Super Housing Partnerships

Response to: Housing Australia Future Fund Bill, National Housing Supply and Affordability Council Bill, and Amendment Bill.

January 2023

Super Housing Partnerships PTY LTD ('SHP') welcomes the opportunity to make a contribution to the Housing Australia Future Fund Bill, National Housing Supply and Affordability Council Bill, and Amendment Bill.

SHP is a specialist housing fund manager focused on increasing the housing supply through partnerships with institutional asset owners and investors. SHP was established to provide innovative solutions to significantly increase the supply of affordable, sustainable and suitable housing choices to all Australians.

SHP works to create a flow of capital from institutional investments into new housing at scale through the opportunity to invest in a portfolio of build to rent (multi-family) housing with resilient long-term returns.

We are pleased to be able to take part in the establishment of such a significant reform to address the critical shortage of affordable housing in Australia. Our submission focuses on actions that could be considered as a part of the legislative package to encourage the participation of institutional capital at scale to meaningfully enhance the supply of sustainable and affordable housing options.

Encouraging private market participants to deliver social impact outcomes can be achieved, they are crucial partners in the supply of appropriate, affordable housing and this package is an enormous opportunity to build the settings required.

RECOMMENDATIONS:

Recommendation 1: The federal government establish a suite of criteria for "Qualifying Projects" with known social impact outcomes and target incentives (or require states to target incentives) to projects delivering these defined outcomes.

Recommendation 2: That the draft make clear, beyond doubt, the meaning of "purpose" and consider the needs of superannuation funds and trusts in this drafting.

Recommendation 3: That project outcomes be the paramount consideration to allowable funding and not company purpose.

Recommendation 4: That consideration be given to reducing the political risk currently inherent in the Ministerial level arrangements.

Recommendation 5: That consideration be given to the ongoing operational and governance structure of Housing Australia to ensure that it is appropriately resourced to interface with institutional investors, the private sector and community housing providers at scale and to achieve the required velocity of investment.

BUILDING THE RIGHT ENVIRONMENT FOR THE RIGHT OUTCOMES (Recommendation 1)

The legislative package takes important steps to create an environment that encourages private investment, importantly there is an understanding inherent in the package of reform and the broader government narrative, of the need to significantly increase the role of the federal government as funding partners.

The investment of a significant amount of public money as enabled by this legislative package is a crucial component to help hastily catalyse the needed private market investment.

SHP considers reform is also required beyond this package in the areas set out below. A paramount consideration for the federal government should be to define a criteria for a **"Qualifying Project"** as being a housing project that delivers outcomes for the underserved market.

As noted above, the depth of private investment interest in the housing market has remained strong but has not delivered outcomes for those who need it most and is not adequately encouraged to do so under current incentive settings.

International experience, shows that to catalyse a strong build-to-rent marketplace delivering housing security for those who need it most, governments need to be specific about their social impact expectations and target incentives towards these outcomes. In the United States, low to moderate income housing has emerged as one of the BTR asset class's largest market segment off the back of tax concessions such as the Low-Income Housing Tax Credit (LIHTC) program LIHTC and concessional financing through Fannie Mae and Freddie Mac.

The federal government has a unique opportunity to set the expectation of impact outcomes through this package and wider housing reform.

Parameters could include:

- A minimum quota of social/affordable housing (for example, a 40% minimum would provide a meaningful contribution), with support linked to delivery of social/affordable outcomes.
- Agreed minimum affordability threshold/definition for affordable housing, with consideration given to affordable housing costing no more than 30% of household income for low-and-moderate income earners.
- Social/affordable housing should be maintained for a minimum period linked to the concessional benefit.
- Minimum development size should be 200 dwellings to encourage institutional investment and maximise impact on housing supply and affordability.
- Mixed-tenure dwellings for improved social and investment outcomes.

Recommendation 1: The federal government establish a criteria for "Qualifying Projects" with known social impact outcomes and target incentives (or require states to target incentives) to projects delivering these defined outcomes.

Areas for reform beyond this package but interrelated to the issue of supply challenges include:

Taxation settings

It may provide a more optimal public policy outcome if consideration is given to taxation settings so that incentives are targeted to the needed outcome. As an example, for qualifying projects, the GST could be removed. Qualifying projects defined by their outcome for social and affordable housing.

A reduction in the taxation rate from 30% to 15% for foreign capital investing in qualifying Australian housing projects via Managed Investment Trusts (aligning with other commercial real estate).

Performance test improvements

The particular way asset classes are benchmarked in the Your Future Your Super superannuation performance test can disincentivise investment in assets like unlisted property where the assets' risk and return profile can differ from whole-of-market indices.

The Your Future Your Super benchmark for property has a zero allocation to the emerging institutional residential property sector and is instead dominated by the office and retail sectors.

THE EQUITY ISSUE (Recommendations 2 and 3)

It has been a widely acknowledged challenge that building equity investors in the affordable housing space is complex.

For many years institutional investors have participated as providers of finance to NHFIC at scale. This is considered a fixed interest / defensive investment for institutions and intentionally acts as attractive government debt in the portfolio. This bond aggregator has natural constraints on the draw-down side and, although it has been successful for community housing providers to aggregate their debt, the style of this reform is not sufficient to address the massive supply issues alone.

To significantly enhance supply, institutions need to participate as equity investors as well as debt providers.

We welcome the opportunity the Housing Australia Future Fund presents to develop new approaches to financing which can facilitate equity investment into affordable housing models.

Effective financing models can encourage private providers to maximise the provision of discounted housing assets.

There are two potential areas of consideration in the Housing Australia reform package that are material to the development of a deep equity investment pool:

Allowable entities:

Treasury Laws Amendment (Housing Measures No. 1) Bill 2023

The draft gives broad parameters of where financing can be provided, the relevant being to 'constitutional corporations' for the purposes of "improving, directly or indirectly, housing outcomes."

It will be important to clarify the meaning of the use of the term "purpose" and "purposes" in this draft.

As discussed, encouraging private market participants is crucial to address the housing shortage but ensuring that their efforts are focused on the undersupplied Australians is key. This focus can be achieved through the use of defined qualifying projects and can be agnostic of the purpose of the entity for participation in those projects.

The current draft suggests that participants who may have a narrow purpose as defined either through legislation or as a result of a trust structure, may not be able to access the incentives provided in this package.

For example, a superannuation fund has a narrowly defined purpose under Sec 62 of the *Superannuation Industry (Supervision) Act 1993.* It may be that the regulatory risk introduced in the language of the *Treasury Laws Amendment (Housing Measures No. 1) Bill 2023* pertaining to purpose is problematic for superannuation funds.

> **Recommendation 2: That the draft make clear, beyond doubt, the meaning of "purpose" and consider the needs of superannuation funds and trusts in this drafting.**
>
> **Recommendation 3: That project outcomes be the paramount consideration to allowable funding and not company purpose.**

INVESTMENT SETTING AND ADMINISTRATION CERTAINTY (Recommendations 4 and 5)

Encouraging a deep and effective pool of equity investors requires an understanding of how institutions consider risk and addressing this or mitigating it as much as possible.
One risk often considered in affordable housing is the role of government and if the policy settings match the needed investment horizon or if there is a potential mis-match and therefore greater risk.

The proposed legislative package gives wide ranging powers at the Ministerial level which can be interpreted as analogous to annual grants – not traditionally attractive as funding sources in a sophisticated institutional scale project.

The package allows for Ministerial decisions annually, while it is imagined that under the current government these decisions would be made in line with stated policy objectives, institutional investors have long time horizons. The annual nature of decisions and broad ministerial power may introduce a risk that could be avoided.

> **Recommendation 4: That additional consideration be given to reducing the political risk currently inherent in the Ministerial level arrangements.**
>
> **Recommendation 5: That consideration be given to the ongoing operational and governance structure of Housing Australia to ensure that it is appropriately resourced to interface with institutional investors, the private sector and community housing providers at scale and to achieve the required velocity of investment.**

ABOUT SHP

SHP officially launched in November 2022 with founding investment partner HESTA who is expected to commit $240 million towards initially developing a pipeline of Victorian mixed-tenure built-to-rent apartment projects alongside SHP.

We were formed to address some of the barriers to institutional investment in affordable housing at scale through a unique aggregator-style platform combined with specialist funds management skills, partnering with affordable and sustainable housing developers and community housing providers.

SHP will aggregate capital from institutional investors into its housing strategies. The first fund will initially develop approx. 2,000 mixed-tenure dwellings blending social, affordable, market-rate and specialist disability housing.

Our focus is on Australian BTR housing, with a mix of affordable, social, market rate and specialist disability accommodation. This mixed-tenure approach aims to provide improved social outcomes while cross-subsidisation strengthens investment outcomes.

SHP's first fund will partner with Assemble, a leading affordable and sustainable housing developer and Housing Choices Australia, one of the largest nationally accredited community housing providers. SHP (Housing Fund 1) provides approx. 2,000 homes and $1bn in assets delivering a minimum 20% low-income housing in developments targeted at people currently on the social housing waiting list in each jurisdiction, in addition to this up to 5% of total housing is specialist disability accommodation. SHP also provides 20% additional essential worker housing at a discount to market rates between 15-20%.

The tenure mix will look to support the delivery of investment returns by providing a smooth income profile, with stable rental income, high demand, and low vacancy rates, giving resilience to changing economic conditions.

All SHP housing projects aim to be net zero operational carbon from day one and SHP will measure and manage impact outcomes against United Nations Sustainable Development Goals.

While super funds, including HESTA have successfully invested in individual affordable housing projects in the past, there have remained barriers to scaling many of these approaches. While SHP can help address these scale challenges, improved policy settings at all levels of Government would further encourage greater institutional investment.

ABOUT BUILD-TO-RENT

The market opportunity for Build-To-Rent (BTR) investment is rapidly growing and reflective of the increasing unaffordability of housing from low to moderate income households. As an asset class, BTR is experiencing a large upward demand within Australia as over 7,400 units are currently planned to be constructed and supported by institutional capital in the next three years.

Relative to other countries, investment in Australian BTR as a percentage of institutional real estate portfolios accounts for a very low portion of less than 1%, compared with the US - over 20%.

Sources of new housing in Australia are predominately driven by private market funding, with public funding contributing little to historical dwelling creation.

SHP's focus on rental housing that is affordable to very low to moderate income households and key workers provides resilient cash flows over time through:

- A larger tenant base drives a higher level of demand which in turn results in lower vacancy rates.
- Lower tenant turnover provides a more stable income and less variability in occupancy rates.
- Lower lifecycle costs for the buildings ensures a more stable cost base.

Policy settings play a crucial role in encouraging institutional investors to participate in the market. Government funding and policy initiatives can help to drive stability of low-to-moderate income focus.

HISTORICAL INVESTMENT PARTICIPANTS

Sources of new housing in Australia are predominately driven by private market funding, with public funding historically contributing little to dwelling creation until the consideration of this package.

Public Funding	Private Funding
Public housing, community housing, crisis accommodation, transitional housing	All non-publicly funded housing, build-to-sell, house and land, owner-occupier
4% of total housing	96% of total housing
Historical Market	
There has been limited public funding of new housing in recent decades, which has led to a critical undersupply of social and affordable housing. • The increase in social and community housing dwellings between 2006 and 2021 of 7.6% has significantly lagged population growth of 28%, and totalled just 31k dwellings. • In 2021 the number of households on social housing waiting lists in Australia was >161k, an undersupply equal to >5 times the number of publicly funded dwellings created in the past 15 years. • From 2023 the Rudd Government's National Rental Affordability Scheme (NRAS) concessions start to cease which over the following 5 years will see over 30,000 homes currently let at a 20% discount to market to eligible households return to full market rent.	Private markets have performed well in delivering housing in line with population growth over the past 15 years. • Between 2006 and 2021 both the population and the supply of housing increased by 28% • House completions have remained relatively flat, reflecting the predominance of owner occupier and domestic purchasers. • Growth in non-house completions has been driven by off-shore investors and mum-and-dad investors. • Supply of rental housing has been concentrated in the upper end of the market in order to deliver sufficient returns for retail investors

The current market (particularly non-house dwellings) has seen a significant pull back from peak construction and completions which has led to supply constraints with the national vacancy rate at 1% and an affordability crisis across both rental and purchasing.

This crisis has been driven by:

- Reliance on the retail investment market to fund growth in non-house dwellings, which has diminished as 'baby-boomers' (typical off-the-plan investors) reach retirement age.
- Return requirements of predominant investor class necessitating product geared at upper end of the market.
- Unattractive policy settings applying higher taxation to foreign purchasers.
- Lack of institutional investment in the asset class.

Fundamentally, the undersupply gap in social and affordable housing is too large to bridge without significant investment by the private sector.

- The emergence of BTR as an attractive asset class and significant institutional investment in housing will be required to fill the investment gap.
- Public policy initiatives will need to legislate to either enable and promote private investment, and/or mandate inclusion.
- Public policy initiatives need to be considerate of institutional investor requirements – such as a degree of certainty over the investment horizon.
- Consideration given to an amendment to foreign purchaser duty settings to encourage renewed investor activity in the off the plan market.

Critically, the policy settings need to focus private sector efforts on the underserved market not traditionally attractive.