



**Australian Government**

Council on Federal Financial Relations

# Innovative Financing Models to Improve the Supply of Affordable Housing



October 2016

**Affordable Housing Working Group**

**Report to Heads of Treasuries**



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## Executive summary

Housing is fundamental to the welfare of all Australians. From a social perspective it promotes and improves employment, educational and health outcomes. From an economic perspective it is a driver of participation and productivity as well as consumption, investment and savings in the economy.

Recognising the importance of affordable housing, the role it plays in the welfare of lower income households and the current significant housing pressures these households face, the Council on Federal Financial Relations asked the Affordable Housing Working Group ('the Working Group') to investigate innovative financing models aimed at improving the supply of affordable housing. The Working Group was asked to focus on models that attract private and institutional investment at scale into affordable housing and to report back to Heads of Treasuries on its findings and recommended next steps.

The Working Group was tasked with looking at affordable rental housing, as distinct from the purchase of affordable housing. While not considered in this report, assisting lower income households with purchasing affordable housing remains an important and ongoing policy challenge, and may benefit from further consideration by governments.

In an Issues Paper, released in February 2016, the Working Group canvassed four possible innovative finance models – a housing bond aggregator, a housing trust, housing co-operatives and social impact investing bonds. Through the paper, the Working Group sought feedback from stakeholders on the merits of the proposed models and to provide opportunities for other models to be considered.

The Working Group has undertaken a comprehensive consultation process that included a public call for submissions, roundtables with stakeholders across the finance, industry and community housing sectors, and a workshop with State and Territory treasuries and housing departments. Following this consultation, the Working Group has determined that the establishment of a financial intermediary to aggregate the borrowing requirements of affordable housing providers and issue bonds on their behalf ('the bond aggregator model') offers the best chance of facilitating institutional investment into affordable housing at scale, subject to the provision of additional government funding.

By providing cheaper and longer-term finance for community and affordable housing providers, the model has several potential benefits:

- It enables providers to refinance their existing borrowings and finance new developments at lower cost and longer tenor.
- It creates a market for private affordable housing investment that both normalises and expands flows of capital to the industry.
- It best addresses the barriers of return and liquidity by providing an instrument that is understood by sophisticated investors as a fixed income investment.
- Due to its financial profile, it can be easily traded in a secondary market and would be seen as an attractive low-risk financial product.

In addition, the bond aggregator model has been successfully implemented in the United Kingdom, where The Housing Finance Corporation was recently able to borrow at rates below that of the Government and in 2014-15 provided over £4 billion in loans to housing associations.

Notwithstanding this finding regarding the bond aggregator model, it is important to note that the housing trust model also attracted significant support in stakeholder consultations and warrants



further investigation, particularly due to its ability to provide affordable housing at a significant scale. The other two models considered: housing co-operatives and impact investment models are important funding and delivery mechanisms, but were not capable of generating the required scale of investment.

In conducting its assessment of financing models, the Working Group finds that the major barrier to the supply of affordable housing is the 'financing gap' – that is, the difference between the rates of return available in affordable housing compared with the market rates of return available in other private developments. No innovative financing model will close this gap and a sustained increase in the investment by governments is required to stimulate affordable housing production and attract private and institutional investment. A key question for further work is the nature and extent of the gap relative to the desired policy outcomes and how it can be funded most efficiently.

The Report further notes the importance of a variety of complementary reforms, including through nationally consistent regulation of community housing providers, planning and zoning regulations, and taxation and concessions. Reforms in these areas would provide the right environment for innovative financial models to succeed, and strengthen the capacity of governments and community housing providers to increase the supply of affordable housing in an effective way.

Without reforms to existing policy settings, the current undersupply of affordable housing is likely to intensify, placing ongoing pressure on the private rental market, community and public housing providers, and government expenditure on housing and other assistance.



# Recommendations

## ***Recommendation 1***

**The Working Group recommends the establishment of an expert taskforce to design a proof of concept for a bond aggregator model to provide for greater private and institutional investment in affordable housing. The taskforce should determine the design features and an implementation plan of the proof of concept and report their findings to Heads of Treasuries by mid-2017.**

The bond aggregator model has the most support from the not-for-profit and finance sectors and would provide affordable housing providers with access to cheaper and longer tenor debt; freeing up capital for the construction of new affordable housing. At a minimum, it would allow for the immediate refinancing of existing debt held by affordable housing providers.

Acknowledging this support and noting that market acceptance of a housing bond is predicated on a credible pipeline of ongoing issuances, the taskforce should advise on design features required to implement the bond aggregator, including the size and timing of bond issuances, the entity responsible for issuing bonds, the entity responsible for assessing loan applications and governance arrangements.

In determining the ongoing viability of the bond aggregator, the taskforce should also advise Heads of Treasuries on:

- the size of the financing gap for the various types of affordable housing, from public housing through to below market rental housing;
- optimal portfolio mixes that could reduce the financing gap by generating the cash flows needed to service loans while delivering the types of affordable housing required;
- the level and form of investment required from governments to close any residual financing gap to support the establishment of a private financing vehicle; and
- the future pipeline of affordable housing required to provide sufficient confidence to institutional investors.

The taskforce should be led by the Commonwealth Treasury and Department of Social Services, with representation from States and Territories while the body of the taskforce should be predominantly composed of industry and financial experts.

## ***Recommendation 2***

**The Working Group recommends that Heads of Treasuries note that government support is required to efficiently leverage long-term institutional investment for affordable housing and provide greater value for government expenditure.**

Closing the financing gap will require a commitment to sustained and dedicated funding by governments. No innovative financing model will close this gap and a sustained increase in the investment by governments is required to stimulate affordable housing development and attract private and institutional investment.



### ***Recommendation 3***

**The Working Group recommends that jurisdictions investigate whether and how existing and future housing policies and practices can be utilised, expanded or redesigned to support the effective implementation of a housing bond aggregator.**

Findings around the viability of options and potential next steps should be reported back to Heads of Treasuries by mid-2017.

Areas that jurisdictions may wish to investigate could include but are not limited to:

- the redevelopment of existing housing assets;
- increased public private partnerships with community housing providers or affordable housing providers;
- the transfer of public housing stock; and
- the provision of rental subsidies.

### ***Recommendation 4***

**The Working Group recommends that governments consider complementary reforms to enhance the ability for a housing bond aggregator model to boost the supply of affordable housing.**

Complementary reforms for governments to consider may include:

- initiatives that enhance the capacity of the community housing sector, including through nationally consistent regulation and reporting mechanisms;
- utilising planning and zoning regulations;
- exploring the role of local government; and
- using taxation and concession arrangements.



# 1. Introduction

## Background

On 16 October 2015, the Council on Federal Financial Relations recognised the work being undertaken under the leadership of the Victorian Government on housing supply and requested that further work be undertaken on housing affordability with a specific focus on solutions to improve the supply and provision of social housing.<sup>1</sup>

On 7 January 2016, the Minister for Social Services, the Hon Christian Porter MP, and the then Assistant Minister to the Treasurer, the Hon Alex Hawke MP, announced that the Commonwealth would establish an Affordable Housing Working Group ('the Working Group') to investigate innovative ways to improve the availability of affordable housing (social housing and rental housing in the private market for those on low incomes).<sup>2</sup> The Working Group comprised members of the Commonwealth Treasury and Department of Social Services as well as members from the New South Wales, Victorian and West Australian Governments.

The Terms of Reference for the Working Group (Appendix A), as well as an Issues Paper, were released on 2 February 2016.<sup>3</sup> These documents sought to clarify the Working Group process and provided the basis for community input on the key issues related to the supply of affordable housing and proposed financing models to increase institutional investment in affordable housing.

## Objective

As stated in its Terms of Reference, the objective of the Working Group is to:

- report on the current state of affordable housing;
- identify potential financing models that increase the provision of affordable housing (social housing and housing in the private rental market) for those on low incomes;
- assess potentially viable proposals put forward by stakeholders; and
- outline the best method to progress any models that were identified as viable.

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1 The Hon Scott Morrison MP, Press Release, 'Council on Federal Financial Relations', 16 October 2016. Available at <http://sjm.ministers.treasury.gov.au/media-release/005-2015/>.

2 The Hon Christian Porter MP and the Hon Alex Hawke MP, Joint Press Release, 'Strengthening the Government's Affordable Housing Agenda', 7 January 2016. Available at: <http://christianporter.dss.gov.au/media-releases/strengthening-the-government-s-affordable-housing-agenda>.

3 The Hon Christian Porter MP and the Hon Alex Hawke MP, Joint Press Release, 'Government calls for innovative ideas to boost investment in affordable housing', 2 February 2016. Available at: <http://christianporter.dss.gov.au/media-releases/government-calls-for-innovative-ideas-to-boost-investment-in-affordable-housing>.



## Scope of the Working Group

The Working Group sought proposals from stakeholders to improve the supply of affordable housing while maximising the effectiveness of government expenditure. In doing so, the Working Group focussed on the twin goals of maintaining a strong social housing safety net for those on the lowest (predominantly income support) incomes and in the greatest need while also facilitating large-scale private sector investment into the affordable housing rental market. This supply of private affordable rental housing is seen as the key stepping-stone to enable mobility of some current social housing clients out of the social housing system, freeing dwellings to allocate to others on the wait list and helping those who are able to achieve greater self-sufficiency. Without an affordable rental housing segment, the step between social housing and the private rental market is too great.

The Working Group has sought to ensure its work and recommendations are complementary to the:

- Smart Cities Plan;
- Housing Supply Working Group; and
- various housing strategies and reforms being undertaken by States and Territories.

The Working Group did not undertake a detailed examination of existing policy settings including Commonwealth Rent Assistance (CRA), the National Rental Affordability Scheme (NRAS), taxation, land release, planning and zoning, or the regulation of community housing providers (CHPs) as these were out of the scope of the Terms of Reference. Where these settings were raised they were considered to the extent that they impacted on the financial viability of a model.

## Review process

Following the release of the Issues Paper, the Working Group undertook four weeks of public consultation and conducted two roundtables with key stakeholders. Over this period, representatives from the Working Group met with a number of stakeholders to discuss the topics and models outlined in the Issues Paper. Stakeholders were also provided with guidance on where they should focus their efforts in framing their submissions.

By the close of public consultation on 11 March 2016, the Working Group had received 78 submissions from a range of individuals, academics, industry representatives and governments. The submissions were then examined through a formal two stage assessment process to determine those submissions which outlined plausible financing models or information that could be used to supplement proposals received from other stakeholders.

This process identified a number of elements necessary for the design of potentially viable models as discussed in this Report. These elements were subject to further discussion by the members of the Working Group, with respect to their impact on the financial viability of the models and their interaction with existing State and Territory initiatives. Members of the Working Group also undertook further consultation with stakeholders on some of these key elements.

A workshop with all State and Territory Treasuries and relevant housing departments was held on 8 April 2016, where the appropriateness and financial viability of relevant models were discussed.

The potentially viable models and associated recommendations contained in this report reflect all of these deliberations, although detailed modelling will be required in order to develop a better understanding of the necessary components of each model.



## 2. What is affordable housing?

### Definition of affordable housing

The Working Group highlighted in its Issues Paper that there are multiple definitions of affordable housing. In their submissions to the Working Group, stakeholders generally referred to the concept of housing stress, which is often defined using either a ratio of the cost of rent to a household's income; or residual income measures that consider whether the cost of housing impedes a household's ability to meet other basic needs.

For the purpose of this process the Working Group has chosen to define affordable rental housing as:

*Affordable housing that reduces or eliminates housing stress for low-income and disadvantaged families and individuals in order to assist them with meeting other essential basic needs on a sustainable basis, while balancing the need for housing to be of a minimum appropriate standard and accessible to employment and services.*

This definition combines the elements of a ratio approach and a residual income approach while seeking to capture broader issues around housing quality and household wellbeing. The Working Group notes that housing stress is not necessarily defined as a set proportion of a household's income and can at times be temporary. Responses are ideally prioritised to those facing enduring and severe housing stress. A brief summary of the ratio approach and the residual income approach and their limitations is set out at [Appendix B](#).

### Types of affordable housing

The definition of affordable housing used by the Working Group encompasses a range of housing provision to households that have incomes in the very low to moderate range. The types of affordable housing examined by the Working Group are illustrated in [Figure 1](#) and include:

- **Sub-market private rental** - housing that is provided by the private market for low- and moderate-income households at rents which are discounted from the market rate. Allocation is usually governed by eligibility criteria. However, this is at the discretion of the provider.
- **Community housing** - rental housing that is owned and/or managed by not-for-profit organisations and generally allocated to lower income households in accordance with eligibility and prioritisation policies. Allocation is the responsibility of individual providers in accordance with their not-for-profit status and any other conditions, such as those imposed by governments in providing assistance.
- **Public housing** - rental housing that is owned and managed by State and Territory government agencies and allocated to very low- and low-income households in accordance with eligibility and prioritisation policies. Allocation is the responsibility of State and Territory government agencies and generally gives priority to those in greatest need but the implementation of this varies across jurisdictions.

These types may overlap. For example, Community Housing Providers (CHPs), though they are government-regulated, are private social enterprises, and may operate rent-restricted private rental housing under contract to private owners. Similarly, several States and Territories contract the management of public housing to CHPs.



In general, affordable housing can be characterised as charging rent based on tenant income, a discount from the market rate or a combination of the two.

‘Social housing’ is often used to refer to the combination of public and community housing dwellings where rents are based on a proportion of a tenants’ income (usually between 20 and 30 per cent).

‘Rent restricted’ or ‘Sub-market private rental housing’ is housing, generally provided by (CHPs) or private providers, provided at rents based on market rental rates at a fixed discount (that is, at 75 per cent of market rate rent). This type of housing is aimed at households who are higher up the housing continuum than those in social housing, such as low income workers, but may face significant housing stress in the private rental market due to shortages in supply and recent trends in rent. This type of housing is currently a significantly under-developed segment of Australia’s housing market and is viewed by some as the missing section of the housing continuum.

Figure 1: Housing continuum



The Working Group was tasked with investigating affordable rental housing, as distinct from the purchase of affordable housing. There are a range of initiatives in Australia that aim to assist lower income households with purchasing affordable housing, such as through selling housing at below market rates or providing shared equity schemes. Whilst the Working Group has not considered this type of housing directly, they remain a key part of the housing continuum.

At the other end of the spectrum, homelessness service providers deliver a range of crisis, transitional and longer-term housing to a broad range of household types. Housing provided by these service providers is also out of the scope of the Working Group. However, in its deliberations the Working Group was mindful that referrals from homelessness services form a significant proportion of the households that receive a priority allocation of social housing.

Housing for those with specialist needs, such as housing that is appropriate in remote communities or for people with disabilities, forms a sub-section of housing across the continuum. This type of housing plays a crucial role in the wellbeing of these individuals. The Working Group did not analyse any particular specialist needs housing. However, the Working Group expects that there is potential for specialist needs housing providers to participate in the financing models considered.

In addition to subsidised housing, rental subsidies are also provided to assist households to meet rents in the private rental market. For example, the Commonwealth provides housing assistance to around 1.3 million families and individuals in the private and community housing rental markets through the provision of CRA. In 2016-17 it is estimated that the Commonwealth will spend around \$4.5 billion on the provision of CRA.

Some jurisdictions also have significant rental assistance programs. For example, NSW provides a number of financial and non-financial products and services to assist eligible social housing clients to access and sustain accommodation in the private rental market. In 2014-15 this included providing 18,880 households with rental assistance in the private sector.



### 3. The current state of affordable housing and impediments to improving supply

The current state of the affordable housing market is closely linked with broader trends across the rest of the housing market. Constrained supply combined with strong demand due to factors such as population growth, rising incomes, tax settings, increased levels of investment (domestic and foreign), reductions in the number of people per dwelling and deregulation of the financial system has led to a significant increase in overall house prices. In turn, this has put pressure on lower income groups as higher income groups that are unable to enter home ownership remain in the private rental market – increasing competition for the available rental stock.

Where demand for housing exceeds supply, this would normally lead to increased prices and, in response, an increase in the supply of housing stock provided by the private market. However, in the context of affordable housing, this has not occurred to date primarily due to its non-market nature, resulting in a shortage of affordable housing.

A shortage of affordable housing means that many low-income and disadvantaged households are unable to access adequate housing at a price that enables them to also meet the basic costs of living. For most, their only option is to rent in the private market where high prices and low security of tenure often place them in housing stress.

#### The current state of affordable rental housing

In 2013-14, approximately 31 per cent (2.7 million) of Australian households were in the rental market. Around 47 per cent (1.3 million) of these households were classified as lower income households.<sup>4</sup> As highlighted in **Table 1** there is significant variation with respect to the rental stress for low income households.

There are two distinct trends with respect to rental housing. At the aggregate level growth in rents has increased broadly in line with CPI over the period 2000 to 2016,<sup>5</sup> with rental affordability largely in line with long-term trends. Recent data from RP Corelogic indicates that rental price increases have moderated across Australia with average rents across Australia's capital cities falling by around 0.6 per cent over the 12 months to 31 June 2016. Although this represents a moderate fall, it is the largest annual decline in capital city rents on record. Moderate increases in rents were recorded in Hobart, Melbourne and Canberra, while significant falls were recorded in Darwin and Perth.<sup>6</sup>

While rental affordability at the aggregate level appears to be broadly consistent with long-term trends, the situation for lower income households, those that are generally seeking affordable rental housing, is markedly different with a significant percentage of these households experiencing rental stress. In 2013-14, approximately 42.5 per cent of lower income households who rented indicated that they were spending more than 30 per cent of their household income on housing costs, an indication of the extent of housing stress for lower income households.<sup>7</sup>

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4 ABS 4130.0 Housing Occupancy and Costs, 2013–14 – Table 15.

[www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14?OpenDocument](http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14?OpenDocument).

5 Real Estate Institute of Australia, June Quarter 2016 Housing Affordability Report, Chart 7.

6 Corelogic, Rental Rates continue to dive across national capitals, 7 July 2016. Available at: <http://www.corelogic.com.au/news/rental-rates-continue-to-dive-across-national-capitals>.

7 ABS 4130.0 Housing Occupancy and Costs, 2013–14 – Table 15 Available at:

[www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14?OpenDocument](http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14?OpenDocument).



While around 50 per cent of low income rental household are in rental stress **Table 1** highlights that there is significant variation with respect to the rental costs for low income households based on tenure type:

**Table 1: Housing costs of lower income rental households by landlord type**

Housing costs as a proportion of gross household income	State/territory housing authority	Private landlord	Total renters
25% or less	66.4	25.5	36.0
More than 25% to 30%	17.7	12.4	13.9
More than 30% to 50%	14.7	41.4	34.7
More than 50%	1.1	20.7	15.4

Source: ABS 4130 Housing Occupancy and Costs, 2013-14 – Table 15

A range of factors have contributed to this outcome for lower income households. These include:

- increases in rents in the private rental market driven by increased competition from higher income households priced out of home ownership or preferring to rent;
- an overall increase in demand driven by higher levels of population growth; and
- the low levels of construction of affordable housing stock in recent years.<sup>8</sup>

The Working Group has found that a significant issue with reporting on the state of the affordable housing sector is the lack of data on the sector and inconsistencies in how affordable housing is defined across the sector, academia and governments. The main source of data on affordable housing is the Productivity Commission’s annual Report on Government Services, however this only reports on housing managed by either public housing authorities or CHPs. It reports based on the management of the dwelling, rather than ownership of title and does not differentiate between the types of housing provided by CHPs (i.e. social versus sub-market rentals). Given this, there is an opportunity to improve consistency in national data collection and there would be benefit in publishing this data. Noting data limitations, a general overview of the two main segments of the affordable housing sector is presented below.

### **Sub-market rental housing**

Sub-market rental housing fills the gap in the housing continuum between social housing and the private rental market. It is provided to low- and moderate-income tenants by CHPs and the private sector due to a lack of private rental housing that is available at lower price points and in locations that are accessible to employment and other services. It may be provided in order to house key service workers, such as nurses and police officers, near their places of employment.

There is very little data available on sub-market rental housing as until recently it has only formed a small part of the stock of affordable housing. The major driver of the recent increase in the number of sub-market rental dwellings has been the implementation of the NRAS.

<sup>8</sup> Hulse, K., Reynolds, R., Stone, W. and Yates J. 2015, *Supply shortages and affordability outcomes in the private rental sector: short and longer term trends*, Final Report No. 241 pp. 60-63. <http://www.ahuri.edu.au/research/final-reports/241>.



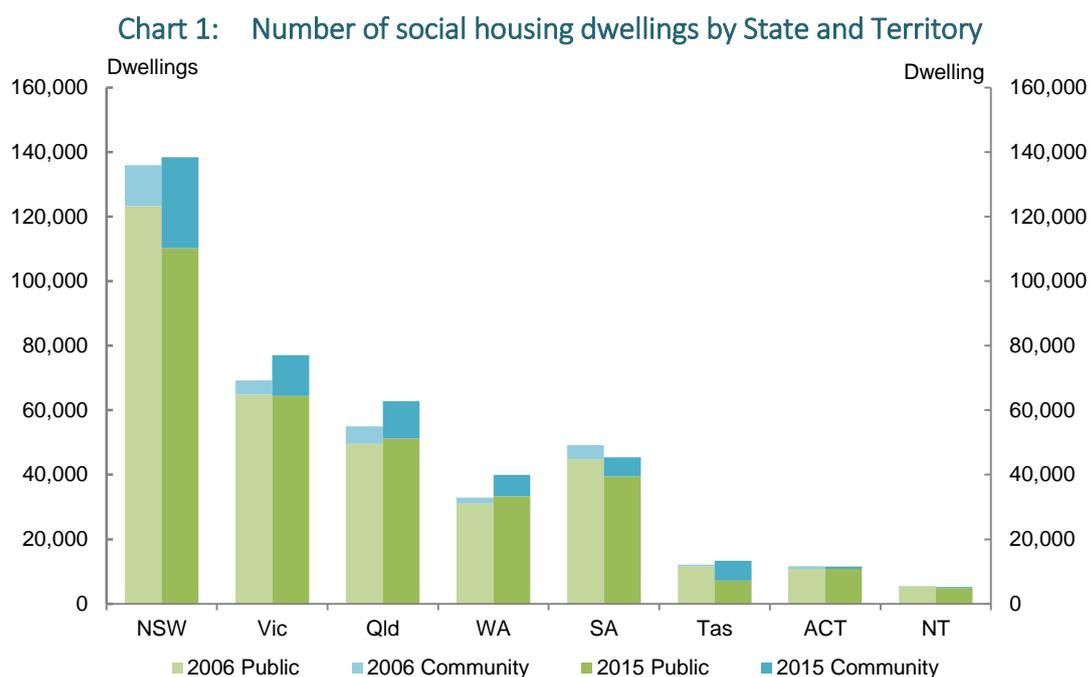
Since 2008, the NRAS has delivered over 30,000 sub-market rental dwellings with over an additional 7,000 expected over the coming years. However, the NRAS only funds these sub market rentals for a lifespan of 10 years and from 2018 it is expected that the majority of these dwellings will begin reverting to full market rate rent.

## Social housing

Social housing is provided to low income tenants by governments and CHPs where the private market is unable to provide appropriate accommodation at lower price points and with sufficient tenant support. In 2013-14, approximately 3.6 per cent of Australian households rented in public housing while 0.8 per cent of Australian households rented in community housing.<sup>9</sup> In 2015, there were 393,732 social housing dwellings, an increase of 6.0 per cent (22,251) from 2006.<sup>10</sup>

## Stock Transfers

Over the past decade, the social housing system has slowly been changing through the transfer of management and/or title of public housing to CHPs (see **Chart 1**) even though the majority of social housing is still managed by public housing providers (82 per cent). One factor that may be driving stock transfers to CHPs is that tenants who are income support recipients become eligible to receive CRA, increasing the amount of rent a housing provider can charge without making the tenant worse off. This has implications for the Commonwealth's expenditure as CRA outlays increase. An additional reason that is often cited is that CHPs tend to provide more flexible services catered to the needs of tenants.



Source: Productivity Commission 2016, *Report on Government Services 2016*, Table 17.A3

9 Report on Government Services 2016. Available at: <http://www.pc.gov.au/research/ongoing/report-on-government-services/2016/housing-and-homelessness/housing>; and ABS 4130.0 Housing Occupancy and Costs, 2013–14. Available at: <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14> (Table 3)

10 State owned and managed indigenous housing and indigenous community housing have not been included in figures and charts on social housing in this report due to their non-mainstream nature and additional public policy goals.



Due to data availability it is difficult to determine what level of stock transfers have taken place through the transfer of management only versus ownership of title. Further, the average length of management transfers cannot be measured reliably.



## Rental Stress

As social housing rents are generally based on a set proportion of a household's income, social housing tenants are predominantly not in rental stress. In 2013-14, the median ratio of housing costs to gross household income of tenants renting in public housing was approximately 23 per cent. The affordability and certainty offered by social housing has continued to result in a significant waiting list for available places. Estimates of the true extent of need vary, however the Report on Government Services found that at June 2015 there were around 190,000 households on the waiting list for social housing across Australia, of which around 66,000 were deemed to be of 'greatest need' (see [Table 2](#)).

**Table 2: Current waiting list of public and community housing as at 30 June 2015**

	Public housing	Community housing
Total overall applicants on waiting list	153,989	37,546
Greatest need applicants on waiting list	39,565	25,944
Total available (tenantable) dwellings	318,858	71,425

Source: Productivity Commission 2016, Report on Government Services 2016, Tables 17.A5 and 17.A7.11

In order to manage this large excess demand, social housing is often allocated based on the highest level of need and prioritised based on specific criteria. These criteria vary across States and Territories, as well as between CHPs. Nationally, in 2014-15, around three in four newly allocated social housing dwellings were provided to households deemed to be in greatest need. In addition, where social housing dwellings were not available, alternative rental assistance such as financial supports were provided to high needs households. Non-priority households can wait up to 10 years before they are allocated accommodation.<sup>12</sup>

## Impediments to improving the supply of affordable rental housing

The supply of affordable rental housing is influenced by a range of factors both inside and outside the direct control of governments. These factors vary between social and sub-market rental housing and are also influenced by the interplay of policy settings across the housing continuum.

A key impediment to the increased supply of affordable housing is the presence of a financing gap, the size of which varies across housing types and client needs.

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11 These figures are highly indicative only due to data quality issues; comparability issues; and inability to measure those who are in need and choose not to register due to unrealistic waiting times as well as those who are on the waiting list but receiving alternative rental support. They also exclude Indigenous community housing and state owned and managed Indigenous housing.

12 NSW Family and Community Services 2015, Expected Waiting Times for Social Housing June 2015 – Overview. <http://www.housingpathways.nsw.gov.au/how-to-apply/expected-waiting-times>.



## The financing gap

The financing gap is the gap that exists between the low rates of return available on affordable housing investments compared to market returns available on alternative investments with similar risk profiles. The rate of return from any investment is a function of its income, expenses and capital base.

By design, affordable housing providers charge rents that are below market rates in order to assist tenants with their costs of living. Affordable housing providers are also unlikely to readily sell a dwelling as they aim to provide tenants with security of tenure. As such, the income and capital gains (and thus returns) available from investing in affordable housing are limited.<sup>13</sup>

Also, there are significant ongoing asset management and operating costs associated with affordable housing. The 2016 Report on Government Services indicates that in 2014-15 the net recurrent cost of providing dwellings (excluding costs of capital) was approximately \$9,264 per dwelling for community housing.

An illustration of the financing gap for social housing is presented in [Table 3](#).

**Table 3: A worked example of the financing gap for 100 social housing / affordable housing dwellings**

	Social Housing	Subsidised Housing (\$300 rent) <sup>14</sup>	
Variable	Value (\$ million)		Notes
Dwelling costs	35.0	35.0	Based on an assumed cost of \$350,000 per dwelling (includes land costs).
Annual operating revenue	1.3	2.0	<i>Social housing:</i> Based on assumed average rent of \$180 per week plus CRA. <i>Affordable housing:</i> Based on assumed average rent of \$300 per week plus CRA.
Annual asset management costs	0.5	0.5	
Annual administration costs	0.1	0.1	
Annual interest expense	0.7	1.3	Based on an assumed financing from a 20 year fixed bond at an interest rate of 4.25 per cent, amortising to 40 per cent of face value.
Supportable private funding	14.0 (40%)	23.0 (65%)	Funding provided by tenants as a proportion of income for social housing and a proportion of market rent for affordable housing
<b>Financing gap</b>	21.0 (60%)	12.0 (35%)	Gap difference mainly due to the difference in contribution from tenants.

Source: Independent analysis provided to the Working Group.

<sup>13</sup> It should be noted that affordable rental housing is a new asset class and should not be compared with conventional rental housing returns, as this investment has greater similarities to long-term financial assets than a property acquisition. The risk profile of affordable housing operated at scale is lower than conventional housing returns and is therefore attractive for these reasons, but the returns will also be lower than market rental returns. For example, in the UK rates on debt funding for affordable housing are only slightly higher than UK bond returns.

<sup>14</sup> \$300 represents approximately 60% of combined capital city rental rates for houses and 64% for units, although there is significant variability *between* and *within* cities: see Corelogic, Monthly Rental Report, 29 August 2016.



While income and expenses will vary across States and Territories and tenure types, these figures highlight that while current settings may be able to cover operational costs, they are not able to provide a sufficient level of return to attract institutional investors and fund the development of new social housing stock. The gap reduces for affordable rental targeted at low to moderate income households, given that these tenants do not require the extent of subsidy as social housing tenants.

The successful introduction of any innovative financing model would aim to lower the operational and capital costs associated with the provision of affordable housing, however it would be unable to close the financing gap entirely. Closing the remainder of the gap will require some form of government assistance.

### ***Other factors***

Underpinning the supply of affordable housing are long-term strategic policy settings that have not facilitated growth in affordable housing sufficient to keep pace with demand. It has been noted that existing policy and funding settings are fragmented and lack a transformative impact on supply outcomes.<sup>15</sup>

A number of additional factors have contributed to an undersupply of affordable housing. These include: changing tenant demographics; an ageing stock profile which is inappropriately sized for current tenant cohorts; the application of land use and planning frameworks; defensive housing stock management practices (such as the sale of dwellings and delayed maintenance) in order to maintain budgetary positions; and taxation settings at all levels of government.

Restrictive planning, zoning and land release policies have limited the supply of development sites for new housing and increased the cost of sites that are made available. As a result, developers invariably have more attractive development options than affordable private rental housing for the limited number of sites. Recent increases in dwelling approvals, commencements and completions have therefore done little to increase the supply of affordable rental housing, as the majority of this has not been targeted at the affordable housing segment of the housing continuum.

### ***Current impediments to improving the supply of sub-market rental housing***

The main issue impacting on the supply of sub-market rental housing is the lack of investment available to construct new and enduring dwellings. This lack of investment is driven by the financing gap and the new nature of the asset class.

The financing gap, whilst smaller than the gap in social housing, is still present in sub-market rental housing, which by design does not aim for market rates of rent. Sub-market rental housing tenants generally have relatively moderate or low levels of income. This reduces the ability of property owners to increase the income streams they can generate by raising rents and can also reduce the attractiveness of the yield that can be generated, especially in periods of low capital growth.

As such, investors are reluctant to provide capital for the development of new stock as they are unlikely to make a market level of return compared to other assets with similar risk profiles.

The recent increase in the supply of sub-market rental dwellings has been driven by financial incentives from governments under the NRAS, which has assisted in closing this financing gap.

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<sup>15</sup> Australian Housing and Urban Research Institute 2014, *Enhancing affordable rental housing investment via an intermediary and guarantee*, pp 11-12.



However, this has only managed to attract small-scale, rather than institutional, investment and the availability of dwellings at sub-market rates are time-limited by the structural design of the program.

As sub-market rental housing is a relatively new type of housing and investment, investor understanding of it as an asset class is not widespread. Stakeholders advised the Working Group that investors compare investing in this type of housing with equity-like returns on investing in residential housing. Some stakeholders suggest investing in sub-market rental housing should be seen as a debt-like investment as it provides a steady, government-backed and ongoing stream of income and does not aim to realise capital gains. Debt investments tend to require lower rates of return than equity investments, meaning that they are more closely aligned with the income streams of sub-market rental housing.

Some sub-market rental housing providers are also CHPs and have difficulties in efficiently leveraging their existing stock ownership and management to assist them with developing new stock. This is discussed further in the section below.

### ***Current impediments to improving the supply of social housing***

In simple terms, the rent received from tenants is not sufficient to both cover operating costs and fund new supply. This shortfall is partially a result of 'residualisation' (see [Box 1](#)).

#### **Box 1: Residualisation of the social housing stock**

Social housing providers, in particular public housing providers, use income and asset tests to establish a threshold for entry onto their waiting lists. The selection of households from those waiting lists to be allocated a tenancy is then governed by a range of approaches to prioritisation based on need.

All State and Territory governments prioritise access to social housing by segmenting their waiting lists in some way. Segments are defined differently across jurisdictions but generally reflect the urgent need to address homelessness and inability to access appropriate private market accommodation.

The prioritisation of social housing to those in greatest need has seen the type of tenant in social housing shift from households with at least one employed person to entirely non-working households reliant on government welfare payments and assistance. Given social housing providers charge rent at a set percentage of a tenant's income, and the overwhelming majority of tenants' incomes are comprised of statutory welfare payments this has decreased the revenue bases available to social housing providers.

These types of social housing tenants are now also more likely to have difficulty meeting their obligations as tenants when compared to tenants in the private rental market. This can increase the property and management costs incurred by social housing providers especially, if wrap around services, such as assistance with gaining education, searching for employment and programs for dealing with addiction issues, are not provided effectively. The result can be an increased overall cost of providing social housing and associated services.

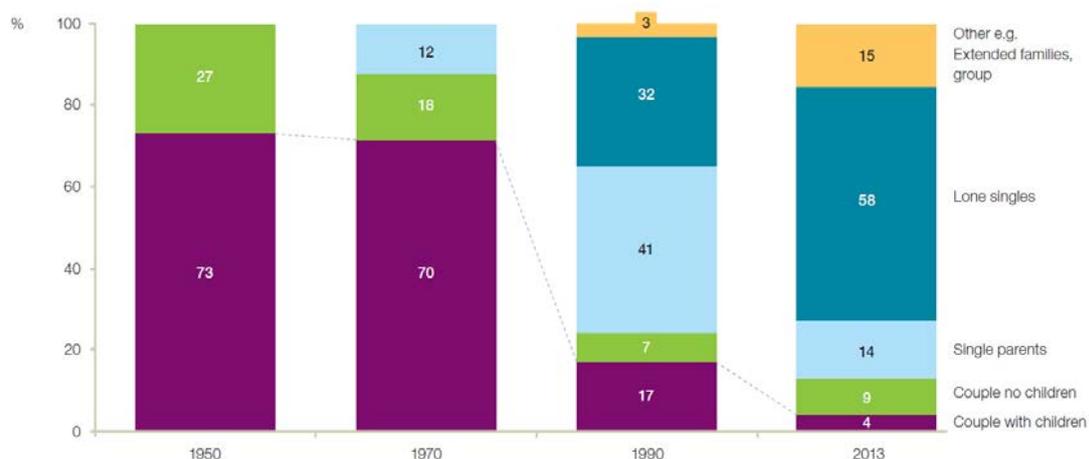
The change in income capacity of tenants in social housing over recent years is referred to as 'residualisation' and can clearly be seen in the income characteristics of public housing tenants (see [Table 1](#)). In short, prioritisation policies have led to reduced revenues for social housing providers, while also increasing the cost of providing their services.

In addition to the residualisation of the social housing stock, there has been a significant change in the household composition of tenants. As highlighted in [Chart 2](#), in 1970 around 70 per cent of public



housing tenants in NSW were couples with children, by 2013 this household type represented around four per cent of tenants. The number of single person households has also changed significantly, increasing from around 32 per cent of tenants in 1990 to around 58 per cent of households in 2013.

**Chart 2: Public housing tenant profile NSW 1950 -2013**



Source: Social Housing in NSW: A discussion paper November 2014, p. 58

As noted, the largest cohort of tenants in public housing were single person households (**Chart 2**). This cohort made up around half of all public housing households, with approximately one third of these tenants being over the age of 55. In addition, approximately 97 per cent of these tenants are characterised as low-income households.<sup>16</sup> As can be seen in **Table 4**, most of these tenants receive the majority of their income from government welfare payments.

**Table 4 – Income characteristics of public housing tenants**

Primary source of income	Public Housing	
	Number	Per cent
Employee cash income	24,679	7.8
Youth allowance	1,677	0.5
Newstart Allowance	30,080	9.6
Other allowances	999	0.3
Age pension	79,108	25.1
Disability pension	93,112	29.6
Other government payment	59,693	19.0
Other cash income	1,954	0.6
Not Stated	23,661	7.5
<b>Total</b>	<b>314,963</b>	<b>100.0</b>

Source: AIHW National Housing Assistance Data Repository 2014-15

Thus, while demographics and income characteristics of public housing tenants have changed, a large part of the social housing stock has not been updated, leaving significant maintenance issues and

<sup>16</sup> ABS 4130.0 Housing Occupancy and Costs, 2013–14. Available at: <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14>.



underutilisation of stock as family-sized dwellings have been allocated to single person households. In 2015, 16 per cent of public housing tenancies nationally had two or more spare bedrooms.<sup>17</sup> This highlights the need to re-balance stock configuration across the current public housing portfolio.

As discussed above, CHPs have difficulty accessing the capital required for the acquisition or development of new housing stock due to the presence of the financing gap. Whilst difficult to quantify, the financing gap is even larger for the provision of social housing than sub-market affordable rental housing given the lower rents able to be charged by housing providers.

In recent times, the transfer of dwellings funded through the Commonwealth Social Housing Initiative (see *Government's involvement in affordable housing*) has provided equity to CHPs against which housing providers have been able to borrow to increase the size of their portfolios. There has also been a recent trend towards the transfer of management, and at times ownership, of public housing dwellings to CHPs which has marginally increased the ability of CHPs to access finance. However, feedback to the Working Group from stakeholders through its consultation process has been that most of these have been management transfers under short-term leases which has made it difficult for CHPs to use them as security and/or sources of future income for financing purposes.

### ***Potential ways to address the financing gap***

As discussed previously, the financing gap can be reduced through reductions in the cost of construction as well as access to more efficient forms of finance; however these actions are unlikely to close the gap entirely.

A mixed portfolio of different housing types can help bridge the financing gap by balancing the provision of heavily-subsidised social housing with other forms of affordable and market-based housing that generate surpluses and improve portfolio-wide income streams.

Closing the remainder of the financing gap will require some form of government assistance. There are a variety of ways that stakeholders have suggested that the financing gap could be closed. These include, but are not limited to: the provision of, or access to, free or discounted land; encouraging or mandating mixed developments; inclusionary zoning requirements; planning and zoning regulation exceptions; and additional direct government grants or additional recurrent funding.

The Working Group has not analysed the potential for any of these to close the financing gap as it is out of the Working Group's scope. Any decision on addressing the financing gap is one for governments. The success of financing models that rely upon the engagement of private institutional investment, however, will likely require take-up on a multi-jurisdictional basis in order to provide the necessary scale (for both threshold investor engagement and for financing efficiency).

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<sup>17</sup> Source: AIHW National Housing Assistance Data Repository 2014-15.



## 4. Government involvement in affordable housing: what are we seeking to achieve?

### Government involvement in affordable housing

Housing plays an important role in the social and economic wellbeing of individuals and the economy as a whole. From a social perspective, it improves employment, educational and health outcomes. From an economic perspective, housing is a significant driver of investment, productivity and participation, as well as consumption and household savings.

Governments of all levels have a long history of involvement in the provision of affordable housing. State and Territory governments have been largely responsible (either directly or indirectly through CHPs) for the construction and management of affordable housing in Australia, with funding support and assistance from the Commonwealth Government.

#### *Joint Initiatives*

The Commonwealth-State Housing Agreement (CSHA), first negotiated in 1945, established a national public rental housing program funded by the Commonwealth (through loans to the States) and administered by the States. The agreement was limited to the construction of new dwellings and was designed to provide affordable accommodation for working families. Over time the focus of governments has shifted towards targeting direct housing assistance to low-income earners using eligibility requirements, while rent assistance payments have been used to assist low and moderate income households renting privately.

In 2008, the CSHA architecture was replaced by the National Affordable Housing Agreement (NAHA), which is still in place today. The NAHA framework provides States and Territories with increased flexibility around how funds can be spent and does not explicitly require matched levels of funding. Through funding associated with the NAHA (the National Affordable Housing Specific Purpose Payment) the Commonwealth continues to provide the States and Territories with significant support for housing assistance and homelessness services (around \$1.3 billion in 2016-17). In addition to this, the Commonwealth and States and Territories will spend a combined \$230 million in 2016-17 on homelessness services through the National Partnership Agreement on Homelessness.

Through the NRAS, and in partnership with the States and Territories, the Commonwealth also provides financial incentives to the business sector and community organisations to build and rent dwellings to low and moderate income households at a rate that is at least 20 per cent below market value rent. The Commonwealth will provide assistance of around \$3.8 billion over the life of the scheme to construct approximately 38,000 dwellings. However, the financial incentives expire 10 years after the date of activation, meaning that these dwellings are unlikely to remain at below market rent after this time.



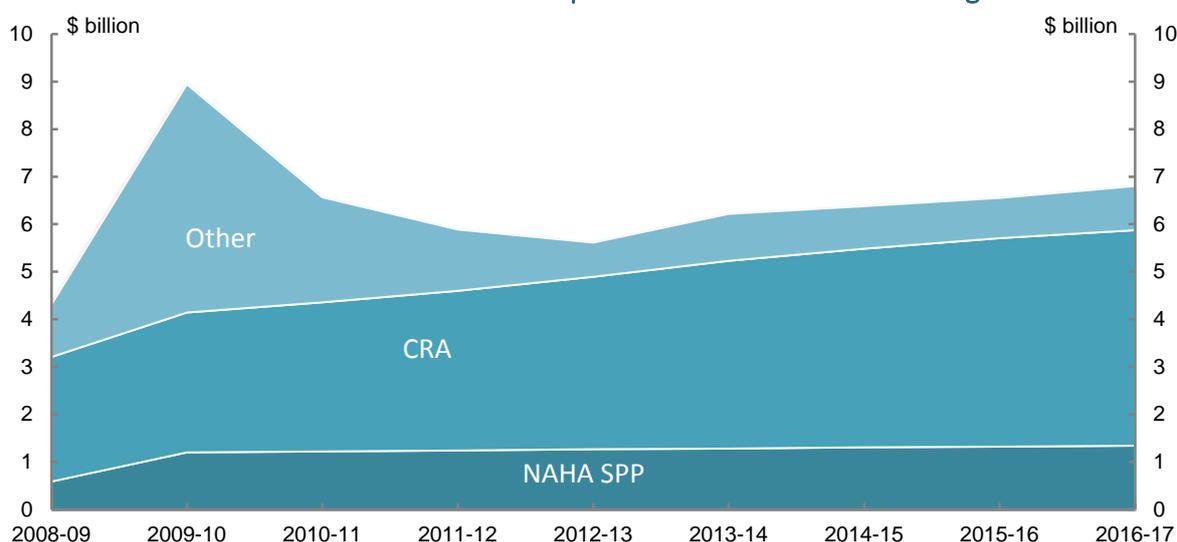
## Commonwealth

Given the Commonwealth is not primarily responsible for affordable housing, its role has largely been providing funding assistance for affordable housing rather than delivery. This assistance has increased significantly in recent times (see [Chart 3](#)). This has included one-off increases, such as the Commonwealth's \$5.6 billion direct investment under the Social Housing Initiative, which occurred in response to the Global Financial Crisis.

The Commonwealth also provides a significant amount of housing assistance to Australians on low and moderate incomes through the provision of CRA. In 2016-17, the Commonwealth will spend around \$4.5 billion in CRA to support more than 1.3 million individuals and families renting in the private and community housing markets.

There are also non-mainstream programs to facilitate access to housing, which cater to specific needs. For example Specialist Disability Accommodation, where funding assistance is provided through the National Disability Insurance Scheme.

**Chart 3: Commonwealth expenditure on affordable housing**



Source: Working Group calculations based on data from the Department of Social Services.

## States and Territories

Different States and Territories have taken different approaches to the way in which they deliver affordable housing. Some States and Territories include housing as part of their human services or welfare portfolios, while others have adopted a more commercial/property focus, acting primarily as a developer and/or landlord, with support services provided by other parts of government.

For example, in Western Australia, the Housing Authority is a market-based statutory authority that uses broad roles and partnerships within the land and property development market to deliver social policy outcomes. It operates across the residential land, housing and mortgage lending sectors to provide a broad range of affordable housing solutions – both for rental and home ownership. Profits generated from its development activities are reinvested into other programs, including social housing.



Alternatively, in New South Wales, the Government has set aside \$1.1 billion in cash reserves for the Social and Affordable Housing Fund. The money will be invested by NSW Treasury Corporation and returns flowing from the fund will be used to directly fund and support social and affordable housing projects. This is in addition to the Communities Plus program, where the NSW Government has committed to directly engaging the non-government and private sectors to deliver up to 23,000 new and replacement social housing dwellings.

## What are governments seeking to achieve in affordable housing?

The shortage of affordable housing for lower income households has significant social and economic consequences. This affects governments through expenditure on health, education, employment and welfare, as well as the broader productivity of the economy.

The provision of affordable housing has also been shown to have wider economic and social benefits. In 2013, the Grattan Institute's Productive Cities report highlighted the need to increase the supply and diversity of housing close to cities to ensure the deep labour market required to maintain economically productive cities. Higher housing costs closer to cities not only reduces the pool of available workers but leads to negative social consequences, creating concentrated areas of disadvantage in outer suburbs.<sup>18</sup> The economic and social implications of this spatial segregation are well documented.<sup>19,20,21</sup>

Governments of all levels are broadly seeking to achieve five key outcomes through the provision of affordable housing. These are:

- obtaining maximum impact for investment;
- growth in the stock of affordable housing;
- efficient management of new and existing affordable housing stock;
- improved tenant outcomes; and
- the creation of a more sustainable affordable housing system.

### Value for government spending

Commonwealth and State and Territory governments were projected to spend approximately \$10 billion on affordable housing in 2015-16.<sup>22</sup>

Despite the significant amount of funding, waiting lists for public housing remain above 150,000 nationally, although they have declined by around 12,500 between 2011 and 2015.<sup>23</sup> Waiting lists for

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18 Jane-Frances Kelly and Peter Mare, 2013, *Productive cities: Opportunity in a changing economy*. Grattan Institute.

19 Randolph, B. & Tice, A. (2014) 'Suburbanising Disadvantage in Australian Cities: Socio-Spatial Change in an Era of Neo-Liberalism', *Journal of the Urban Affairs* 36 (S1) pp 1-16.

20 Pawson, H. & Herath, S 2015, *Dissecting and Tracking Socio-spatial Disadvantage in Urban Australia*.

21 Rawnsley, T. & Spiller, M. 2012, *Housing and urban form: a new productivity agenda Australia's Unintended Cities: Housing Markets, Policies and their Urban Outcomes*, Melbourne: CSIRO Publishing.

22 This figure constitutes funding provided under the National Affordable Housing Agreement, the National Partnership Agreement on Homelessness, CRA, NRAS, NPARIH, Reconnect and State and Territory expenditures on social housing and homelessness services reported in the Report of Government Services.

23 Report on Government Services 2016 – Tables 17A.5. Available at: <<http://www.pc.gov.au/research/ongoing/report-on-government-services/2016/housing-and-homelessness/housing>>.



community housing also remain around 40,000 having declined from 39,582 in 2011 to 37,546 in 2015.<sup>24</sup>

The proportion of households in housing stress also remains largely unchanged, with the proportion of households paying more than 30 per cent of their gross household income increasing from 15.4 per cent in 2007-08 to 17.7 per cent in 2013-14.<sup>25</sup> For low income households the proportion of low income rental households spending more than 30 per cent of their gross income on housing costs has however increased markedly from 35.4 per cent in 2007-08 to 42.5 per cent in 2013-14.<sup>26</sup>

A number of processes have recognised the need for governments to adopt a different approach to the funding of affordable housing. These include the NSW Auditor-General's Report 'Making the best use of public housing'<sup>27</sup> and more recently the Queensland Department of Housing and Public Works discussion paper 'Working together for better housing and sustainable communities'.<sup>28</sup>

Given the current fiscal environment and the increasing demand for affordable housing, governments of all levels need to examine and embrace new and innovative ways of providing affordable housing to ensure that the finite amount of government investment available is achieving the best housing outcomes for the greatest number of tenants possible.

## Growth

Despite large investment there has been minimal enduring annual growth in the stock of affordable housing in Australia over the last five years. While private dwelling supply has increased significantly in recent years, social housing dwelling construction has remained flat. Between 2010 and 2015, social housing grew by 3.4 per cent, compared to 8.0 per cent growth in Australia's population over the same period, with social housing falling from 4.3 per cent of total dwellings in 2011 to 4.1 per cent of dwellings in 2015.<sup>29</sup> This growth is mainly due to the Social Housing Initiative, which provided additional funding to support the development of 19,700 new social housing dwellings. Without this investment, the social housing stock is likely to have reduced in absolute number over the period.

As has been noted, determining the growth in the supply of Further, while sub-market rental housing is difficult. However, with respect to the supply of government subsidised affordable housing while supply has increased through the NRAS, these properties are not enduring at sub-market rents once incentive payments under the NRAS are exhausted.

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24 Report on Government Services 2016 – Tables 17A.7. Available at: <<http://www.pc.gov.au/research/ongoing/report-on-government-services/2016/housing-and-homelessness/housing>>.

25 ABS 4130.0 Housing Occupancy and Costs, 2013-14 – Table 3. Available at: <<http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14?OpenDocument>>.

26 ABS 4130.0 Housing Occupancy and Costs, 2013-14, Additional – low income rental households. Available at: <<http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4130.02013-14?OpenDocument>>.

27 NSW Auditor General's Report Making the best use of public Housing, July 2013. Available at: <http://www.audit.nsw.gov.au/publications/performance-audit-reports/2013-reports/making-the-best-use-of-public-housing>.

28 Queensland Department of Housing and Public Works, Discussion Paper Working together for better housing and sustainable communities'. Available at: < <https://www.qld.gov.au/housing/public-community-housing/have-your-say-housing-strategy/>>.

29 Report on Government Services 2016 – Tables 17A.5. Available at: <<http://www.pc.gov.au/research/ongoing/report-on-government-services/2016/housing-and-homelessness/housing>>.



## ***Efficient management of stock***

Governments of all levels are looking to ensure that government expenditure is used as efficiently and effectively as possible. A key element of this is ensuring that existing and new affordable housing stock is managed in a way that improves tenant outcomes, reduces maintenance expenses and improves the financial sustainability of the stock.

Currently, the vast majority of social housing stock is managed by individual State and Territory housing authorities. However, in future, depending on increases in the capacity of the community housing sector, there may be benefit in exploring a more significant role for the community housing sector or other alternative providers in the management of this stock.

## ***Improved tenant outcomes***

Governments provide affordable housing in order to assist lower income households not only with their housing costs but also in order to improve health, education, employment and other social outcomes.

Governments are looking for an affordable housing system that maximises tenant outcomes. This includes improving housing options available to tenants as well as providing housing options that also contribute towards improvements in other tenant outcomes, such as health and employment, through important wrap-around services.

## ***A sustainable affordable housing system***

Governments want an affordable housing system that is financially sustainable. This is why the Working Group has been tasked with focussing on innovative financing models that can assist housing providers in accessing private finance in order to improve the supply of affordable housing.

Governments are looking for a financially sustainable affordable housing system that contains a mix of housing types that respond to the needs of different cohorts. This would include households whose primary income source is welfare payments (where income-based rents may be required), as well as some working households (e.g. those in casual or low-paid jobs) who may be unable to obtain social housing and unable to find affordable accommodation in the private rental market (where market-based rents might be more appropriate). A sustainable system would provide a pathway to full market rents for households that are able to transition along the housing continuum.

In order to achieve a sustainable system with appropriate affordable housing that responds to the needs of different cohorts, governments may need to conduct a needs analysis in order to determine an optimal mix of housing.

As part of a financially sustainable affordable housing system, governments and housing providers will need to better utilise existing affordable housing stock. A number of State and Territory governments have already begun to do this. For example, NSW has committed to increase the redevelopment of its current public housing stock through increased partnerships between the private sector and the Land and Housing Corporation. South Australia is taking similar steps through Renewal SA and its 'Renewing our Streets and Suburbs' program.<sup>30,31</sup>

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30 NSW Government, 2015, 'Future Directions for Social Housing in NSW', page 9.  
<http://www.facs.nsw.gov.au/reforms/social-housing/future-directions>.

31 RenewalSA, 'Renewing our Streets and Suburbs'. [https://renewalsa.sa.gov.au/building-our-future/renewing-streets-suburbs/#renewing\\_our\\_streets\\_and\\_suburbs](https://renewalsa.sa.gov.au/building-our-future/renewing-streets-suburbs/#renewing_our_streets_and_suburbs).



## 5. Innovative financing models – stakeholder views

The Working Group's Issues Paper identified four potential models that could facilitate an increase in the finance available to housing providers to increase the supply of affordable housing. The 78 submissions received as part of this process suggested a number of variations on each of the models presented in the Issues Paper.

A significant issue raised by stakeholders in relation to all of the proposed models was the presence of the financing gap. It was noted that while some models may reduce the financing gap, some form of government co-investment will be required to close this gap entirely and ensure the success of any financing model.

Stakeholders also put forward views on some of the key barriers faced by the potential models, in particular their ability to generate adequate scale, returns and liquidity. A more detailed discussion of the current barriers to increased institutional investment in affordable housing can be found in the Working Group's Issues Paper.

### **Model 1: Housing loan/bond aggregators**

Affordable housing bonds have been a frequently proposed way of attracting greater private sector investment into affordable housing in Australia. A housing bond aggregator model provides a vehicle for affordable housing providers to aggregate their debt financing requirements, assisting them to obtain funding from the wholesale market at a better price and longer tenor than is available to them individually.

The establishment of a housing bond aggregator would require the establishment of a specialist financing intermediary, whose function would be to liaise with affordable housing providers to determine the amount of debt they are seeking to raise. The intermediary, or entity acting on its behalf, would then source these funds in aggregate from wholesale markets by issuing bonds to investors. The funds generated would then be loaned to the relevant housing providers in return for ongoing interest payments.

Stakeholders indicated broad support for the establishment of a housing bond aggregator due to its potential to generate lower cost and longer-term debt, its simplicity and investor awareness. However, they also emphasised that establishing an aggregator will not be sufficient in itself to unlock institutional investment. The model's success is predicated on providing sufficient scale of new affordable housing supply, closing the financing gap and undertaking a suite of complementary reforms to make affordable housing commercially attractive to institutional investors.

#### ***Submissions***

A large number of submissions directly addressed the bond aggregator model and support was widespread from the community housing and financing sectors.



The National Australia Bank (NAB) noted the suitability of the bond aggregator model, stating that:

*'For investors, the aggregator model provides a scale opportunity to invest in a new asset class. For the housing providers, the model improves access to capital without disrupting the current industry structure.'*<sup>32</sup>

One of the key benefits stakeholders perceived with the aggregator model was its ability to allow CHPs, including smaller ones, to access finance at lower rates over a longer period of time. The current difficulties of small CHPs accessing finance was noted in a joint submission by First State Super, Per Capita and CFS Financial Services Knowledge Hub.

*'Ultimately, the volume of bank lending (which is currently relied upon for the limited development projects undertaken by CHPs) is constrained and would not be sufficient to enable meaningful changes in housing supply... Capital markets financing through traded debt issuance will be required.'*<sup>33</sup>

A bond aggregator model could be effective in addressing this issue. NAB noted that:

*'Debt capital markets can also provide tenors in the range of seven to 15 years, compared with the Australian bank market, which provides maximum tenors of only five to seven years. Longer tenor reduces the housing provider's refinance risk and enhances its capacity to build up equity.'*<sup>32</sup>

Several submissions highlighted the attractiveness of using bonds to fund affordable housing as a highly liquid asset with characteristics already familiar to institutional investors. In reference to the bond aggregator model, Grace Mutual Limited noted that:

*'The simplicity of going down a well-trodden path enables the lowest cost and easiest approach to introducing a new investment.'*<sup>34</sup>

First State Super, Per Capita, and CFS Financial Services Knowledge Hub considered that this would help to facilitate investment as:

*'Investors require lower rates of return from such liquid securities compared to illiquid direct investments. This allows institutional investors such as superannuation funds who have liquidity requirements to invest in such securities.'*<sup>35</sup>

The NSW Federation of Housing Associations suggested that a bond aggregator model allows a pipeline of investment deals to be generated as:

*'Community housing providers can pool debts to issue sizeable repeatable transactions.'*<sup>36</sup>

Several submissions, including Corrs Chambers Westgarth and Grace Mutual Limited, stated that broad investor appeal of affordable housing bonds would come from a strong credit rating applied by an internationally recognised credit rating agency.

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32 National Australia Bank, *Submission*, p. 9.

33 First State Super, Per Capita & CFS Financial Services Knowledge Hub, *Submission*, p. 6.

34 Grace Mutual Limited, *Submission*, p. 10.

35 First State Super et al., p. 9.

36 NSW Federation of Housing Associations, *Submission*, p. 12.



Additional factors which would improve the credit rating on a bond would be the aggregation of geographically diverse housing projects into an issued bond or the application of a government guarantee and ultimately, track record in an established market.

### Box 2: A financial intermediary

A financial intermediary acts as a coordinating entity/clearinghouse to facilitate the flow of funds between investors and borrowers, in this case, institutional investors and affordable housing providers. The establishment of a financial intermediary would assist in creating scale by pooling the debt requirements (in the case of the bond model) or assets (in the case of a housing trust model) necessary to attract institutional investment.

The Housing Finance Corporation (THFC) in the United Kingdom is often referred to as the exemplar of the bond aggregator model. THFC is an independent, specialist, not-for-profit organisation in the United Kingdom that makes loans to regulated housing associations that provide affordable housing throughout the United Kingdom. The THFC is a debt-matching organisation that offers long-tenor loans to regulated housing associations, efficiently passing through funds raised via credit-rated 30-year bonds in the capital markets.

The use of a specialised financial intermediary to attract large-scale finance and vet the borrowing needs of housing providers can generate cost efficiencies, which are then able to be passed onto the borrowers. Intermediaries can also allow for the diversification of risk, such as through the aggregation of geographically diverse assets, making the investment more attractive to investors.

Though the THFC has operated successfully for nearly 30 years with nil defaults, it was further augmented by the UK government during the global financial crisis with a government guarantee to further stimulate affordable rental housing construction. With this credit support, the THFC has been able to issue bonds at yields lower than the UK government itself.

### ***Ability of the community housing sector to provide scale***

Many stakeholders, including First State Super, Per Capita and CFS Financial Services Knowledge Hub, the Community Housing Industry Association (CHIA) and NAB, indicated that a financing intermediary offering a pipeline of investment-grade bonds would overcome the scale and liquidity barriers identified and would go some way towards reducing the funding gap.

*'The development of a pipeline of projects would allow the financing entity to undertake [housing bond] issuances on a semi-regular basis improving the breadth and depth of Australia's asset-backed/secured bond debt market and capital markets in general. Additionally, the development of a strong pipeline of housing projects provides additional economies of scale further enhancing the risk-return profile of the securitized assets.'*<sup>37</sup>

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37 First State Super et al., p. 11.



While recognising the potential of an affordable housing bond aggregator some stakeholders however expressed concern about the capacity of the community housing sector to mature and expand their stock in order to absorb the scale required by institutional investors. The CHIA noted that:

*'Of immediate importance is gaining a greater understanding of the sector's appetite for and ability to service and repay levels of debt greater than what they are currently accustomed to taking on.'*<sup>38</sup>

The Property Council of Australia (PCA) took the view that:

*'While they are crucial to the success of large-scale affordable housing delivery, the CHP sector in Australia does not currently have the capacity to meet the demands of institutional level investment in this space. We would strongly encourage greater opportunities for developers and investors to partner with CHPs in order to build that capacity, and ensure that the risks are appropriately distributed.'*<sup>39</sup>

### **Intermediary structure**

In order to facilitate aggregation of debt financing requirements, submissions acknowledged the need for a financial intermediary (see **Box 3**). The potential structure of an intermediary was generally discussed, though few submissions expressed a preference on the type of intermediary to be established. Housing consultant Mr Mark Nutting stated that a decision would need to be made on:

*'whether ... the entity should be a government, commercial business or a social enterprise.'*<sup>40</sup>

In the United Kingdom, THFC utilises a social enterprise structure in order to fund loans to regulated affordable housing providers through the issue of bonds to private investors and institutions. The THFC predominantly raises its funds from institutional bond markets. It then on-lends these funds to affordable housing providers that it has assessed as being creditworthy, charging an interest rate (including a margin for funding its own operating costs and developing an equity reserve) that is significantly below, and at a longer tenor, than what affordable housing providers were charged by their then-traditional financiers.

Several submissions suggested that a similar entity to THFC be developed in Australia based on this model.

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38 Community Housing Industry Association, *Submission*, p. 15.

39 Property Council of Australia, *Submission*, p. 7.

40 Mark Nutting, *Submission*, p. 18.



## How does the model deal with the current barriers to institutional investment?

<b>Scale</b>	Submissions indicated that institutional investors seek recurrent bond issuances between \$100 million and \$600 million. To satisfy this demand CHPs could refinance their existing borrowings as well as secure finance for projects yet to commence, though there is currently not a credible pipeline of these projects without a new program of substantial government co-investment. Where further issuances are required to satisfy demand, using a housing bond to help finance the redevelopment of public housing stock could be considered. Most submissions suggest an initial phase before the bond is scaled up. However some submissions have supported going straight to full implementation to ensure investor confidence and interest, as the debt capital markets will not perceive credible ongoing government co-investment of new supply pipeline in a staged implementation.
<b>Return</b>	A range of values were nominated in submissions on the rate of return required for a bond (between 3 and 5 per cent), depending on the structure and risk profile suggested. Establishing credibility in the aggregator's bond issues would require government assistance in bridging the financing gap given the current yields which can be generated from affordable housing assets, and achieving a competitive return would likely vary with the investors' perception of sovereign risk in the robustness of the government co-investment program
<b>Liquidity</b>	The ability to trade bonds makes them a liquid investment. A housing bond could be structured so that it could be traded in either the wholesale market or retail market as an exchange traded bond.
<b>Investor awareness</b>	The bond aggregator model is familiar to investors as bonds are a recognised asset class. There is strong demand for highly rated assets in this class.
<b>Long-term consistent policy settings</b>	Governments would need to commit to the funding required both to close the financing gap for an ongoing pipeline of affordable housing projected and to support the establishment of a financial intermediary. Certainty around the future of CRA funding is needed to provide investors with confidence in the income streams available from affordable housing.
<b>Project pipelines</b>	Submissions raised concerns that there is currently not a large enough pipeline of projects to populate the required size of ongoing bond issuances and whether the CHP sector has the appropriate property development capacity. Investors' confidence in this pipeline will be a function of the credibility of program of government co-investment.
<b>Capacity</b>	The capacity of the bond aggregator model would depend on the community housing sector's capabilities in managing an increased level of housing stock and tenants, in addition to their ability to manage the construction of new stock
<b>Governance</b>	There are a range of ways in which an intermediary could be structured and governed. For example, if the intermediary were to be set up as an independent body, it would be governed by a board of experts. Alternatively, the intermediary could operate through a new or existing government body.

## Model 2: Housing trusts

Housing trusts have also been suggested as a means to overcome the current difficulties with scale and the geographic diversity of assets required to attract large scale investment into affordable housing.<sup>41</sup>

The creation of a housing trust would provide an additional vehicle for States and Territories to renew their existing public housing stock and boost the overall affordable housing stock. It would also provide a vehicle to develop sites that are currently underutilised by not-for-profit organisations.

41 AHURI October 2015, Newell G, Lee Chyi Lin, Kupke Valerie, The opportunity of unlisted wholesale residential property funds in enhancing affordable housing supply. Available at: <https://www.ahuri.edu.au/research/final-reports/249>.



A housing trust could pool State and Territory public housing assets in order to achieve economies of scale in regards to the management of these assets and their tenants, as well to achieve the geographic diversity of assets necessary to attract institutional investors. States and Territories would receive units in the trust in return for the transfer of existing public housing stock or other assets.

A housing trust could take various forms, and could involve: the establishment of a head trust and individual sub-trusts for each State and Territory; the engagement of CHPs to provide rental management services for stock held within the trust; and only the transferal of dwellings rather than the land they are situated on.

In contrast to other approaches, a housing trust could potentially leverage the significant equity value of the current public housing stock rather than solely relying on the cash flow derived from affordable housing assets.

### **Submissions**

There were a range of views put forward by stakeholders about the desirability of establishing a housing trust, with most stakeholders aware of the concept but unable to provide detailed comments on how a trust model could or should be operated.

The submissions which did provide detailed comments on the viability of a housing trust nominated either a standard real estate investment trust (REIT) model or a ground lease trust model. Under the ground lease trust model, governments or another entity would retain ownership of the land on which a trust would then build affordable dwellings for rent or sale. Some submissions suggested that a trust could be used to increase the size and/or regenerate public housing stock, including through the acceleration of stock transfer to CHPs, and undertake the role of a financial intermediary.

A key issue raised with respect to the establishment of a housing trust was how such a trust would impact upon the current activities of CHPs. Stakeholders noted that under a trust model the activities of CHPs may largely be limited to the management rather than ownership and development of housing stock. The City of Sydney noted in its submission that:

*'...it is critical that the trust is not set up to compete directly with CHPs through its land holdings, in the role of developer, as this would create additional obstacles for the community housing sector to overcome in an already challenging market.'*<sup>42</sup>

### **REIT**

The standard REIT model was referenced in the submissions by NAB and the PCA. Both noted there is currently minimal institutional interest in residential REITs due to tax inefficiencies and that the trust model relies on the underlying assets producing sufficient commercial returns, which would need to be largely driven by realising capital appreciation in the underlying assets – something seen as undesirable for affordable housing purposes. It should be noted that investor's return expectations would be higher for a REIT, given it is an equity investment, than it would be for the bond model, a debt financing tool. This would significantly increase the size of the funding gap, which would ultimately have to be met by governments.

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42 City of Sydney, *Submission*, p. 7.



NAB highlighted the experience of the US Housing Partnership Equity Trust. Investors contributed US\$100 million to the trust in December 2012 and received their first dividend of US\$1.3 million in November 2015, representing a 3-year return of only 1.3 per cent. The PCA noted that there are no institutional grade investments much below an income return (that is, excluding equity gains) of 5 per cent and that most institutions would be unwilling to invest in assets that achieved lower returns.

Submissions noted the widespread use of REITs in other sectors, and that a key benefit of this approach was investor awareness of the model if the significant issues around the rate of return could be resolved.

### ***Ground Lease Trust***

An alternative approach suggested by stakeholders was to use a trust or other entity to split the ownership of affordable dwellings from the land upon which they are located. Under this approach, the government or a government entity would retain ownership of the land (existing public housing stock or other surplus land holdings) and allow a trust to build and manage affordable housing on the site. The trust would pay the government an annual rent for the use of the land (potentially at concessional rates) and generate returns for investors based upon the rental stream that could be derived from tenants and any uplift in the value of the dwellings that the trust had constructed or purchased.

The attraction of this approach is that a significant amount of the capital cost of affordable housing is removed allowing for lower risk and higher returns to be generated from rental dwellings or a reduction in price when dwellings are 'sold', for example as part of a shared equity scheme. This approach would also allow the land owner to retain ownership of the land and, if necessary, to buy back the dwellings before using the land for another purpose.

The key downside of this approach is the loss of any capital appreciation on the land for the investor and that such an approach would also require detailed negotiation between the parties involved to clarify their relationships and expected levels of return. A further complication identified was ensuring that there was a robust legal framework to allow this split in ownership to occur.

In their joint submission, Churches Housing and Baptist Care Australia outlined how community housing land trusts (CLTs) could be used to encourage not-for-profit organisations with significant land holdings to provide surplus land for the construction of new affordable housing. The submission noted that CLTs could be used to provide both affordable housing for purchase as well as rental stock and that previous attempts had not proceeded due to lack of funding or because title and equity issues were not able to be resolved. The submission recommended that the Commonwealth Government develop, in partnership with not-for-profit organisations that can contribute land (such as the aged care, disability, or church sectors), financial incentives that would see community housing developed for vulnerable groups.

St Kilda Community Housing's (SCH) submission indicated that CLTs could be used to provide a variety of housing tenures from public housing through to shared equity or 'private ownership'. SCH sees the role of government as the enablers of the CLTs, most commonly through the release of government-owned land upon which the CLT can be built.



## How does the model deal with current barriers to institutional investment?

As highlighted above there were two broad trust models identified by submissions. The models arguably deal with the barriers identified in the Issues Paper in similar ways.

<b>Scale</b>	<p>Submissions varied in their expectations of the scale of a housing trust. Suggestions for a proof of concept ranged from \$30 million to \$250 million, while a full scale housing trust would need to facilitate hundreds of millions of dollars of ongoing investment per year.</p> <p>The scale of a housing trust largely depends on the size of the assets made available to the trust by the Commonwealth, State and Territory and local governments as well as not-for-profit landholders. Currently, there is around \$100 billion in public housing assets across Australia – only a small portion of this would be required to satisfy the scale required by institutional investors.</p>
<b>Return</b>	<p>Expectations around the required return also varied from 5 per cent to 13 per cent for equity investments. Returns on debt issued by the trust ranged from 3 per cent to 5 per cent.</p> <p>There was broad consensus that any trust structure would require additional government assistance in the form of a tax credit, cash grants, reduced land rent, planning or zoning concessions to allow for densification of redevelopment sites or the sale of land or a portion of any housing developments undertaken by the trust.</p>
<b>Liquidity</b>	<p>A trust could be listed or unlisted. While the benefit of an unlisted trust is less volatility in the price of the units in the trust and less onerous compliance, a listed trust would allow units to be traded by a larger pool of investors and thus increase liquidity.</p>
<b>Investor awareness</b>	<p>Submissions noted that REITs are widely used in Australia to facilitate investment in office, industrial, retail and childcare sectors, but not residential due to current tax settings in Australia. Housing trust structures are also used in the United States and United Kingdom. Stakeholders considered that while the creation of an affordable housing trust would represent a new investment product in Australia, the type of investment product is already widely known.</p> <p>However, a ground lease trust or CLT are less understood by investors and would require significant investor education. Significant work has however been done on this model by Australian academics, including a 'CLT Manual' to aid in investor education.<sup>43</sup></p>
<b>Long-term consistent policy settings</b>	<p>The establishment of a trust is reliant on consistent long-term policy settings. Firstly, a long-term commitment by government to the additional 'top up' would be required to close the financing gap between the return produced by the trust and the return required by investors. Secondly, dependent on the trust structure employed, a long-term lease arrangement would be required for existing public housing or other land owned by governments and local councils or not-for-profit organisations. Finally, change in legislation may be required to allow either housing improvements to be separated from land ownership, or to allow workable tax treatment for trusts.</p>
<b>Project pipelines</b>	<p>As with scale, project pipelines would be determined by the amount of land or existing stock that is leased or contributed to a housing trust by governments or not-for-profit organisations.</p>
<b>Capacity</b>	<p>A trust model would allow for key services to be outsourced. The capacity of the trust is therefore dependent on the capability of not-for-profit and private service providers. Where this is insufficient to meet the needs of the trust, a trust would retain the ability to contract with government agencies as appropriate.</p>
<b>Governance</b>	<p>A trust structure could be governed as a public entity or separate from government. A trust structure would allow for the engagement of a specialist trustee service provider to ensure that the trust was administered in accordance with the requirements set down in its deed.</p>

43 [http://www.westernsydney.edu.au/\\_\\_data/assets/pdf\\_file/0006/600567/Australian\\_CLT\\_Manual.pdf](http://www.westernsydney.edu.au/__data/assets/pdf_file/0006/600567/Australian_CLT_Manual.pdf).



## Model 3: Housing co-operatives

Housing co-operatives are not-for-profit legal associations formed for the purpose of providing a housing product for members and are usually owned and controlled by members. Many housing co-operatives are organised and managed on principles of participatory democracy and a common purpose. They seek to blend the provision of affordable housing with direct member participation and, depending on the model, shared equity.

### Submissions

The majority of submissions considered that while housing co-operatives served an important role in the affordable housing market it was unlikely that this model could be used to generate the significant scale of investment required to expand the supply of affordable housing.

For example, NAB and the CHIA both noted that housing co-operatives serve as a delivery model, rather than a financing model and hence while they offer a secure form of tenure they are unlikely to be able to raise the quantum of funds required to finance meaningful increases in the supply of affordable dwellings.

The exception to this general view was contained in the joint submission provided by the Business Council of Co-operative and Mutuals, Common Equity Housing Limited and Common Equity NSW. This submission highlighted the role that co-operatives could play with respect to the delivery of mixed housing developments, taking into account full and shared equity home ownership approaches. The submission detailed the benefits of a co-operative including its ability to incorporate tenants with different levels of income, better alignment between housing preferences and outcomes, and security of tenure.

### How does the model deal with current barriers to institutional investment?

<b>Scale</b>	Submissions generally did not consider that a co-operative model could generate the scale sufficient to attract institutional investors.
<b>Return</b>	None of the submissions canvassed the level of return that would need to be generated by a co-operative.
<b>Liquidity</b>	A share in a co-operative is unlikely to be liquid given trading ownership is likely to be counter to the principles of the co-operative model.
<b>Investor awareness</b>	Co-operatives are not widely used for housing investment purposes in Australia. Significant work would be required to ensure institutional investors were comfortable with co-operatives as a residential investment class.
<b>Long-term consistent policy settings</b>	Co-operatives, as with the other models, are likely to require additional funds to close the financing gap between the yield produced by the co-operative and the yield required by investors. If a co-operative was linked to a land trust, long-term lease arrangements would be required between the co-operative and land trust.
<b>Project pipelines</b>	As with the scale of a trust the project pipelines for a co-operative would be determined by the amount of land or other development opportunities available.
<b>Capacity</b>	A co-operative model largely seeks to rely on input from its members, which may limit the scalability of this model. However, co-operatives could seek expert advice on development, financial issues or management of its stock from relevant service providers where appropriate.
<b>Governance</b>	Sufficient expertise would need to be held within the co-operative or alternatively an independent manager would need to be brought into the co-operative to satisfy the requirements of potential investors.



## Model 4: Impact investing models including social impact bonds

Impact investing is an emerging form of finance aimed at addressing challenging social problems by harnessing private investors to back innovations in social service delivery that lead to proven reductions in government expenditure. Impact investing offers an opportunity to bring together capital and expertise from the public, private and not-for-profit sectors to deliver better outcomes for the community. Key features of an effective impact investment include robust measurement, value for money, a service likely to achieve social outcomes and appropriate sharing of risk and returns.

Impact investing allows investors to pursue opportunities that provide both social and financial returns through a variety of models including social impact bonds, social enterprises and impact investment funds. Any investment in affordable housing could broadly be considered impact investing given its social impact.

### Submissions

Few submissions commented on the use of impact investments to increase affordable housing supply.

Impact Investing Australia recommended that governments commit between \$150 million and \$180 million to establish an independent wholesale funder called Impact Capital Australia. This fund would provide catalytic investments to impact investment funds which build affordable housing. A similar organisation in the UK, Big Society Capital, provided £12 million to establish the Cheyne Capital Social Property Impact Fund (the Fund), launched in 2014, which purchases properties and leases them to organisations such as housing associations and councils.<sup>44</sup> The leases are long-term and at attractive rates, with the properties being rented out to clients at 20 to 40 per cent below market rates.

Cheyne Capital aims to grow the Fund to £900 million, with the size of the fund and the CPI-linked leases attracting institutional investors such as pension funds. While the Fund does not receive government funding, the organisations who lease the properties (or their clients) may use government funding to pay for rent or support services.<sup>45</sup> Other examples of impact investment funds noted by Impact Investing Australia include the Living Cities Fund and the New York City Acquisition Fund in the US, and the Real Lettings Property Fund in the UK.

In his submission, housing consultant Mr Mark Nutting noted that the scalability of impact investments is limited, and this model would be unlikely to attract institutional investment on a large scale. He did however highlight that impact investing could complement the provision of affordable housing by focusing on improving client outcomes through ancillary services, particularly where specific client groups are targeted. For example, an impact investment approach could focus on transitioning high-service, high-cost cohorts into more effective service models or on supporting work-ready individuals out of social housing.

Overall, stakeholders considered that impact investing is typically too small in scale to finance affordable housing, however there is potential to use such investments to target the needs of specific client groups, for example people who have experienced homelessness or work-ready individuals who could move out of affordable housing.

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44 Big Society Capital 2016, *Cheyne Social Property Impact Fund*, <http://www.bigsocietycapital.com/what-we-do/investor/investments/cheyne-social-property-impact-fund>.

45 Cheyne Capital 2016, *Press Release: New Communities Partnership launched to deliver £1 billion of new UK housing*, <https://www.cheynecapital.com/media/1942/press-release-new-communities-partnership-3-5-16.pdf>.



## How does the model deal with current barriers to institutional investment?

<b>Scale</b>	Impact investment is unlikely to be able to finance affordable housing supply as the limited scale and replicability of impact investments are more suited to recurrent social services provision rather than the provision of affordable housing. As such, they would not be able to attract sufficient institutional investment.
<b>Return</b>	The cost of establishing projects and difficulty in measuring the benefits of affordable housing makes it difficult for impact investments to deliver a market rate of return that reflects the perceived risk. These costs are unlikely to be significantly lower in the short-term as it has proven difficult to replicate projects.
<b>Liquidity</b>	Impact investments to date have had little liquidity due to generally being one-off projects with limited ability to trade interests. Liquidity will remain as a barrier to most potential investors, especially institutional investors.
<b>Investor awareness</b>	Impact investing is a nascent market and there have been few impact investments in Australia. Impact investments are small and usually not scalable, which limits the distribution model for impact investments and awareness among institutional and sophisticated investors.
<b>Long-term consistent policy settings</b>	Impact investments are typically dependent on government policy settings and involvement, through the establishment of the project, governance, the evaluation of the social and financial outcomes and the payment of financial returns.
<b>Project pipelines</b>	Impact investments are typically bespoke individual projects which have been difficult to scale and replicate. A shortage of deals is a global challenge for the impact investment market despite motivated capital.
<b>Capacity</b>	Impact investments require strong relationships between government, the private sector, the not-for-profit sector and service providers. The capacity of service providers to establish impacts investments can be limited by the complex structure of the projects and the business case required to attract investors.
<b>Governance</b>	Governance would depend on the form of the impact investment as governance structures vary depending on the service provider and the structure of the project. For example, social impact bonds often have a complex governance structure involving governments, the service provider and private sector investors.



## 6. Viable financing models

The Working Group has examined a number of models that largely focussed on providing longer-term credit for CHPs, facilitating the re-development of existing public housing stock or the provision of ongoing subsidies to affordable housing providers.

After extensive consultation with key stakeholders and a two-stage assessment process, the Working Group has concluded that there are two broad models that should be further tested and considered for implementation. These are:

- the issuance of a housing bond, through a financial intermediary, that aggregates the borrowing needs of affordable housing providers; and
- the establishment of a mechanism, such as a housing trust, that assists States and Territories to expedite the redevelopment of their existing housing stock and boost overall supply.

The Working Group's analysis has found that the bond aggregator model is the most viable, due to its ability to generate acceptable returns to investors with the smallest financing gap and provide liquidity to institutional investors, whilst also being an understood and accepted asset class.

The establishment of a vehicle that assists States and Territories to leverage their existing housing stock could take many forms. The predominant form considered by the Working Group was through a housing trust, which could pool the assets of participating States and Territories and be implemented with or without access to the equity value of the public housing stock.

As discussed above, all of the potential models canvassed rely on various levels of government assistance in order to close the financing gap and ensure their viability. The types of assistance that may be required to ensure their viability are listed in [Appendix C](#).

### Model 1: Housing bond aggregator

#### *Rationale*

A housing bond aggregator aims to provide cheaper and longer-term finance for community housing and affordable housing providers. This model would allow providers to refinance their existing borrowings and finance new developments at lower cost and longer tenor. Further, it creates a market for private affordable housing investment that both normalises and expands flows of capital to the industry.

This model best addresses the barriers of return and liquidity through providing an instrument that is understood by sophisticated investors as a fixed income investment that can be easily traded in a secondary market. It also has the potential to reach significant scale.

Similar models have been successful internationally, as shown in the United Kingdom where THFC was recently able to borrow at rates below that of the Government and in 2014-15 provided over £4 billion in loans to housing associations.<sup>46</sup>

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<sup>46</sup> The Housing Financing Corporation 2015, Annual Report and Financial Statements.  
<http://www.thfcorp.com/accounts/2015/THFC%20Ltd%202015.pdf>.



Feedback from finance and community housing stakeholders is that the finance provided by a housing bond aggregator would be used to replace existing bank finance, rather than be used as project-based construction finance. Construction-phase finance carries higher risks, and thus higher required returns, and traditional commercial bank financiers are seen as having a comparative advantage at appropriately assessing and managing the risks associated with this short-term type of finance.

Whilst the finance from the housing bond aggregator would not be used to finance the construction of affordable housing directly, it would increase the borrowing capacity of affordable housing providers once new dwellings are generating rental cash flows, and through decreasing CHP's interest costs and refinancing risks, in turn allowing them to develop more affordable housing.

Finance stakeholders also noted that the ability for affordable housing providers to access finance following the construction phase of a development decreases their risks with providing project-based finance as there is a clear avenue for the affordable housing provider to refinance upon completion of the project. The housing bond aggregator would provide investors with this reassurance, which would lead to an increase in the supply of affordable housing.

### ***What does this model involve?***

A broad outline of how a housing bond aggregator would operate is illustrated in [Figure 2](#).

The establishment of a housing bond aggregator model would involve:

- the establishment of an appropriate national aggregator or financial intermediary;
- the design of the bond to be issued;
- the evaluation of applications for funding from individual community housing or affordable housing providers by the aggregator – this function could be done internally as with the Clean Energy Finance Corporation or alternatively could be outsourced to an appropriate credit assessor and finance provider; and
- consideration of the housing providers making up the bond issuance, as the aggregator would need to have the bond rated before issuance;

The housing bond aggregator would also need to consider how it funds its ongoing operating and credit assessment costs. This could be achieved through imposing a transaction charge (that is, an interest margin above what funds are raised at) sufficient to fund the ongoing operation of the aggregator. A similar charge could also be used to build up a sufficient capital buffer for the aggregator to cover any payment default by an affordable housing provider, as well as to reduce investors' perception of the default risk of any bond issuance.

In particular, the design of any bond will be important. Four key things that would need to be decided include:

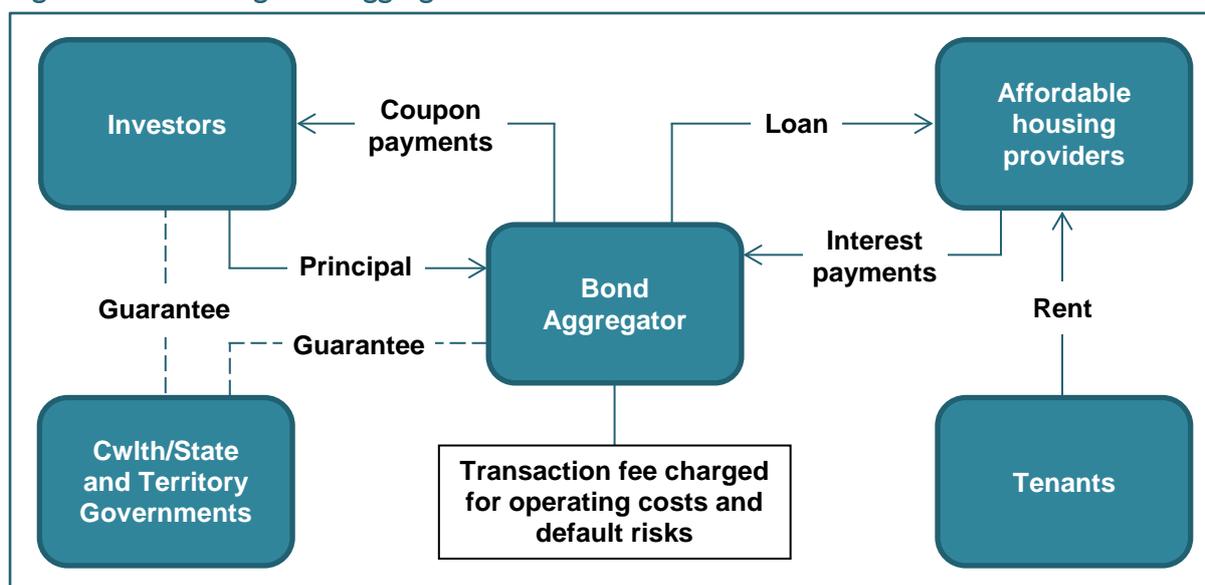
- the type of bond and its coupon payment (that is, fixed or indexed to inflation);
- the length of the bond to be issued (a bond length between 25 and 40 years would best match the lifespan of housing investments, however Australia has traditionally had a much shorter tenor bond market);



- the loan to valuation or interest coverage ratios used for lending purposes; and
- whether any government guarantee is provided, as well as which level of government issues the guarantee, the size of the guarantee and whether it is transitional or ongoing.

In particular, stakeholders have suggested there are a number of ways in which a bond could be structured. The key consideration is whether the bond is designed to pay down the principal value of the borrowing over the life of the bond ('amortising bond') or whether principal is paid upon maturity ('bullet bond'). The benefit of an amortising bond is the enforced paying down of principal, which may reduce the likelihood of an entity facing repayment or refinancing risk at the maturity of the bond. A hybrid structure that partially amortises through the term of the bond down to a more refinanceable level would raise more finance than a fully amortising bond.

Figure 2: A housing bond aggregator



Feedback from stakeholders was noted that a bullet bond that makes regular coupon or interest payments but does not amortise may be preferred as it has higher investor understanding and appetite – this is illustrated by it being the predominant form of bond issues in institutional debt markets. It was noted that facilities, such as a 'sinking fund', could be constructed (either within the bond aggregator or the borrower) in order to replicate the amortising bond structure for debtors whilst providing investors with a bullet bond.

Additionally, whether the financial intermediary sits within government, a not-for-profit or a commercial entity would be important, as there are benefits and risks associated with each option. Stakeholders generally expressed a desire for the aggregator to be independent of government, noting that it would be subject to relevant financial and prudential regulation.

A key consideration for the implementation of a housing bond aggregator is the increased role it would give CHPs and other non-traditional affordable housing providers. Tenants, investors and governments will all want to ensure risks are managed appropriately. The importance of good risk management is illustrated in the success of the United Kingdom's affordable housing system in raising and providing significant levels of finance, driven by its strong and credible regulator. This issue is discussed further in *Creating the right environment for models to succeed*.



It is likely that governments would need to play a significant role in the establishment of the aggregator. Once established, governments could easily reduce their role in the operation of the aggregator. However, governments may wish to maintain an ongoing interest in the bond aggregator, subject to the level of subsidy and/or other forms of assistance that they provide.

International experience with bond aggregator models has shown that they enable government roles in affordable housing to shift over time from primarily direct support (through the provision of land, development finance and grants), to primarily indirect support (via guarantee schemes, coupled with significant demand side assistance to make rents affordable and support investment returns). Importantly, however, no government has been able to exit the space completely.

### ***What subsidies may be required?***

Four subsidies may be required to implement a housing bond aggregator.

The first is the initial set up costs of the aggregator. The Clean Energy Finance Corporation was provided with approximately \$20 million in initial establishment funding.<sup>47</sup> While the establishment costs of a bond aggregator have not been costed, stakeholders consider establishment costs would be significantly lower and could be recouped over time.

The second is the government co-investment to close the financing gap and enable an ongoing pipeline of affordable housing construction that would address the documented shortfalls and continued population requirements, as well as investor requirements for program credibility. This can be achieved through the upfront provision of land or equity, and/or through providing an ongoing income stream to affordable housing providers.

The level of such a subsidy is dependent on the type of housing that is being constructed by affordable housing providers – sub-market rental dwellings will require a lower subsidy than social housing dwellings.

In terms of the success of a housing bond aggregator, it would be preferential for subsidies such as land, grants, planning incentives or tax concessions to be provided for the construction phase of borrowing in order to allow the housing bond aggregator to focus and specialise in providing operating phase financing once construction has finished. The housing bond aggregator provides the opportunity to tap institutional investors with long-term financial liabilities, such as superannuation funds, in order to match the operational life of affordable housing stock.

The third is an increase in CRA expenditure. New stock under the housing bond aggregator model will likely be managed by CHPs or other non-government providers, making income support recipient tenants in these dwellings eligible for CRA.

Fourth, as discussed above, the implementation of a housing bond aggregator will also require strong governance structures and the appropriate management of risk. An additional subsidy may be required to assist with bolstering these structures, such as a strong regulator.

Given the new nature of the asset class and stakeholders/governments' desire to secure finance at the lowest cost possible, some proposals suggested that a government guarantee on bond issuances would be necessary on bonds issued by the housing bond aggregator. If bonds are provided with a government guarantee then caution should be taken to ensure additional risks are not created. Any

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<sup>47</sup> Commonwealth Mid-Year Economic and Fiscal Outlook 2011-12. Available at: [http://www.budget.gov.au/2011-12/content/myefo/html/09\\_appendix\\_a\\_expense-19.htm](http://www.budget.gov.au/2011-12/content/myefo/html/09_appendix_a_expense-19.htm).



government guarantee should also be transitional. This would assist with establishing confidence in the asset class which allows government involvement in the housing bond aggregator to decrease over time.

There are various ways in which governments can provide a government guarantee of any bond issuance, including guaranteeing: the payment of the principal and/or interest payments; the purchase of unpurchased securities; or a single tranche or layer of each bond issuance. A joint government guarantee could also be provided by all governments.

However, a government guarantee is not costless and is analogous to governments borrowing the funding themselves, likely at a lower cost, and then providing these funds directly to affordable housing providers. Any form of government guarantee needs to have transparent policy goals.

### ***What outcomes is a bond model likely to produce?***

The housing outcomes that can be produced from a housing bond and aggregator will be asset-focussed. The housing bond is aimed at increasing the stock of affordable housing dwellings and is unlikely to have an impact on the cost or quality of management services or the transfer of public housing stock to CHPs. However, these may occur as a by-product of the affordable housing industry beginning to reach larger scale through the increased development of affordable housing financed under a housing bond model.

The impact that a housing bond model can have will depend on the demand for credit by affordable housing providers as well as the appetite of institutional investors. At a minimum if the aggregator simply allows for the refinancing of the existing debt of CHPs (estimated at over \$1 billion)<sup>48,49</sup> it could result in an increase in their borrowing capacity by over 65 per cent or an additional \$765 million.<sup>49</sup> If this amount were reinvested into new affordable housing it could fund the construction of up to 2,200 new dwellings.<sup>50</sup>

However, in the Working Group's consultation with the UK financial intermediary THFC it was noted that UK affordable housing providers predominantly channel the loans they receive into operational financing requirements rather than project-based financing for new development. However, this lessens their financing constraints, implicitly allowing affordable housing providers to increase their total debt capacity or use savings as equity for further investment in developing affordable housing dwellings.

### ***Proof of concept***

A 'proof of concept' of a housing bond aggregator would provide the opportunity to closely assess the design features and requirements to build market confidence and ensure the success of the model.

Based on stakeholder feedback, a minimum of \$200 million would need to be issued in order to adequately gauge the interest from institutional investors and the viability of the model. Further analysis would be needed to determine this and other design features of the bond, including in relation to the timing of the bond release and entities responsible for issuing and assessing the bond. A critical design feature to be considered will be whether and how the bond is underwritten or guaranteed in order to ensure it remains successful and attractive to investors.

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48 AHURI August 2016, Milligan V et al, Profiling Australia's affordable housing industry. Available at: <http://www.ahuri.edu.au/research/final-reports/268>.

49 Working Group calculations from various CHP financial reports, submissions to the Working Group and stakeholder feedback.

50 Assuming an average dwelling cost of \$350,000 and no increased equity requirements.



Detailed modelling work would also be needed to determine the market viability of the bond aggregator, including in relation to the size of the financing gap in different markets, optimal portfolio mixes that could reduce the financing gap by generating cash flows, the future pipeline to provide confidence to institutional investment, the level and form of government assistance required to close the residual financing gap and to support the establishment of a private financing vehicle. In order to undertake this assessment, an expert industry-led taskforce would be required.

## Model 2: Housing trust

### *Rationale*

One proposed mechanism that may assist States and Territories to expedite the redevelopment of their existing housing stock and boost overall affordable housing supply is a housing trust. A housing trust aims to facilitate the redevelopment of public housing stock through utilising private investment. This model allows for a mix of housing types to be built on existing public housing sites.

This model best addresses the barrier of scale as it has the potential to better utilise the existing public housing stock, leveraging it to assist with the development of new stock.

A housing trust would assist individual jurisdictions with the steps they have already taken to renew their public housing portfolios. It would also have a greater geographic diversity than individual or state redevelopment projects and allow for both equity and debt investment by investors.

The benefit of a housing trust over individual title or management transfers by States and Territories is the cost efficiencies in managing and administering the stock obtained from achieving scale, as well as the geographic diversity in assets which improves the ability to attract institutional investors.

### *What does this model involve?*

A broad outline of how a housing trust would operate is illustrated in [Figure 3](#).

Under a housing trust, public housing assets and/or land would be pooled into a trust in return for units of ownership in the trust. Further equity units in the trust could be issued in order to attract the private and institutional investment required to redevelop existing public housing assets and boost supply. However, this would dilute the States and Territories ownership of the trust.

Alternatively, a housing trust could be utilised on a non-equity basis utilising a ground lease structure. Under this structure the land on which new dwellings are developed is retained exclusively by the government or the not-for-profit organisation which initially owned the land. This structure would address concerns around the ownership of land and perceptions of decreased security of tenure for tenants. In this structure investors would be purchasing units in a trust which owns the properties built on top of the land owned by the government or not-for-profit organisation.

If desired, under either approach, units in either structure of the trust can be sold by States and Territories to raise funds for further alternative investment in boosting the supply of affordable housing.

The establishment of a housing trust would involve:

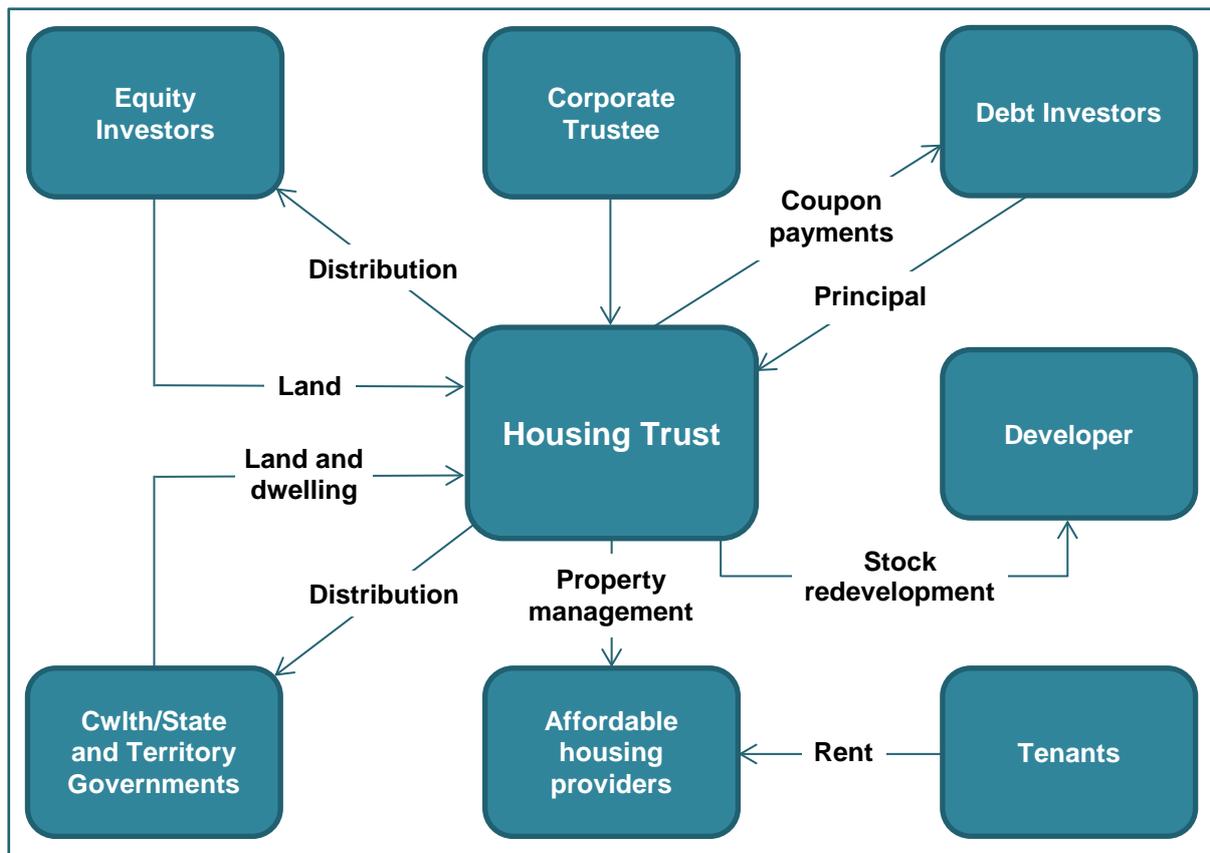
- the establishment of an appropriate trust structure to hold and manage assets transferred into the trust by the Commonwealth and States and Territories, in particular the principles for stock management and security of tenure for tenants;



- the appointment of a corporate trustee to manage the trust in accordance with the trust deed;
- the issuance of units to governments in return for the assets transferred into the trust;
- the issuance of units to private investors in return for contributions of land or equity into the trust;
- the issuance of a bond to provide additional finance for the redevelopment of stock either through an independent housing bond aggregator or by the trust itself;
- the engagement of an asset portfolio manager (potentially one for each State and Territory) to actively manage the redevelopment of the assets of the trust;
- the engagement of a property manager, such as a large scale and diverse CHP, to provide management and wrap-around services to the tenants in the assets of the trust; and
- the engagement of developers to redevelop the trust’s housing portfolio to provide a mix of housing tenures, which could include public, community, affordable, shared equity and private ownership.

As noted by stakeholders, the trust structure is complex and, in addition to strong legal and governance arrangements, clear communication and stakeholder education would be required in order to explain the calculation of returns to debt and equity investors.

Figure 3: A housing trust



### ***What subsidies may be required?***

Four subsidies may be required to implement a housing trust.

The first is the initial set up costs of the trust. As with the housing bond model, the establishment costs of a housing trust have not been costed. However, establishment costs are likely to be low in comparison to the assets and cash flow of the trust.

The second is the necessary zoning and planning process in each state where the assets sit to allow for significant densification of appropriate existing public housing and other underutilised land. A key element of the sustainability of the trust model is capturing the value of changes in zoning to subsidise the provision of social housing.

The third is the provision of CRA. New stock under the trust model is likely to be managed, where possible, by CHPs allowing tenants in these dwelling to be eligible for CRA.

The fourth is an additional subsidy to close the financing gap. This can be done through the upfront provision of land or equity, or through providing an ongoing income stream to housing providers.

The level of such a subsidy is dependent on the returns which can be generated by the trust from the redevelopment of stock and the cross subsidisation of social housing by other housing types. Following this an additional cash or tax subsidy is likely to be required in order to increase investor yields to the levels required to be competitive with comparable equity investments.

Governments will receive a share in the trust equivalent to any contribution of land or dwellings and hence this arguably does not represent a net subsidy depending on original site characteristics.

A housing trust utilising a ground lease would require an additional subsidy. It is presumed that jurisdictions would only charge the trust a nominal amount of rent for the use of land given that they retain full control of the land and access to any potential increases in land value.

### ***What outcomes is a housing trust likely to produce?***

The housing outcomes that could be produced from a housing trust would be dependent on the amount of housing stock and land contributed by the Commonwealth, States and Territories and not-for-profits as well as the increase in density allowed by changes to zoning or planning settings.

A number of submissions reference this model with assumptions ranging from an increase in density of three to six times. While substantial increases in density will only be appropriate in some cases, an increase in the density of dwellings across the existing public housing portfolio of three times would lead to the development of a mix of approximately 650,000 new affordable dwellings.

### ***Proof of concept***

A proof of concept of the model could be established with around 5 per cent of existing public housing stock or around 15,000 dwellings. Each State and Territory could establish its own trust and contribute the stock into these vehicles. The amount of housing stock contributed could be varied depending on the number of States and Territories wishing to participate.

Each trust would have the same corporate trustee to ensure the management of the trusts is similar and in accordance with the objectives of a housing trust.

This structure would create a virtual affordable housing trust by State and Territory. In the event of unwinding the model, this structure would enable the States and Territories to recoup the value of



their particular contributed assets rather than having an undivided interest in all of the assets from the point of establishment.

However, if the proof of concept was successful, each of the trusts could then contribute its assets to a single trust to be offered to external investors.



## 7. Creating the right environment for models to succeed

Throughout submissions received by the Working Group, and in stakeholder consultations, it was emphasised that a financing model on its own would not be enough to guarantee an improved supply of affordable housing. Stakeholders suggested a range of areas that will also need to be considered to ensure the right environment is created to give any financing model the best chance of succeeding. These areas are out of scope of the Working Group, however a brief summary of stakeholders' views on the more significant issues are presented below.

Affordable housing sits within a multi-disciplinary policy context. There are a number of other policy settings that impact on incentives to invest in increasing the supply of affordable housing as well as the ability of the sector to attract private investment. These include (but are not limited to): the capacity of the community housing sector, planning and zoning, the role and capacity of local government and taxation and concessions. It will be important for these policy settings to be taken into account when developing future policy responses aimed at impacting affordable housing supply.

### The community housing sector

Community housing provides a range of housing to differing community needs – from subsidised rental accommodation for lower income working households, to managing public and crisis accommodation for individuals with the highest needs. CHPs operate at varying scales and are well regarded for providing innovative and 'people centred' approaches to housing tenants. Increasingly, CHPs work in partnership with 'wrap-around' service providers such as local government, disability and employment support providers.

The four financing models canvassed by the Working Group's Issues Paper included, to varying degrees, the involvement of the community housing sector. It is therefore important for the implementation of any innovative financing model that the community housing sector functions efficiently and effectively and that appropriate governance and regulatory arrangements are in place to ensure that risks to the government, community and private sectors are appropriately managed.

Evidence from stakeholder roundtables and submissions received by the Working Group indicate that while there are significant strengths in the CHP sector, there are also some areas of considerable concern. For example, in addition to sub-market rates of return, there are two main characteristics of the community housing sector which are inhibiting greater private sector investment in the sector. These characteristics are:

- sub-optimal scale of operation, including capacity to deliver large scale projects; and
- the lack of national regulation of CHPs.



The major concern is that there are too many CHPs operating below the scale necessary to attract significant private sector institutional investment because past policy has been too inconsistent to support their growth. The main concern expressed was the perceived inability of smaller CHPs to be able to ensure an adequate pipeline of future projects to maintain the interest of institutional investors. The majority of the growth in community housing has come through fits and starts of stock transfers from governments rather than rational up-skilling. For example, Westpac noted that:

*“Currently the size of the deals in the sector is an inhibitor to attracting capital. The government should consider how best to increase the scale of CHP’s and develop a pipeline of projects...Larger scale projects will attract larger scale private sector stakeholders, enabling more complex, innovative solutions that will provide the economies of scale not currently available to the sector.” (2016, p. 3)*

Social Ventures Australia and Macquarie Group Limited perceived that consolidation of CHPs would improve operational efficiency and effectiveness:

*“In NSW for example, there are 16 ‘Tier 1’ CHPs; financiers have indicated the ideal number is closer to 3 to 5 at scale...We believe consolidation of CHPs can improve their operational efficiency and effectiveness; well-run CHPs will benefit both tenants and financiers. This could be encouraged via provision of incentives for voluntary mergers (such as agreed transfer of public stock to merged entities).” (2016, p. 16)*

However, stakeholders also reflected the value of having a diverse CHP sector that responds to a diverse range of unique needs. Whilst some consolidation is required in the CHP sector, it should not be at the expense of specialist providers who have a role to play. Over consolidation could also be a risk to the sustainability of the sector as it has in the UK. Diversity in Tier 1 providers (and their equivalents) is required in order to manage systemic risks associated with the failure of a single large organisation. Necessary consolidation could instead be achieved by grouping CHPs together by the housing trust.

Some stakeholders also highlighted governance arrangements as a key issue facing the CHP sector, particularly when attempting to attract larger scale investment from financiers. A National Regulatory System for Community Housing (NRSCH) was established in January 2014 with the objective of providing a consistent regulatory environment to support the growth and development of the community housing sector. It aims to reduce the regulatory burden on housing providers working across jurisdictions and provide a level playing field for providers seeking to enter new jurisdictions. Victoria and Western Australia are not formally participating in the National Regulatory System at this time but have their own community housing Registrars who meet regularly in a forum of all state and territory Housing Registrars.

Strong governance arrangements are seen as vital to reducing uncertainty for investors, particularly in scenarios where CHPs may experience financial distress. For example, SGS Economics and Planning noted the need for:

*“... strong prudential supervision arrangements for the social and affordable housing provider sector, recognising, firstly, that substantial amounts of Government capital will be entrusted to non-government providers and, secondly, that institutional investors will only contemplate large scale involvement in the sector if they are convinced of the financial robustness and management capabilities of not-for-profit providers.” (2016, p. 19)*



The NSW Federation of Housing Associations also recognised the need for good governance and oversight arrangements:

*“... a single strong national regulatory system is essential, one in which both government and investors can have confidence...[as] financial instruments become more sophisticated...the regulators’ financial review and engagement needs to be similarly sophisticated.” (2016, p. 18)*

Given the financial models under consideration, there is a clear need to ensure that effective governance and oversight arrangements are in place, providing confidence and attracting large scale capital from institutional investors. The governance arrangements should also provide a sufficient level of flexibility to enable the structure of the CHP sector to evolve over time. This could include consolidations or mergers within the CHP sector and increasing the number of CHPs which operate across different jurisdictions, which to date has been inhibited by the multi-regulatory approach.

A further reform that could assist CHPs is the Compulsory Rent Deduction (CRD) Scheme. In the 2015-16 Budget, the Commonwealth Government announced its intention to establish a CRD Scheme, under which occupants of social housing who receive income support payments or Family Tax Benefit could have their rent and related tenancy costs deducted from their payments and automatically transferred to the relevant housing provider. The CRD Scheme could benefit CHPs by improving their rental income streams and reducing investor perceptions of the risk associated with these cash flows.

## Planning systems

Planning systems influence the supply of land and the nature of development allowed on that land, thereby directly affecting overall housing supply and thus the supply of affordable housing. For example, the Urban Development Institute of Australia stated in their submission to the Working Group that:

*“Holding costs comprise a significant proportion of the end cost of land and new housing, so significant delays in planning, zoning and approvals can have a marked effect on affordability.” (2016, p. 4)*

AHURI (2007) highlighted the importance of the planning system to facilitate an increase in the supply of affordable housing:

*“Planning mechanisms for affordable housing have proved crucial for securing land for affordable housing development and achieving the broader goal of socially mixed communities. While the evidence shows that these mechanisms do not replace the need for dedicated funding for affordable housing supply, planning levers can maximise the outcomes of this expenditure and complement other financial incentives or subsidies to support affordable housing development.” (AHURI 2007, p. 5)*

Planning systems can be used to encourage the development of affordable housing stock, either on private or publicly owned land. This could be achieved through inclusionary zoning policies such as those adopted in some Australian States and Territories. For example, the South Australian Housing Strategy commits to ensuring that at least 15 per cent of all new housing (government and private land developments) in significant developments is affordable to low and moderate income households. Western Australia’s Affordable Housing Strategy 2010-2020 also includes a commitment for government land and housing developments to include a minimum of 15 per cent affordable housing.



Inclusionary zoning aims to deliver a supply of affordable housing through the private sector by requiring new developments to consist of a certain percentage of affordable housing; for sale or lease to eligible households below certain price points. However, it is important to acknowledge that there is still a cost associated with dwellings built under such a policy. While inclusionary zoning theoretically involves no government subsidy, in practice there is an effective cost, either to government or private developers associated with delivering affordable housing, which are ultimately passed on to home purchasers.

Other planning tools that can be used to enforce or encourage the development of affordable housing include:

- mechanisms that protect existing sources of affordable housing, such as change of use controls on land or buildings
- incentives to encourage the development of areas likely to be accessible to lower income cohorts, such as additional floor space ('density bonus');
- mandatory requirements for developers to contribute to affordable housing; and
- application of developer levies that fund the construction of affordable housing.

Developers will consider any use of planning mechanisms to mandate affordable housing inclusion or contribution to be a 'taking' or reduction in land value unless it is calculated clearly in advance from the point a parcel of land is purchased. For this reason, states that have introduced these useful mechanisms have limited them to state-owned land earmarked for redevelopment.

## Local government

Local governments and councils play an important role in developing, managing and implementing the regulatory environment, which can support increases in the supply of housing. In their submission to the Working Group, the Council of Capital City Lord Mayors noted that:

*"The role of Local Government in facilitating affordable housing is limited, however it does provide a vital role in partnering with state governments for the co-ordination of planning and development of housing, employment and essential infrastructure." (2016, p. 2)*

However, the City of Whittlesea in Victoria noted the limitations on the ability of local governments to influence the supply of social housing:

*"Local governments have an important, although limited role to play in promoting and encouraging the development of social and affordable housing. Local government in Victoria have limited capacity to intervene in the housing market to ensure the provision of affordable housing." (2016, p. 6)*

Local governments are responsible for building approval, urban planning and development processes and may be involved in the provision of public housing. Approval timeframes and conditions placed on development and building activities can impact on the supply and price of housing (both ownership and rental). However, it is also important that any restrictions imposed through planning or building requirements do not create disproportionately negative barriers to efficient land use.



## Taxation and concessions

Taxation arrangements and concessions at all levels of government have a significant impact on supply and demand of housing across the housing continuum. They can also directly affect the viability of innovative financing models for affordable housing through their impact on:

- the supply of affordable housing in general; and
- the attractiveness of the CHP sector to private investors in housing.

Commonwealth Government taxation policy affects housing in a variety of ways, in particular through capital gains tax and negative gearing arrangements, which are applied to investments more broadly. These settings may affect investment decisions in established housing and possibly make housing investment more attractive to individual ‘mum and dad’ investors over institutional investors due to the ability to deduct losses against other earned income.

At the State and Territory level, there exists a variety of taxes, concessions and grants that affect the housing market. These include:

- stamp duties and land taxes;
- concessions on stamp duty and grants for first home buyers;
- principal place of residence rebates/concessions; and
- housing finance schemes such as shared equity.

Some taxation settings, such as land taxes based on aggregated land holdings, may also encourage ‘mum and dad’ investors into rental housing at the expense of institutional investors.

The primary issue with some forms of government assistance for housing is that they can increase demand for housing without necessarily increasing supply.

For example, grants to first home-buyers and stamp duty concessions increase the individual’s buying power, which in the absence of an increase in housing supply put upward pressure on housing prices. This reduces overall affordability which has flow on impacts for households looking to rent in the private market by increasing competition for appropriate rental dwellings. Governments are tending to restrict these to new homes and cap their values in order to attempt to mitigate these negative effects.

In Working Group consultations, many stakeholders regarded taxation incentives as one way to improve the financial attractiveness of affordable housing to institutional investors. Taxation arrangements are regarded as one way to bridge the financing gap by improving the after tax rate of return available to investors (see [Box 3](#) for an example). Taxation incentives have been seen as successful internationally in improving the supply of affordable housing.



### Box 3: Low-Income Housing Tax Credits

In the United States Low-Income Housing Tax Credits (LIHTCs) are used as an incentive to attract investors into affordable housing. LIHTCs allow affordable housing developers to leverage private investor equity capital to support the construction of affordable rental housing.

LIHTCs are federal tax credits that are allocated to States who then allocate them to developers of qualified projects for the new construction of rental housing that will be rented to low-income households. The tax credit can be sold to outside investors in exchange for equity, which reduces the debt developers would otherwise have incurred and the equity they would have contributed.

Currently, there are two types of LIHTCs available depending on the type of rental housing construction:

- a 4 per cent per credit rate to subsidise 30 per cent of the costs of the new dwellings (that also employ tax-exempt bond financing); and
- a 9 per cent per credit rate to subsidise 70 per cent of new construction (without tax-exempt bond financing).

Once in the program, a property is generally eligible for the tax credit every year for 10 years (of a 15-year tax compliance period). In many states, affordability restrictions continue for up to 55 years (for example, California).

The LIHTC program has facilitated the development of 2.4 million affordable housing dwellings from 1986-2012, of which over 80 per cent were developed by the for-profit sector. The LIHTC was estimated to cost \$USD 6.7 billion in foregone revenue in 2014-15. It was made permanent by act of Congress seven years after its introduction, at which time small-scale retail investment was supplanted by more efficient large-scale institutional investor capital. It is the predominant funding mechanism for the majority of affordable rental housing constructed in the United States today.



# Appendix A: Affordable Housing Working Group: Terms of Reference

## Context

Affordable housing is that which reduces or eliminates housing stress for low income and disadvantaged families and individuals in order to assist them with meeting other essential basic needs on a sustainable basis, whilst balancing the need for housing to be of a minimum appropriate standard and accessible to employment and services.

There is currently a structural problem in Australia where the demand for affordable housing outstrips its supply, leading to lengthy social housing waitlists and some low-income households facing rental stress or being unable to retain housing at all. The problem is too big for governments to solve (and finance) alone, requiring a long-term market-oriented response, at scale.

Access to affordable housing (social housing and affordable private rental) has interactions with employment and other social outcomes. As such, deteriorations in the accessibility of affordable housing can have a negative effect on other areas, such as employment, welfare, health, justice and productivity.

State and territory governments are responsible for the service provision of social housing, in conjunction with funding from the Commonwealth. There are significant variations across jurisdictions including the amount of stock, level of maintenance, location and overall standard of the social housing stock and policies to support affordable private rental. Despite these differences, both the states and territories and the Commonwealth have a desire to improve the affordable housing provided to Australians, whilst also facing a constrained budget environment.

The rental system is central to a healthy housing continuum in Australia – and a very high proportion of people on low incomes rely on it. As such, the twin goals of maintaining a strong social housing safety net for those on the lowest incomes and in the greatest need, while also facilitating large-scale market investment in an affordable rental market, is the focus of this work.

## Objectives

The Affordable Housing Working Group ('the Working Group') will:

- identify potential financing and structural reform models that increase the provision of affordable housing (social housing and housing in the private rental market) for those on low incomes;
- provide assessments of potentially viable proposals put forward by stakeholders; and
- outline the best method to progress further any models that are identified as potentially viable.

This work will culminate in a report by the Working Group to the Heads of Treasuries.



## Terms of Reference

The Working Group will report on the current state of affordable housing, focusing on both social housing and the affordable private rental market for low income households. This report will include the historical and current role that all levels of government play in its provision and the differences in approach between jurisdictions.

The Working Group will examine the feasibility of, and make recommendations for, how the states and territories and Commonwealth can progress innovative financing models to facilitate sustainable long-term private sector investment at scale to increase the supply and availability of affordable housing, including (but not limited to):

- capital provided at scale through normal market mechanisms such as bonds, for the purposes of creating an intermediate rental asset class;
- housing loan/bond aggregators, where an entity acts as an intermediary between the capital markets and the housing delivery system (primarily community housing providers);
- housing trusts, where existing housing assets are pooled together to attract private investment and improve management of the assets;
- housing co-operatives and mutuals, where residents may own a share of a dwelling alongside other community members;
- impact investing models, where investors are able to pursue opportunities that provide both social and financial returns through either direct investment in not-for-profit or social enterprises, or through alternative intermediaries; and
- social impact bonds, where the public sector issues a contract with non-government providers in which a commitment is made to pay for improved social outcomes that result in public sector savings.

In doing this, the Working Group will also consider the roles of governments, investors, the not-for-profit sector and other groups in the provision of affordable housing.

The Working Group may also consider alternative structural models that facilitate improved affordable housing outcomes, such as the role of community housing and housing associations in the provision of social housing and examine other regulatory changes, including planning and zoning changes, which would support the increased supply of affordable housing accessible to employment and services. This work would include consideration of the appropriate mix of tenant cohorts within social housing and affordable private rental, and more broadly within the wider community.

## Process

The Working Group will undertake public consultation, and targeted stakeholder engagement, including roundtable discussions with key stakeholders in early 2016. Following this consultation process the Working Group will assess workable proposals put forward by stakeholders, including those from the not for profit, financial and government sectors to determine their workability.

In doing so the Working Group will draw on relevant local and international experience and consult with a range of stakeholders, including subject matter experts from across sectors, including governments, the community sector and financial investors.



The Working Group will also draw on submissions and proposals that have been made to other review processes in relation to affordable housing.

The Working Group will then develop its final report:

- having regard to the work of the Cities and Built Environment Taskforce, the Reform of the Federation White Paper and the Housing Supply Working Group;
- taking into account experiences in developing a social housing investment trial based on applicable social impact investment models, in coordination with relevant areas of Treasury and the Department of Social Services; and
- assessing and taking account of differences between states and territories.

The Affordable Housing Working Group will provide its final report to Heads of Treasuries by 30 June 2016.

## Membership

The members of the Working Group will be:

- Commonwealth Treasury;
- Commonwealth Department of Social Services;
- New South Wales Treasury;
- Victoria Department of Treasury and Finance; and
- Western Australia Department of Treasury.

Jurisdictions will draw on the expertise of their relevant housing and planning departments.

External expertise will be engaged as appropriate.



# Appendix B: Alternative definitions of affordable housing

## The ratio approach – ‘30 per cent rule’

The ratio approach uses the ‘30 per cent rule’ to measure affordability by considering housing costs as a proportion of household income. Housing is said to be unaffordable if housing costs make up more than 30 per cent of gross household income.

This measure is often more strictly applied to low-income households whose equalised gross household income<sup>51</sup> is in the bottom 40 per cent of the income distribution. This 30/40 indicator assumes that households on higher incomes exercise choice if paying more than 30 per cent of their income for housing and that this would not impair their ability to afford other necessities. This measure of affordability is the definition of housing stress used in the annual Reports on Government Services.

The 30 per cent rule and the 30/40 rule have however been criticised for:

- applying a single measure across all tenures, locations and household types;
- issues with defining the two central variables, income and housing costs, and where to set the affordability benchmark;
- failing to account for issues of housing quality and over-crowding; and
- failing to consider the capacity of particular households to meet both their housing and non-housing costs, and thereby maintain adequate housing and an adequate standard of living, (that is, housing stress does not always equate to a position of financial stress).<sup>52</sup>

In light of these constraints, the ‘30 per cent rule’ should be used as an indicator of changes in housing stress over time rather than an assessment of an individual’s level of housing stress at a point in time.

## The residual income approach

The residual income approach considers whether households can afford both housing and non-housing expenses. This approach relies on defining adequate standards of living; in Australia the Henderson poverty line and the budget standard developed by the Social Policy Research Centre at the University of New South Wales in 1998 have been used.

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51 Equivalised gross household income is total household income adjusted by the application of an equivalence scale to allow comparison of income levels between households of differing size and composition, reflecting the requirement of a larger household to have a higher level of income to achieve the same standard of living as a smaller household. Australian Bureau of Statistics, 2016, <http://www.abs.gov.au/ausstats/abs@.nsf/0/A390E2529EC00DFECA25720A0076F6C6?opendocument>.

52 Gabriel et al 2005, *Conceptualising and measuring the housing affordability problem*, p. 23.



However, this approach has been criticised for:

- requiring subjective judgments about essential expenditure;
- suffering from data availability problems; and
- not taking into account the individual nature of housing consumption choices and the resulting variation in outcomes, which may be both financial and non-financial.

## Severity and duration of housing stress

Housing stress indicators have been criticised for providing only a narrow financial measure and failing to consider the consequences of housing consumption for overall household wellbeing. Recent research has found that 45 per cent of households in housing stress regarded themselves as financially 'reasonably comfortable' or 'very comfortable' and concluded that the 30:40 rule could be regarded more correctly as an indicator of household risk of falling into hardship.<sup>53</sup>

The point in time snapshots provided by housing stress measures must also be set against information on the lifetime housing experiences of different household types. Research using the HILDA Survey to track the frequency and duration of individual households' periods in housing stress has found that:

*73 per cent of Australians in [housing affordability stress] will escape by Year 1. This rate of escape declines rather steeply, but only a small minority fail to climb out of spells of housing stress by Year 5.<sup>54</sup>*

This analysis found that private renters and home buyers have similar profiles but identified that some types of households appeared to have persistent and recurring periods in housing stress: low-income households with dependent children; low-income migrants from non-English-speaking backgrounds; and the self-employed.<sup>55</sup> Responses to housing stress problems need to be carefully targeted to households who have difficulty escaping housing stress without specific assistance.

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53 Rowley, S. and Ong, R. 2012 Housing affordability, housing stress and household wellbeing in Australia, AHURI Final Report No.192. Melbourne: Australian Housing and Urban Research Institute p47.

54 Wood, G., Ong, R. and Cigdem, M. 2014 Housing affordability dynamics: new insights from the last decade, AHURI Final Report No.233. Melbourne: Australian Housing and Urban Research Institute p3.

55 Wood, G., Ong, R. and Cigdem, M. (2015) Factors shaping the dynamics of housing affordability in Australia 2001–11, AHURI Final Report No.244. Melbourne: Australian Housing and Urban Research Institute p40.



## Appendix C: Potential government subsidies

Type of subsidy	Level of government	Duration of subsidy
Contribution of land	Commonwealth/States and Territories	One off
Contribution of dwellings	States and Territories	One off
Zoning or planning changes allowing densification or change of land use	States and Territories/Local government	One off
Inclusionary zoning	States and Territories/Local government	One off
Stamp duty exemptions	States and Territories	One off
Land Tax exemptions	States and Territories	Ongoing
Cash grants	Commonwealth/States and Territories	Ongoing
Income tax credit/exemption	Commonwealth	Ongoing
Increased depreciation allowance	Commonwealth	Ongoing
Concessional loans	Commonwealth/States and Territories	Ongoing
Government guarantee	Commonwealth/States and Territories	Ongoing
Increase to rent assistance	Commonwealth/States and Territories	Ongoing

## Appendix D: Commonwealth, State, Territory and local government initiatives

	NSW	Victoria	Queensland	Western Australia	South Australia	Tasmania	ACT	Northern Territory
<b>Housing strategy</b>	<i>Future Directions for Social Housing in NSW</i> ; a 10-year reform programme.	Due for release later in 2016.	Due for release in late 2016. Currently seeking submissions on discussion paper <i>Working together for better housing and sustainable communities</i> .	2010-2020: <i>Opening Doors to Affordable Housing</i> .	<i>Housing Strategy for South Australia</i> 2013-18.	<i>Tasmania's Affordable Housing Strategy</i> 2015-25.	<i>Affordable Housing Action Plan Phase III</i> 2012-onward.	<i>Housing Strategy: Setting the Direction</i> 2016-2021.
<b>Innovative financing</b>	Two social impact bonds (SIBs) delivering out-of-home care: a) Newpin - a 7 year bond has achieved returns of 7.5% and 8.9% in its first and second years, respectively. b) The Benevolent Society Bond - a 5 year bond - return rates have not been made public.	A number of rental housing co-operatives operate throughout Victoria, offering a more inclusive form of community housing to people on low to moderate incomes. The Victorian Government is exploring Social Impact Bonds (SIBs) to trial innovative interventions in complex areas of	Plans to introduce three SIBs to address: a) re-offending b) homelessness c) issues affecting Aboriginal and Torres Strait Islander people.	The Housing Authority is engaged in a number of large-scale partnering arrangements with the private sector to deliver low cost and affordable housing through major development and redevelopment projects.	Renewal SA is responsible for regenerating South Australian Housing Trust (SAHT) stock, and aims to increase housing density in the metropolitan areas under the <i>Renewing Our Streets and Suburbs</i> strategy. SIB to deliver intensive support to at least 400 South Australians who have experienced homelessness.			

	NSW	Victoria	Queensland	Western Australia	South Australia	Tasmania	ACT	Northern Territory
<b>Innovative financing</b> (continued)		social disadvantage. As part of the 2016-17 Victorian Budget, \$700,000 was provided to help to deliver market testing and the procurement phases of Victoria's first SIBs.						
<b>Financial assistance for homebuyers on low-to-moderate income</b> (continued)		<p>The Victorian Government offers a First Home Owner Grant of \$10,000 to households who purchase new homes valued up to \$750,000.</p> <p>Other exemptions and concessions, including for Principal Place of Residence and Off-the-plan purchases may apply, and a duty exemption applies for purchasers with a family who</p>	<i>Pathways Shared Equity Loan</i> contributes up to 40% of the purchase price to enable a tenant in a government-owned dwelling to buy it.	Deliver at least 3,000 new Keystart low deposit home loans and shared equity loans during 2015-16 and 2016-17. Under Shared equity the Housing Authority retains a percentage of a property (generally 20-30%) enabling an eligible purchaser to acquire the balance with the support of a	HomeStart Finance administers two schemes to provide finance for homebuyers in low/moderate income and key worker households: <ol style="list-style-type: none"> <li>1. Breakthrough shared equity loans contribute up to 30 per cent more than the standard HomeStart loan of the purchase price of a property,</li> </ol>	\$2.8m for the HomeShare shared equity loan programme, which contributes up to 30 per cent (price limits apply) of the purchase price of an owner-occupied property.	Shared equity including sale of public housing dwellings to eligible tenants, and mechanisms to support eligible lower-income and first time buyers.	<i>Homebuild Access</i> scheme provides access to low deposit or subsidised interest rate loans for either newly constructed homes or vacant land on which to build (purchase price limits apply).

	NSW	Victoria	Queensland	Western Australia	South Australia	Tasmania	ACT	Northern Territory
<b>Financial assistance for homebuyers on low-to-moderate income</b>		purchase property worth not more than \$200,000.		Keystart loan. When the property is sold, proceeds are split between the buyer and Housing Authority according to their equity share.	taking a share in the property in return. <i>The EquityStart home equity loans</i> provide a subsidised loan to existing public housing tenants (in addition to the base Homestart loan).			
<b>Financing incentives to increase supply</b>	Social and Affordable Housing Fund. Phase 1 aims to bridge the funding gap between existing revenue streams and commercially viable projects by paying recurrent subsidy for 25 years to deliver at least 3,000 new social and affordable dwellings.			Attract \$500m of private capital into affordable housing by 2020.		\$2m for CHPs to leverage transferred dwellings to finance up to 150 new houses. \$5m for private developer social housing grants.		

	Commonwealth	NSW	Victoria	Queensland	Western Australia	South Australia	TAS	ACT	Northern Territory
<b>Initiatives aimed at increasing supply</b>	<p>The Building Better Regional Cities (BBRC) programme aimed to increase the supply of affordable dwellings for sale and rent in regional cities. The BBRC provided \$106.3 million for 15 projects and is expected to deliver 2,392 affordable dwellings. 14 of the projects have an agreement end date of 30 June 2016, with the remaining project having an end date of 1 December 2018.</p> <p>The Housing Affordability Fund (HAF) programme provided \$396.2 million over five years to 30 June 2013 for infrastructure and reform projects, to help reduce the cost of new homes for home buyers and increase housing supply. The programme is expected to bring forward almost 26,000 dwellings. The last HAF project is expected to be completed by 31 December 2018.</p>	<p>Communities Plus is an estate renewal program will deliver up to 23,000 new and replacement social housing dwellings.</p> <p>Ensure large scale redevelopment target of 70:30 private (including affordable housing) to social housing.</p>		<p>An additional 10,000 affordable housing dwellings by 2031.</p> <p>Ensure 15% of new dwellings developed on large areas of surplus state land are available as social or affordable housing.</p>	<p>30,000 new affordable homes between 2010 and 2020.</p> <p>Housing and its partners to deliver approx. 4,500 lots across 2015-16 and 2016-17, with at least 70% below the median land price.</p> <p>Housing to produce an additional 3,000 entry-level dwellings for sale and rent during 2015-16 and 2016-17, including 1,000 new social housing dwellings under the \$560m Social Housing Investment Package.</p> <p>Minimum 15% affordable housing quota on government land and housing developments.</p>	<p><i>One Thousand Homes in 1000 days</i> – 1000 new SA Housing Trust homes to be built on existing public land</p> <p>At least 15% of new dwellings should be affordable housing, of which 5% is specifically for high needs.</p>		<p>The Government is reviewing its landholdings and properties to determine those which could be transferred to the community housing sector to deliver more affordable rental properties to eligible tenants.</p>	<p>Reducing lot sizes to improve affordability</p> <p>Processing rezoning applications and development approvals simultaneously.</p>



## Appendix E: International approaches

There are several OECD countries where the financing mechanisms discussed in the Affordable Housing Working Group Issues Paper operate successfully. In examining these international examples, it is important to note that while some have achieved moderate success, each housing market has its own conditions and operating environments which may not be directly applicable to the Australian housing market.

### Housing loans/bond aggregators

Housing loans/bond aggregators provide a vehicle to aggregate debt financing and allow housing providers to combine their finance requirements to obtain funding from the wholesale market at a cheaper price than would be available to them individually.

**Table 5: Housing loans/bond aggregators**

**UNITED KINGDOM**  
*The Housing Finance Corporation (THFC)*

THFC is a not-for-profit funding aggregator that operates at arms-length from the United Kingdom (UK) Government. It was established in 1987 to pool the borrowing demands of smaller housing associations and raise long-term (25 to 30 years) debt finance from pension and annuity funds at competitive rates (1-2 per cent above UK treasury bonds).

THFC acts as an aggregating financial intermediary, diversifying risk for those private investors which fund housing associations and providing standardised loan terms to regulated housing associations for the purpose of repairs to existing stock and regeneration activities as well as new housing developments. It funds itself through the issuance of bonds to private investors and by borrowing from banks.

THFC lends to 152 registered housing associations across the UK and in 2013 had a lending loan book of £3.4 billion. By 2016 this had increased to £4.4 billion.

The UK Government operated a Housing Guarantee Scheme which provided housing associations (and other private registered affordable housing providers) a government guarantee of up to 30 years on debt they raised, to deliver additional newly-built affordable homes. In 2013 the UK Government licensed THFC to issue government-backed guarantees for loans to the value of £3.5 billion. Although this right ends in 2016, it has been extended.

The UK housing system is strongly underpinned by subordinated grants and rent assistance paid directly to landlords as well as sector regulation and secured financing.

**AUSTRIA**  
*Housing Construction Convertible Bonds (HCCBs)*

The HCCBs Scheme has been in operation in Austria since 1993. HCCBs provide lower cost funds with commercial loans with 20-30 years maturity at 0.3 per cent above the Euribor rate (the Euro Interbank Offered Rates' are based on the average interest rates at which a large panel of European banks borrow funds from one another), at either a fixed or variable interest rate.

HCCBs are issued by housing construction banks and receive income tax relief for the first 4 per cent of returns. The sale of these bonds channels investment into new affordable housing at favourable interest rates. The model operates by using tax incentives, such as partial exemptions from capital gains tax and income tax, for purchasers of HCCBs.

Funds raised through the issuance of a HCCB must be used in Austria-based social construction projects with a three year timeframe. HCCBs are directed at private investors and, in 2012, they accounted for approximately 40 per cent of finance for new affordable rental construction in Austria. This is largely attributed to the bonds' low risk profile and tax privileges.

The housing banks that can issue bonds also have preferential underwriting criteria allowing them to operate with lower transaction costs. HCCBs provide a yield that is 1 per cent lower than capital market bonds and, when combined with the tax advantages, the bond offers a long-term, low-risk, ethical form of investment.



**Table 5: Housing loans/bond aggregators (continued)**

<b>AUSTRIA</b> <i>Housing Construction Convertible Bonds (HCCBs)</i> (continued)	<p>There is no government guarantee for HCCBs; instead they are backed by public loans and grants. Additionally, the sound financial position and robust regulation of the limited profit sector gives comfort to investors.</p> <p>Through the global financial crisis, Austria's housing production continued uninterrupted at pre-GFC annual levels thanks to this underpinning of a robust affordable housing finance system based on consistent government co-investment. Its residential construction sector, therefore, required no special stimulus.</p>
<b>SWITZERLAND</b> <i>Bond Issuing Cooperative (Emissionzentrale für Gemeinnützige Wohnbauträger, EGW)</i>	<p>EGW was established in 1991 by the Federal Housing Office and the Swiss not-for-profit housing sector as a mechanism to allow investors to subscribe to a special-purpose housing bond, covered by a government guarantee. It was introduced to help facilitate the construction of affordable rental housing in an unfavourable mortgage market due to a recession.</p> <p>The Swiss Government secures capital from the market and EGW pools the borrowing demands of its members and meets these by issuing 5 to 15 year fixed bonds covered by a federal joint guarantee. Funds are only available to housing cooperatives that are members of the EGW.</p> <p>This system allows smaller builders access to long-term, low cost finance from pension funds for affordable rental housing at typically 1-1.5 per cent below comparable market rates and just above Swiss Government Bonds.</p> <p>As at December 2013, the EGW had issued CHF 4.7 billion (\$6.49 billion AUD) in a series of 66 bonds and placements. EGW bonds are highly sought after, with 99 per cent of bonds issued purchased by pension and insurance funds. Since 2003 the bonds have been rated AAA and they have recorded no repayment defaults.</p>
<b>UNITED STATES</b> <i>Multi-family Housing Revenue Bonds (MFHRBs)</i>	<p>MFHRBs are issued by state and local governments to not-for-profit and for-profit developers to finance construction or rehabilitation of multi-family housing projects where a specified proportion of the units will be rented to moderate- and low-income families. State and local governments sell tax-exempt MFHRBs and use the proceeds to finance low-cost mortgages for lower income first-time homebuyers or the production of apartments at rents affordable to low-income families.</p> <p>These bonds may provide financing either directly or through a loans-to-lenders programme, and may be secured, in whole or in part, by federal agency guarantees or subsidies.</p> <p>Each state's annual issuance of MFHRBs is capped; in 2013 the limit was \$95 multiplied by the state population with a state minimum of USD \$291.87 million.</p> <p>Federal Government regulations require that developers and/or sponsors who utilise MFHRB financing, which is funded through the sale of tax exempt private activity bonds set aside at least 20 per cent of their units for individuals or families earning at or below 50 per cent of the area median income, or at least 40 per cent of their apartments for families with incomes of 60 per cent of the area's median income, adjusted for family size.</p>



## Housing Trusts

Housing trusts allow for housing assets to be aggregated at an individual state or territory level, across several states and territories, or nationally. The trust structure also provides a vehicle for the access to equity and debt investment at scale.

**Table 6: Housing Trusts**

**UNITED KINGDOM**

*Real Estate  
Investment Trusts  
(REITs)*

REITs operate like an investment trust, providing a way for investors to access property assets without having to purchase property directly. The REITs, launched in the UK in 2007, have a tax efficient nature, as 90 per cent of a company's qualifying profits are distributed amongst shareholders through dividends and are exempt from paying Corporation Tax. There has been limited success in encouraging the establishment of social housing REITs due to the limited return that can be generated from social housing assets and availability of other options for investment in the sector.

**FRANCE**

*Fonds de Logement  
Intermediaire (FLI)*

FLI was established by the Société Nationale Immobilière (France's largest social housing provider which is a subsidiary of the French financial intermediary) in July 2014 to facilitate a return for investors of new-built residential housing.

FLI provides financing for the building of new, controlled-rent housing, mainly in the Paris region and some of the larger French cities, where there is shortage of housing for middle-income households.

Since its implementation in 2014, the fund had garnered commitments for a total of €515 million in equity, giving it an investment capacity of €860 million making it one of the five biggest unlisted housing funds in Europe.

**UNITED STATES**

*Community  
Development Trust  
(CDT)*

CDT, established in 1999, is the largest, private, affordable housing REIT in the United States (US), with loans and investments in 41 states. Based in New York City, CDT has a mission to provide long-term capital in the form of debt and equity investments to support the development and preservation of affordable multi-family housing in the United States.

CDT is a national direct lender and secondary market purchaser of permanent mortgages that support the development and preservation of affordable multi-family communities. It makes long-term equity investments and originates and acquires long-term mortgages. Since its creation, CDT has invested over \$1 billion in debt and equity capital to properties in 42 states and regions across the US – which in turn has helped to create housing for around 35,000 families.



## Housing Co-operatives

Housing co-operatives are not-for-profit legal associations formed for the purpose of providing a housing product for members, and are usually owned and controlled by members. They seek to blend the provision of affordable housing with direct member participation and, depending on the model, shared equity. Many housing co-operatives are organised and managed on principles of participatory democracy and a common purpose.

**Table 7: Housing Co-operatives**

**EUROPEAN UNION**  
*Housing Europe: The European Federation of Public, Cooperative and Social Housing*

Housing Europe: the European Federation of Public, Cooperative and Social Housing (Housing Europe) is a not-for-profit, federation of public and co-operative housing providers established in 1988. Housing Europe operates in 23 countries, with 43 national and regional federations of housing providers, totalling around 43,000 housing providers.

Housing Europe aims to provide access to decent and affordable housing, in communities which are socially, economically and environmentally sustainable. Housing Europe's members provide services ranging from domiciliary care and support for residents with specific needs to urban development and urban regeneration.

On 5 May 2015, Housing Europe published its report State of Housing in the EU which compiled data from all member states and considered the latest housing trends in a cross-country observation and the most significant policy updates in those countries since 2012.

The report discussed several key findings, including that a large number of households are overburdened by housing costs, especially in crisis-ridden countries such as Greece; and that the majority of people aged 18-34 live with their parents due to an inaccessible housing market: in Italy 66 per cent, in Portugal 58 per cent, in Spain 55 per cent, and in Slovakia 74 per cent.

In 2016, Housing Europe is advocating for a Community Land Trust model to be implemented in Europe, as well working with Cooperatives Europe to modernise the co-operative housing image.



## Impact Investing Models

Impact Investing Models, including Social Impact Bonds (SIBs), work as a tool for governments and service providers to creatively explore improving both social outcomes and the economic efficiency of investments. These types of models allow investors to pursue opportunities that provide both social and financing returns through either direct investment in not-for-profit or social enterprises, or through alternative intermediaries and social impact bonds.

SIBs involve the public sector issuing a contract with non-government providers, in which a commitment is made to pay for improved social outcomes resulting in public sector savings. Social investors provide funding in exchange for services provided; when outcomes are achieved investors receive payments for their initial investment plus a return. SIBs are usually designed as interventions to improve specific social outcomes. They are more applicable as secondary or complementary measures, rather than as a primary response to housing affordability.

**Table 8: Social Impact Bonds**

<p><b>UNITED KINGDOM</b> <i>London</i> <i>Homelessness Social Impact Bonds (SIBs)</i></p>	<p>The London Homelessness SIB was launched in 2012, for a period of 3 years, with a named and fixed cohort of 831 entrenched rough sleepers. Using a personalised, flexible approach the programme aimed to help that cohort achieve long-term and sustainable housing outcomes.</p> <p>The SIB tailored personal recovery pathways that lead to sustained outcomes by supporting the fixed cohort through the use of existing provision. St Mungo’s Broadway and Thames Reach each targeted half of the cohort using different structures to fund the SIB. St Mungo’s Broadway established a Special Purpose Vehicle which held all of the risk; Thames Reach funded their intervention through social investors’ unsecured loans, thereby sharing the risk. Both providers invested their own equity.</p> <p>Both providers commenced by using a Navigator model which has a budget to support the personalised approach, whereby a key worker supports the client from an individualised assessment through the network of provision necessary to address their support needs. However, both providers modified this model to reflect the needs of their cohort and the structure of their organisation.</p> <p>Currently, the UK Department for Communities and Local Government is undertaking an economic and impact evaluation, building on the two interim qualitative evaluations undertaken in 2015. According to the interim report both the providers and investors noted the SIBs’ success in terms of outcomes and return on investment.</p> <p>The SIB was small scale and initial findings have acknowledged that this may not produce net cost savings within the 3 year period. However, this SIB did demonstrate that this cohort of entrenched rough sleepers could have improved outcomes.</p>
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# Appendix F: Models suggested through other relevant processes

## Senate Inquiry into Affordable Housing

On 12 December 2013, the Senate referred an inquiry into affordable housing to the Senate Economics References Committee (the Committee). The Committee received 231 submissions from a range of stakeholders including state, territory and local governments, academics, community housing providers, banks, builders, real estate agents and the wider community, and held eight public hearings. The Committee presented its final report, 'Out of reach? The Australian housing affordability challenge' to the Senate on 8 May 2015.

A number of submissions to the Senate Inquiry into Affordable Housing highlighted models or mechanisms currently used, or that could be used, to finance affordable rental housing. These included housing bonds, a financial intermediary to help finance affordable rental housing, and housing trusts.

**St George Community Housing (SGCH)** – noted extensive research the Australian Housing and Urban Research Institute (AHURI) had undertaken in conjunction with private sector financiers on the possible application of housing supply bonds in Australia. SGCH highlighted the Commonwealth Government would be needed to establish the legislative framework required to implement housing bonds as well provide initial funding for a pilot project.<sup>56</sup>

**The City of Boroondara** - referenced research undertaken by AHURI, which included research on international use of housing bonds. Their submission in particular noted AHURI's 2012 Housing Supply Bonds proposal that was an adaptation of the Austrian Housing Construction Convertible Bond.<sup>57</sup>

**AHURI** – noted Austrian Housing Construction Convertible Bonds had 'been found to be popular among risk averse investors; an efficient scheme for capturing long-term savings; and, given the modest tax incentive, very cost effective'.<sup>58</sup>

**Dr Julie Lawson and Professor Mike Berry (Centre for Urban Research, RMIT University)** – noted the Housing Supply Bonds Model (HSB) proposal that was developed by AHURI in conjunction with industry specialists in Australia and Europe in 2012. This proposal considered three housing supply bond instruments:

- Public bond issues (National Affordable Housing Agreement (NAHA) Growth Bonds) to provide equity via condition revolving public loans (long-term loan asset attracting low or zero interest). The annual cost to government was calculated as \$35 million (\$700 million in each tranche x 10% x 5%), assuming borrowing cost for government is 5%.

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<sup>56</sup> St George Community Housing, Submission no.176 to Senate Inquiry into Affordable Housing (Senate Inquiry).

<sup>57</sup> City of Boroondara, Submission no.69 to Senate Inquiry, pp.15-17.

<sup>58</sup> AHURI, Submission no.93 to Senate Inquiry, p.29.



- A tax incentive (for example, 6% tax free coupon) on mezzanine investment in social housing rental bonds (Tax Smart Housing Supply Bonds). The calculated annual cost to government is \$33.6 million ( $\$7 \text{ billion} \times 20\% \times 6\% \times 40\%$ ). This is \$336 million over 10 years for each tranche. This assumes tax free 6% coupon rate and that it is the amount of tax foregone by making coupon tax free. It also assumes 20% of funds raised through Tax Smart bonds, and 40% tax rate as hybrid of corporate and personal tax rates.
- AAA+ guarantee on bonds linked to senior loans in approved co-financed projects (supported by NAHA growth bonds). Cost to government calculated to be \$24.5 million each year for 10 years for each \$7 billion tranche issued. It assumes a 0.5% default rate (based on UK settings).<sup>59</sup>

Dr Lawson and Professor Berry proposed adapting the Swiss housing supply bonds model and the United Kingdom's approaches to financial intermediaries to create an Austrian Housing Finance Corporation (Corporation) type entity for the Australian context. Their submission highlighted a number of implementation requirements around governance and costings. For example, they suggested that to achieve an entity that held 10,000 dwellings, worth \$3 billion, the cost to government would be \$553.5 million over 10 years.

**Dr Lawson and Professor Berry** noted a Corporation model:

- was 'simpler than the HSB approach';<sup>60</sup>
- was 'grounded in extensive national research of industry stakeholders and successful international experience';<sup>61</sup> and
- would also provide lower cost finance to housing providers and when properly structured and managed, would reduce levels of probability for a government guarantee being called upon.<sup>62</sup>

**BIS Shrapnel** - identified two housing bond models that it considered would have the capacity to generate large volume private investment in Australia and which would be simple and flexible to implement.

- BIS Shrapnel noted the Guaranteed Housing Bonds (GHB) where governments raise finance for affordable housing through the issue of a housing bond with a guaranteed after-tax return for investors. The funds raised under the GHB model are loaned to housing authorities, developers, or other eligible providers at competitive rates, on the condition that the monies are used to construct affordable rental dwellings. The dwellings are then owned and managed by the approved providers. The risk guarantee takes the form of a tax concession or a budget outlay.
- BIS Shrapnel noted the GHB model has similarities to the Essential Function Bonds used by housing authorities in the United States to finance the construction of affordable housing.<sup>63</sup>

**Victorian Public Tenants Association** - stated that a housing trust established by the federal government could enable investment into affordable housing by large private sector investors including superannuation funds.<sup>64</sup>

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59 Dr Julie Lawson and Professor Mike Berry RMIT University, Submission no.24 to Senate Inquiry, pp.19-21.

60 Dr Julie Lawson and Professor Mike Berry, op.cit., pp.22.

61 Ibid, pp.27.

62 Ibid, pp.23-28.

63 BIS Shrapnel, Submission no.16 to Senate Inquiry, pp.6-7.

64 The Victorian Public Tenants Association, Submission no.40 to Senate Inquiry.



**Saul Eslake (former chief economist at ANZ bank)** –noted financing loans, grants or tax concessions to developers to encourage more affordable housing being built in housing developments.<sup>65</sup>

**Youth Affairs Council of Western Australia** – noted protected pooled savings, which are used to secure a flow of affordable credit for affordable housing outcomes (used in France), guaranteed housing association loans (the Netherlands), tax incentives to investors of special purpose bonds (Austria), and low-income housing tax credits (United States).<sup>66</sup>

**Sean Reynolds (housing affordability commentator)** – discussed community land trusts (such as those used the United States) where governments retain ownership of land, but make it available to not-for-profit providers for affordable housing purposes.<sup>67</sup>

## House of Representatives Inquiry into Home Ownership

On 13 May 2015, the House of Representatives Economics Committee announced it would conduct an inquiry into home ownership.

While not focussed on affordable housing, a number of submissions highlighted ways to finance affordable housing. The Australian Bankers Association (ABA) suggested that housing supply bonds could channel investment into the community housing sector and enhance the investment proposition for private investors. The ABA also recommended government and the banking industry look for alternative models of attracting institutional investment.<sup>68</sup>

Dr Judith Yates (Honorary Associate in the School of Economics at the University of Sydney) identified the establishment of a housing finance corporation to give community land trusts or community housing provider’s access to cost-effective finance. This proposal has an element of a government guarantee or other form of credit enhancement, which might be fulfilled by requiring mainstream lenders or institutional investors (such as superannuation funds) to commit to social investment.<sup>69</sup>

The use of social impact bonds as a means of financing community services or to achieve a variety of social outcomes was identified by a number of submissions; however, none elaborated how these types of bonds could finance large-scale investment in affordable housing.

This inquiry lapsed when the Standing Committee on Economics ceased to exist at the dissolution of the Senate and the House of Representatives on Monday 9 May 2016.

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65 Saul Eslake, Submission no.2 to Senate Inquiry, p.15.

66 Youth Affairs Council of Western Australia, Submission no.166 to Senate Inquiry, p.6.

67 Sean Reynolds, Submission no.61 to Senate Inquiry.

68 The Australian Bankers Association, Submission to House of Representatives Inquiry into Home Ownership, Submission no.14, pp.18-19.

69 Judith Yates, Submission to House of Representatives Inquiry into Home Ownership, Submission no.3, p.13.



## Appendix G: List of contributors to public submissions

- ACT Government
- Anglicare Australia
- Australian Council of Social Service
- Australian Housing and Urban Research Institute
- Australian Unity
- BlueCHP Limited
- Bullock, Ms Emily
- Business Council of Co-operatives and Mutuals
- Cbus
- Centre for Urban Research RMIT
- Christian Super
- Churches Housing and Baptist Care Australia
- City Future Research Centre
- City of Sydney
- City of Whittlesea
- City of Yarra
- Clean Energy Finance Corporation
- Coffs Property Estate Agents
- Community Housing Industry Association
- Compass Housing
- Consumer Action Law Centre
- Corrs Chambers Westgarth Lawyers
- Council of Capital City Lord Mayors
- Equity Rights Alliance
- First State Super, Per Capita and CFS Financial Services Knowledge Hub
- Frankston Peninsula Carers
- Future Asset Services
- G21 - Geelong Regional Alliance
- Good Shepherd Microfinance
- Grace Mutual Limited
- HillPDA Consulting
- HomeStart Finance
- Horrocks Consulting
- Impact Investing Australia
- Industry Super Australia
- Launch Housing
- Leichhardt Municipal Council
- Master Builders Australia
- Master Builders WA
- Mission Australia Housing
- Moreland City Council
- Muller, Mr Peter
- National Affordable Housing Consortium
- National Affordable Housing Providers
- National Australia Bank
- National Shelter
- NSW Federation of Housing Associations
- Nutting, Mr Mark



- People with Disability (PWD) Australia
- Pillar+Post
- Porter Davis
- PowerHousing Australia
- Property Council of Australia
- Refugee Council of Australia
- Residential Land Lease Alliance
- Senior, Mr Robert
- SGS Economics and Planning
- Social Ventures Australia and Macquarie Group Limited
- Spannenberg, Mr Andrew
- St Kilda Community Housing
- St Vincent de Paul Society
- Summer Foundation
- Tandara Lodge Community Care
- United Housing Co-operative
- Urban Development Institute of Australia
- Urban Taskforce Australia
- Victorian Public Tenants Association
- Westpac Group
- WNC Inc

