Affordable Housing Working Group

Response to Issues Paper, January 2016

Prepared by the National Australia Bank
March 2016

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1. Overview

Social and affordable housing plays an important role in Australian society and NAB has been actively involved in supporting this sector across Australia. As a leading financier in this area, NAB understands that any procurement model, ownership model or capital solution must facilitate and improve the sector's social outcomes.

In terms of capital, a number of structural issues currently constrain both institutional investment in affordable housing and sector bankability. These include scale (Section 1.1), risk adjusted returns and yield gap (Section 1.2) and regulatory framework (Section 1.3). This paper focuses on these capital investment and financing issues and looks at the current credit rating system (Section 1.4).

Both equity and debt capital are required to develop an institutional grade, robust, self-sustaining asset class. Ownership and funding models should seek to maximise the involvement of both sources of capital into the sector. In order to maximise access to this capital, a sound underlying risk profile and acceptable risk-adjusted returns, as well as an investment grade credit rating, are needed.

Structured appropriately, social and affordable housing could be considered as social infrastructure rather than real estate, which would have the eventual flow-on effect of lowering the cost of capital.

Finally, the Government can effectively catalyse investment in the sector through a range of financial and non-financial mechanisms. In this paper, NAB proposes that financial support can be provided in the form of a debt service subsidy, availability payment, viability gap payment or guarantee. NAB's view is that the principal non-financial options available are managing the stock transfer process to accelerate scale and adjusting the regulatory settings to create a more supportive underlying risk framework. All of these mechanisms would deliver benefits including:

- Motivating private capital to address housing affordability;
- Giving housing providers the capital they need to expand their service; and
- Creating an asset class that super funds can invest in, and that provides a social benefit to the community.

1.1 Scale

Scale is the primary barrier to funding for housing providers. Larger, geographically diverse portfolios should deliver a stronger underlying credit profile. This drives the credit rating, investor appetite and cost of capital. Optimal debt market outcomes are driven by a strong credit profile and the need to regularly access markets. In other words, market appetite for bonds within a sector or asset class can be driven higher through the volume and frequency of issuance. Therefore, scale makes the sector relevant to bond investors.

In addition, institutional equity providers typically seek to deploy minimum equity tickets of $100m-$500m, depending on the size and nature of the institutional investor.

There are some specialist infrastructure asset managers (particularly in the public-private partnership (PPP) space) that can deploy smaller parcels and are likely to participate in housing projects, given the adjacency with other social infrastructure assets. Furthermore, institutional investors are encouraged by a pipeline of significant infrastructure projects. A full pipeline of such projects will encourage investors to allocate resources to a sector or asset class – in this instance, social and affordable housing.

Impact on credit profile

Rating agencies attribute significant weighting to 'scale' when assessing the credit ratings of social housing providers. Scale also supports the ongoing strategic nature of the assets to government, which is further supportive of the credit profile. For example, under Moody's proposed methodology for European social housing providers, the number of dwellings in a portfolio drives 10% of the rating. Moody's considers scale to be a proxy for an issuer's market position[1], where:

- Larger providers potentially carry more influence in negotiations with local and national governments and other key players in the sector;
- Larger balance sheets provide resilience to financial stresses, including a housing downturn;
- Larger organisations have higher expenditure flexibility, with room to increase operational efficiency, and the ability to take advantage of economies of scale during economically challenging times; and
- Greater size typically implies broader geographic diversification.

To further illustrate this issue, NAB notes that under the current Moody's methodology for European housing providers, at least 5,000 dwellings are required to achieve an investment grade rating.[2] While the approach to ratings that is taken by European housing providers is important, it should be noted that the same criteria could not be applied directly to the Australian market due to fundamental differences in scale and regulation. For instance, only four Australian housing providers report more than 3,000 properties - Community Housing Limited (5,700), Compass (4,500), St George Community Housing (4,300) and Housing Choices Australia (3,200).

How the Government can help

Governments can accelerate scale through management of the stock transfer process. Governments have a clear policy lever available when allocating and transferring existing stock. This could be achieved by concentrating stock transfers into a limited group (or single) provider or structure, rather than spreading stock across a wide range of providers.

[1] 'European Social Housing Providers – Request for Comment' (December 2015), Moody's Investors Service

[2] Ibid

This approach would need to be carefully managed to ensure that the delivery of services and programs is not compromised as a result of higher concentration of stock ownership. On the contrary, larger operators should be able to take advantage of economies of scale in their procurement, service delivery and development activities in order to drive down overall costs and promote efficiencies.

1.2 Risk adjusted returns and yield gap

In order to be attractive to both institutional investors and banks, public housing assets must generate adequate risk adjusted returns. Return expectations vary among the investors and are influenced by a number of factors, including underlying cost of capital, foreign exchange issues, funding structures and benchmarks.

Many Australian superannuation funds target a minimum return of 8-10% for brownfield infrastructure and higher for Greenfield risk. Given rental for social housing is typically set as a proportion of household income (c.25-30%) and rental for affordable housing is set as a proportion of market rent (c.50-75%), the yields from these assets are below both market and minimum investor return requirements.

Note that, when considering yield gap, there is a need to distinguish between social and affordable housing. Both segments already benefit from a level of direct and indirect Government support. Welfare payments support rentals in social housing (and other forms of community housing such as disability and indigenous), while affordable housing residents may also receive some level of Commonwealth Rental Assistance payments.

In addition to Government funding reform, which is discussed later in this paper, the yield gap could also be reduced by diversifying housing providers' income sources and reducing the cost of asset delivery, as described below.

Sourcing other income

Internationally, housing providers have responded to a reduction in Government support by increasing exposure to other income sources, such as commercial development market rent and sales – effectively cross-subsidising their social and affordable programs. Increasing exposure to commercial developments can change the risk profile of the provider and therefore impact its rating and cost of capital.

Delivery model and cost

Another factor that influences return is the choice of delivery model. Delivery models that allow equity holders to retain some ownership of the asset are more likely to deliver a higher rate of return. This is in contrast to a delivery model in which, from the equity holder's perspective, no asset ownership is retained and therefore no terminal value is assigned to the asset – instead, total return on the asset is based solely on yield achieved during the term of the investment.

Reducing the delivery costs of housing assets could also improve the attractiveness of the asset class, as lower delivery costs would increase the rate of return (assuming there

is no associated reduction in rental). This particularly applies to funding models where the housing provider can contribute equity. There are a number of initiatives already in place which support reduced delivery costs (including the GST exemption for not-for-profits); however, there is scope to drive this further. Scale will also support this through improved purchasing power.

Availability and viability gap payments

Structures that include an availability payment, such as social PPPs - which are based on asset availability rather than demand - allow the yield requirements of investors to be met through appropriate sizing of the payment. History dictates that PPPs have been an effective way to deliver major infrastructure projects, particularly where there is a high level of social utility in the assets, the value of which can be balanced against the cost of capital.

NAB sees significant scope to adapt this model to structure a viability gap payment structure. Under this proposal, the government payment could be sized to bridge the gap between the yield from the assets and investor return requirements. As portfolios mature, even when factoring in the impact of commercial development and inflation, this payment could reduce over time. The procurement process could be run in a way that creates competitive tension in the extent of the viability gap payment. This would ensure the most efficient outcome for the Government.

1.3 Regulatory framework

The regulatory framework plays an important role in enabling the sector to access capital. Further strengthening of existing regulatory powers that can be activated in the event of distress would materially support the credit profile of the provider. Examples could include: providing the regulator with powers to rehabilitate, provide financial support, supervise, merge or amalgamate private sector housing providers. Proposals such as these, if adopted, would be incremental, but important changes to the existing system which, under the NRSCH, already contemplates protecting the interests of secured creditors[3].

In the UK, the strength of the regulatory intervention powers (and demonstrated willingness to exercise those powers), together with the maturity of the regulatory framework, are significant drivers of the rating profile of housing providers. Under Moody's proposed methodology for European social housing providers, the regulatory framework drives 10% of the rating. NAB's view is that strengthening the regulatory framework is a proxy for government support, without the need for the Government to provide direct financial support.

In addition, the sector would benefit from a common regulatory framework being formally applied nationally. This would require that Victoria and Western Australia both adopt the NRSCH. This would also require broad-based political buy-in for the

[3] 'Enforcement Guidelines for Registrars' (Version 1.0), NRSCH

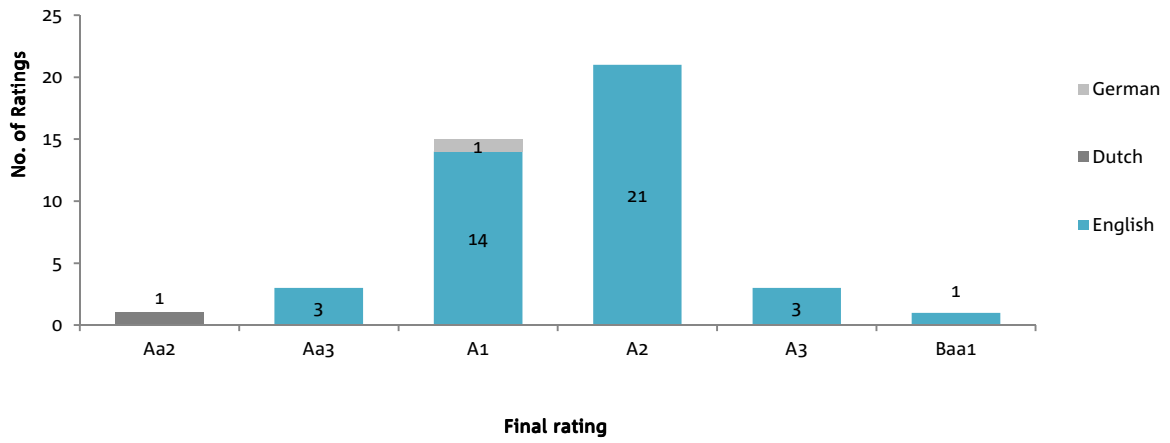
relationship between a consistent regulatory framework and increased capital to successfully flow into the sector.

1.4 Credit rating

To access debt capital markets, the providers, intermediaries and/or projects must have a credit rating. Therefore, ratings agencies are important stakeholders in the development of a financeable sector.

NAB's commentary and analysis reflects many of the issues that the ratings agencies will focus on in applying rating criteria to the Australian sector, and therefore, the ability of Australian housing providers (or projects) to achieve investment grade ratings. It needs to be noted that there are currently no rated providers in Australia. In contrast, in Europe, for instance, all 43 rated providers are investment grade (*Exhibit 1*). As noted previously, while Moody's rating methodology for Europe provides a sound basis for NAB's analysis, the rating outcomes cannot be applied directly in Australia given current differences in scale and regulatory framework.

Exhibit 1: Moody's rated housing providers[4]



[4] European Social Housing Providers, ibid.

2. Model 1: Housing loan/bond aggregator

The housing loan/bond aggregator model ("aggregator") is a debt financing solution. By pooling the borrowing capacity of housing providers, the aggregator can issue larger tranches of bonds and achieve a lower cost of capital. This would have the benefit of:

- Improving returns from the assets;
- Improving the availability of cash flow to be reinvested in the assets or deliver new assets; and
- Allow the centralisation of capital raising, therefore enabling the providers to reduce costs and focus on core service delivery.

The aggregator model could also be combined with a tax concessional regime for bonds to further reduce the cost of borrowing. There are a number of examples where tax exempt bonds have been used to stimulate investor demand and catalyse key social and economic infrastructure.

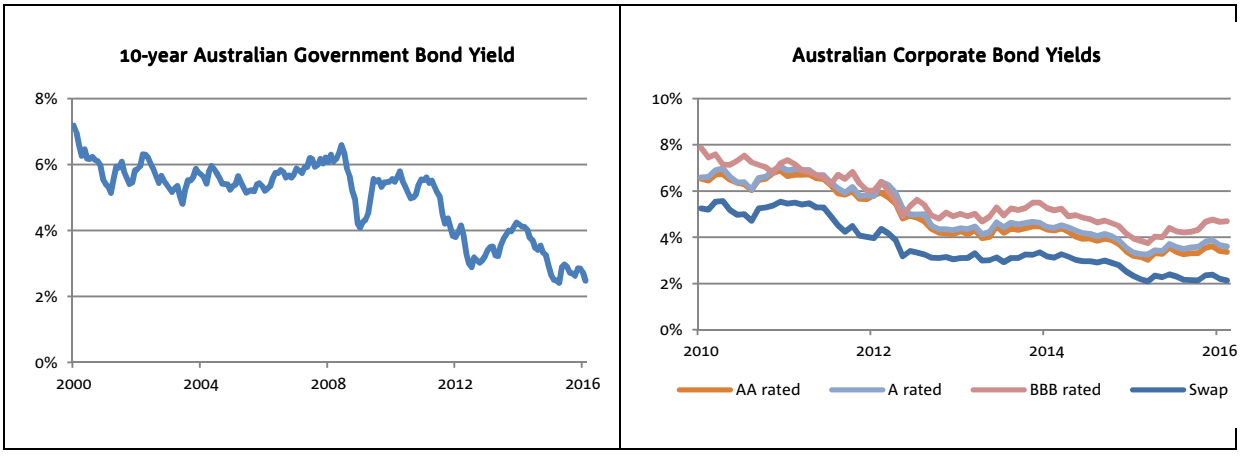
Internationally the aggregator model is not new and Australia can learn from these markets. For instance, the United Kingdom and its experience with The Housing Financing Corporation (THFC), which is rated A+/Stable by Standard & Poor's (S&P).

2.1 Advantages

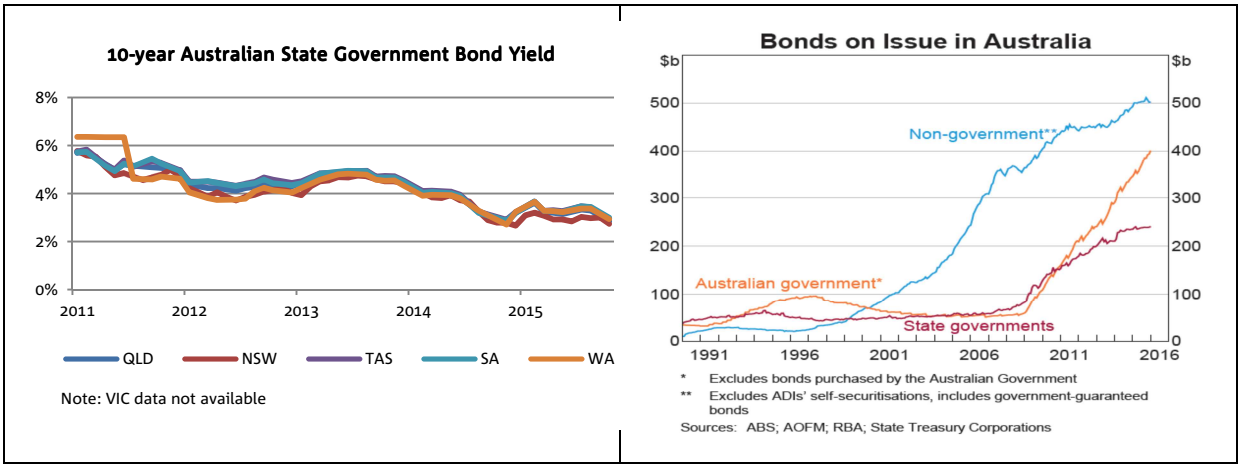
Access capital at lower cost

By consolidating the borrowing capacity of housing providers, it allows the sector to access a deeper pool of funding at a more competitive rate, particularly with Government support. Bond yields are currently in the range of 2.5-3.0% for Government issuance compared with 3.0-4.5% for investment grade corporates.

Exhibit 2: Bond Yields and Issuances[5]



[5] Source: Bloomberg, RBA Statistics



Longer tenor

Debt capital markets can also provide tenors in the range of seven to 15 years, compared with the Australian bank market, which provides maximum tenors of only five to seven years. Longer tenor reduces the housing provider's refinance risk and enhances its capacity to build up equity. It can also help the provider realise more upfront value (further discussed in Section 2.3).

Ease and speed of implementation

The aggregator model could be implemented quickly with minimal structural reform, relative to other models discussed in this paper including regulatory change, which is highlighted above. Debt investors are likely to seek some form of credit enhancement from the Government, such as a Government guarantee (Section 2.4).

Scale

For investors, the aggregator model provides a scale opportunity to invest in a new asset class. For the housing providers, the model improves access to capital without disrupting the current industry structure. In the longer term, the model could also indirectly give housing providers capacity to undertake further developments by reducing the cost of capital.

2.2 Disadvantages

Not a total capital solution

The model does not facilitate equity participation nor enhance commercial returns of the sector to support a future equity solution. In comparison, in the UK, housing providers need to contribute 20% equity. While the model delivers a lower cost of capital, it leaves the providers dependent on existing mechanisms for growth – such as stock transfers, capital grants or commercial developments subsidising social assets. Therefore, it does not overcome a number of the existing barriers.

Does not support policy reform

The model does not incentivise long term policy commitments. Changes in policy settings increase the risk of orphaned assets – i.e. where government investment or liquidity is withdrawn. While the National Affordable Housing Agreement (NAHA) outlines broad principles guiding sector investment at federal, state and territory levels, there has been a lack of longer-term supply-side commitments, particularly with the cessation of the National Rental Affordability Scheme (NRAS) and the Social Housing Initiative (SHI).

2.3 Key features

Loss provisioning

In order for the aggregator model to be successful, it needs to achieve a high investment grade rating. This could be achieved based on the standalone credit profile of the vehicle or through credit enhancement from the Government. When determining the credit rating of an aggregator in the housing context, the rating agencies focus on:

- The individual housing provider's financial position, such as asset quality and asset-liability management; and
- The broader sector's characteristics, such as the essential nature of the service provision, explicit government support and implicit support through the appropriate regulation of the sector.

In terms of financial position, capitalisation of the Aggregator to buffer for loan losses is a key rating driver. In the case of THFC, S&P's view is that the most significant weakness in its financial profile is the small size of its reserves. S&P states that THFC's rating could be lowered if its reserves are eroded as it absorbs losses in the loan portfolio[6]. Conversely, its rating could be raised if there is a much steeper build up in the capital buffer[7].

The aggregator could retain a capital buffer in the form of one or more of the following:

- A specific provision, which would only be used in the event that a housing provider borrower defaults on a payment. However, if the particular borrower does not default, then the amount is returned to the borrower at the end of the financing term. The amount retained could be up to 12 months debt service, deducted from the capital received from the bondholder. The net effect is that the housing provider temporarily receives a lower loan-to-value ratio for the duration of the loan term (as opposed to bondholders overcapitalising).
- A collective provision, which would also only be used in the event that a housing provider borrower defaults on a payment. However, unlike the specific provision, the collective provision would be retained by the aggregator as a permanent capital

[6] However, an important mitigant of liquidity risk is that THFC receives nearly all payments from borrowers one month before it is due to pay its creditors, which also provides THFC with a source of investment income.

[7] Source: The Housing Finance Corp. Ltd (February 2016), S&P.

buffer, even after any particular loan has been repaid. The amount retained could be a small margin over the coupon rate. This would be inconsistent with the UK's approach, where THFC lends on substantially the same terms on which it borrows. However, S&P states that THFC's credit rating is 'constrained by the modest level of reserving'[1].

- A fee payable by the housing provider to the aggregator, which covers running cost and a capital contribution, where the latter gives the housing provider a proportionate share of ownership over the asset. In the event of default, the entire fee would be retained by the aggregator, and the housing provider would lose its share of ownership of the asset.

Collateralisation

Collateralisation is also a key driver in rating agencies' assessment of credit rating for the aggregator. S&P states that THFC's strong standalone credit profile (rated A) partially reflects the robust collateralisation of its loan book, which has a loan-to-value ratio (LVR) of c.50%. According to THFC, all loans are secured by either:

- A fixed charge over specific property, with minimum asset coverage of 150% on a market value basis (equivalent to LVR 66.67%); or
- A floating charge over all assets, with a minimum 300% coverage (equivalent to LVR 33.33%)

In Australia, a similar collateralisation arrangement could be adopted, noting that the current average LVR for financing property through commercial banks is c.60-70%.

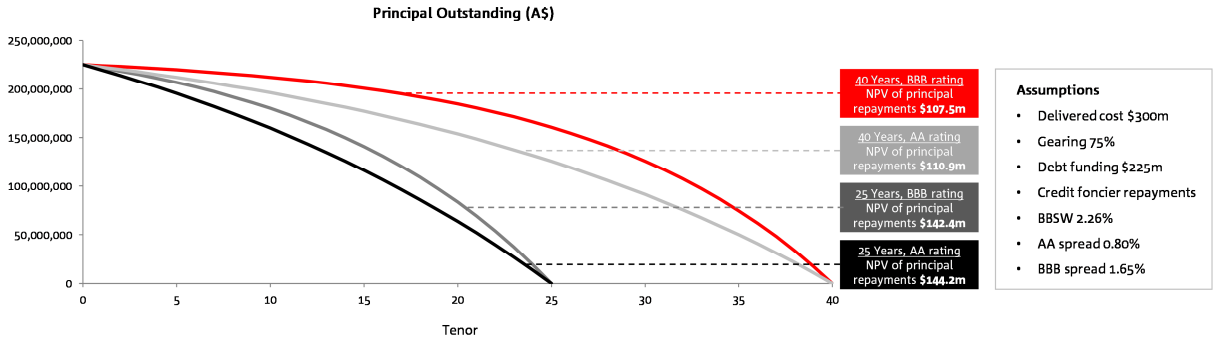
Bond insurance

Monoline insurance could be used to enhance the credit rating of bonds issued by the aggregator and further reduce the cost of borrowing. A premium is payable for the insurance and there is increasing evidence of renewed bond investor appetite for wrapped issuance from social infrastructure projects.

Tenor vs upfront value

By extending the tenor of the loan, housing providers can reduce the upfront cost and realise more value. As tenor increases, the present value of the housing provider's payments reduces, due to the slower amortisation. Hence, as shown below, upfront value can be realised through both a reduction in cost of debt (via stronger credit rating) and longer tenor. While credit ratings AA and BBB have been chosen for illustrative purposes, most Australian housing providers would probably achieve a rating closer to BBB.

Exhibit 3: The impact of credit rating and tenor on net present value (NPV) of principal debt repayments



Housing provider's liability

The liability of the underlying housing provider could be several, as opposed to joint and several, with the Government. Importantly, NAB believes that the liability of the housing providers would need to be several in order to ensure sufficient uptake within the aggregator.

2.4 Role of government

Guarantee and indemnity

The aggregator model relies on support from the Government, likely to be in the form of a guarantee for the bond issuer (the aggregator). An explicit Government guarantee could accelerate the development of new housing supply, with minimal budgetary impacts and limited public cost. While an explicit guarantee is unlikely to have a limited impact on the budget the Government would need to consider the potential impact it could have on its overall credit rating. Encouragingly, international precedents indicate that affordable housing aggregators have been assessed as low credit risk (

Exhibit 4). The social and affordable housing sector's enterprise profile is assigned a strong score of '2'[8] by S&P.

Exhibit 4: Social housing bond issuers rated by S&P

	Rating	Country
The Housing Finance Corporation	A+/Stable	U.K.
GB Social Housing PLC	A-/Negative	U.K.

[8] 1=lowest risk, 6=highest risk

Other features of an explicit guarantee to consider:

- The guarantee could be structured as 'first loss' or 'last resort', depending on the ability of the aggregator to build its capital buffers. In the case of 'last resort', loss provisions would be utilised first in the event of a default.
- Guarantees may be provided as: (a) a single guarantee for the entire pool of bonds, with default risk treated homogenously; or (b) individual guarantees for each bond issuance.

An alternative to an explicit government guarantee could be relying on implicit government support through a robust regulatory framework. While credit rating agencies may still look favourably upon implicit support, it is unlikely to attract the same extent of credit rating uplift, noting that S&P generally distinguishes between explicit and implicit support in its rating methodologies.

Alternate government support: Interest subsidy

As an alternate to an explicit guarantee, the Government could provide a limited time interest subsidy (e.g. ten years) to the aggregator. The subsidy would cover the vehicle's entire interest expense, enabling the provision of ten year interest-free loans to the borrowers (housing providers). This would allow rental to be applied to principal loan reductions, with debt refinanced at commercial rates at the end of a fixed period or once a threshold debt service ratio is achieved. Dependent on the proven ability of the aggregator model, the program could be scaled up as required in future years.

Ownership and control

Ownership and control of the aggregator vehicle will be important to consider, noting the two are not necessarily synonymous. Even if the vehicle is not wholly owned by the Government, the Government could still exercise a negative control over the aggregator through a golden share arrangement, with incremental capital being contributed by the community housing sector. In this case, an initial capital contribution by the Commonwealth would be required to establish the aggregator's legal structure; however, the absence of a guarantee and positive control of the aggregator by an independent board may allow the aggregator's assets and debt to be treated as an off-balance sheet for the Commonwealth.

Capacity, cost and leverage

Across the models of debt aggregation, the debt capacity, cost and leverage that can be achieved will differ depending on the style and nature of the support provided by government and the market conditions at the time of execution.

3. Model 2: Housing trust

The housing trust model facilitates both debt and equity participation in the asset class. While this is a significant advantage, the primary constraint to implementing the model is economic viability. Unlike the aggregator model, which relies on some form of Government credit enhancement, the trust model relies on the underlying assets producing sufficient commercial returns.

Housing trusts (or similar models) are already being used as investment vehicles in the affordable housing sector offshore in countries including the United States (US) and Netherlands. The model has had some success in both countries; however, it has been less impactful compared with the aggregator model in the UK. To illustrate, the US' Housing Partnership Equity Trust (HPET) was established in December 2012 and has provided c.1,100 dwellings over the past three years. By comparison, the UK's THFC funded c.43,000 home completions in the year to March 2014 alone[9]. This is indicative of the challenge in implementing the Trust model at a large scale.

Given the learnings from these models, NAB outlines a model that draws heavily on the US experience, including the Housing Partnership Equity Trust (HPET).

3.1 Advantages

Total capital solution

The trust model would facilitate participation from both debt and equity investors. This was the case for HPET, which launched with a US$100million fund comprising equity investments from the McArthur Foundation, the Ford Foundation and Prudential, and a line of credit from Citibank and Morgan Stanley.

Delivers scale

The housing trust model allows housing providers to achieve scale.

Outsourced operations and facilities management

The model facilitates outsourced operations and facilities management. This ensures that those tasks (and their associated risks) are allocated to the party best placed to manage them, which would result in lower operating and management costs.

3.2 Disadvantages

Returns

The key issue with this model is that it does not, in isolation, address the return issues. As noted previously, many Australian superannuation funds target a minimum return of 8-10% for brownfield infrastructure and higher for Greenfield risk. Given rental for social housing is typically set as a proportion of household income (c.25-30%) and rental for affordable housing is set as a proportion of market rent (c.50-75%), the yields from these

[9] THFC Annual Report 2015

assets are below market and minimum investor return requirements. NAB's analysis indicates that if an institutional investor funded 60% of the property value, the investor would need to receive 100% of the property's capital gains to achieve an overall internal rate of return of 7% (based on the 10-year CAGR in Australian residential property of 6.1%[10] and assuming rental yield is 4%[11]). The issue of underlying economic return would still need to be resolved in order for this model to be viable.

The issue with commercial returns is illustrated by the HPET in the US. HPET investors contributed US$100million to the trust in December 2012 and received their first dividend of US$1.32million in November 2015, representing a 3-year return of only 1.32% (implied annual return of 0.45%).

Limited market for listed infrastructure

Since the global financial crisis, there has been no market for listed infrastructure. However, equity markets have remained open for listed real estate. In order to pursue a listed structure, the Housing Trust would need to be positioned with investors in the right investment category. The significance of this is that infrastructure investors have a lower cost of capital than real estate investors.

For the listed infrastructure market in Australia, while the market has shrunk considerably, the performance of remaining infrastructure funds has recovered since the global financial crisis. The S&P/ASX Infrastructure Index has delivered a compounded annual return of 11% to investors over the past seven years. In general however, the infrastructure market has preferred unlisted investment vehicles, which provide no valuation volatility for investments.

For the listed real estate market, the property fundamentals of A-REITs remain strong, as property valuations continue to improve. The defensive nature of this asset class is demonstrated by the quality and characteristics of the A-REIT income streams, being contractual rent with lease terms of 5 to 20 years. This rent is often linked to the Consumer Price Index and the properties are typically leased by high quality tenants. This has been reflected in the S&P/ASX200 A-REITS Index, and has delivered a compounded annual return of 14% to investors over the past seven years.

Initial fund required

The housing trust model is likely to require a cornerstone equity commitment in order to launch, which would be provided either by the Government or ESG/SRI/philanthropic investor. In the United States, HPET was launched with an initial equity investment of US$100m from the MacArthur Foundation, the Ford Foundation and Prudential Financial Inc. – the former two being philanthropic organisations.

[10] From Sep-05 to Sep-15. Source: Australian Bureau of Statistics 6416.1 Residential Property Price Index.

[11] Represents the approximate yield achieved on affordable housing, according to a major Australian housing provider

Gearing

Gearing at the trust level would depend on the cash flow profile of underlying assets, after operating and capital expenditures. Therefore, the economic return on the underlying stock remains the key factor for success.

4. Model 3: Housing cooperatives

Housing cooperatives serve as a delivery model, rather than a financing model. This section focuses on the non-equity rental housing cooperative model, rather than the full equity and shared equity models. NAB's view is that the non-equity rental model would be the most sustainable and viable, given most housing providers still need to grow their equity base to access capital.

As with the previous models outlined in this paper, cooperatives are not new to the sector. The model is in operation in Northern Europe, Canada and the United States. The model was also more commonly used in Australia during the 1950s and 1960s, when cooperative societies were a key housing financier, alongside banks, building societies and credit unions. Australia is in a position to learn from these markets, building on its past experience, to optimise its success in this area. The most commonly used cooperative model in Canada is the non-equity rental model, and would therefore be the most relevant to an Australian market.

Advantages

The key benefit of the cooperative model would be its short term economic viability as it promotes a relatively higher rental yield. Non-equity rental cooperatives typically allow for a mix of tenants – for instance, in Victoria, registered housing agencies are expected to take up to 50 per cent public housing eligible tenants, with the remaining being other household tenants[12]. Low-income households who pay discounted rent are supported by moderate income households who pay market rent, which increases the overall rental yield of the asset.

Disadvantages

The cooperative model would reduce the incentive for providers to consolidate, thus allowing the fragmented nature of the industry to persist. This limits the scope for external institutional capital into the sector.

Key features

Existing housing stock acquired needs to be in relatively good condition. One of the benefits of the cooperative model is its ability to accumulate surplus funds. However, if the stock acquired is in poor condition, maintenance capital expenditure could deplete these surplus funds.

Government role

The cooperative model would require initial Government support in the form of direct funding or provision of land/stock, given the non-equity nature of the model. This has been the case in Canada, where the Canada Mortgage and Housing Corporation (CMHC) provides grants to cooperatives, on the condition that the housing is provided for low-to-moderate income households.

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[12] 'Guidelines for Registered Housing Agencies' (September 2015), Department of Human Services Victoria

5. Model 4: Impact investing models, inc. social bonds

Any approach taken by the Commonwealth to have a positive social impact through the provision of affordable and/or social housing can be seen as an impact investment (subject to measurement). This includes the approaches outlined in sections two and three above, which could be structured as impact investments and appeal to "impact investors" if the necessary measurement tools are in place. However, the cost of housing and the scale of the task would be significant. Therefore, this could have a negligible impact on the cost of addressing the issue.

Despite predictions, impact investment capital is scarce and comes in a range of forms, with most investors being "financial first" investors – this is particularly true for investors in debt instruments. Most "impact first" investors provide capital in the form of equity, which is of greater value to all parties.

Given the scale of the problem, focusing on a solution which enables access to the lowest cost of debt and equity capital is likely to be more cost effective than seeking to deploy a scarce investment resource (impact capital); as impact investors seek a similar level of return to other investors. Social benefit bonds created through the NSW Government social impact policy are variable interest products, with returns of up to 15% depending on the impact delivered. Consequently, the potential cost of a social benefit bond is prohibitive, in the context of the scale of the affordable housing problem.

6. Conclusion

NAB supports the development of government policy in this vital sector and welcomes efforts to review the existing framework.

For investment to be catalysed, the specific requirements of the affordable housing sector need to be acknowledged and supported by a revised framework that directly addresses its unique challenges.

By focusing reform on areas outlined in this paper – increasing scale, risk adjusted returns, yield gap and regulatory provisions – the affordable housing sector will be in a significantly better position to attract long-term investment, and in turn, enable the Government to better support this segment of Australian society.