to manage and operate their housing without the responsibility that comes with owning the asset.

In a social and affordable housing context, this model works well in specific environments but does not stimulate supply at a large scale. Like other community housing models, it is a vehicle for the *delivery* of affordable housing but is not in itself a mechanism for *generating* investment.

Cooperatives have participated in NRAS and have effectively used that tax incentive as one funding component in joint venture projects to build more social and affordable housing. The cooperative model would be one that could benefit from a housing related tax credit as it would provide equity financing as opposed to the existing debt financing that is currently on offer to such housing entities.

Social impact bonds

The beauty of social impact bonds in the housing arena is their capacity to achieve verifiable social outcomes in tandem with increasing the supply of affordable housing. While the social impact bonds do have the capacity to leverage private investment and provide equity to community housing providers, experience to date indicates that the scale of supply will be relatively small.

There is also the cost of the government incentive. While acknowledging that there will be savings realised in other parts of a federal budget, e.g. improved health-related outcomes means a reduction in expenditures in the health budget, it will require a government outlay from some existing Federal budget area, most likely housing. Depending on how the social impact outcomes are structured, a housing expenditure may result in an improved social outcome for the tenant and improve their housing experience but not necessarily substantially increase the supply of affordable housing .

The design of the bonds as depicted in the Issues Paper example may also limit participation to those entities with significant balance sheets. It appears that the outcomes must first be delivered and verified before any payments can be made. Only entities with sufficient cash flow will be able to undertake the contracted activities, achieve the outcomes, and wait for the outcomes to be assessed and verified before being paid.

Tax system approach to stimulate supply

Despite its much publicised problems, we believe NRAS is fundamentally an attractive tax incentive that successfully generated a new supply of affordable housing and brought private investment into the affordable housing market. Its deficiencies are largely the result of administrative complexities and initial design flaws that provide valuable lessons for developing a fresh approach to stimulating affordable housing supply through a tax system mechanism.

Implementing NRAS required the Federal Government to invest in the necessary infrastructure within the ATO to administer the tax incentive arrangement through a refundable tax offset (RTO). The cost to develop that infrastructure was significant and should be a consideration in the deliberations on potential new models to deliver affordable housing. The financial expenditure and administrative resources required to modify and improve existing processes around NRAS RTOs would be far less costly than creating a new structure. A tax credit targeting the establishment of affordable housing, similar to the US Low Income Housing Tax Credit (LIHTC) described below, would capitalise on the Government's already substantial investment in existing ATO systems while delivering an efficient and effective mechanism to generate a supply of new affordable housing stock.

Efficiencies could also be realised by consolidating affordable housing subsidies within one agency, i.e. the ATO. Complexities arise when there is a 'hybrid' system that provides payments either through a tax credit with the ATO *or* a cash payment administered and delivered by the Department of Social Services. A tax credit available to all participants administered through one agency avoids unnecessary duplication and streamlines payment processing, making it a more simplified and cost-effective subsidy.

Many overseas affordable housing schemes that have successfully attracted private and institutional investment have, at their core, delivered an attractive incentive through the tax system. By example, the Low Income Housing Tax Credit (LIHTC) in the US is a tax credit specifically developed to generate affordable housing. LIHTC has generated 2.4 million affordable homes since 1986 and the development process for these properties accounts for approximately 95,000 jobs annually, mostly in the small business sector.

Simply put, LIHTC provides an investor a credit against their tax liability in exchange for capital contributions made to finance the development of an approved affordable housing project. State housing agencies approve the projects based on local needs and desired outcomes and allocate the credits accordingly. A similar approach in Australia would provide State/Territories with the ability to use a tax credit mechanism to align affordable housing development within their broader housing strategies, providing a partial but critical funding source for social housing re-development projects and other mixed tenure ventures. As well, a tax credit would not require a matched financial or in-kind contribution, thereby freeing up state housing resources to be used in a less restrictive manner to address housing affordability.

The LIHTC on new builds is equal to 9% of the project (excluding land) and can be claimed annually for 10 years. However, the housing must stay as affordable housing for a minimum of 15 years (30 years in some instances); non-compliance anytime during this initial 15 year period results in the recapture by the IRS of previously paid tax credits. Consequently, LIHTC compliance is market-driven, not government-driven, with a high level of private sector scrutiny of the initial project underwriting and ongoing operation to safeguard their investment. The success of this approach can be seen in the near zero record of defaults and tax recaptures. In an Australian context, this market-driven discipline would release government from the substantial administrative cost of compliance, reduce the complexity of administration and would likely reduce the political influence than can occur with directly allocated subsidies.

Unlike previous US housing related subsidies, the LIHTC is a uniform and direct subsidy that is attractive to investors and has resulted in a very strong take-up rate as a low yield, low risk investment. Policy uncertainty was relieved when it was made a permanent program in 1993, triggering greater institutional investment and the eventual emergence of a mature market focused on financing affordable housing through tax credits. As well, since the tax credit is a subsidy for equity investment, it replaces debt that would require the cash flow from rents to service that debt. This helps keep rents low and affordable**.**

There are parallels here with NRAS: it was developing similar interest by investors who had taken the time to understand the Scheme and its benefits and were incorporating NRAS into their forward investment planning. This was evidenced by the oversubscription for the last funding round of NRAS, i.e. there were more than eight times the number of applications than there were available incentives.

Conclusion

NAHP recognises the shortcomings that were evident in the delivery of NRAS, however, the success of the program for all of its flaws – the delivery of some 30,000 new dwellings – has provided affordable housing to over 66,000 tenants which would have never been delivered without this supply stimulus.

During the delivery period of NRAS, NAHP commissioned Bond University to prepare an Economic and Taxation Impact Study. This study determined that as a supply stimulus NRAS would:

- Deliver 50,000 new dwellings – of which 43% were new investor/owners and 70% would not have invested into these high need areas without the NRAS initiative.
- Cost Federal and State Governments - $6 billion
- Generate $5.7 billion in Federal Revenue from GST and income taxes associated with jobs created by NRAS driven activities.
- Created State Revenues of $2.7 billion in Stamp Duties and State Fees

Recent AHURI Investigative Panels have considered international models and are currently providing a dissertation of the NRAS delivery program. These investigations have recognised that NRAS did deliver, and that a Supply Stimulus will be required to enable the closing of the gap in affordable housing across Australia.

In summary, NAHP is supportive of all models under consideration, and believes that each model will be enhanced and deliverable with the addition of a Tax Credit based supply stimulus. Such could be provided by adopting a number of the successfully applied mechanisms supporting the LIHTC, and would utilise the current infrastructure in which the Federal Government and ATO have already heavily invested. Industry support for such an initiative has been demonstrated by the over subscription of Round 5 of NRAS and the 24 years of success of the LIHTC in the USA.