

Lessons of Defence Housing Australia for affordable housing provision

DEFENCE HOUSING AUSTRALIA (DHA) OPERATES A SUCCESSFUL MODEL OF LARGE SCALE PRIVATE INVESTMENT IN PROVISION OF RENTAL HOUSING. ITS INNOVATIVE SALES AND LEASEBACK PROGRAM MIGHT BE ADAPTED TO EXPAND AFFORDABLE HOUSING IN AUSTRALIA BUT ONLY IF THERE WAS A GOVERNMENT GUARANTEE TO OFFSET VACANCY AND ARREARS RISKS.

KEY POINTS

- The Defence Housing Australia (DHA) business model integrates a range of functions including housing construction and asset and tenancy management. The sales and leaseback (SLB) program means DHA sells housing to private investors who then lease the property back for DHA to manage. This allows DHA to tap into funding not available to other affordable housing providers.
- In this model, key attributes are asset development and management, robust design guidelines which provide a framework for the acquisition and development of appropriate housing, good governance and regular and high quality reporting as a way of engaging investment.
- There are a number of barriers to the adoption of the DHA model in the affordable housing sector, including provision of a market rent to investors, overcoming stigma relating to affordable housing tenants and the availability of a government guarantee.
- These barriers might be addressed and the DHA model of sales and leaseback adapted to the affordable housing sector, leveraging from National Rental Affordability Scheme (NRAS) investment, assuming investors have assurance relating to rental arrears and vacancies.

*This bulletin is based on research by **Professor Peter Phibbs** and **Dr Bronwyn Hanna** of the AHURI UNSW-UWS Research Centre. The research reviewed the operations of Defence Housing Australia in order to investigate what lessons were available for affordable housing provision in Australia.*

CONTEXT

DHA is a successful model of private investment in the large scale provision of rental housing. In 2009, DHA had a portfolio of over 17 000 dwellings valued at over \$7 billion that were owned by a mix of public, individual and institutional investors. The study sought to understand the business models that have underpinned the success of DHA across the market cycle, the underlying returns to investors that drive private investment in DHA properties and the lessons of this model for the emerging affordable rental housing sector.

RESEARCH METHOD

The study involved a series of interviews with current DHA staff and staff in the affordable housing sector that previously worked for DHA. In addition, a detailed review of historical records dating from its establishment in 1918 was undertaken in order to trace the history and development of current DHA practice. These records included DHA website, annual reports, Hansard and government reports.

KEY FINDINGS

Success factors of the DHA model relevant to affordable housing

1. Sales and leaseback program

A key advantage of the sales and leaseback program is that it enables the DHA to tap into a source of private finance not currently available to other affordable housing producers. The sales and leaseback program attracts risk averse small and medium private rental investors who can take advantage of the fact that DHA provides a rent guarantee and includes a significant maintenance program at the end of the lease. These investors appear to be willing to pay a premium to reduce these risks.

The sales and leaseback program has evolved since operations commenced in 1988 and DHA has been able to build a significant pool of sales and leaseback properties over this period.

2. Efficient asset management

The large scale of the DHA operation has been a critical factor in their success. This has enabled them to drive down average maintenance costs by tendering large maintenance contracts. This scale has also meant they have been able to trade stock to better fit the profile of their tenants. Robust design guidelines around the acquisition and development of appropriate housing have allowed the lessons from previous developments to be applied in future acquisitions and have been instrumental to the success of the DHA operation.

3. Governance and management

Finally, DHA exhibits good practice in terms of governance and management that may provide some useful lessons for affordable housing providers. DHA has a comprehensive governance framework developed as the organisation moved from direct government provision to being a government business enterprise. It also provides high quality and regular reporting about its operations. There is an annual report and comprehensive website, plus detailed reporting on surveys of key stakeholders, investors and tenants. DHA identifies the requirement for good information for all stakeholders as particularly important given that the organisation is convincing investors to participate in its sales and leaseback program.

Addressing barriers to applying a sales and leaseback program in the affordable housing sector

A range of barriers exist including:

- *Reputational*: the disciplined nature of defence personnel (in the eyes of the investor) and the patriotic element of assisting defence personnel provide a marketing opportunity for DHA. 'Keyworker' rhetoric might work just as well in the eyes of investors—helping nurses, policemen, etc., live near their workplace.
- *Financial*: the investor requires a market rent payment, but the affordable housing provider will charge tenants a proportion of market rent.

(usually 74.9% to maintain their tax free status), therefore presenting a high risk of running tenancies at a loss.

- *Risk:* the DHA scheme has the security of being government owned and guaranteeing rent payments, which is not available for other affordable housing providers.

A government guarantee could be used to support a sales and leaseback provision for the affordable housing sector. A guarantee aimed at covering the vacancy and rental arrears risks for affordable housing providers would attract private capital into the lower rent end of the private rental market—a market that traditional private investors often avoid. This guarantee may not necessarily be expensive for government, though it would need further market research to ascertain the size of this guarantee.

POLICY IMPLICATIONS

The current attempts to attract large scale institutional investment into affordable rental housing have highlighted the difficulties of attracting this investment stream into affordable housing products. DHA has developed a sustainable model of sales and leaseback that has created a product that provides advantages for both DHA and small and medium investors. It is possible that a similar sales and leaseback product could provide a sound investment vehicle for affordable housing.

The financial and operational parameters of the DHA model has many features in common with intended directions for affordable housing signalled under recent national and state policies—especially plans to promote private ownership of affordable housing and to encourage larger scale housing

TABLE: OPERATIONS AND FINANCIAL DATA FOR DHA SHOWING SOME KEY BENCHMARKS: 2002–03 TO 2007–08

	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08
EBIT	\$81m	\$74m	\$82m	\$110m	\$109m	\$99m
Annual dividend (inc. tax)	\$67m	\$81m	\$71m	\$77m	\$79m	\$76m
Total managed stock	17,311	16,756	16,824	16,875	17,005	17,393
Acquisitions	539	489	451	460	482	421
Constructions	420	620	520	510	508	658
Leased (not including SLB)	230	1,063	515	343	307	221
Sale of surplus stock (SSS)	573	468	412	327	241	165
Revenue generated from SSS	\$136m	\$111m	\$109m	\$69m	\$68m	\$42m
Sale and leaseback (props) (SLB)	1,061	891	699	844	761	634
Revenue generated from SLB	\$338m	\$323m	\$247m	\$354m	\$316m	\$265m
Contracted maintenance to DHA houses	\$34m	\$32m	\$30m	\$32m	\$34m	\$31m
Maintenance per property (rounded to nearest 50)	1,950	1,900	1,750	1,900	1,950	1,750
Number of relocations	32,256	30,378	30,809	32,130	33,073	34,608
Total staff	779	781	687	689	697	697

managers, with a focus on the potential of the not-for-profit housing sector.

This study suggests this could be supported through known or existing measures. For example the level of subsidy in NRAS of \$9140 per annum in 2010 would mean that affordable housing providers return a small recurrent surplus from houses constructed in low and moderate cost regions.

A full feasibility study of an affordable housing sales and leaseback program (possibly in conjunction with DHA) would support the potential for a pilot study in one state.

Assuming the program is feasible, two options are suggested:

The first is for individual state governments to pursue their own program. This increases the risks for government because the guarantee pool is smaller. However, the recurrent costs of the program are reasonably small. A state government program could be launched with a small number of staff (about 5–10 staff depending on the size of the program) plus a marketing budget of approximately \$200 000.

The second option is a national program, leveraging from the expertise within DHA and expanding its sales and leaseback program into the affordable housing space. This would be possible under the existing Defence Housing Australia Act if investors were in receipt of a government subsidy to provide affordable housing (such as NRAS). The addition of affordable housing investors would provide some portfolio benefits for DHA, with additional dwelling and location choice for potential investors and the reduction of the entry price for investment given the likely focus of the affordable

housing program on smaller dwellings. An additional benefit of combining the programs is that it would also allow access to an existing pool of DHA investors who may be interested in diversifying their portfolios.

FURTHER INFORMATION

This bulletin is based on AHURI project 70575, *Lessons of Defence Housing Australia for affordable housing provision*.

Reports from this project can be found on the AHURI website: www.ahuri.edu.au or by contacting AHURI Limited on +61 3 9660 2300.

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