POLICY EVIDENCE SUMMARY October 2022

Stimulating private sector involvement in social and affordable housing

AHURi

Based on AHURI Final Report No. 388: Private sector involvement in social and affordable housing

What this research is about

This research investigates models for engaging private sector investors and developers in financing or delivering social and affordable housing, across different market segments and tenures in Australia and internationally. It also identifies key existing and potential players, and financial, regulatory, or development barriers to wider participation. This informed a road map of strategic options for increasing private sector participation in affordable housing provision while managing potential risks.

The context of this research

Prior to the COVID-19 pandemic, around 3,000 social and affordable dwellings were being produced per year, against an estimated annual need of around 36,000 homes (727,000 by 2036). To meet the forecast demand, it is clear 'hybridity' of the housing system is essential, whereby social and affordable housing is increasingly financed, developed and managed by a combination of government, community-based and market providers, and cross-sector partnerships; no one sector can address the need alone.

The key findings

Overall, private investors, developers and industry leaders revealed strong appetite for affordable housing partnerships, reflecting high levels of demand for this type of housing and an increasing focus by boards and shareholders on projects that deliver social and environmental outcomes. However, it is clear from the international evidence that private involvement should be viewed as a way of extending, rather than replacing, public subsidy to house low-income earners and those with special needs.

Industry participants see the community housing sector as an essential partner in mixed tenure projects, but acknowledge they will need to scale up to deliver increased supply which requires reliable subsidy from government.

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Several institutional investors and superannuation funds expressed the view that the current low interest rate context and post-COVID period had seen new interest in investing in social and affordable housing, despite the fact that yields are typically lower than in other forms of residential investment. Lower yields were seen to be offset by lower risk in the social and affordable rental sector, which some participants advised holds value for longer than market rate rental, thus appealing to institutional investors. However, there are geographical differences in investment appetite. Institutional investors reported being more focused on Sydney and Melbourne where demand is consistently high.

Public private partnerships (PPP)

There was overall agreement that the PPP model was an established and workable approach to private involvement in social and affordable housing supply.

Based on a service agreement for housing development between government, private sector, and community housing organisations, such partnerships can deliver upgraded and new social and affordable housing assets at limited upfront cost to government. Land is either provided to the private developer at no cost in exchange for new social and affordable housing built on the site. Alternatively, government provides a ground lease on the land at no cost and provides a subsidy to cover the capital costs of social and affordable housing.

Some developers identified the appeal of PPPs involving leases on government land, provided the duration of the lease, the level of service agreement and the level of subsidy supports the financial viability of the project. However, some policy participants stated that Governments are reluctant to identify their land as 'surplus' and even if they do, the valuation may be based on highest and best use (such as development of full market rate apartments) which impacts the financial feasibility for including social and affordable housing in the project. Some policy participants identified government's preference for leasing land for PPPs, combined with upfront subsidies, rather than selling the land.

Government tendering and planning approval processes for PPPs are often very long and complex, leading to additional costs. Unique procurement requirements across jurisdictions and programs further increases costs.

Community housing participants warned that tendering for partnership projects often created fierce competition between CHOs and was costly to the sector. While regarding some competition as beneficial, smaller CHOs may be unable to participate.

Mixed tenure

Mixed tenure is often integral to PPPs and is a strategy for cross-subsidising new housing developments. In large PPPs, typically new construction of social housing for very low-income earners is cross subsidised through a combination of market housing for unrestricted sale and commercial rental components, affordable rental and home purchase products for moderate income households.

From the perspective of private developers and investors, mixed tenure development was seen as an attractive model for reducing risk and achieving an acceptable level of return through the blend of housing sold to the market with a long term hold on affordable rental housing.

However, some larger developer participants stated that they have struggled to make mixed tenure projects work in Australia, but they are standard practice in the UK due to the presence of large community housing providers with strong balance sheets underpinned by reliable government subsidies as well as a long established inclusionary planning system (Section 106 agreements) that require private developers to include social and affordable housing in their projects.

Tax subsidies for affordable supply

Participants advised that tax subsidies, such as the NRAS initiative, can successfully leverage private investment in new affordable housing supply. NRAS was seen to have worked well when incentives were used to target locations of high housing need, for instance, by supporting higher density transport-oriented developments in key metropolitan employment markets. However, some participants expressed the view that the approach may have supported development in cheaper, less well serviced and lower demand areas where the tax incentive has greatest benefit to project feasibility, but less benefit to housing need.

Criticism of NRAS focused on the relatively short 10-year affordability requirement and the fact the program was cut short by government. Participants advised that longer term affordability is likely to require longer term subsidy, which was also seen as enabling the community housing sector to leverage private finance.

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Home ownership schemes

Low-deposit home loans and shared equity schemes were assisting even low income households into home ownership in South Australia and Western Australia. SA's HomeStart Finance institution has been a critical support for low-income earners. Similarly, Keystart loans in WA have assisted low income earners into homeownership requiring only a 2 per cent deposit thereby overcoming the biggest barrier to ownership.

The Tasmanian Government's Better Housing Future program was identified as a successful model for supporting affordable home purchase while also subsidising improvements to social housing. Under the program, public housing sites were transferred to CHOs. In one example, a CHO partnered with a private builder to develop a higher density tenure mix, of which a third comprised social housing and two-thirds private affordable purchase.

Build to rent

There was growing interest in the potential for build to rent developments, including projects with a community housing partner or those targeting moderate income home ownership.

Participants generally agreed that build to rent projects by the for-profit private sector cannot provide affordable housing without additional subsidy. They advised that although some land tax concessions are coming into play in some jurisdictions such as NSW, these are not of a sufficient level to subsidise affordable housing. In fact, developers emphasised that returns associated with the build to rent are not comparable to yields arising from traditional development projects where units are sold to investors or owner-occupiers.

Delivery of affordable home ownership has been more successful, albeit in a limited number of projects to date, through the build to rent to buy model targeted to middle income Australians.

Inclusionary planning mechanisms

By international comparison, inclusionary planning mechanisms in Australia remain limited both in prevalence and scale. Overall, development panel participants expressed the view that mandatory inclusionary requirements for affordable housing inclusion as part of new developments should be more widespread, particularly in high value markets.

The inclusionary zoning scheme used in SA (which requires 15 per cent of homes in new residential areas to be affordable, and is mandatory on government land) was seen to provide a fair and level playing field. As a mandatory policy, there is certainty around requirements, making it easier to assess project feasibility.

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To ensure that existing projects are not unfairly affected, developers and policy participants advised phasing in mandatory inclusionary schemes over time. This could be operationalised by 'staircasing' requirements when land is rezoned, commencing with a lower level which would be increased over a five-year period.

The use of planning incentives, such as increased floorspace or car parking concessions, was seen as complementary to inclusionary zoning requirements. However, there was concern that poorly designed inclusionary schemes that do not enable developers to offset some of the costs of affordable housing inclusion could impact the viability of projects.

Constraints on private sector participation

Participants identified additional barriers and risks that must be addressed if the private sector is to support a significant increase in social and affordable housing. These include uncertain and inconsistent policy and regulation; development challenges including lack of access to suitable sites; labour shortages; and planning system delays. Participants also warned of risks to government, community or specialist housing organisations and residents arising from poorly designed processes. These risks included the 'leaking' of public assets and subsidies; inefficient and poor delivery of projects; tenant disruption; and the diversion of resources and opportunities from the community housing sector.

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Subsidies

Participants emphasised that affordable housing for low and very low-income earners will always require some government subsidy or capital contribution. Some specialist housing provider participants explained that it is not even possible to repay low cost NHFIC loans from the rental revenue from the people they house who are very low-income.

A partial alternative to direct government subsidy is to reduce project costs, such as by providing access to government land or using inclusionary planning mechanisms. Private sector participants emphasised that the need for subsidy is not driven solely by private sector profit margins, but to address the gap between construction and management costs and the cash flow generated by affordable rent or sale income. Additionally, private sector participants explained their need for a profit margin that reflects the risks associated with extensive negotiation processes, novel partnering arrangements or uncertain timeframes.

A consistent theme across investors and developers was the need to consider social housing for low and very low-income earners and those with particular housing needs as social infrastructure which should be funded and procured by government like other infrastructure projects such as hospitals and roads. Participants advised this approach has the potential to unlock significant institutional investment.

Uncertain policy settings and regulation

Participants reported that changes in government, changed and discontinued policies and programs and a lack of continuity across political and bureaucratic leadership undermine opportunities to expand social and affordable housing through private sector involvement. They emphasised that certainty is essential for investor confidence, across all regulatory and program settings.

Policy participants recognised the private sector's need for certainty is understood by government, but noted difficulties in practice. For example, housing supply programs established in statute may still not enjoy the bi-partisan support that would underpin certainty or continuity.

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Public sector perceptions of risks

Policy participants discussed a range of potential risks to government. These included reputational, operational and financial risks.

Policy participants saw increased private involvement in social or affordable housing schemes as potentially presenting a reputational risk to government. They cited poor delivery of previous flagship government schemes, such as that for home insulation, as examples of the reputational risks that can arise. They suggested that this risk could be mitigated through strong due diligence and oversight of project delivery by government.

Policy participants were also sensitive to the financial risks from increased private participation in the social housing sector, which depends on rental streams to fund management and maintenance operations. Long term leases of public housing that transfer the operating costs to private partners along with the rental stream mitigates these issues, while retaining the asset.

Case studies of private sector participation in social and affordable housing supply

The research presents case studies which combine models such as planning requirements with public land or funding. These approaches have resulted in mixed tenure developments whereby the private component cross-subsidises affordable housing outcomes. In many cases, additional benefits are achieved, such as environmental sustainability features, as well as training and employment opportunities for target communities.

What this research means for policy makers

This study highlighted that a range of established and emerging affordable housing product types can be supported through collaboration with private not-for-profit and for-profit partners. These depend on different combinations of government subsidy, policy settings, and regulation, and are suitable for delivery across a variety of different development contexts.

A national housing strategy set by the Australian Government and implemented through state, territory and local government commitments is needed to address long term demand for housing across all market segments, including crisis, specialist, social, affordable rental, affordable purchase and private market housing. These strategies should inform funding and specific commitments to be delivered by each level of government.

Methodology

This research reviewed Australian and international evidence, and drew on housing, finance, development and policy experts through a series of Investigative Panels and case studies.

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