

Developing an investment pathway for social housing

Based on AHURI Final Report No. 306:
Social housing as infrastructure: an investment pathway



Australian Housing
and Urban Research Institute

What this research is about

This research informs the development of an investment pathway from the perspective of needs-based social infrastructure. Demographic modelling quantifies the current need for social housing across Australia over the next 20 years. Multi-criteria evaluation and financial modelling compares five investment scenarios involving a range of debt, efficient financing and capital grant strategies and assesses their relative cost to government.

The context of this research

Urban development, and the social and economic opportunities it provides, is underpinned by investment in infrastructure. To meet the needs of a growing population, this entails investment not only in transport infrastructure, but many other beneficial assets such as parks, schools, hospitals and social housing. How social infrastructure is delivered depends on our willingness and capacity to fund it—including secure affordable accommodation for low-income households—to ensure more inclusive and sustainable living environments for the future.

Key findings

Social housing requires an ‘infrastructure investment pathway’

An investment pathway is required which supplies and maintains social housing assets and services over time commensurate with need and in the right locations. Both funding and

financing play an integral role in this pathway.

‘Funding’ describes the resources allocated by governments and the community to cover capital investment and operating costs.

‘Financing’ describes the instruments or arrangements which allows these funding costs, especially high up front capital costs, to be spread over time as government surpluses and service charges allow.

Financing ultimately requires funding and is not a replacement for it. Experience in the UK strongly suggests that some ‘innovative’ private financing schemes can be costly and complex for both governments and service users. This research provides a framework and evidence to assess alternatives under Australian market conditions and on a more transparent basis.

Overview of social housing funding

International experience shows that productive social housing systems can create value, address a range of needs and promote innovation. They use a

combination of urban planning, direct investment and financial instruments to make best use of land resources; drive innovation in construction; and importantly, reduce financing costs. Productive social housing systems also employ a balanced range of demand and supply subsidies to maximise their social and economic outcomes befitting their purpose.

“International experience shows that productive social housing systems can create value, address a range of needs and promote innovation.”

Until recently, there has been a shift away from direct investment in social housing towards investment in private rental housing and rent subsidies, resulting in increasing cost to the public purse and declining amounts of social housing. Greater transparency is required to inform the most effective

future investment pathway appropriate to Australian housing market conditions.

Social housing need in Australia

Over the next 20 years, the research estimates that 727,300 additional social dwellings will be required (nearly three times of the 2016 size of just over 380,000 dwellings), which implies an annual average growth of 5.5 per cent over the existing stock. The procurement costs (including construction and land costs) for a social housing unit range between \$146,000 (in South Australia) and \$614,000 (in Greater Sydney) with the average cost being around \$262,000. This cost variation is a function of both land values in different markets, and different building types and construction costs in different regions.

Funding gap

In Australia, the funding gap between the cost of providing housing stock and the income received from aging and low-income tenants has been met by strategies including delayed maintenance, reduced renovation and very little new construction.

Consequently, supply and maintenance backlogs have grown over the last twenty years. In the context of worsening affordability for low-income households outside the social housing system, this has meant growing waiting lists and intensified reliance on the private rental sector and Commonwealth Rent Assistance (CRA)

All social housing systems involve some form of subsidy, either on the supply side in the production of

dwellings or the demand side via rent allowances. Public subsidies and regulation remain vital to ensure social housing is available, affordable and accessible to low-income and vulnerable households, especially in high pressure housing and employment markets.

The funding gap demonstrates there is very limited capacity for social housing dwellings to carry debt, even after Commonwealth Rent Assistance (CRA) payments are taken into account. Modelling indicates that the average total amount of debt that each dwelling can support (as paid for by income from CRA and rents from low-income tenants over a 20 year timeframe) is approximately \$70,000 Net Present Value (NPV). When compared with the \$262,000 average cost of development per dwelling, this means 73 per cent of

Table 1: Summary current and projected housing need estimates (2016–2036)

Section of Australia	Social housing share		Manifest need		Evident need		Total need 2016–2036
	Current (met)	Projected to 2036	Current	Projected to 2036	Current	Projected to 2036	
Greater Sydney	85,400	31,600	11,600	4,300	67,900	25,200	140,600
Rest of NSW	48,300	7,300	3,500	500	52,800	8,000	72,100
Greater Melbourne	46,500	20,600	8,200	3,600	65,900	29,200	127,500
Rest of VIC	21,100	4,100	1,700	300	27,000	5,300	38,500
Greater Brisbane	32,300	15,400	3,700	1,800	39,400	18,800	79,200
Rest of QLD	35,300	14,100	5,000	2,000	53,400	21,300	95,700
Greater Perth	24,500	17,000	2,100	1,500	28,200	19,600	68,300
Rest of WA	14,900	6,200	1,500	600	7,000	2,900	18,200
Greater Adelaide	33,800	8,500	1,900	500	23,700	5,900	40,400
Rest of SA	9,700	900	600	100	7,200	700	9,500
Greater Hobart	5,700	1,000	300	100	4,400	800	6,600
Rest of TAS	6,400	600	300	0	6,100	600	7,600
ACT	9,900	4,100	600	300	2,500	1,000	8,500
Greater Darwin	3,100	1,000	700	200	900	300	3,200
Rest of NT	7,700	3,700	4,800	2,300	300	200	11,300
Australia	384,600	136,200	46,600	18,100	386,800	139,700	727,300

the cost of newly developed homes must be underpinned by a subsidy of some kind.

This funding gap varies greatly between different locations, with the modelled annual funding gap per dwelling varying from a low of \$5,000 (NPV) in regional/rural South Australia to a high of \$35,000 (NPV) dwelling in Greater Sydney.

Five investment pathway scenarios

The research modelled five scenarios for the costs of developing and operating required social housing dwellings across a 20-year timeframe using different operating subsidies and capital grants. The annual average reflects the growing size of the program over 20 years to deliver the same proportion of dwellings year on year (i.e. 20K in Y1 and 60K in Y20). Our modelling assumes the housing is provided via a not-for-profit entity, being either public or community managed, and therefore does not include any profit margin within the feasibility assessment.

The most cost efficient funding pathway: the capital grant model

The costs to governments are substantially reduced when public equity in the form of a capital grant is

included in the investment mix and debt raised in the most efficient manner. The most cost-effective scenario 5 combines an up-front capital grant with finance raised from the National Housing Finance Investment Corporation bond aggregator. The Government would pay an average annual subsidy of \$9.0 billion over 20 years, which is less than the \$11.8 billion annual subsidy required through private debt coupled with an operating subsidy. Over the lifetime cost of the first year of house building this represents a A\$1.6 billion or 24% saving to the public purse.

Comparing costs over time: capital grant vs subsidy model

One assumed benefit of an operating subsidy program is to spread government subsidy over a longer period as opposed to a capital grant program which may have a higher up-front cost burden. Figure 1 shows the annual payment liability based on an operating subsidy program (Scenario 1) and a capital grant program (Scenario 3) over a 30-year period.

Thirty years has been used to include the operating subsidy expenditure of dwellings built in year 20 and subsidies for 10 years following.

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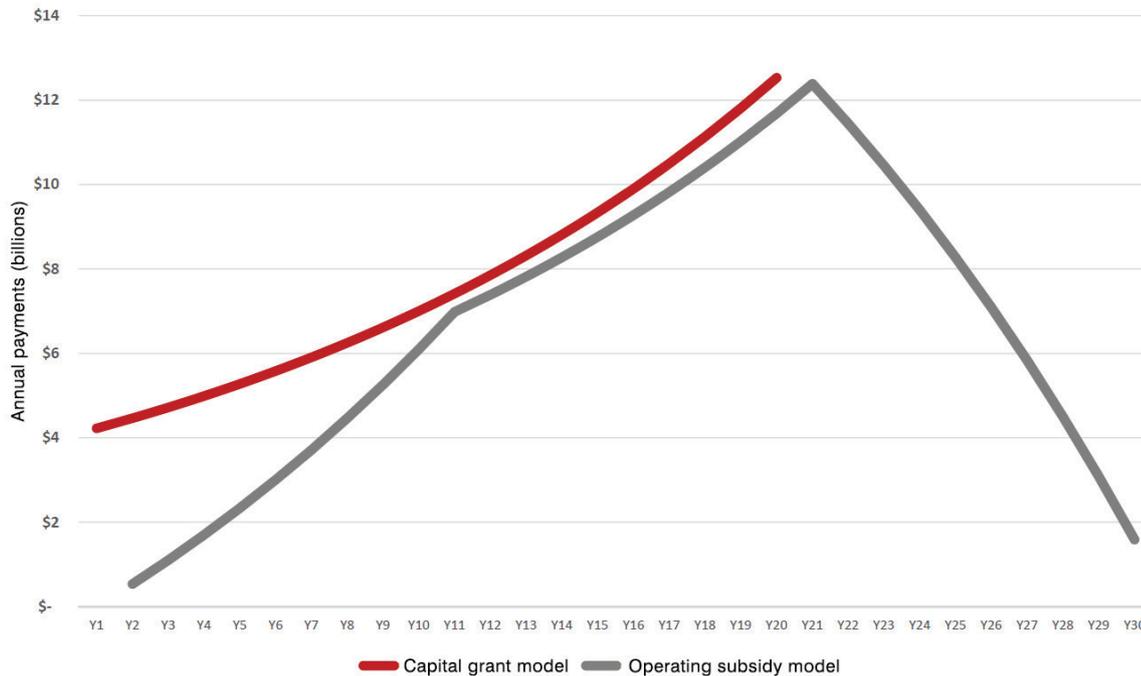
This figure demonstrates that government expenditure on an operating subsidy program may initially be lower, however not over the medium and long term, with any difference marginal by year 10. This is because with each passing year, an operating subsidy program is required to also pay for the previous years' housing development. So by year 10, operating subsidies are paid on 10 years' worth of development. The real disadvantage of this model comes at the end of year 20, when operating subsidies would still be required to be paid out on dwellings built in the later part of the program, unlike a capital grant model.

Table 2: Investment pathways scenarios for comparison

Scenario	Definition	Government subsidy
1 Operating subsidy	Base case, funding gap is supported by an annual operational subsidy payment that supports paying for finance (where all the required debt is taken out by the provider in the expectation of future subsidy support).	\$11.8b
2 Operating subsidy + National Housing Finance Investment Corporation (NHFIC) bond aggregator	Builds on Scenario 1 but applies an interest rate deduction on private finance of 1.5% which is consistent with estimated impacts of a bond aggregator on the cost of private finance.	\$10.9b
3 Up-front capital grant	As an alternative to private debt, a capital fund invests in developments which reduces the level of required subsidy because it eliminates financing costs.	\$9.86b
4 Up-front capital grant + NHFIC bond aggregator	Introduces an interest rate deduction on the capital grant model similar to that of Scenario 2. This reduces the interest rate of finance from assumed market rate of 5% p.a. to 3.5% p.a.	\$9.56b
5 Up-front capital grant + NHFIC bond aggregator, but with NO CRA	CRA appropriately conceptualised as tenant income and not as a cost in delivering new housing developments. Models the impact of excluding CRA payments from a capital grant model.	\$9.06b

Note: Average annual government subsidy over 20 years

Figure 1: Annual expenditure under capital grant or operating subsidy programs



What this research means for policy makers

While governments tend to favour “financial innovation” options that push costs into the future, capital grant funding is the rational investment pathway to follow. This model produces tangible assets which in turn can deliver key societal objectives—economic productivity, social wellbeing and environmental sustainability—and,

where private financing is modestly used, does not rely on tenant access to CRA.

Debt based approaches will have lower impact on public expenditure only in the short term and will increase to a size commensurate with a capital investment approach within a number of years. In addition, this approach would impact on public finances for a much longer period of time and ultimately at a higher cost

Methodology

This research reviewed extensive national and international literature on infrastructure investment and involved demographic modelling of estimated needs and financial modelling costs and the subsidy required from government. Interviews and industry workshops were also conducted with key international and national experts.

Further information

TO CITE THE AHURI RESEARCH, PLEASE REFER TO:

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