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exSell Capital submission to consultation on exposure draft: amendments to the Housing Australia Investment Mandate Direction 2018

Our submission comprises three Parts:

1. Part I [PUBLIC]: this cover letter, including:
 - a. Our Freedom of Information Act claims
 - b. Our approach to Treasury's *Submission Guidelines*, including remarks about our credentials, relevance, and role to the above
 - c. An artefact based on #livedexperience, which influences my personal input
2. Part II [PUBLIC]: our Public Submission
3. Part III [CONFIDENTIAL]: our Confidential Submission to elaborate upon our Public Submission and to provide additional information and views

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Freedom of Information Act claims

Part III contains material that we formally claim protections under these sections of the Freedom of Information Act:

- taxation and trust/SPV remarks, subject to legal professional privilege (s 42)
- institutional investor identities and activities acquired in the course of our funding and non-funding client mandates, and to which we are ourselves subject to confidentiality deeds and non-disclosure agreements, being material obtained in confidence (s 45)
- market intelligence and specific transaction proposals that we claim as commercially valuable information (s 47)

Our credentials, relevance, and role

Before turning to our substantive Submissions, we respond to those items the Treasury recommends in its Submission Guidelines:

- **exSell Capital**, as we are identified in structured finance markets, is making this submission
- exSell Group is our legal entity, incorporated in Australia as a company under the Companies Act, and which in two months' time will have been established for **eight years**
- Alex Sell, as founder and managing director of exSell Group, possesses in excess of **twenty years structured finance experience**. This encompasses roles at banks, consulting firms, a structured finance industry peak body, policy development within financial regulators, a central bank, and as political adviser and researcher for **ministers in the United Kingdom**.
- **Our experience encompasses significant direct structured finance exposure to offshore regulatory jurisdictions and markets, particularly the United Kingdom, the United States, New Zealand, and the European Union as well as Australia.**
- We look forward to opportunities to elaborate, iterate and develop with *Housing Australia*, *The Treasury*, global debt capital markets participants, and others to share our empirics and blueprints.

#livedexperience artefact: a backstory to Alex's passion and commitment to housing

Alex's mother, Diana, was adopted in Second World War-ravaged London at 18 months of age.

She was housed with a family that to her became her 'real family'.

Despite working for then publicly owned British Rail in a low-grade clerical role, her adoptive father did not earn enough to buy a home. It was of course still not economically seen as necessary, culturally the norm or aspiration, nor in any event within reach of what we might term today middle-England, or middle-Australia.

The family rented a dwelling privately. Unable to have children, they adopted Diana at quite a late age. He died fifteen years thereafter, just weeks prior to Diana sitting her A-Levels (HSC equivalents). Soon after, she and her mother found themselves evicted due to lack of income (remembering that women were often not in the paid workforce where their spouse was neither at war nor without a reasonable job).

They were swiftly housed in public housing, on one of the now infamous British *Council Housing Estates*.

She scraped through her A-Levels to secure a government university scholarship, first introduced by Prime Minister Clement Attlee, who said famously that no one who was qualified "should be deprived of a university education for financial reasons".

She was then able to be a beneficiary of another first: attending one of the Harold Wilson Government funded 'new universities', Brunel University in West London. She passed, with a 3rd Class Bachelor's degree, all things considered a blessing and a success given she worked full-time to support her by now frail mother as well, in addition to university study.

She began her professional career working for the London Boroughs of Hillingdon and Uxbridge as a public housing officer, giving back from her #livedexperience as she saw it to those who had been dealt often an even rougher, tougher hand.

Alex has grown up with this story over the proverbial family dinner table. The broader thematic of how life events, poverty, and educational opportunities being available without having adequate financial resources, and then giving back in one's career has stuck. Alex is now giving back – with passion and within reason!



PART II

Section 1: HAFFF, NHIF and Accord (the 'Schemes') strategic issues

1. Preamble

We recommend that the Direction requires Housing Australia to devise a hierarchy or weightings-based methodology to reflect the inevitably competing and potentially conflicting requirements set out in s 28 chiefly, and elsewhere.

The Direction presently places no 'signpost' or emphasis on any particular eligibility criteria such that, provided all criteria meet thresholds to as yet unknown minima, a financing proposal would not be defeated on s 28 grounds.

This introduces unacceptable and unnecessary risks to the Schemes' effectiveness because [plausible] unintended consequences – most likely in the form of risk and return avidity¹ – whether too high or too low – could dominate decisions deleterious to other public policy objectives.

From a structured finance perspective such risks will naturally contribute to reasons for institutional investors to question whether or not to commit. This takes us to key, specific matters relating to the way in which this market and its securities ought to evolve.

2. Financing/funding round frequency and homogeneity

Fragmentation of processes, standards and reporting from the expectations set out in the Direction and primary legislation arise as follows. We do not feel these are addressed adequately, and so we offer recommendations on how they might.

- States & Territories equitability requirement – pools of dwelling collateral or land in a SPV might very well become **too concentrated to one geographic area** (i.e., a jurisdiction and 'metro' or 'non-metro'), which could very well increase the risk premia demanded by institutional investors.

¹ e.g., credit risk, execution and operational risk, political risk, etc.

- Target dwelling types – similarly, **dense apartment complexes in collateral pools** increase risks in the minds of institutional investors² because they can render an entire collateral pool materially impaired³, and can lead to avoidance altogether or, at best, add avoidable risk premia, resulting in the costs of funds rising.
- Target dwelling **resident concentrations** – as above – whether by occupation, employer, socio-economic group, etc.

The equitability and other motivations from which these expectations stem need not be compromised. **We recommend that NHAFF and HAFF and Housing Australia are obliged to co-ordinate and ultimately promote homogeneity in structural features**, or else undermine the attractiveness of this asset class in the minds of institutional investors. **We further recommend that collateral pools err on the side of larger in preference to smaller** than might otherwise be necessary. Through size *ceteris paribus* increased diversification and mitigation of negative ‘portfolio effects’ tends to be promoted.

Larger, more diversified SPV collateral pools have the tendency to offset undesirable positive correlations through a smoothing out of endogenous and exogenous events. They cannot usually be solved for through public policy, here or elsewhere, not least as their nature and timing are sometimes⁴ unknown. Notwithstanding this, we do acknowledge and endorse the building code and related criteria, which should certainly increase institutional investor confidence. ESG and other conformance could be amplified to improve future versatility of dwelling stock without going so far as to stifle originations. Here, there are global and domestic sources⁵ to which Housing Australia, States & Territories, and CHPs should at least have regard because institutional investors themselves do (or must, in many cases, by decree or regulation).

Section 2: Structured finance conduct and governance matters

3. Governance

The breadth and depth of Housing Australia’s powers and flexibility are seismic. And, by extension, its impact on housing debt capital funding markets.

It is poised to perform a catalytic function as well as financing role. Just shy, we are inclined to suggest, to a measure that might make an impact on the nation’s entire

² It is well-documented in securitisation markets that ‘black-lists’ exist among institutional investors, such that they amend their portfolio construction to prohibit entire postcodes and dwelling types due to susceptibility to single, devastating exogenous and endogenous events.

³ Fire risk cladding or uninhabitability due to major engineering defects are specific examples of *types* of historical events that lead to impairment. Natural disaster events are of course another type.

⁴ [COVID-19-impact-on-RMBS-pool-a-complex-assessment.pdf \(realinvestments.com.au\)](#)

⁵ For example, CFA Institute [Global ESG Disclosure Standards for Investment Products](#), PEXA [Environmental, Social & Ethical Governance \(ESG\), Market monitoring and intervention | NDIS](#), and in the European Union [ESAs ESG disclosures for Securitisations \(europa.eu\)](#).

financial architecture. This is as it should be, given the urgency, scale of the change, and the impact on wellbeing.

We do not consider, however, that proportionate governance, accountability and resources are contemplated in the primary or secondary legislation. The professional staff of Housing Australia may well deliver commensurate to their broadened and deepened mandates. Nonetheless, we query whether more certainty for institutional investors could be included without binding Housing Australia operationally. Specifically, that 'goal posts' will not be susceptible to the vagaries or preferences of a portfolio agency; left assured that only legislation could alter things. The ratings agencies pay particular attention to such matters, too: categorised variously as 'regulatory risk', 'political risk' and 'legal risk'.

Given these circumstances, the Direction **ought to contain codification and requirements for Housing Australia to retain independent but constructive, external infrastructure and advisory resources.** For example:

- vendors to enhance institutional market surveillance, data and analytics
- advisers with global perspectives to suggest best practices for competitiveness
- those with visibility of emerging trends in structured finance domestically

Customarily, this would specifically include legal advisers with structured finance knowledge (as distinct from transaction-specific legal counsel instructed from time to time)⁶; including taxation, trust, offshore issuance⁷ as well as other structured finance experts, current or potential transaction counterparties excepted.

Directions and related Delegations for the RMBS, SFSF, ABSF and fSPV AOFM programmes are helpful exemplars as are those at NSW's T-Corp and Victoria's VFMC, both of whom are accustomed to interacting with structured finance markets by their performing roles on the buy- and sell-side.

Successive Treasurers, too, have imposed market conduct obligations⁸ on AOFM, and done so in such a way as to not inhibit AOFM to enhance them even further. This has contributed to AOFM's high performance against its statutory objectives. It has also influenced through network effects improvements in conduct⁹ and standards among other structured finance issuers and institutional investors.

⁶ For example, in the light of scandals involving major professional services firms providing transaction advice as well as audit services to government, government-funded; privately operated entities, and private firms on the identical taxation and retirement living matters.

⁷ For example, under the EU Prospectuses Directive and the US SEC filing and compliance regimes.

⁸ *inter alia* 'leave no trace (or footprint)'; creating conditions tending to increase over time private markets participation (and less AOFM intervention); similarly, positively avoiding the introduction of behaviours that would distort structured finance markets.

⁹ For the avoidance of doubt, this is not intended to imply that the opposite was the case in Australia – namely, 'misconduct' – but to highlight that a positive, further raising of the conduct bar has occurred.

Section 3 – funders/investors: liability demand side

Part III: Confidential Submission contains our detailed views and proposals. They discuss the following:

- a. Global and domestic competitive forces in debt capital allocation
- b. Relative Value judgements between debt and equity, and within debt capital securities
- c. Ratings agency criteria and methodology
- d. ESG and property eligibility criteria
- e. The term structure of interest rate curves
- f. Foreign currency relativities
- g. Financial conduct and prudential regulations
- h. Other, as yet unknown, influences on investor preferences and constraints

To buttress this, periodic review should be built into the Instrument (and its Direction) so that all participants can benefit from dynamic responses to what are, from a debt capital markets perspective alone, perennially changing structural characteristics. See *Part III: Confidential Submission* for further details.

Given the very significant involvement that the Federal Government – through Housing Australia and the National Housing Accord – is poised to take, financially and non-financially, it would be unwise to invite ‘market-led’ solutions. **Instead, we advocate a co-design framework that is conspicuous (visible), porous (accessible to broader thinking), and always enlivened to developments (actually ‘in-market’)**. Its role would be to iterate blueprints that continuously improve in how they cater to the needs of stakeholders. (Of course, nor should government- or community housing provider-led approaches prevail, either).

Further, we urge this to occur at inception. It is extremely difficult to get such things done once the ‘horse has bolted’, however much the respective market participants may wish. The reasons being:

- Transaction confidentiality means few would wish to ‘telegraph’ what, how and with whom they are contemplating a transaction
- Transaction time pressures will crowd out the greater good of setting standards
- Inertia will exist as some will be inclined to want to wait until the market evolves a little before doing something standardised; there will also be a sense among many that until there is a problem needing to be solved it is not worth pre-emptively devoting time and resource

Section 4 – issuers, sponsors, and originators: liability supply side

We refer here to the special purpose vehicles (SPVs) as the legal issuers – or suppliers – of most securities under the Schemes. Sponsors are delineated at s28F but originators (typically, CHPs and others identified under The Accord) are not. We recommend that the Direction adopt strict legal definitions for each.

4. Sponsors

We query whether the types of Sponsors listed at 28F(1) might constrain certain structures that would otherwise be highly palatable to institutional investors – and still achieve for beneficiaries contemplated outcomes.

For example, at **Error! Reference source not found.** in Part III we caricature permutations and an evolution trajectory. This matrix contemplates as a plausible state a mix of not only private capital, CHPs and governments all participating in any given structure or transaction but also private capital alone.

To elaborate: it is conceivable that private capital may wish to avail itself of only non-financing features of the legislation. The ED currently precludes this and, whilst amendments could be assessed on their merits later, the risk is that certain structural interests may by then have embedded themselves into meta-structures and processes, effectively blocking evolution. History is our guide here.

Clarificatory – whilst the ED contemplates co-sponsors of a SPV. It ought to spell out more clearly what is (and perhaps is not) meant here in order to heighten transaction expediency.

Policy intent – the primary legislation requires and expects private capital to be brought to bear, and for a market to evolve over time where it can operate without as much or indeed in certain circumstances any government financing. Meanwhile, exclusively private capital solutions would likely wish to avail themselves of non-financing provisions in the legislation. **For example, in relation to withholding tax** Absent an eligible co-sponsor they would be ineligible.

5. Infrastructure & Standardisation

However, there is usually considerable scope even in structured finance environments to standardise several aspects that are common to most transactions.

This is possible for the Schemes too, such **we recommend that co-design is conducted pre-emptively**, being recognised as being in the interests of all concerned beyond the narrow confines and time pressures encountered in discrete transaction situations.

A simple, widely accepted and globally commonplace example is with swaps and derivatives. The International Swaps and Derivatives Association's [*ISDA Master*](#)

[Agreement and Credit Support Annex](#) is universally adopted, for instance. It has proven adaptable to changing market practices and legal precedents, both in terms of its foundational architecture and specific annexes used to accommodate specific use cases. **We recommend that Housing Australia and others be obliged to make every effort to identify and adopt pre-existing [global] documentation.** AFMA would be the lead Australian body to support this initially, and on an on-going basis to ensure currency; ICMA the international equivalent.

We also note Treasury's role in amending the Banking Act to permit covered bonds to be issued by ADIs. This made legislative provision for certain things such as minimum overcollateralisation and specific reporting standards. Ordinarily, secondary legislation might not have been the place for such things because neither have a bearing on depositor preference, which was the focus of the amendment. However, by including these items, the amendment managed to also assuage concerns among institutional investors offshore about Australian equivalence. Australian covered bond marketability into the very markets into which they would face most competition [from other global covered bond issuers] was achieved.

Section 5 – public policy and intergovernmental matters

Alignment and co-ordination with other areas of public policy and the constitution has clearly been considered. Three areas – in order of seriousness and likelihood of eventuating – are as follows, and ought to be addressed through the Instrument's Direction, either through amplification or substantive amendment.

1) Intergovernmental

- a. Through the COAG *Intergovernmental Agreement on Federal Financial Relations* and the *National Affordable Housing Agreement*, mutual obligation expectations already exist in relation to housing, housing affordability, and homelessness. These detailed agreements in the context of The Accord, Acts, and this Direction raise the spectre of avoidable confusion and fragmentation. **We recommend alignment is obliged upon relevant parties so that expectations and performance metrics** reinforce and promote rather than conflict with one another.
- b. Usually included but historically neglected in practice, are measures relating to cross-border capital flows under Free Trade Agreements and the like¹⁰. These should be harnessed, and therefore included in the Direction so that securities issued from, and the programmes established by, special purpose vehicles can more likely avail themselves of such (sic) benefits.

¹⁰ See: [Pull, Push, Pipes: Sustainable Capital Flows for a New World Order](#), 2019, Carney M. and [P040619-2 \(fsb.org\)](#).

2) Jurisprudence and constitutional matters

- a. 28F(1)(a)(i) regarding *constitutional corporations* notes that 51(xx) of The Constitution (Cwlth) applies. **We recommended that this be reviewed in greater detail given prevailing case law¹¹**, which we are advised gives rise to material legal uncertainty risk.

3) Broader public policy and regulation

The following could be undermined or unnecessarily neglected. Various, we recommend alignment, acknowledgement and/or explicit arrangements be provided for in the Direction:

- a. The National Wellbeing Framework's *Measuring What Matters* has five wellbeing themes supported by twelve dimensions and fifty key indicators. Given the very high relevance and bearing of the housing package on this Framework's objectives, **we recommend that they are explicitly aligned to eligibility criteria**. Reporting by Housing Australia should for the same reason be aligned to these KPIs at 28K.
- b. Banking Act, SIS Act, and general and life insurance legislation and regulation¹² **ought to have regard to potential housing structured finance solutions so that regulation does not diminish the marketability of securities** suitable for institutional investors, including banks, insurance companies, and superannuation funds.
- c. Central bank matters – the Reserve Bank of Australia's Monetary Policy, Market Operations, and Financial Stability Wings ought to be acknowledged in the Direction:
 - Monetary policy: having regard to **micro inflationary effects** of increasing funding to the property sector in certain locations, for example.
 - Financial markets and operations: data reporting alignment with and eligibility of securities issued under the various Schemes in the RBA's Open Markets Operations' **Eligible Collateral framework plus co-ordination with APRA and AOFM on primary (and secondary) markets activities** (this is a discrete point to that made at e. below).

¹¹ That is, "the decision as to the validity of particular laws yet to be enacted must remain for the Court when called upon to pass upon them." [Strickland v Rocla Concrete Pipes Ltd \("Concrete Pipes case"\) \[1971\] HCA 40; \(1971\) 124 CLR 468 \(1971\)](#)

¹² Encompassing prudential (capital, solvency and liquidity), conduct, and Listing Rules as well as superannuation and pension fund Members Best Interest fiduciary duties and regulations.

- d. Consumer credit – variously, regulations in relation to the consumer data right, open banking, credit reporting bureau, and credit contracts – **ought to be considerations** for Housing Australia in its activities to ensure equitability as well as operational simplification for it and others **so that reporting and eligibility as well as eventual transaction execution can be enhanced**.

- e. The Australian Office of Financial Management – given the material increase in Schemes' issuance volumes and frequencies, 'crowding out' and primary market issuance disruption could arise due to the long-standing spread premium that NHFIC bonds have printed at over AOFM's issuance of conventional Commonwealth Government Securities (in a range typically between 30bp and 40bp for equivalent tenors). We recommend that there be an **obligation placed upon AOFM and Housing Australia to co-ordinate on issuance timing, pricing, and tenor** so as to not interfere with their respective operations and objectives.