CORRS CHAMBERS WESTGARTH
lawyers

Review of the operation of the National Housing Finance and Investment Corporation Act 2018
Issues Paper
*December 2020 (**Issues Paper**)*

Submissions of Corrs Chambers Westgarth

1 Introduction

Corrs Chambers Westgarth (**Corrs**) is one of Australia's leading independent law firms, with many years of experience in the Community Housing Provider (**CHP**) sector, including multiple financings in respect of CHPs both prior to and following commencement of the National Housing Finance and Investment Corporation Act 2018 (**NHFIC Act**).

Our experience in respect of the National Housing Finance and Investment Corporation (**NHFIC**) has in the main involved assisting CHPs access financing from NHFIC, in relation to NHFIC's Affordable Housing Bond Aggregator (**AHBA**). Accordingly, our submissions are focussed on issues relating to such financing.

2 Impact of NHFIC on the CHP sector

2.1 Source of funds

It is clear that NHFIC, through the AHBA, has generated a most welcome source of funds for many CHPs, which have, among other things, refinanced numerous debt facilities made available by commercial lenders, with lower cost and longer-term financing from NHFIC. The resulting savings for CHPs are significant and should have a beneficial effect on housing supply by CHPs, given that in effect equity for CHPs has been freed up and this no doubt will be used in relation to the provision of more housing.

However, the operation of the AHBA is not without potential issues, including the following.

(a) <u>Crowding out commercial lenders</u>

In respect of crowding out, at the outset, it is certainly worth noting that there were significant issues in relation to debt funding for CHPs prior to the availability of financing from NHFIC. In particular:

- whilst commercial lenders were offering loans to CHPs, the short tenor was a significant concern for CHPs, chiefly because it created refinancing risk and costs for them; and
- some commercial lenders struggled with the credit policy to apply to CHPs. This, among other things, led to capped commitments, which were lower than optimal and hampered the growth of CHPs and their provision of housing.

NHFIC financing and the way it has evolved are important steps in relation to dealing with these issues. However, NHFIC's success may have unintended consequences.

As noted in the Issues Paper, the Government's intention is for the AHBA to operate in conjunction with and complement commercial lenders, and the stated policy intent is that NHFIC financing is additional to that which is otherwise available, rather than replacing finance available from other sources.

From our experience and discussions with both commercial lenders and CHPs, there are significant concerns as to whether the stated policy intent is being achieved.

Naturally, CHPs are attracted to the reduced borrowing costs and longer tenor available in NHFIC financing. However, such financing appears to be replacing, rather than complementing, commercial lenders and other potential lenders including super funds (together, **Private Lenders**). In general, Private Lenders cannot compete with the pricing or tenor offered by NHFIC and, thus, many are leaving, or significantly scaling back their lending to, the CHP sector.

In the shorter term, provided there is sufficient financing available from NHFIC, the crowding out of Private Lenders from the CHP sector may not result in any material adverse outcomes for the sector. However, unless it is intended that there will always be sufficient financing available from NHFIC to meet the increasing debt requirements of the CHP sector (and we assume that may well not be the intention), the failure to establish a functioning debt capital market with a variety of funding sources in the CHP sector could have material adverse consequences in the longer term. In particular, if NHFIC financing is not available at maturity of existing NHFIC loans and Private Lenders have ceased to lend to the sector in a major way, then there are serious questions as to what would happen. In the worst case, there could be less funding sources available to the CHP sector than prior to commencement of the NHFIC Act and an inability for some CHPs to refinance NHFIC loans (other than with NHFIC financing).

In order to address the current trend of crowding out, what may be needed is a collaborative approach between NHFIC on the one hand and Private Lenders on the other and/or the development of debt capital market solutions so that there are other long term financing options for CHPs, such as a bond market in respect of which CHPs (or at least those of good creditworthiness) could issue bonds directly to investors, including to refinance loans from NHFIC.

Suggestions in this regard include:

(i) NHFIC would generally not provide construction or development financing (**CD Financing**), but would leave CD Financing to commercial lenders which are very well placed to provide it (with excellent due diligence capability and long term experience in CD Financing), but would make available term debt to take out CD Financing once practical completion is achieved. Alternatively, NHFIC could consider partnering with commercial lenders to provide CD Financing to leverage off their expertise in this area, with the aim of keeping commercial lenders involved in the sector. In such a partnership, we would envisage that in the main the CD Financing would be managed by the commercial lenders and, in general, NHFIC would be a silent partner.

(ii) NHFIC and one or more Private Lenders could provide debt financing to a CHP with shared security. This could be done as secured creditors with different rankings or as a unitranche structure with all debt providers having the same ranking. A unitranche structure could potentially optimise cost savings for CHPs, while maintaining the involvement of Private Lenders in the CHP sector.

(iii) NHFIC could in certain circumstances consider being a lender of last resort, and taking a subordinated position as against Private Lenders. This could fill a funding gap and not involve competition with Private Lenders.

(iv) NHFIC could develop a strategy in respect of growing the debt capital market solutions that may be available to CHPs in the longer term, with the ultimate aim being the availability of a range of debt funding sources for CHPs, including Private Lenders and a number of debt capital market options.

(b) Refinancing risks

The longer tenor of NHFIC means that CHPs do not face the same refinancing risks they would face in relation to financing from commercial lenders, which typically has a maturity of 3 to 5 years.

However, as noted above, if the issue of crowding out is not appropriately addressed, there could potentially be major refinancing risks across the CHP sector when NHFIC financings mature.

2.2 A more efficient source of funds?

In respect of efficiency in this context, we take this to mean the ease and efficiency of having financing approved and put in place.

In our experience, there is not a material difference as to efficiency between a NHFIC financing and financing from a Private Lender. The processes are quite similar. However, it sometimes appears that in relation to certain issues there is less flexibility in NHFIC's approach than that of some Private Lenders. We believe that in certain transactions a less rigid application of NHFIC's baseline positions in precedent documents and a more flexible approach to accepting commercially pragmatic or market standard positions may benefit both CHPs and NHIFIC, including in relation to reduced transaction costs.

It is hoped that over time NHFIC's approach and processes will be streamlined, such that NHFIC does generate a more efficient source of funds, with, for example, less time and effort spent on credit processes and due diligence with respect to entities and a sector that NHFIC knows well.

A financing process that is more efficient than that of Private Lenders would no doubt be greatly appreciated by the CHP sector.

However, if efficiency is referring to the overall position of NHFIC in relation to credit policy (in particular, in relation debt sizing), it would seem that over time NHFIC's initial conservative approach is becoming more flexible. Nevertheless, it may be that further loosening of credit policy will be appropriate in certain cases and could benefit growth of the CHP sector.

2.3 Monitoring and covenants – potential for a lighter touch

Under the National Regulatory System for Community Housing (**NRSCH**), CHPs are accountable for complying with the National Law. The governing body and management of each CHP is responsible for ensuring they deliver community housing in compliance with the National Law. Specifically, CHPs are subject to a range of performance requirements and conditions that are monitored and enforced by the Registrar for Community Housing.

Furthermore, certain state legislation recognises the partnership role of CHPs in assisting governments achieve social policy outcomes. They stand in contrast to typical private sector borrowers.

Given the above, we query if the extensive covenant package (including monitoring requirements) that would usually apply to a private sector borrower is warranted in relation to a CHP. It is submitted that a lighter covenant package may often be appropriate. (At the lower end of the CHP market, there may be less pressure or need for tailored documentation, and it would seem that this is where NHFIC may be able to lend on template terms.)

Similarly, it would seem that in certain cases funding by NHFIC on an unsecured basis may be appropriate – e.g. where a CHP has a good credit standing and provides a negative pledge in relation to not providing significant security (other than standard permitted security interests) to other creditors. NHFIC should as a minimum be given the flexibility to lend without security.

2.4 Long term commitment and stability

We understand from our discussions with certain CHPs that, given the election cycle and concomitant policy changes, there are concerns as to the role NHFIC may play over the longer term. Key concerns are:

(a) The lack of forward capital commitments from NHFIC. There are opportunities for CHPs a number of years into the future. More certainty as to whether NHFIC financing would be available for such opportunities (of course subject to suitable financing conditions being satisfied at the relevant time) would be greatly appreciated by CHPs. In addition, it should help to build investor confidence. Our understanding from CHPs and other participants in the CHP sector is that a consistent barrier for investors is lack of certainty in respect of the future of the CHP sector.

(b) Will NHFIC cease funding at some point?

(c) How may NHFIC's funding approach and requirements change?

The fundamental issue appears to be the CHPs crave as much certainty as possible as to NHFIC's future funding role, so that they can plan their future operations including required financing. Perhaps comfort could be provided to the CHP sector on a rolling 5 year basis, as to NHFIC's plans for the next 5 years including any limits on funding from NHFIC.

3 Government's guarantee of NHFIC's liabilities

It seems that the success of the AHBA, including the oversubscription of bond issuances to date, may not have occurred without the Commonwealth's guarantee of NHFIC's liabilities (**Cth Guarantee**). However, it is not clear whether such success has been solely as a result of the Cth Guarantee. It is possible that investors are looking for long term, stable investments and identify the CHP sector as being able to provide that stability. Further consideration should be given to whether there would be appetite for bonds without the Cth Guarantee, and, if so, what would be the impact on pricing.

We expect that ideally the Government wishes not to increase the $3 billion liability cap and in due course have NHFIC (or a NHFIC SPV) issue bonds without the Cth Guarantee. This may be feasible if NHFIC can obtain an appropriate stand-alone credit rating. However, it is worth noting that, provided there are no significant monetary defaults by CHP borrowers of NHFIC, the Cth Guarantee should have very limited effect on the Commonwealth's finances.

As CHPs have to date been using their assets as security for NHFIC financing, bondholders may, at least indirectly, be able to have the benefit of such security – for example, by limited recourse security in favour of bondholders over relevant assets of the NHFIC lender to CHPs (which assets would include mortgages and other security granted by CHPs). Accordingly, the state and territory interests in certain CHP assets may not be a significant issue in relation to bond issuance without the Cth Guarantee.

It is hoped that if the transition is effectively managed the increase in borrowing costs that may apply in relation to bond issuance without the Cth Guarantee can be minimised. In this regard, there may be potential for a transition over a number of years, perhaps with reducing levels of credit enhancement in respect of bond issues, until, hopefully, issuance without a Cth Guarantee or any other credit enhancement becomes feasible.

Finally, in respect of the Cth Guarantee, we query if it may be possible to use a guarantee from the Commonwealth to help facilitate the provision of debt financing to CHPs at lower levels of their capital structures – i.e. mezzanine and subordinated debt. Increasing the availability to CHPs of debt at those levels could significantly aid the expansion of housing provided by the CHP sector.

4 Contacts

If you have any questions in relation to our submissions, please contact any of the following, who have contributed to our submissions:

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