

Director,
Housing Australia Future Fund Unit
Housing Division
Treasury
By email: housing@treasury.gov.au

Amendments to the Housing Australia Investment Mandate Direction

Dear Director,

Thank you for the opportunity to provide a submission in relation to the Amendments to the Housing Australia Investment Mandate Direction (the Mandate).

Lighthouse Infrastructure (Lighthouse) is a private sector boutique investment manager that invests institutional capital into Key Worker Affordable Housing, Specialist Disability Accommodation (SDA) and Renewable Energy. As it relates to housing investment, we:

- Commenced investing in SDA in 2018 when we had gained confidence in the regulatory framework and funding provided by the NDIS. We have invested \$260 million in SDA in partnership with the community sector in homes for up to 400 NDIS eligible participants. We have committed capital to the sector of another \$340 million in investment capacity. We have recently secured \$132 million in debt from NAB and CBA as Australia's first Social Loan dedicated to SDA; and
- Commenced investing in Key Worker Affordable Housing in 2021 after we gained the confidence in both the capability and capacity of the community housing sector and the ability to invest in a model that was not reliant on government interventions to succeed. We have invested \$120 million with SGCH to provide 161 homes to eligible key workers and their families at a minimum of 25.1% discount to market rent. We are looking to expand this investment program to cover more than 1,000 homes and replicate private sector Social Loan funding in the process.

Lighthouse's comments on the Mandate are as follows:

- We are supportive of the approach to give Commonwealth support to both State and Territories and registered community housing providers. We believe that the public interest will be best served by constraining support from Housing Australia to the public and community sectors.
- We are supportive of the flexibility to provide finance via grants or loans and long-term payment contracts. Long-term payment contracts will enable private sector capital investment to occur at scale, gaining added comfort from the returns provided by these

contracts. We are supportive of loans and grants being provided by Housing Australia to social housing. But it should be noted that loans and grants to affordable housing projects will significantly restrict the private sector investment opportunity by displacing the need for their capital to finance a project.

- We are supportive of the objective of Housing Australia to encourage private sector investment in projects. Private investment can play a vital role in the expansion of social and affordable housing market. However, this will only be a net positive to all where these private investors take risks more efficiently than the public or community sector. The appropriate allocation of risk needs to occur in the process of encouraging private sector investment or we will be developing an inefficient capital market which will not be sustainable or valuable over the longer term.
- We are supportive of the requirement of Housing Australia to make reasonable efforts to promote funding to proponents. There are very few private sector participants in this market currently. We have found the interest level from institutional investors to provide capital to be significant, but institutional investors working in the execution of investments in the sector is very low. One of the principal concerns of institutional investors is reliable execution at scale and the proper allocation of, and pricing of risk, in the capital stack.
- We are supportive of expanding the definition of capacity building for registered community housing providers. As noted by the Interim Housing Supply and Affordability Council, “the scale and capability of community housing providers varies across and within jurisdictions, including in terms of organisation type, core business, capacity, scale and maturity. Institutional investors assess that only 10 – 15 providers have sufficient capability to partner with them”¹. Capacity building is an important ingredient for the community housing sector to be able to engage successfully in programs such as HAFF. Like institutional investors, one of the principal concerns around capacity investment is the reliable utilisation of this resourcing and at scale.

However, we have some concerns and challenges. To provide some context to our comments, we are currently looking to evaluate our ability to organise capital in support of Housing Australia’s objectives to increase the number of social and affordable houses under the HAFF and NHAF.

Lighthouse is a private sector investment manager. We require the commitment of capital from institutional investors before we can commence investing in projects. Institutional investors often rely on investment managers when they do not have the capability to access desirable investments with their own resources. To secure commitments from these investors, we will need to demonstrate:

- The nature of the investment opportunity which is available (the investible universe);
- The capacity of the Community Housing Providers to partner with institutional capital to both undertake social and affordable housing developments;

¹ Interim National Housing Supply and Affordability Council - Barriers to Institutional Investment, Finance, and Innovation in Housing Report - July 2023

- The competitive landscape and our ability to compete and to secure investments from this opportunity set;
- The risk and returns associated with those investments and our ability to manage those risks;
- The cost to investors and our business from the activities in securing and managing investments; and
- Make a compelling investment proposition from the above.

In order to decide to participate in Housing Australia funded projects, we will need to answer these questions for ourselves and to institutional investors. Our concerns and challenges listed below should be considered in the context above.

- The criteria for financing decisions are extensive. From a private investor standpoint, the risk around the ability to secure HAFF financing seems significant. The risks presented by the criteria expose us to significant externalities which would be beyond our control. For example: private sector funding is likely to only have a role in working with registered community housing providers (but not State or Local government projects). It appears that privately funded projects will be competing for HAFF funding against State, Territory or Local government funded projects. It is unclear to us how the private sector investor can have confidence in securing funding support for projects where they partner with the community housing sector. It should be noted that we are not objecting to the criteria as an appropriate way to assess the impact of the provision of public funds. It just appears very challenging for the private sector to develop a compelling strategy to give confidence to investors to commit to the sector. In addition, State and Territory based programs with different contractual and regulatory settings are unlikely to attract sufficient institutional capital to deliver 30,000 homes with the imposition of the inefficiency of smaller scale, jurisdictional specific requirements.
- From the Exposure Draft and Explanatory Memorandum, the investment model is deliberately ambiguous to let the market develop. However, it is equally ambiguous how "value for money" will be evaluated. This is a critical issue for institutional investors as money is the principal resource that they provide to Housing projects. Without understanding these criteria, it is difficult to create a risk-return framework. In order to understand and demonstrate to institutional investors how we can compete for projects, we will need to be able to answer this question in a compelling manner.
- Social housing, affordable housing and acute housing have loose definitions in the investment mandate. While trying to be helpful and flexible in the delivery of homes for those in need, this ambiguity is unhelpful for the market to develop proposals and understand their eligibility. Given our particular focus on affordable housing, we would welcome a definition for the HAFF and Accord around what constitutes affordable housing. A useful definition would be the discount to market required and perhaps reference to the relativity to relevant moderate to low-income households. Without this definition, the ambiguity requires the market to apply higher risk to the successful application outcomes.

- The criteria for funding makes reference to “at the time a dwelling under the project is available to be occupied” as the point in time that the compliance with HAFF criteria will be assessed. This implies that the HAFF will only be funding the operating phase and until ready to be occupied, HAFF funding will not be assured. It is not clear that this risk around eligibility will be passed on to the project developers in acquisition contracts that will be subject to HAFF funding being available. It can only be assumed that private sector capital be in a similar position, with capital contingently committed during the construction phase and only being drawn in operations. This feels complex and heavily structured for every project to operate in this manner. Given the scale of some of the projects, it is questionable whether “value for money” can be delivered given the complexity required here. The firm commitment of operational funding would likely be more welcome to the developer market and financiers and perhaps this should be reconsidered.
- The application of the NCC guidelines appears to deliberately exclude projects which commenced construction prior to 1 October 2023 and had not voluntarily applied the requirements of the Code. We believe that this would make the majority of projects which commenced construction but that would otherwise meet all other requirements be excluded. If this was not the intention, perhaps the application of the requirements to projects which commenced construction after 1 October 2023 could be more useful
- It is almost certain that private sector investment will only occur within a special purpose vehicle and with a community housing provider. We appreciate that the investment mandate is deliberately flexible to accommodate these needs. However, we make two recommendations in this area:
 - o The definition of constitutional corporations for the purpose of providing social and affordable housing be further expanded to incorporate not-for-profit status through ACNC registration. The criteria seems to allow for the creation of for profit and purpose entities that could create market disruptions and unintended consequences that may require further interventions in the future.
 - o Housing Australia needs to be able to provide either eligibility rulings at an early phase of the development of investment strategies. There is significant work that needs to be done in structuring and establishing a special purpose vehicle and allocating risks. The time, cost and risk allocation are of critical concern to investors and community housing providers.
- The quantum or proportion of social and affordable housing (versus market) required in a project before eligibility is not explored. The criteria appear open to market developments and that HAFF and NHAF financing are available across an entire project. There seems to be no requirement to ringfence the market properties. If the Investment Mandate is not amended to include criteria around the minimum amount of social and affordable housing, or alternatively, the maximum amount of market housing in a project, then it is expected that this will be made clear by Housing Australia through its engagement with both community housing providers and institutional investors.
- The overall mandate appears to be for HAFF funding to be assigned to individual projects only rather than a portfolio approach. This will require Housing Australia to be involved and approve each project. Given the challenges already faced by the housing industry in terms of planning approvals and other factors impacting “speed to market”, imposing Housing Australia approval across each project has the potential to be suboptimal to the

outcome of producing social and affordable housing efficiently. It may also impede the establishment of a large private sector capital market supporting social and affordable housing. All projects will be required to have the detailed involvement of Housing Australia which will dominate and potentially stifle any private sector engagement or innovation.

There is no review date set in the Investment Mandate. Given the significance of the HAFF and NHAF, it is recommended that an independent statutory review of the operation of the Investment Mandate be undertaken within 18 months of the commencement of the Investment Mandate. This ensures accountability and transparency and will allow the Government and key stakeholders to understand whether the Investment Mandate is delivering on its statutory objectives and whether any amendments to the Investment Mandate should be considered.

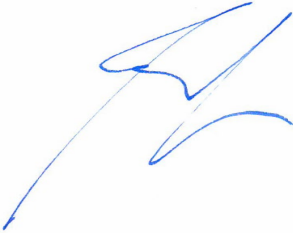
Further to our observations, we provide the following suggestions for efficiency of implementation, value for money for public sector funding and meeting the objective of encouraging private sector investment in social and affordable housing.

- Establish minimum targets for registered community housing providers and their SPVs. The policy has set minimum allocations for the States and Territories to ensure there is fair and minimum participation. Establishing the same minimum targets for the registered community housing sector will enable the financier market to be able to have some comfort around the size of the investment opportunity.
- Simplification of support models to make them repeatable and easy to implement for registered community housing providers and their financiers:
 - o Social housing – utilise grant funding to the maximum extent possible to avoid excessive leverage throughout the sector and add to the speed of implementation;
 - o Affordable housing – provide benchmarked payment streams to registered community housing providers which compensate them for the rental losses forgone in the provision of discounted housing. This is simple to implement and regulate and can leverage off the systems used in the allocation and funding of aged care and/or SDA; and
 - o Avoid the use of concessional loans to registered community housing providers – that crowds out private finance rather than crowding it in. A subsidy to make the project financeable shouldn't require a stapled financing instrument to achieve the outcome desired.
- Avoid the misconception that market housing and other forms of profitable developments will cross subsidise social and affordable housing financing. This will only create market distortions and be unsustainable. Private financiers will see these products for their risk which requires its own return on capital.
- Avoid an implementation process which requires approval of each individual project and consider providing allocations of funding on a use-it-or-lose-it basis to registered community housing providers. This will enable a more efficient implementation of the funding to an individual project and reduce the number of parties and legal advisers needed to close on a project.

- Housing Australia needs to work to with Community Housing Providers and institutional investors to standardise the application process and transaction documentation, otherwise, the bid costs are going to be large. Also, it may deter institutional capital from partnering with community housing providers if the costs versus the risk of an application not being successful are considered too high.

The HAFF and NFAH are welcome steps in creating certainty, consistency and scale in the provision of social and affordable housing in Australia. We look forward to working with Housing Australia and the community housing sector to channel institutional investment to this critical important area.

Yours Sincerely

A handwritten signature in blue ink, appearing to read "Peter Johnston", written over a light blue grid background.

Peter Johnston
Managing Director
Lighthouse Infrastructure Management Limited