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Housing Policy Unit Manager
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The Treasury
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To the Housing Policy Unit Manager

Re: National Housing Finance and Investment Corporation Consultation

Thank you for the opportunity to make a submission to the consultation for the establishment of the National Housing Finance and Investment Corporation (NHFIC).

The Australian Housing and Urban Research Institute (AHURI) has undertaken a significant body of research on housing supply bonds¹ and housing investment through an intermediary and guarantee scheme² which has informed the Affordable Housing Working Group report, the discussion paper, and associated material.

The purpose of this submission is to highlight AHURI research relevant to the consultation paper's identified issues for consideration.

Section 2: The National Housing Finance and Investment Corporation

The structure of the scheme

AHURI research has indicated that a guarantee scheme should have clear and agreed structure including compliance process, lines of defence against default, expert resources to assess risk and build up reserves and agreed loss sharing arrangements.³

Other AHURI research suggests a change in the governance arrangements around housing, planning and economic development at local scales would facilitate more information sharing and greater understanding of the economic implications of housing.⁴ There is potentially an advantage

¹ Lawson, J., Milligan, V. and Yates, J. (2014) How might bond finance expand affordable housing in Australia? AHURI Research and Policy Bulletin No. 173, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/research-and-policy-bulletins/173>.

² Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014) Enhancing affordable rental housing investment via an intermediary and guarantee, AHURI Final Report No. 220, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/220>.

³ Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*.

⁴ MacLennan, D., Ong, R., Wood, G. (2015) Making connections: housing, productivity and economic development, AHURI Final Report No. 251, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/251>.

if this structure drives policy thinking at a systems level and contributes to a seamless supply of affordable housing.

Governance

International financial intermediaries range from not-for-profit membership cooperatives and stakeholder managed organisations to publicly-owned companies reporting to governments demonstrating a variety of ways to establish the organisation depending on jurisdictional context.⁵ A governing expert Board of Directors would require directors with extensive experience and expertise in financial management and credit assessment along with community housing provider representation.⁶

Resourcing

In terms of the self-funding objective—AHURI research has identified intermediaries based overseas that deliver a dividend to their governments, while others build and hold reserves as risk mitigating funds.⁷ Some collect a guarantee fee which can be used to build up a reserve fund.⁸

Section 3: The National Housing Infrastructure Facility

Complementarity

AHURI research which examines social impact investment argues the introduction of a bond aggregator is important to address “many of the valid concerns of institutional investors which cannot be adequately addressed, making it difficult to attract institutional capital to participate—one of the critical success factors” in developing social impact investment in Australia.⁹

Affordable housing

AHURI research supports the focus on affordable housing including for key workers in cities including options through a combination of planning policy interventions, use of public lands and state-funded housing support initiatives.^{10,11}

⁵ Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*.

⁶ *Ibid*, p 85.

⁷ Lawson, J., Berry, M., Pawson, H. and Hamilton, C. (2014) Enhancing affordable rental housing investment via an intermediary and guarantee, AHURI Research and Policy Bulletin No. 174, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/research-and-policy-bulletins/174>.

⁸ Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*.

⁹ Muir, K. Moran, M., Michaux, F., Findlay, S., Meltzer, A., Mason, C., Ramia, I. and Heaney, R. (2017) The opportunities, risks and possibilities of social impact investment for housing and homelessness, AHURI Final Report No. 288, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/288> , doi:10.18408/ahuri-7110101, p 5.

¹⁰ van den Nouwelant, R., Crommelin, L., Herath, S. and Randolph, B. (2016) Housing affordability, central city economic productivity and the lower income labour market, AHURI Final Report No.261, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/261>.

¹¹ Maclennan, D., Ong, R., Wood, G. (2015). *Op cit*.

Value uplift

Current AHURI research—an inquiry into increasing affordable housing supply—is examining how value uplift can be captured and shared.¹² This research will be released in late 2017.

Section 4: The Affordable Housing Bond Aggregator

Eligibility

AHURI research has contended that one of the roles of the intermediary would be to assess the risks and benefits of applications for borrowing money from individual community housing providers (CHPs).¹³ The proposed limitation to Tier 1 and 2 CHPs registered under the NRSCH would reduce the resources involved in having to assess these organisations themselves. They consider that ‘high calibre and professional expertise in the financial management of not-for-profit organisations is very important, both inside these organisations and those regulating them. This requires adherence to clear and appropriate commercial benchmarks for solvency ratios, interest rate cover and equity to be eligible for any guarantee’.¹⁴

Purpose of loans

The consultation paper suggests that loans might be for funding housing maintenance and turn-key purchases (though not construction finance which is deemed higher risk and for shorter periods). The core aim of housing supply bonds in research undertaken by AHURI was seen to reduce the cost of finance for CHPs and enhance their capacity to increase the supply of affordable housing for example through purchase or development.¹⁵

AHURI research has found that CHPs “raise commercial debt for three reasons: to finance construction, to fund turnkey acquisition, or to refinance existing loans”.¹⁶ The research also notes that “Construction finance is much higher in risk for the lender due to non-completion hazard: the risk of being unable to recoup value from a security asset if a halt in construction delays the generation of rent revenue. Some community housing organisations’ debt facilities covered a construction period for two years, converting to an operating loan upon project completion”.¹⁷

However, participants in an AHURI Investigative Panel reported that construction finance is in general difficult to secure in Australia,¹⁸ and this has driven many CHPs toward purchasing turnkey developments from the open market rather than constructing their own purpose-built housing.¹⁹ The research found that a number of CHPs who had raised construction-period finance noted that significant government funding of development costs had unlocked banks’ willingness to lend. Also, one interviewee noted that the active involvement of government as a party to a tri-partite lending structure was viewed by the lender as critically important. It was seen that banks derive

¹² Gurrán, N., Gilbert, C., Gibb, K., Phibbs P., van den Nouwelant, R. and James, A. (forthcoming 2017) Supporting affordable housing supply: inclusionary planning in new and renewing communities, Australian Housing and Urban Research Institute Limited, Melbourne.

¹³ Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*.

¹⁴ *Ibid*, p 18-19

¹⁵ Lawson, J., Milligan, V. and Yates, J. (2014). *Op cit*.

¹⁶ *Ibid*, p 31.

¹⁷ *Ibid*, p 31

¹⁸ Milligan, V., Yates, J., Wiesel, I. and Pawson, H. (2013) Financing rental housing through institutional investment—Volume 1, AHURI Final Report No. 202, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/202>.

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

comfort from the understanding that the government will intervene to stave off or respond to a borrower default, even if this pledge is explicitly limited to nominating another CHP to step in.²⁰

AHURI research has supported the use of funds to construct new projects (where, for example, not for profit affordable housing providers also have a construction arm). International guarantee schemes target affordable (for low and middle income) new, newly completed and renovated housing for rental or home ownership (see attached Table).²¹

Security for loans

AHURI research has examined two models of intermediaries to fund affordable housing in Australia, the first being the issuing of bonds backed by government guarantee while the other, which was seen as a second best alternative, relies on the issuing of debt using conventional securitisation methods for example, where mortgages are bundled together and sold to other investors, creating a tradeable market that encourages investment. This would then draw on the leadership of the financial sector in securing a large flow of private investment into highly-rated housing bonds. It was found that a guarantee by government is not required in this instance but is replaced by direct equity contributions to the scheme.²²

AHURI research has identified that currently, despite CHPs loans being sized on the cash flow fundamentals of development projects, commercial banks have often required security beyond the subject property:

Typically, project-specific loans are secured by specified assets, and broader lines of credit are secured by broad charges over a company's entire assets (Fixed and Floating Charges—FFCs). However, in the case of community housing lending, all banks have endeavoured to impose FFCs irrespective of the specific nature of some loans. CHOs' efforts to resist such terms have met with mixed success. From the borrower viewpoint, FFCs are undesirable because of the constraints placed on future activities: a CHO would have to obtain bank consent before encumbering any assets in financing subsequent development projects. Several CHOs reported modest success in negotiating down banks' security demands by playing lenders off against one another. Most had, nevertheless, had to pledge assets in addition to those being financed, thus sterilising this part of the balance sheet from underpinning later growth activities. In practice, many borrowers found that the smaller banks have been the most inflexible on insisting on FFCs.²³

This research found that existing bank loans are often lines of credit (not tied to a particular project) or finance linked with a new development. Some CHPs consulted were seeking to refinance other debts to enable expansion so getting better deals on finance could be decisive in enabling growth. The research concludes that the cost and inefficiency of negotiating one-off debt facilities and the unfavourable terms experienced in the sector, underscores the importance of securing a new, more stable, and large-scale source of debt finance for Australia's growing community housing sector to realise its potential to meaningfully supplement the country's inadequate affordable housing supply.²⁴

²⁰ *Ibid*, p 32.

²¹ *Ibid*, p 20.

²² *Ibid*, p 6.

²³ *Ibid*, p36.

²⁴ *Ibid*, p 38.

Bond issuance size

EY suggested \$100 million as a minimum size for bond issuance.²⁵ They also estimate that multiple issues could be done, and suggest that Bond Aggregator (BA) could achieve 30-50 per cent of CHP sector debt over the medium term—and 50-100% CHP participation—this suggests that BA could issue \$300 to \$500 million debt and provide savings for CHPs of \$56million (based on \$400 million over 10 year BA bonds).

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

The AHURI research suggested a lower minimum than EY, of \$50 million—the research found that for adequate rate of return, “in mid-2011, Housing Supply Bonds (HSBs) would have had to yield around 8–9 per cent to attract self-managed retirement funds. Any lower yield would have to be offset by either a tax concession advantage (substantial enough to lift yields to an adequate level of return) or by a high rating, reflecting a low risk. This is why enhancements (e.g. government guarantees or tax incentives) are required to reduce risk and improve HSB yields”.²⁸

Government guarantee

Evidence from AHURI research, in reviewing international guarantee schemes, is that government guarantee would reduce borrowing rate and reduce uncertainty for investors. The research found that “it overcomes many of the barriers to investment in affordable housing by offering investment opportunities at an appropriate scale, simplicity and risk weighted return. It is also attractive to housing providers because of its lower cost. The government guarantee would help establish a robust and competitive investment market”.²⁹

The researchers claim that guarantees have had a minimal impact on government budgets with most sporting a zero default record and a few even provide a return for government. The UK’s THFC has reportedly “harnessed the lowest cost long-term private investment for registered social landlords in the history of private investment in social housing. With the government guarantee, they offered 28 years of credit at 3.76 per cent interest cost, being only 0.37 per cent over the long-term government bond rate. The THFC issue was three times over-subscribed by investors”.³⁰

EY analysis suggests it would reduce borrowing rate by 50 basis points interest rates CHPs would otherwise pay. The AHURI research found that in the Netherlands, the borrowing rate was even greater where the Dutch WSW has reduced interest rates by 1–1.5 per cent below the going equivalent mortgage rate.³¹

²⁵ EY Canberra. (2017). Establishment of an Australian affordable housing bond aggregator. EY Canberra, Canberra.

²⁶ Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*, p 18.

²⁷ *Ibid*.

²⁸ *Ibid*, p 2.

²⁹ Lawson, J., Berry, M., Pawson, H. and Hamilton, C. (2014). *Op cit*.

³⁰ *Ibid*, p 3.

³¹ *Ibid*.

A similar guarantee scheme was proposed in the AHURI report, assuming the intermediary would raise \$7 billion to finance 20 000 dwellings.³² On the basis of what retail and institutional investors required, the bonds were allocated 70 per cent to AAA bonds, 20 per cent to Tax Smart bonds and 10 per cent to NAHA growth bonds. As a result, the average cost of funds available for on-lending to CHPs was 4.7 per cent, considerably lower than the then current costs of around 8.2 per cent (usually required by self-funded retirees). An additional allowance would need to be made for costs incurred by the financial intermediary in raising and distributing these funds.³³

AHURI research suggests that a condition of any guarantee is that the Government would need to give a clear commitment to continuity of funding eligible tenants, for example via CRA, and the term of the guarantee, so that potential investors can be confident of a pipeline of future bond issues. The Corporation could negotiate and sign an overarching agreement with government(s) offering an issue-specific default guarantee on bonds issued by the Agency. The clear commitment to policies and programs ensure a stable operating environment, such as adequate supply incentives and revenue side subsidies.³⁴ The EY modelling assumed no change in present policy settings.

The research also outlined a number of principles for successful guarantee schemes, and one of these was the imposition of boundaries to borrowing. This included agreed principles, defined characteristics of eligible projects for guarantee, as well as overall and project-related borrowing volume cap (and hence contingent liability for government).³⁵ EY also saw that prudent BA credit policies, oversight and monitoring, and a resolution period could successfully mitigate risks of default.³⁶

If the Australian government is seeking to limit the risks associated with providing a guarantee, they might also consider the example of the Netherlands and Switzerland where “a guarantee fee can also be used to build up a reserve fund proportional to the obligations guaranteed. It can also be conceived as the government guarantee's second line of defence against being called upon. In Switzerland, the fee is used to cover interest payments for a maximum of one year and is, of course, in addition to any issuance fee”.³⁷

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

If there is any way we can be of further assistance, please contact me directly on 03 9660 2300.

Yours sincerely



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³² Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*, p 15.

³³ *Ibid*.

³⁴ *Ibid*, p 9.

³⁵ *Ibid*, p 23.

³⁶ EY Canberra. (2017). *Op cit*, p 13.

³⁷ Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014). *Op cit*, p 19.

Table: International Guarantee Schemes

Guarantee Scheme	Type of organisation	Type of guarantee	Housing targeted
Dutch Guarantee Fund Social Housing (WSW) (1983)	Independent foundation	Backed by the sector, a fund and central and local governments	Yes New and renovated nominated rental housing, low to middle income, registered and monitored providers
Swiss Bond Issuing Co-operative for Limited Profit Housing (EGW) (1991)	Cooperative owned by sector	Backed by the Swiss Confederation	Yes New and renovated cost rental housing, low to middle income, compliant with Charter and government standards monitored providers
French Mutual Fund for Guarantees of Social Housing (CGLLS), (2001)	Publicly owned and administered	Backed by the French Government	Yes New and renovated nominated rental housing, low to middle income, registered and monitored providers
Irish Housing Finance Agency (HFA) (1982/2012)	Publicly owned company	Backed by the Irish Government	Yes New and renovated income related rental and ownership housing, low to middle income, registered and monitored providers
UK Affordable and Private Rented Housing Guarantee Schemes, 2013 (THFC)	THFC non-profit corporation	Backed by UK Government since	Yes Newly completed below market rental or ownership housing, low to middle income, registered and monitored providers
Scottish Government's National Housing Trust, (2010)	Publicly owned trust	Backed by the Scottish Government	Yes Newly completed near market rental housing, low to middle income, managed by registered and monitored providers
US Risk Sharing Scheme between Housing Finance Authorities and Department of Housing and Urban Development (HUD), (1992 pilot/2001 permanent)	Publicly owned corporations	Backed by Federal Housing Administration insurance	Yes Rental or ownership housing, low to middle income, registered and monitored providers

Source: adapted from Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014) Enhancing affordable rental housing investment via an intermediary and guarantee, AHURI Final Report No. 220, Australian Housing and Urban Research Institute Limited, Melbourne, <https://www.ahuri.edu.au/research/final-reports/220>, p 20