Private sector finance

Increasing the options for affordable rental housing

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What the evidence tells us

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Objectives

1. To bridge a financing gap and fulfill policy commitments to attract institutional investment to increase the supply of affordable rental housing

2. To design instruments and intermediaries based on sound principles, best practice and appropriate to Australian conditions

3. To provide a clear, feasible strategy for implementation
Why we need investment

1. Size of unmet demand, inadequate supply, market failure
2. Under provision of both private and public investment
3. Limited and short term bank finance
4. Longer horizon investors more suitable landlords
5. Capacity to transform RS
6. Focus on returns from income rather than speculative gains
Current lending conditions

- Increased CHO financial management expertise
- Immature and weak commercial lending
- Shallow and inadequate competition
- Key person risk
- Lengthy negotiations, lack of bank policies
- Very short loan tenures
- Inefficient mismatch with asset life
- Often interest-only, no build up of equity
- Excessive security requirements
- Refinancing risk,
- ... but some CHOs report relations improve with time.
1. Focused literature reviews—international experience in SHGs and role of managed funds (Lawson), Australian policy, debate and practice with GGs (Berry), provider capacity and investor appetite (Hamilton and Pawson)

2. 44 stakeholder interviews in Europe and in Australia (across four states)

3. Intensive finance sector, public and third sector Industry Think Tank (24 participants) facilitated by research team and international experts a, hosted by Australia’s largest super fund b

4. Additional public seminar, National Housing Conference, with over 800 attendees, further contribution to public debate via quality media, Senate inquiry, professional journals.

5. Peer review and online publication

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a EGW, Swiss Bond Issuing Co-operative with GG and the Housing Finance Corporation with GG (UK)

b Australian Super
Review
Why governments use guarantees

1. Market failure causing undersupply
2. Shrinking government budgets, increased reliance on private investment
3. New asset class hence need to increase investor comfort
4. Reduce cost, increase leverage and broaden access
5. Speed up provision of necessary infrastructure at minimal government cost
6. Improve terms thereby maximise benefit of any government subsidy
7. Growing importance post GFC
<table>
<thead>
<tr>
<th>Guarantee scheme</th>
<th>Intermediary</th>
<th>Targeted</th>
<th>Financial impact</th>
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<tbody>
<tr>
<td>Dutch Guarantee Fund Social Housing</td>
<td>Yes Independent foundation</td>
<td>Yes New and renovated nominated rental housing, low to middle income, registered and monitored providers</td>
<td>100–150 BP below going market rates for similar mortgages</td>
</tr>
<tr>
<td>Swiss Bond Issuing Cooperative for Limited Profit Housing</td>
<td>Yes Cooperative owned by sector</td>
<td>Yes New and renovated cost rental housing, low to middle income, compliant with Charter and government standards monitored providers</td>
<td>Competes to bring down commercial costs. Very small margin above low government borrowing costs</td>
</tr>
<tr>
<td>UK Affordable and Private Rented Housing Guarantee Schemes</td>
<td>Yes THFC non-profit corporation, licenced guarantor</td>
<td>Yes Newly completed below market rental or ownership housing, low to middle income, registered and monitored providers</td>
<td>Provides 30 year loans at small margin above government borrowing costs</td>
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<tr>
<td>French Mutual Fund for Guarantees of Social Housing</td>
<td>Yes Publicly owned and administered</td>
<td>Yes New and renovated nominated rental housing, low to middle income, registered and monitored providers</td>
<td>Market only exists with guarantee</td>
</tr>
<tr>
<td>Irish Housing Finance Agency</td>
<td>Yes Publicly owned company</td>
<td>Yes New and renovated income related rental and ownership housing, low to middle income, registered and monitored providers</td>
<td>Very limited market without guarantee</td>
</tr>
<tr>
<td>Scottish Government’s National Housing Trust</td>
<td>Yes Publicly owned trust</td>
<td>Yes Newly completed near market rental housing, low to middle income, managed by registered and monitored providers</td>
<td>NA</td>
</tr>
<tr>
<td>US Risk Sharing Scheme between Housing Finance Authorities and HUD</td>
<td>Yes Various publicly owned corporations</td>
<td>Yes Rental or ownership housing, low to middle income, registered and monitored providers</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: Lawson (2013)
Findings and implications
What’s important

1. Agreed principles, long term mandate, facility agreement
2. Strategies to lower the risk of investment and avoid any potential call on the guarantee
3. Informing investors and marketing guaranteed bonds
4. The importance of an expert financial intermediary
5. Pooling for scale, investment pipeline and predictable bond issues
6. Appropriate structure to share the risks amongst those able to manage them
7. A well-managed guarantee has little or no implications for government budgets
Towards a more efficient and effective investment pathway

- Reform current financing mechanisms
- Boost economic productivity, stability, competitiveness
- Bridge the financial demands of investors and housing providers
- Efficient use of limited public resources
- Enhance national cohesion and social inclusion
- Address a clear and unmet need
- Strengthen preferred suppliers
The potential of managed funds

- Large and growing
- Key players in developing bond markets
- Fixed income increasingly important as policy holders enter pension phase
- Interest from major funds in Housing Bonds
Infrastructure agenda

- Demand for long term investment
- Role of pension funds
- Their concerns and requirements
- Addressing these issues in the design of housing bonds
Australian guarantees - policy and practice

- Policy—*Guidelines for issuing and managing indemnities, guarantees, warrantees and letters of comfort*.

- Accounting treatment—identify risks, determine rights and obligations, risk factors, potential exposure, probability, likely loss

- Practice—4 case studies

- What can we learn from this?
Cost of dwelling: $300,000

Financed by:
- Grant (10%) $30,000
- No-interest loan (20%) $60,000
- 10-year Bond loan (70%) $210,000

Assumptions:
- Interest foregone at 4% p.a.
- Default rate on guaranteed bonds = 0.5% (in line with international experience)
- Default on no-interest loan = 0.5%

Cost to Government:
- $30,000 + interest foregone on loan = $2,400 p.a. for 10 years
- + $1,050 expected bond default
- + $300 expected no-interest loan default
- = $55,350 over ten years (= $50,816 present value at 4% social discount rate)
High level design principles

1. Boundaries
2. Lowering risk
3. Transparency and commitment
4. Expert intermediation
5. Scale and frequency of issues
6. Adequate structure of guarantee
Preferred model

1. Simple and transparent
2. Harmonised Regulatory Systems
3. Fits well with existing government subsidy policies, notably CRA and NRAS
4. Leverages the extent to which current sector competencies and strategies are progressing
5. Minimises the impact on government budgets
6. Provides lower cost of finance to providers
7. Likely to maximise the expansion in the stock of affordable rental housing
8. Reduces probability of the government guarantee being called.
9. Draws on the successful experience and expertise of other countries
A strategy for implementation

Creation of AHFC
Establishment of board
Aggregation of demand
Bond issuance

Overarching agreement
Market scan
Reserve funds
Conclusion

1. New funding pathway, draws on success and adapted to context
2. Overcomes barriers—scale, simplicity, risk weighted return
3. Bridges the gap between investment needs and risk return demands of growing super funds
4. Provides independent and specialist intermediation
5. Well structured guarantee strengthens model to establish a robust market improved terms and conditions, while protecting government from risk
Take home message

1. Government leadership required to close the ‘virtuous circle’
2. Properly structured and managed a guarantee is a highly cost efficient lever to achieve key policy outcomes
3. A financial intermediary is essential to establish a robust market and offer specialist credit assessment for the sector
Further information

For all published reports, presentations, articles and related media coverage go to:

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Thank you