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UDIA Submission on Innovative Funding Models for Affordable Housing in Response to the Issues Paper Released by the Affordable Housing Working Group of the Council on Federal Financial Relations

The Urban Development Institute of Australia (UDIA) welcomes the opportunity to provide this submission to the Affordable Housing Working Group ("the Working Group") of the Council on Federal Financial Relations.

UDIA is the peak body representing the interests of the development industry around Australia, acting on behalf of over 2,500 members across the country, from a wide variety of fields and professions.

The property development industry is a major contributor to the Australian economy.

- It is the fourth largest industry in Australia in terms of its contribution to GDP. It directly accounts for 7.3% of GDP and, taking into account indirect impacts on the rest of the economy, delivers an additional 6.2% of national output.
- Almost one in ten Australian workers are employed in property development, with the industry directly accounting for over 9.1% of the workforce. In comparison, the mining industry employs less than 2% of the workforce. Property development employs further people through its indirect impact on the rest of the economy.
- Conservatively, the property development industry, both directly and through associated industries, generated in excess of $29.7 billion of state and federal taxes.

As one of the wealthiest countries in the world, affordable access to quality housing (both for rent or ownership) should be one of the most basic rights enjoyed by all Australians. Unfortunately, this is increasingly not the case. Rapid increases in the cost of housing over the last few decades have greatly outstripped increases in income, putting not only low income and vulnerable households, but also a growing number of middle income households, under tremendous financial strain.

The relationship between prices and supply is borne out in the UDIA 2016 *State of the Land* report. This report shows that supply (measured in lots released) in Sydney fell by 4.6% between 2014 and 2015 while the median lot price rose by 29.7%. Meanwhile, in Melbourne, supply rose by 53.3% between 2014 and 2015, with the median price rising by a modest 3.8%.

The causes of, and solutions to, poor housing affordability have been outlined comprehensively in multiple past inquiries and reports into housing affordability, tapping institutional investors to help fund affordable housing, and home ownership undertaken by Senate committees, the Productivity Commission, and COAG among others, over many years. In that time, the core issues have not changed, with supply of ample and affordable development sites being the ongoing major issue.

Australia has one of the largest institutional funds pools in the world, and yet – unlike in other parts of the world – none of these fund affordable rental housing. Many studies have been done and governments are well aware of the options. It is now time to take action to ensure all Australians can be housed while still being able to afford to live.

Affordable housing is important, not only to the productivity and liveability of cities our but also more widely in supporting the economy and our growing population.

Recommendations

The Commonwealth should:

- Stimulate and reward states that actively increase new and affordable land and housing supply
- Take a structured and active role in encouraging state governance models that create and deliver visions and ample and affordable supply to meet population forecasts
- Provide additional funding for investment in new urban infrastructure, in order to unlock zoned land supply and ensure regulator governance and productivity is a factor in these investment decisions.

To encourage a greater flow of finance to affordable housing, the Commonwealth should consider:

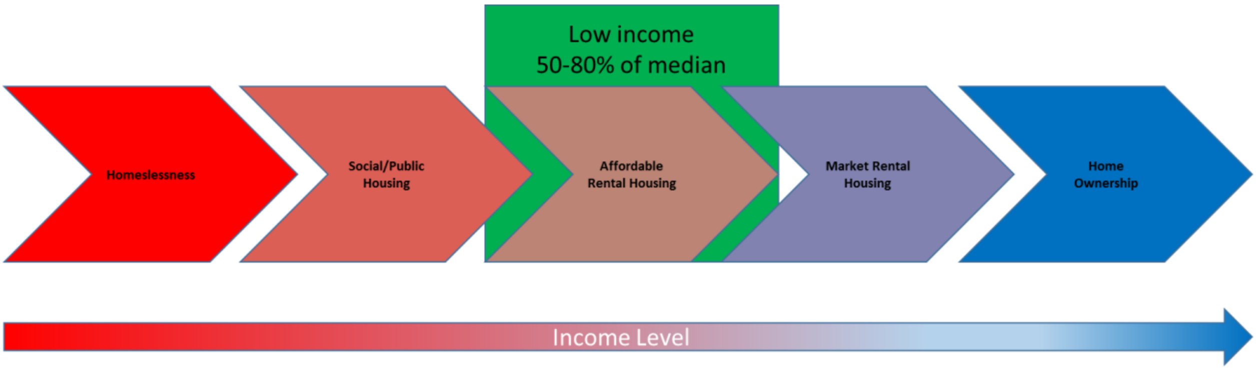
- Guaranteeing loans to the Community Housing Provider (CHP) sector
- Removing barriers that exist that prevent CHPs from recycling their assets
- Continuing and expanding NRAS and amending Division 6C of the *Income Tax Assessment Act 1936* to enable the policy to work as intended
- Raising or guaranteeing affordable housing bonds
- Extending the DHA delivery and financing model to provide new affordable housing sector supply through private financing.

What is Affordable Housing

Affordable housing is usually defined as housing for the second quintile of income earners – those who do not qualify for social/public housing but who cannot afford market rental housing without being placed in housing stress.

The housing market in Australia is complex and can be seen as a continuum (see diagram below). It is important to recognise that affordability for different types of housing tenure are connected, with factors such as interest rates, house prices, and rents interplaying across the owner occupier, private rental, and social housing sectors. For example, high house prices increase demand in the rental market, and high rents can lead people who could otherwise be in the market rental housing sector to seek affordable rental housing. When this occurs, those who were in the affordable rental housing sector can be crowded out, and could be forced onto the social/public housing sector waiting lists or become homeless.

DIAGRAM 1 – THE HOUSING CONTINUUM



UDIA considers that increasing supply is the only sustainable solution to the provision of market supplied affordable housing for purchase and rental markets. Increasing the housing supply/stock will ensure that supply can meet or exceed demand, therefore moderating price increases, leading to more affordable housing ~~being~~. Any policy settings or measures that undermine supply of affordable housing will increase the scale of the existing affordability crisis.

Supply constraints, government levies and charges and productivity in delivering supply is primarily under the direct purview of state and local governments. However, the current messaging from the Turnbull Government around the introduction of “value capture” mechanisms raises significant concerns for future affordability. This potentially means that the Commonwealth is looking to burden more taxes on new housing supply and therefore contributing significantly to Australia’s affordability crisis.

UDIA has evidenced that delayed, complex, uncertain, and restrictive planning regimes and new home buyer levies at the state and local government level are often a major supply side barrier to affordable new housing being delivered. We encourage the Commonwealth government to implement measures to encourage higher productivity and supply at state and local government levels but UDIA is now concerned that the Commonwealth may be considering additional levies and charges on new home and apartment buyers via the label of “Value Capture”.

In 2012 the COAG Housing Supply and Affordability Reform (HSAR) working party report[1] identified “multiple instances where developers and builders faced significant delay, uncertain time frames, and unpredictable regulatory frameworks in bringing new land and dwellings to market”, which

[1] COAG 2012, *Housing Supply and Affordability Reform*, < https://www.coag.gov.au/node/451 >

increases the cost of housing by adding to holding costs and business risk, and lowers the overall supply of new dwellings.

The extent of delays caused by planning and approvals regulation was highlighted in the 2011 Productivity Commission Report on Planning, Zoning and Development Assessment, which found that across Australia's five largest cities, it can be as long as a decade from the commencement of rezoning to subdivision approval and the installation of infrastructure[2]. Holding costs comprise a significant proportion of the end cost of land and new housing, so significant delays in planning, zoning and approvals can have a marked effect on affordability.

In the affordable housing segment of the market, providers compete in a commercial environment for land, construction services etc, whilst offering below market rental housing. Some level of on-going subsidy will be required to not only continue to operate day-to-day but also to make provision for future supply growth. Commonwealth Rent Assistance does not guarantee any new supply of affordable housing nor ongoing maintenance costs.

It is also important to acknowledge Australia's unique housing model. Australia does not rely on huge outlays to fund social housing. Australia relies on one major policy setting being the combination of negative Ggaring and capital gains tax. Negative gearing is used by private investors in both the affordable rental and market rental sectors. That negative gearing support is clawed back through the capital gains tax system when a property is sold. UDIA considers that this remains the most efficient and proven way to deliver rental accommodation, given our low yielding nature of residential. Negative gearing and capital gains tax are vital incentives to stimulate private investment in rental supply. The UDIA believes that any changes to the existing negative gearing/capital gains tax regime will be detrimental to Australia's unique housing investment model and result in a reduction in housing supply. This will put enormous pressure on governments to fund potentially billions to supply and manage rental accommodation and social housing.

Financing Models for Affordable Housing

Over the last 10 years or so, governments have been looking for ways to further encourage private sector investment in affordable rental housing. This is because governments can no longer afford or have a desire to hold large portfolios of social/public housing. These state ownership models are seen as providing poor outcomes for tenants and the tax payer.

However, even with private sector involvement in the affordable housing sector, government subsidy of some sort will likely be required given the low yielding nature of residential housing. What is necessary to stimulate private sector involvement and investment in housing is a long-term commitment by government to a level of subsidy and/or incentive that ensures viability, as well as a long-term commitment to stability in the policy environment. Without these certainties, investors will continue to see the sector as high risk and low yield and migrate to other asset classes.

[2]Productivity Commission 2011, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessment*, < http://www.pc.gov.au/inquiries/completed/regulation-benchmarking-planning >

This section looks at five strategies the Working Group should consider to finance and fund affordable rental housing in Australia.

Government guarantor for loans to CHPs

One of the major difficulties Community Housing Providers (CHPs) face is in obtaining finance to purchase land upon which to build affordable housing. In purchasing land, they are frequently in competition for "good" sites (those with high access to services, jobs and transport) with fully commercial operators.

The Commonwealth could use its superior balance sheet and borrowing power to provide a bank guarantee to CHPs, on terms that the Commonwealth stipulates. This would have the effect of making money cheaper for CHPs and increase their ability to leverage their holdings into more affordable housing.

A bank guarantee would not require any outlays by the Commonwealth. It would only be called upon in circumstances of default, as it would be budgeted as a "contingent liability".

A policy such as this could also encourage consolidation and increased managerial professionalism in CHPs, as the Commonwealth could insist on a certain scale and diversity in investments before committing to individual CHPs.

The Commonwealth already runs a number of "guarantee schemes", one of which is the Accommodation Payment Guarantee Scheme that guarantees the repayment of aged care residents' accommodation bond, entry contribution balances and, from 1 July 2014, refundable accommodation deposits and contributions if the approved provider becomes insolvent or bankrupt and defaults on its refund obligations.[3]

The government should consider a scheme to guarantee the loans of CHPs.

[3] http://budget.gov.au/2015-16/content/bp1/html/bp1_bs8-08.htm

Asset recycling by CHPs

Asset recycling could be a very successful way for CHPs to accumulate capital and use this capital to build affordable housing.

In this model, CHPs develop (or partner with private for-profit developers) a mixed tenure development, where a proportion of the dwellings are offered to the market at full market price, while others are retained for rent at full market rent, while a further proportion is offered as affordable housing below the market rent.

CHPs (and their joint venture partners) are then able to use the "value uplift" in the dwellings offered for sale, and recycle this capital into their next affordable housing development.

Where there are impediments at the Commonwealth, state and local level to this model, these should be removed, including where a CHP's deductible gift recipient status is threatened by engaging in these commercial-like activities.

An added bonus to this type of development is that it can also assist in mixing tenants throughout a development, which has been shown to provide social advantages. It also allows a transitioning from affordable rental housing, to market rental housing to home ownership in the one development as needs change.

The government should remove all impediments that prevent CHPs from asset recycling. Asset recycling could also be used in combination with a government guarantee for loans to CHPs.

The National Rental Affordability Scheme

Since its launch in 2008, the National Rental Affordability Scheme (NRAS) has successfully incentivised the construction of tens of thousands of homes affordable to those on low incomes, by providing investors with an attractive investment return. Whilst recognising that there is room for improvement in the administration of the scheme, UDIA considers that NRAS has proven to be successful in its goal of increasing the availability of affordable rental dwellings, and as such, supports the continuation and expansion of the scheme.

However, from its inception, NRAS was set up in a way that was destined to achieve only a relatively modest boost in affordable rental housing, as institutional investors saw little benefit in coming into the scheme. For example, NRAS incentives were not of sufficient scale to attract institutional investment, and even then the return on investment was not high enough to compensate for the perceived tenant and liquidity risk. In addition, NRAS could not catalyse a "real estate investment trust" model for affordable housing because Division 6C of the *Income Tax Assessment Act 1936* stood in its way.

The Commonwealth should continue and expand NRAS and amend Division 6C of the *Income Tax Assessment Act 1936* to enable the policy to work as intended.

Bonds

Institutional investors have said on many occasions that they would invest in social housing if there was an investment vehicle that provided a return above the government bond rate, is relatively low risk and relatively liquid. There is a significant opportunity to tap Australian (and international) superannuation and sovereign wealth funds if the right institutional investment vehicle was created and the policy environment was accommodating.

A framework is required to ensure private capital can be attracted and sustained at the scale required to reduce public funding. This framework should involve the issuing of a credit-rated corporate bond, the involvement of an intermediary to issue the bond and allocate to capital to CHPs and developers, and a large housing delivery pipeline.

Bonds are widely understood and can be evaluated for their risk/return. Advantages include that they are:

- tradeable
- relatively liquid
- a financial product, and therefore investors and financial intermediaries do not need to be involved in the management of the housing assets
- cheaper and less complicated than equity funding
- easier and less expensive for CHPs and developers to obtain finance through, if government-backed, than bank debt.

In order to make bonds a successful way to finance affordable housing, a national programme would be required. Without a national programme, scale, liquidity and diversity would not be achieved and institutional investors would be less likely to be interested.

It is important to also realise that raising a bond does not result in "free" money. At some point the bond needs to be paid back. It is therefore important that the CHP sector grows to ensure its long-term viability and is able to accumulate assets and income to enable it to pay back the bonds. It may also be necessary for governments to fund or guarantee the whole or some of the bond upon maturity.

It is imperative that the Commonwealth government works with institutions to ensure these initiatives will work. A "proof of concept" phase should be used so that tweaks can be made within an overall settled policy environment, to ensure ongoing success. Once the concept is proven, full roll-out should commence immediately.

The government should work with institutions to raise or guarantee affordable housing bonds.

DHA Delivery and Financing Model Extended to the Affordable Housing Sector

There is no silver bullet for financing affordable housing. Even the Defence Housing Australia sale-and-leaseback model requires a subsidy from the Department of Defence (and some other government agencies) in excess of $500m per annum (shown in the annual report as income from housing services provided), although through the DHA Investment Managament Limited fund, they have been able to attract institutional investors.

That said, DHA generates significant capital to meet its affordable housing provisioning commitments through their sale-and-leaseback programme, through the sale of surplus land, and the disposal of properties surplus to requirements. As DHA essentially provides “keyworker” housing for Defence personnel, there are considerable lessons to be learned from the sale-and-leaseback model.

The possibility for DHA to be used more broadly for key worker housing should be explored. This would require a change to the Act under which DHA operates, and also a change to where and how DHA receives it subsidy, along with other policy and legal changes to ensure its viability.

Another possibility is for the CHP sector to take up the sale-and-leaseback model on a wide scale. This would still require government involvement, either in terms of a rental guarantee (which is part of the rental agreement between owners and DHA) or some kind of underwriting of rental payments by government, with CHPs responsible for an amount of arrears to minimise moral hazard.

The government should explore opening up DHA to provide affordable housing and also explore the possibility of the CHP sector taking up the sale-and-leaseback model on a wide scale.

CONCLUSION

UDIA thanks the government for the opportunity to provide this submission on Housing Affordability. UDIA would welcome the opportunity to discuss any aspect of this submission in greater detail. For further information, please contact UDIA National on 02 6230 0255 or at udia@udia.com.au.