National Housing Finance and Investment Corporation

Consultation Paper

SGCH Submission

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Contact details

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Overview of SGCH Group

SGCH is the largest community housing provider in NSW, providing a place to call home for more than 8,900 people in 4,700 properties across the Sydney metropolitan region. We develop and manage sustainable, safe and affordable homes and work in partnership to create vibrant, inclusive communities.

Our vision is great places for everyone. Our business is people and places. We develop and manage sustainable, safe and affordable homes and work in partnership to create vibrant, inclusive communities.

SGCH applies commercial principles to the pursuit of our purpose of connecting people to opportunity and collaboratively shaping great places through sustainable, safe and affordable housing.

The group comprises three Tier 1 entities registered under the National Regulatory System for Community Housing: St George Community Housing Limited and two wholly owned subsidiaries, SGCH Portfolio Limited and SGCH Sustainability Limited.

SGCH is currently delivering on a development pipeline of 802 affordable housing dwellings, of which 149 have already been completed. SGCH has an ongoing partnership with Clean Energy Finance Corporation (CEFC), Westpac and Commonwealth Bank of Australia (CBA) though which SGCH currently has more than $240m of committed financing to help us deliver on this substantive program.

Latest update

In October 2016, the Department of Family and Community Services (FACS) announced the outcome of the Social Housing Management Transfer Program to transfer the management of around 14,000 social housing properties in four FACS districts across NSW to the community housing sector.

SGCH has been announced as the successful community housing provider to be awarded Service Package 9 – North Sydney which includes social housing properties in North Sydney, Hunters Hill, Lane Cove and Willoughby local government areas. This means we will be working with FACS and tenants to transfer the management of around 1,400 existing tenancies to SGCH and we will take over the coordination of the social housing system in these areas, providing tenant support coordination as well as property and tenancy management.

The current timeframe for the transfer of these properties is proposed for Quarter 2, 2019. Following this transfer, the number of properties managed by SGCH will be well in excess of 6,100 properties.

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Executive Summary

Affordable housing is critical infrastructure that is the backbone of strong communities and a vibrant economy. The National Housing Finance and Investment Corporation (NHFIC) has the potential to be a significant pillar of the affordable housing market, working alongside other initiatives, incentives and programs to increase the delivery and long-term operation of affordable housing in Australia.

As one of the largest community housing providers (CHPs) in NSW and nationally, SGCH Group manages 4,700 homes and has a development pipeline of 802 affordable housing dwellings which will be funded, in part, by more than $240m of committed financing from our financing partners CEFC, Westpac and CBA. Based on our experience establishing these financing facilities, we see that with the right policy settings, the NHFIC has the potential to offer a significant and complimentary form of financing for organisations like SGCH.

The following presents a summary of the key features we would see as providing the right settings to ensure the bond aggregator (BA) contributes to the market and drives efficient capital solutions:

- **Government guarantee** is essential until a track record is established and bonds offer better liquidity to investors. A government guarantee will also establish confidence in the asset class and the importance of this sector to government (a key rating consideration), enhance pricing and allow time for resolution of (currently fragmented and complex) regulatory and contractual issues across jurisdictions and programs.
- **Funding the yield gap** – ultimately, the ongoing success of recurrent tranches of funding offered by the BA rests on federal and state government commitments to additional, recurrent revenue to close the yield gap inherent in the provision of (particularly) social and affordable housing. As such, we suggest that the yield gap 'funding solution' be an integrated part of the BA implementation phase.
- **Security for loans** under the BA ultimately impacts on whether this form of funding can be complimentary to existing and future private and public sector investment into the CHP sector – we submit that security should be on an unsecured / subordinated basis to complement existing forms of financing available in the market.
- **Tenor vs pricing** – borrowers such as SGCH will likely seek to achieve an optimal balance between tenor and pricing. As such, we encourage NHFIC to explore pricing impact of shorter tenors (between 5 to 10 years) and longer tenors (10 years plus).
- **Minimum bond aggregator loan size** for CHPs should be put in place to ensure cost efficiencies for NHFIC (and ultimately CHPs).
- **Administrative burden** – ensure administrative and reporting burden on CHPs is minimised given existing reporting requirements to numerous stakeholders.

As the NHFIC and the bond aggregator moves into the implementation phase, ultimately the 'devil will be in the detail'. This will be particularly relevant for resolving issues such as complementarity and security for loans. However, if these issues, along with fundamental corresponding issues such as funding to close the yield gap are addressed (and not avoided or left for later), we believe the NHFIC can be the turning point which will catalyse significant growth in the CHP industry to deliver and operate the affordable housing that Australia needs.

Section 2 - National Housing Finance and Investment Corporation

Issues for consideration
1. **Structure** – The proposed 'one entity, two functions' structure for the NHFIC, including how the NHIF and bond aggregator functions can be designed to ensure that they are delivered effectively?
2. **Governance** – The proposed NHFIC governance structure, including: the role of the independent board; what issues may be reflected in the investment mandate; and the potential role of the Government in decision making?
3. **Resourcing** – Whether 30 staff members split across the NHIF and bond aggregator is likely to be sufficient; the potential outsourcing of some NHFIC functions; and whether the self-funding objective for the NHFIC is attainable and if so, over what timeframe?
4. **Engagement** – How can the NHFIC effectively engage with stakeholders across Australia to ensure that viable projects are identified?

Learnings from CEFC

SGCH currently has $170m of committed finance from CEFC to build social and affordable homes to high standards of energy efficiency. CEFC appears to share many similarities with the intended functions of the NHFIC in terms of both an investment / lending function into the community housing sector as well as having substantial ties with the Australian Government.

From this perspective, CEFC could be a useful case study in terms of learnings that could be applied by the NHFIC for consideration around both the setup and ongoing operations. This would inform many of the issues raised for consideration around structure, governance and resourcing.

Self-funding objective

In relation to the potential self-funding objective of the NHFIC, recovery of operational costs would appear reasonable. However, we would seek that the quantum of fees charged / costs recovered consider the following:

- considered against some form of cost benchmark on the basis of an efficient, full-scale operations (i.e. on the basis that there are regular BA issuances occurring to spread the costs);
- minimum lend level for CHPs to ensure NHFIC achieves relative scale and cost efficiencies; and
- ensure early adopters are not penalised – we would see the implication of this being that the NHFIC would be operating at a loss for a number of years as the fees charged back to CHPs would be less than incurred operating costs (i.e. until such times as the NHFIC reaches full scale cost efficient operations).

Section 3 - National Housing Infrastructure Facility

Issues for consideration	
1.	**Infrastructure** – Noting the examples identified in Table 4, what types of infrastructure do LGs fund, deliver and own? What types of infrastructure could be prioritised to address infrastructure bottlenecks?
2.	**Design features** – Are the design features appropriate, including the considerations that the NHIF could take into account when assessing projects?
3.	**Financing options** – Are the types of tailoring potentially available under the NHIF's three types of finance sufficiently flexible?
4.	**Metrics** – What metrics could enable assessment of infrastructure bottlenecks and housing supply and affordability pressures?
5.	**Financing arrangements** – Could the NHIF expand 'eligible applicants' to include a consortium of investors, such as institutional investors, social impact investors, CHPs and other stakeholders (for example, state and territory governments)? In addition, what could a partnership with LGs involving a NHIF equity injection look like? Are there further opportunities for aligning the interests of investors and other stakeholders to create incentives for co-investment to accelerate housing developments? Given the long lead times associated with the infrastructure construction, what are the appropriate repayment timeframes (on the loans and equity)?
6.	**Complementarity** – Given existing state and territory lending facilities, how can the NHIF position itself so that it complements the state and territory financing schemes and private sector finance options?
7.	**Affordable housing** – Should the NHIF also focus on facilitating the supply of affordable housing, including for key workers? If so, what is the most effective way to achieve this objective?
8.	**Value uplift** – How should the NHIF factor value uplift and associated value capture schemes into its investment decisions?

Affordable housing outcomes

One of NHIF's key objectives is currently stated as "*boosting and accelerating the supply of housing through investment in housing-related infrastructure*". At a national level, $1 billion of funding through the NHIF is unlikely to make a major impact on broader housing affordability unless this funding is targeted towards a more specific set of outcomes.

Issue item 7 raises the possibility of NHIF funding being tied to the provision of affordable and/or key worker housing. Tying NHIF funding to affordable housing outcomes is an approach we strongly endorse. Providing a more narrow and clear focus on the housing outcomes being sought from the funding will address / provide more direction on many of the issues which have been raised for consideration such as:

- clearer focus on design features and assessment criteria for funding applications (including metrics used for assessment) resulting in a streamlined application and assessment process;
- ensures the NHIF is complimentary to state and territory initiatives, particularly if 'eligible applicants' are expanded to include CHPs; and

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- maximises leveraging by tying the use of funds to long-term affordable housing outcomes rather than potentially creating leakage into general outcomes (without any additionality of affordable housing).

Design features

The concept of 'additionality' is difficult to measure and quantifying the potential impact of NHIF funding on the 'additionality' for a project is likely to be quite subjective. The subjective nature of an assessment process is difficult to avoid - however, having a clear focus on affordable housing outcomes will at least narrow the focus on long term outcomes and likely avoid the benefits of the NHIF funding leaking into general and opaque outcomes. Therefore, as part of linking the NHIF funding to affordable housing outcomes, our view is that the definition of 'eligible applicants' should be expanded to include CHPs. Focusing the use of these funds to achieve affordable housing outcomes and allowing CHPs access to the NHIF funds will allow consideration of measuring 'additionality' based on factors such as:

- **additional** affordable housing delivered – improved project feasibility for affordable housing projects if NHIF grants / lending is provided to CHPs for a portion of the project costs attributable to housing-related infrastructure (for lending, this should be considered at a subsidised rate, for longer tenor and on a subordinated basis to improve feasibility and deliver more affordable housing); and
- affordable housing delivered in **improved** locations – NHIF funds should be provided where additional incremental funding results in affordable housing being delivered in higher value locations that provide better connections to public transport and employment opportunities. NHIF money could be used to fund incremental cost of land and other housing-related infrastructure costs where they are higher than those typically encountered on other affordable housing developments, therefore improving the location outcome for the affordable housing project.

In relation to the latter point, the form of financing could be linked to tenant cohorts. For example, grants could be tied to provision of housing to 'social housing' eligible households (tenant rents not linked to location) whereas lending could be provided to fund the provision of housing to tenants with key worker households (rents linked to market rates).

From the perspective of the broader assessment process, we would suggest that:

- the NHIF funds be accessible by a pipeline of smaller projects to deliver earlier and more consistent flow of outcomes;
- less focus be placed on large urban regeneration / greenfield projects on state owned land – these projects will likely go ahead without NHIF funding and can take 10+ years to deliver; and
- clarity around expectations with regards to applications to ensure cost efficiency and timing certainty for applicants.

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Financing options

We would question how the $225 million ring-fenced for equity investments would work. Our view is that a NHFIC (/Australian Government) equity stake in a project would be complex and challenging to implement and likely lead to significant transaction costs. With this being the case, our view is that this money would be better served if transferred into the grants and/or lending pool (which could include 'equity like' investment into CHP projects with back ended returns).

Financing arrangements

As highlighted above and given CHPs (as developers) invest into the 'housing-related infrastructure' described in the consultation paper, our view is that the definition of 'eligible applicants' should be expanded to include CHPs.

In order to maximise affordable housing outcomes and best utilise / leverage the use of the NHIF funds, our view is that lending to CHPs could be provided on the basis of subsidised cost, on a long-term basis (e.g. 10 - 20 years to match the long-term nature of the assets being funded) and on a subordinated basis. The Australian Government is in a position to provide flexibility on these terms (compared to banks) – this would maximise the use of the funds on offer from the perspective of achieving long-term affordable housing outcomes.

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Section 4 - The affordable housing bond aggregator (BA)

Issues for consideration
1. **Eligibility** – It is currently envisaged that the bond aggregator will only provide loans to Tier 1 and Tier 2 CHPs. Could there be benefits to expanding the eligibility criteria to include other stakeholders involved in the provision of affordable housing?
2. **Purpose of loans** – The bond aggregator's loans are expected to be primarily used for funding housing maintenance and turn-key purchases. Do stakeholders agree with this focus? Is there scope for the bond aggregator to provide construction finance or should the bond aggregator be prevented from providing such finance?
3. **Security for loans** – What forms of security should CHPs be asked to provide to access bond aggregator loans? Are there any circumstances where such loans could be unsecured? If security is provided, to what extent should it be collateralised against other assets owned or operated by the CHP? What forms of financial covenants from CHPs should exist alongside any security? If a CHP has multiple secured creditors, how should the security in favour of the bond aggregator rank?
4. **Complementarity** – How could the Government ensure that the bond aggregator complements and partners with existing private and public sector investment into CHPs?
5. **Bond issuance** - Could affordable housing bond issuance be expanded to the offshore market or the retail bonds market? What are the potential benefits and costs?
6. **Bond issuance size** – What is the likely preferred issuance size for large-scale institutional investors?
7. **Contracting out functions** – Are there potential benefits from contracting out bond issuance and back-office functions? What are the potential costs?
8. **Government guarantee** – How would a potential Government guarantee on NHFIC bond issuances impact the NHFIC's ability to raise and price funds? What are the risks associated with applying a guarantee and how could those risks be mitigated?

Eligibility

The Australian CHP sector is growing and has demonstrated capacity which can be leveraged with an efficient source of capital. The Australian Housing and Urban Research Institute research project '*Affordable housing industry capacity'* notes that "Australia's emerging affordable housing industry has considerable potential to expand".

Whilst recognising the need to balance factors such as portfolio diversification and capacity building across the sector, our view is that availability of BA loans should be targeted to sophisticated Tier 1 type CHPs with proven management and operational capabilities. This, coupled with a minimum loan size for CHPs, will achieve cost efficiencies for NHFIC (with respect to both due diligence and ongoing monitoring activities) and maximise the ongoing success of the BA.

We utilised the phrase '*sophisticated Tier 1 type CHPs*' – in relation to the question of limiting the availability of BA loans to Tier 1 and Tier 2 CHPs, we are relatively agnostic about whether the tiered approach is a compulsory component of how an organisation's capability is

measured from a regulatory perspective. However, our view is that limiting to Tier 1 and Tier 2 CHPs is a useful starting point on which further assessment is overlaid to ensure a CHP has the capacity to participate in the BA and manage the BA loan over the long term. It may also go some way to addressing issues of counter party risk (reputational and other risk) for participants in a BA issuance. The group of CHPs approved for BA loans need to have a demonstrated track record of proven management and operational capabilities at scale in this sector – otherwise the risk profile is significantly altered and the credit underpinnings of the BA vehicle may be questioned.

Our experience over the last decade of expansion has shown us that putting in place the necessary expertise in senior management and governance, as well as developing the in-house capabilities to manage at scale, takes time to develop, and though not universally the case, is in our observation in part a function of scale of operations. This is particularly true in 'non-core' services areas which have typically not been the domain of small scale CHPs but are now an essential part of operating at scale and taking on significant levels of financing – these include areas such as development, asset management, risk management and corporate finance & treasury.

Purpose of loans

Given the proposed long-dated tenor and non-amortising nature of bullet bonds, it is essential that flexibility for CHPs be afforded in relation to the purpose of the use of funds. As such, we would agree that a focus on 'general corporate' purpose appears reasonable.

With respect to the issue of use of funds for construction, although the EY Report distinguishes between the two uses (which we agree with), we felt that it was important to confirm our understanding of 'construction finance' under the BA:

- new dwellings being constructed which form part of the security for the loan (if required) and/or measure of financial and other covenants – under this scenario, we agree that this should be excluded from an eligible purpose of the BA loan given construction risk impacts the security on offer / covenants; and
- new dwellings being constructed which do not form part of the initial security pool for the loan (if required) and/or measure of financial and other covenants – if these projects are in addition to those offered for security / used to measure covenants then construction funding for these dwellings should not be prevented. This would allow CHPs the flexibility to manage the BA funding envelope and utilise the spare debt capacity which may be available or would build up over time.

Security for loans and complementarity

The security of loans required under the BA ultimately impacts on whether this form of funding can complement existing and future private and public sector investment into CHPs. We understand that complementarity is a strong focus for the Australian Government and we agree that this needs to be the case – ultimately the BA loans should form part of the overall

funding mix for CHPs and therefore needs to complement existing forms of financing available. This requires the BA to complement, and not compete with or be seen as or become a substitute for, other sources of funding that are currently (or may become) available to CHPs, including bank debt. In this regard, we are aware of concerns amongst some current financiers of CHPs in respect of the proposed BA competing with them.

In order to address such concerns and ensure that BA loans complement other funding sources currently available to CHPs, a preferred position with respect to security for BA loans would be as follows:

- If a CHP has no secured creditors, the BA should lend on an unsecured basis, subject to appropriate financial and other covenants being given by the CHP. Among other things, this would simplify the relevant BA loans and avoid the need to enter into tripartite arrangements with State government agencies in respect of security arrangements relating to land that has been made available to CHPs by such agencies.
- If a CHP already has secured creditors or is likely to have secured creditors (i.e. banks or other providers of finance), other than the BA, any security in favour of the BA should rank behind those secured creditors. This is especially important where higher risk construction finance is being provided by those secured creditors. However, even where only term debt is being provided by those secured creditors (and there is no construction risk), security in favour of the BA should still rank behind other secured providers of finance.

Frequently, lower ranking secured debt would be more expensive than first ranking secured debt. However, in the case of BA loans that rank behind other secured debt of CHPs, we would argue that this need not be the case. Rather, such BA loans should be priced as if they were first ranking secured debt and the only secured debt in respect of the relevant CHP – i.e. pricing should be as contemplated in the consultation paper.

The main reasons for our recommendations in relation to ranking of security and pricing are as follows:

- Lower ranking security in respect of BA loans should assist greatly with respect to such loans complementing other funding sources currently available to CHPs, and would go a long way to addressing concerns that the BA may operate in competition to such funding sources. Furthermore, lower ranking security for BA loans would mean that intercreditor arrangements with other secured creditors should be much more straightforward and easier to put in place than would be the case if the BA ranked alongside (or ahead of) other secured creditors.
- Not increasing pricing in respect of BA loans which have lower ranking security should ensure that the principal objectives in respect of the BA (as referred to in the consultation paper), including providing CHPs with a more efficient source of funds,

reducing refinancing risk and reducing their borrowing costs, are most likely to be achieved.

- BA loans would (could) be backed by a Government guarantee which would be the primary driver for cost of funds to NHFIC. Choosing to pass on this saving whilst taking an unsecured or second ranking security position would present an offering not replicable in the market, whilst ensuring the most efficient capital solutions for CHPs to deliver and operate affordable housing.

If BA loans were to rank in terms of security ahead of, or pari passu with, other secured providers of finance to CHPs or if pricing was to be increased above that contemplated by the consultation paper, there is a very real risk that the principal objectives of the BA would not be met. In addition, there would be a significant risk that the BA would not complement existing private and public sector investment into CHPs and could displace such investment. Indeed, there is a strong likelihood that existing private lenders to CHPs (including Australia's major banks) would simply be taken out of the market, perhaps creating a sole source reliance on the NHFIC over time.

Bond issuance

SGCH does not have specific subject matter expertise on the bond issuance mechanism, and as such we are agnostic about the structure and form of the bond issuances except to the extent that the necessary pricing, tenor and terms are obtained which will ensure efficient financing if we take up BA loans.

We would observe that it appears logical to issue the bonds in the domestic wholesale market if there is sufficient demand, at least in the early stages. To the extent that the offshore market presents additional complexities (e.g. foreign exchange risk), we would note that complexity may add to transaction costs and create leakages, particularly for early stage transactions.

In terms of issuance size, we would advocate for a reasonable minimum loan size for CHPs to ensure cost efficiencies for NHFIC are achieved (with respect to both due diligence and ongoing monitoring activities).

Contracting out functions

Please refer to our comments in section 2 under '*Learnings from CEFC*'.

Government guarantee

We see an explicit Australian Government guarantee as an essential part of the bond issuances, certainly in early tranches of the BA:

- Until the BA gains a track record and given the perceived scale and capability of the Australian CHP sector, a Government guarantee would provide greater confidence to investors (as well as other stakeholders).
- Whilst recognising the upward sloping forward yield curve, it is inevitable that the various forms of finance available to CHPs will be compared predominantly on the

basis of total pricing. As such, the enhanced pricing that a Government guarantee represents is essential to incentivise CHPs to take up BA loans and ensure additionality of outcomes through efficient capital solutions. On the issue of tenor and the upward sloping forward yield curve, we would encourage NHIFC to explore the pricing impact of shorter tenors (tenors greater than 5 years). Our main objective is to optimise the balance between tenor and pricing and as such, would consider a spread of tenor options from 5 to 10 years plus.

- Regulatory and contract issues identified in the EY Report will take some time to be resolved. Until such times as these issues are resolved, we view a guarantee as essential to allow a more expedient path forward and provide certainty in any proposed timelines set by NHFIC for the early BA issuances.
- Credit assessment will rely on the importance of the sector to government. Whilst there is an implied strong support from government, a guarantee will be an explicit signal that sets up a strong market signal for the long term.

In recognising the risks around enforcement that a guarantee would impose on the Australian Government, our observation is the Australian Government (in conjunction with the States and Territories and utilising the regulatory system) can effectively manage this risk. Therefore, and until such times as the following issues are resolved, we see a Government guarantee as needing to stay in place to ensure the pricing and terms of the BA loans are acceptable for both investors and CHPs and achieve real outcomes:

- a comprehensive and national regulatory framework tailored to supporting the activities of the BA;
- a nationally consistent and simplified set of rules around encumbrance / government interest (where applicable) on properties held by CHPs; and
- a clear framework around cure process / step-in rights under the BA loans developed by NHFIC in conjunction with the Australia Government, States, Territories and CHPs and in parallel to consideration of the role of the Regulator.

In looking at the issue of encumbrance from government on properties held by CHPs, we would encourage the Australian Government to work with the States and Territories to simplify these restrictions to allow effective and efficient asset management and financing. Some of the restrictions on dealings being imposed / raised as potential requirements constrain the flexibility and agility required. With a stronger, nationally consistent regulatory approach, and efficient financing in place, we would suggest these requirements could be streamlined.

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Ongoing success of the BA

As noted by multiple stakeholders and numerous papers / reports including the consultation paper, EY Report and the Affordable Housing Working Group's (AHWG) Report to Heads of Treasuries, the ongoing success of the BA and NHFIC ultimately rests on the level of additional, recurrent funding committed to fund the yield gap inherent in the provision of (particularly) social and affordable housing.

Whilst we understand that options to fund the yield gap are being further considered as part of the new National Housing and Homelessness Agreement, we suggest that resolution of this issue and an announcement on committed solutions (on a long-term basis) is an absolute precondition for the success of the BA.

Although there may be sufficient demand from CHPs for a first issuance under the BA, the long-dated and non-amortising nature of the proposed bullet bonds means that existing debt capacity / appetite will quickly be exhausted.

If funding to close the yield gap is addressed, the NHFIC and in particular the BA has the potential to offer a significant and complimentary form of financing, and together with the funding to close the yield gap, will catalyse further significant growth in the CHP industry to deliver and operate the affordable housing that Australia needs.