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Committee Secretary
Senate Economics Legislation Committee
Department of Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

To Committee Secretary

Re: Senate Economics Legislation Committee Inquiry into the National Housing Finance and Investment Corporation Bill 2018

Thank you for the opportunity to make a submission to the Senate Economics Legislation Committee's Inquiry into the bills relating to the National Housing Finance and Investment Corporation (NHFIC).

Australian Housing and Urban Research Institute (AHURI) research has examined a range of initiatives to increase affordable housing supply. These include: planning policy interventions, use of public lands and state-funded housing support initiatives. For example, recent research on increasing affordable housing through inclusionary planning shows how value uplift can be captured and shared.[1]

AHURI has undertaken a significant body of research on housing supply bonds[2] and housing investment through an intermediary and guarantee scheme.[3] This material has informed the Affordable Housing Working Group report to Heads of Treasuries, *Innovative Financing Models to Improve the Supply of Affordable Housing*, The Treasury Consultation Paper and associated material.[4,5,6]

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[1] Gurran, N., Gilbert, C., Gibb, K., van den Nouwelant, R., James, A. and Phibbs, P. (2018) Supporting affordable housing supply: inclusionary planning in new and renewing communities, AHURI Final Report No. 297, Australian Housing and Urban Research Institute Limited, Melbourne, http://www.ahuri.edu.au/research/final-reports/297

[2] Lawson, J., Milligan, V. and Yates, J. (2014) *How might bond finance expand affordable housing in Australia?* AHURI Research and Policy Bulletin No. 173, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/research-and-policy-bulletins/173.

[3] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014) *Enhancing affordable rental housing investment via an intermediary and guarantee*, AHURI Final Report No. 220, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/final-reports/220.

[4] Australian Government (2016) *Innovative Financing Models to Improve the Supply of Affordable Housing*, Council on Federal Financial Relations Affordable Housing Working Group report to Heads of Treasuries, Canberra, October. https://static.treasury.gov.au/uploads/sites/1/2017/06/C2016-050_Final_report.pdf

[5] Australian Government (2017) National Finance and Investment Corporation, Consultation Paper September; https://treasury.gov.au/consultation/c2017-222774/

[6] EY Canberra (2017) *Establishment of an Australian affordable housing bond aggregator: Advice, modelling, evidence and an implementation plan for the establishment of an affordable housing bond aggregator*, Final Report to Australian Treasury https://static.treasury.gov.au/uploads/sites/1/2017/09/c2017_222774_EY_report-2.pdf

AHURI research on social impact investment has shown that the introduction of a bond aggregator might address 'many of the valid concerns of institutional investors which cannot be adequately addressed, making it difficult to attract institutional capital to participate—one of the critical success factors' in developing social impact investment in Australia.[7]

The purpose of this submission is to highlight AHURI research relevant to the National Housing Finance and Investment Corporation Bill 2018.

The National Housing Finance and Investment Corporation Bill 2018

Part 1: Preliminary

Section 3: Object of this Act

In establishing the National Housing Finance and Investment Corporation, the Bill has multiple objectives including: 'strengthening efforts to increase supply of housing'; 'encouraging the investment in housing (particularly in the social and affordable housing sector)' and 'contributing to the development of the scale, efficiency and effectiveness of the community housing sector in Australia' (p.2). The findings of a body of AHURI research support these objectives, as described in subsequent sections of this submission.

Part 2: National Housing Finance and Investment Corporation

Division 1: Establishment and functions

Functions of the NHFIC

(a) to make loans, investments and grants to improve, directly or indirectly, housing outcomes

The NHFIC has the potential to improve housing outcomes because at present Community Housing Providers (CHPs) may be constrained in undertaking new construction, or new construction at scale, due to lack of finance. AHURI research has found that CHPs 'raise commercial debt for three reasons: to finance construction, to fund turn-key acquisition, or to refinance existing loans'.[8] The AHURI research found that 'construction finance is much higher in risk for the lender due to non-completion hazard' (the risk of being unable to recoup value from a security asset if a halt in construction delays the generation of rent revenue). This research identified that: 'some community housing organisations' debt facilities covered a construction period for two years, converting to an operating loan upon project completion'.[9] However, participants in an AHURI Investigative Panel reported that construction finance is in general difficult to secure in Australia,[10] and this has driven many CHPs toward purchasing turn-key developments from the open market rather than constructing their own purpose-built housing.[11] The construction of new housing stock by public and community housing providers has been modest in Australia, constituting only 2.7 per cent of all dwellings built in a year.[12]

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[7] Muir, K. Moran, M., Michaux, F., Findlay, S., Meltzer, A., Mason, C., Ramia, I. and Heaney, R. (2017) *The opportunities, risks and possibilities of social impact investment for housing and homelessness*, AHURI Final Report No. 288, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/final-reports/288 , doi:10.18408/ahuri-7110101, p 5.

[8] *Ibid*, p 31.

[9] *Ibid*, p 31

[10] Milligan, V., Yates, J., Wiesel, I. and Pawson, H. (2013) Financing rental housing through institutional investment—Volume 1, AHURI Final Report No. 202, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/final-reports/202.

[11] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). O*p cit*.

[12] *Ibid*,

Provision of government grants and guarantees are important to facilitating finance. AHURI research has shown that CHPs who had raised construction-period finance found that significant government funding of development costs had unlocked banks' willingness to lend. Banks derive comfort from the understanding that the government will intervene to stave off or respond to a borrower default, even if this pledge is explicitly limited to nominating another CHP to step in.[13]

A key role of intermediaries such as the NHFIC should be to assess the risks and benefits of applications for borrowing money from individual CHPs.[14] For the system to have credibility and accountability, CHPs and regulators need to have: 'high calibre and professional expertise in financial management'. Management also requires 'adherence to clear and appropriate commercial benchmarks for solvency ratios, interest rate cover and equity to be eligible for any guarantee'.[15]

(b) to determine terms and conditions for such loans, investments and grants

The NHFIC should aim to originate loans or investments that are appropriate to the needs of CHPs. At present the terms of loans are too short (around 3 years) and do not match the life of assets they finance. AHURI research indicates that this is the single greatest issue for Community Housing Organisations (providers) in obtaining finance:

> *Clearly the short loan terms experienced by CHOs in the current market do not match the asset life of the rental dwellings, and add significant refinancing risk as well as recurring time burden of negotiating new loans time after time. It is the single most untenable borrowing condition facing CHOs in Australia today, underscoring the relevance of this project's exhaustive search for more workable financial mechanisms*[16]

The research found that existing bank loans are often lines of credit (not tied to a particular project) or finance linked with a new development. Some CHPs consulted were seeking to refinance other debts to enable expansion so getting better deals on finance could be decisive in enabling growth.

Securing loans only with the relevant asset would also reduce the practice of use of Fixed and Floating Charges. At present, although CHPs loans are sized on the cash flow fundamentals of development projects, commercial banks have often required security beyond the subject property:

> *Typically, project-specific loans are secured by specified assets, and broader lines of credit are secured by broad charges over a company's entire assets (Fixed and Floating Charges—FFCs). However, in the case of community housing lending, all banks have endeavoured to impose FFCs irrespective of the specific nature of some loans. CHOs' efforts to resist such terms have met with mixed success. From the borrower viewpoint, FFCs are undesirable because of the constraints placed on future activities: a CHO would have to obtain bank consent before encumbering any assets in financing subsequent development projects. Several CHOs reported modest success in negotiating down banks' security demands by playing lenders off against one another. Most had, nevertheless, had to pledge assets in addition to those being financed, thus sterilising this part of the balance sheet from underpinning later growth activities. In practice, many borrowers found that the smaller banks have been the most inflexible on insisting on FFCs.*[17]

The research concluded that negotiating one-off debt facilities, which attract unfavourable terms, is costly and inefficient. A new, more stable, and large-scale, source of debt finance is required for Australia's growing community housing sector to supplement the country's inadequate affordable

[13] *Ibid*

[14] *Ibid*

[15] *Ibid*, p 18-19

[16] *Ibid,* p.34.

[17] *Ibid*, p36.

housing supply.[18] A housing bond scheme, which sources institutional investment and provides for longer borrowing terms would achieve this aim.

In addition, AHURI research has found that housing supply bonds need to reduce the cost of finance for CHPs *and* enhance their capacity to increase the supply of affordable housing (for example, through purchase or development).[19] Evidence from a similar scheme in Austria has shown that bond schemes have been successful in enabling CHPs to borrow at competitive rates and increase the supply of affordable housing.[20]

(c) to provide, to registered community housing providers, business advisory services and other assistance in capacity building

The NHFIC should play an important role in building the capacity of the affordable housing industry. The *AHURI Inquiry into affordable housing industry capacity* highlights five dimensions of industry capacity that require further development: resource, organisational, industry-specific, networking and political.[21] The research found that a 'priority area for capacity building is pooling funds from industry and government sources to promote the long-term development of the industry in areas such as the application of digital technologies and research and evaluation'.[22]

Industry stakeholders reported that industry professional development requirements need to be enhanced, including in the areas of 'specialist property development and development finance ability; long-term asset management and asset-management planning; complex tenancy management; culturally adapted housing services; and contract management'.[23]

The research identified that a particular gap was capacity building for Indigenous housing providers. Other areas identified for assistance to build the capacity of the industry were the strengthening of national industry regulation and standards; the enhancement of collection and access to housing performance and finance data; and the establishment of a national housing policy and industry leadership framework.[24]

Division 2: Investment mandate

Making loans, investments and grants

AHURI notes that the NHFIC Bill has an object of 'encouraging the investment in housing (particularly in the social and affordable housing sector)' (p.2) and notes that while there are good reasons for the Bill not limiting the object to investment only in social and affordable housing, the increase of affordable supply could be constrained if bond issues extended mainly to develop market-priced rental housing. International guarantee schemes target affordable housing—where affordable housing can comprise a range of types: for low, and middle, income earners; new, newly completed and renovated housing; and for rental or home ownership.[25]

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[18] *Ibid*.

[19] Lawson, J., Milligan, V. and Yates, J. (2014). O*p cit*.

[20] AHURI 'Attracting large institutional investors for affordable housing developments' policy issue analysis https://www.ahuri.edu.au/policy/policy-analysis/institutional-investment

[21] Milligan, V., Pawson, H., Phillips, R. and Martin, C. with Elton Consulting (2017) *Developing the scale and capacity of Australia's affordable housing industry*, AHURI Final Report No. 278, Australian Housing and Urban Research Institute Limited, Melbourne, http://www.ahuri.edu.au/research/final-reports/278 p.8

[22] *Ibid*, p6

[23] *Ibid*, p3

[24] *Ibid*

[25] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*.

AHURI research shows that CHPs sometimes need to develop market housing as well as affordable housing as part of new developments[26], so limiting the range of investment only in social and affordable housing could limit the scope for organisations including CHPs to be more entrepreneurial. While the mandate involves giving a high degree of discretion to the Minister in directing how the NHFIC should function, there may be ways to make the priority towards affordable housing reflected in a clearer way in either the investment mandate, or that the performance of the organisation in meeting the objective of supply of affordable housing is clearly measured, reported and held to account.

Loans or investments would also need to consider the appetites of investors and liquidity. AHURI research suggests that 'the size of the bond issue is important to investors. Scale efficiencies can be achieved by pooling multiple smaller borrowing demands with cost of issuance shared between participating borrowers and added as a premium on the loans'.[27] The research indicates that pooling mechanisms can work effectively, but regularity and predictability of bond issue is also important for investors, thereby developing a liquid market for the bonds. The research suggests that this requirement could dovetail with a long-term housing program with annual supply targets. In the example of Switzerland the research notes that 'since 1991, quarterly pooled bond issues in 5000 lots have varied from CHF (Swiss Franc) 23 million (AUD 26 million) to CHF 123 million (AUD 141 million), attracting strong and sustained interest from large and small investors'.[28]

Risk and return relating to NHFIC's investments

Critical to NHFIC's operation is to mitigate any risk associated with investment along with offering a government guarantee to investors to reduce their risk exposure. AHURI research has identified a list of principles for the NHFIC to adhere to (boundaries in permitting eligible projects, lowering risk, transparency and commitment, expert intermediary, scale and frequency of bond issues and adequate structure) to address risks. For example, in relation to an adequate structure, the guarantee scheme should have clear and agreed structure including targets, volume caps, contestable allocation, on-going compliance process and 'trigger points', practical lines of defence against default, mechanisms to build up contingency reserves and agreed loss sharing arrangements.[29]

Providing a government guarantee is part of reducing perceived risks for investors. The AHURI research found that for adequate rate of return, 'in mid-2011, Housing Supply Bonds (HSBs) would have had to yield around 8–9 per cent to attract self-managed retirement funds. Any lower yield would have to be offset by either a tax concession advantage (substantial enough to lift yields to an adequate level of return) or by a high rating, reflecting a low risk. This is why enhancements (e.g. government guarantees or tax incentives) are required to reduce risk and improve HSB yields'.[30]

Part 3: Board

AHURI research supports that a governing expert Board of Directors requires directors with extensive experience and expertise in financial management and credit assessment along with community housing provider representation.[31] AHURI would be pleased to offer assistance in identifying potential Directors.

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[26] Milligan, V., Pawson, H., Phillips, R. and Martin, C. with Elton Consulting (2017), *Op Cit*

[27] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*,. p 18.

[28] *Ibid*. p18.

[29] *Ibid.* p.6

[30] *Ibid*, p 2.

[31] *Ibid*

Part 5: Finance

Maintenance of adequate capital and reserves; Payment of annual dividends to the Commonwealth

In terms of a self-funding objective—AHURI research has identified intermediaries based overseas that deliver a dividend to their governments, while others build and hold reserves as risk mitigating funds.[32] Some collect a guarantee fee, which can be used to build up a reserve fund.[33]

Guarantee by Commonwealth

Evidence from AHURI research, in reviewing international guarantee schemes, suggests that a government guarantee would reduce the borrowing rate and reduce uncertainty for investors. The research found that 'it overcomes many of the barriers to investment in affordable housing by offering investment opportunities at an appropriate scale, simplicity and risk weighted return. It is also attractive to housing providers because of its lower cost. The government guarantee would help establish a robust and competitive investment market'.[34]

The AHURI research concludes that guarantees have had a minimal impact on government budgets, with most boasting a zero default record and a few even provide a return for government. The UK's The Housing Finance Corporation (THFC) has reportedly 'harnessed the lowest cost long-term private investment for registered social landlords in the history of private investment in social housing. With the government guarantee, they offered 28 years of credit at 3.76 per cent interest cost, being only 0.37 per cent over the long-term government bond rate. The THFC issue was three times over-subscribed by investors'.[35]

EY analysis[36] suggests 'CHPs could achieve pricing benefits of up to 1.4 per cent p.a. based on a like for like comparison with the bank market'. Similarly, AHURI research found that in the Netherlands, the Dutch Guarantee Fund Social Housing has reduced interest rates by 1–1.5 per cent below the going equivalent mortgage rate.[37]

A guarantee scheme was proposed in a 2014 AHURI report, assuming the intermediary would raise $7 billion to finance 20,000 dwellings.[38] On the basis of what retail and institutional investors required, the bonds were allocated 70 per cent to AAA bonds, 20 per cent to Tax Smart bonds and 10 per cent to NAHA growth bonds. As a result, the average cost of funds available for on-lending to CHPs was 4.7 per cent, considerably lower than the then current costs of around 8.2 per cent (usually required by self-funded retirees). An additional allowance would need to be made for costs incurred by the financial intermediary in raising and distributing these funds.[39]

AHURI research has concluded that a condition of any guarantee is that the Government would need to give a clear commitment to continuity of funding eligible tenants, for example via CRA, and the term of the guarantee, so that potential investors can be confident of a pipeline of future bond issues. The Corporation could negotiate and sign an overarching agreement with government(s)

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[32] Lawson, J., Berry, M., Pawson, H. and Hamilton, C. (2014) Enhancing affordable rental housing investment via an intermediary and guarantee, AHURI Research and Policy Bulletin No. 174, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/research-and-policy-bulletins/174.

[33] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). O*p cit*.

[34] Lawson, J., Berry, M., Pawson, H. and Hamilton, C. (2014). *Op cit*.

[35] *Ibid*, p 3.

[36] EY Canberra. (2017). *Establishment of an Australian affordable housing bond aggregator*. Canberra. See p.12 (executive summary).

[37] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*

[38] Lawson, J., Milligan, V. and Yates, J. (2014). O*p cit*.

[39] *Ibid*

offering an issue-specific default guarantee on bonds issued by the Agency. The clear commitment to policies and programs ensures a stable operating environment, such as adequate supply incentives and revenue side subsidies.[40]

The research also outlined a number of principles for successful guarantee schemes, and one of these was the imposition of boundaries to borrowing. This included agreed principles, defined characteristics of eligible projects for guarantee, as well as an overall and project-related borrowing volume cap (and hence contingent liability for government).[41] EY also saw that prudent bond aggregator credit policies, oversight and monitoring, and a resolution period could successfully mitigate risks of default.[42]

If the Australian government is seeking to limit the risks associated with providing a guarantee, they might also consider the example of the Netherlands and Switzerland where 'a guarantee fee can also be used to build up a reserve fund proportional to the obligations guaranteed. It can also be conceived as the government guarantee's second line of defence against being called upon. In Switzerland, the fee is used to cover interest payments for a maximum of one year and is, of course, in addition to any issuance fee'.[43]

I would like to thank the Senate Economics Legislation Committee for its consideration of this submission. I would welcome the opportunity to elaborate further on the submission. All AHURI research is available free from www.ahuri.edu.au.

If there is any way we can be of further assistance, please contact me directly on [redacted]

Yours sincerely

[redacted]

Dr Michael Fotheringham
Executive Director

[40] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*

[41] *Ibid*

[42] EY Canberra. (2017). *Op cit*

[43] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*, p 19.