



# The opportunities, risks and possibilities of social impact investment for housing and homelessness

Inquiry into social impact investment for housing and homelessness outcomes

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### Related reports and documents

Inquiry into social impact investment for housing and homelessness outcomes

<http://www.ahuri.edu.au/research/research-in-progress/inquiry-71100>

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## Acronyms and abbreviations used in this report

ACNC	Australian Charities and Not-for-profits Commission
AIHW	Australian Institute of Health and Welfare
AHURI	Australian Housing and Urban Research Institute Limited
BRF	Build to Rent Fund (UK)
CDFI	Community development finance institutions
CHP	Community Housing Provider
DGR	Deductible gift recipients
FASES	Finding Australia's Social Enterprise Sector study
GIIN	Global Impact Investing Network
HGS	Housing Guarantee Scheme (UK)
HNWIs	High net worth individuals
HSB	Housing supply bonds
IRIS	Impact Reporting and Investment Standards
LIHTC	Low Income Housing Tax Credit
NFP	Not for profit
NRAS	National Rental Affordability Scheme
NSW	New South Wales
PAFs	Private Ancilliary Funds
PRI	Program related investments
SEDIF	Social Enterprise Development and Investment Fund
SIB	Social impact bond
SII	Social impact investment
SIIT	Social Impact Investment Taskforce
SFF	Stronger Families Fund
UK	United Kingdom
US	United States
WUT	Wholesale Unit Trusts

## Glossary

A list of definitions for terms commonly used by AHURI is available on the AHURI website [www.ahuri.edu.au/research/glossary](http://www.ahuri.edu.au/research/glossary).

# Executive summary

## Key points

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- Australia faces numerous and complex housing policy challenges. The waiting lists for social and affordable housing are long (and a significant proportion of the social housing stock is no longer fit-for-purpose), large proportions of the population are in housing stress and too many people are experiencing homelessness. At a time of diminishing resources, new and scalable solutions are required to address these challenges.
  - Social impact investment (SII) is one innovative and growing mechanism for funding solutions to complex social problems. SIIs are investments intending to generate social and financial returns, while actively measuring both (SIIT 2014a; GIIN 2016). SIIs aim to bring together government, philanthropic and mainstream capital, and cross-sector capability to help address social problems.
  - SII has gained renewed interest from individuals (philanthropists, social investors), institutions (foundations), policy-makers, and increasingly, mainstream financial markets (asset managers) in the United States (US), the United Kingdom, Canada, Australia and other developed economies seeking to address a broad range of social issues, including housing and homelessness.
  - Government has a key enabling role in developing the SII market for housing and homelessness in Australia, controlling many of the levers that could remove barriers for other actors in the system, as well as many of the levers in the broader housing market that influence both the size and shape of the housing affordability challenge.
  - For both social and affordable housing there exists a significant financing gap (exacerbated by current housing market conditions in Australia), and government has a critical role in filling it if it wishes to engage the investment community in collaborating and contributing to solutions.
  - SII presents significant opportunities to contribute to housing and homelessness outcomes in Australia, but it is not a panacea. It will not be the most appropriate nor the most effective solution in all cases. Further, where SII does have a role to play, in many cases it will need to be implemented alongside other funding solutions and policy interventions.
- 

This report is the first of three project reports to be released as part of the Australian Housing and Urban Research Institute (AHURI) Inquiry, *Inquiry into social impact investment for housing and homelessness outcomes*. This report primarily answers the first research question for the Inquiry:

- 1 What is social impact investing and how can it be applied to housing and homelessness policy in Australia?

It also begins to answer the second and third research questions for the Inquiry (which will be dealt with in more detail in the following two project reports and in the overall Inquiry report):

- 2 What are the actual, potential and perceived opportunities and risks of social impact investing for housing and homelessness policy in Australia?
- 3 How can social impact investment be operationalised to housing policy in the Australian context?

In answering these questions, this report unpacks the definition of SII and outlines key instruments and models of SII. It also presents evidence from a workshop, interviews and an online survey with diverse stakeholders on how SII can be utilised in Australia to create change and the actual, potential and perceived barriers, risks and opportunities involved. The report uses systems thinking to show how SII might be applied or operationalised to housing policy in Australia, including in addressing issues related to affordable rental housing, social housing and homelessness.

## Key findings

The market for SII is still in its infancy and consequently the evidence base is, as yet, limited. That being said, research has outlined and demonstrated numerous case studies and examples in Australia and internationally where SII is successfully bringing together cross-sector actors to collaborate on exploring, implementing and financing programs and initiatives that are making a positive impact on the outcomes for and the lived experience of some of society's most disadvantaged citizens. This includes examples that have successfully increased the supply of fit-for-purpose social and affordable housing and delivery of innovative homelessness services.

SII potentially provides government with additional policy tools that can be used strategically to drive better social outcomes and achieve higher returns on investment of public money. SII may also provide a useful framework to help support innovation through cross-sector collaborations and partnerships. It might help drive cultural and behavioural change by:

- Focusing on paying for outcomes rather than funding activities and outputs.
- Increasing accountability for outcomes through measurement and increased transparency.
- Focusing on prevention and early intervention before problems become chronic or entrenched.
- Incentivising greater coordination and integration of services delivery and housing solutions by designing SII to include elements of both property provision and support services.

The ability of SII to contribute to these outcomes in practice will need to be tested as the evidence base evolves.

Government has a key enabling role in developing the SII market for housing and homelessness in Australia, controlling many of the levers that could remove barriers for other actors in the system, as well as controlling many of the levers in the broader housing market that influence both the size and shape of the housing affordability challenge—including the size of the financing gap (i.e. the difference between actual rates of return and competitive market-based rates of return demanded by mainstream investors).

Government will continue to provide and fund affordable housing and homelessness services. SII cannot supplant government funding and investment—'*No innovative financing model will close this gap and a sustained increase in the investment by governments is required to stimulate affordable housing production and attract private and institutional investment*' (Council on Federal Financial Relations 2016b: 2). What SII may be able to do is enhance the return on government's (increased) investment in housing and homelessness by attracting other sources



of capital (including mainstream capital) with different capabilities and risk return objectives to co-invest alongside it.

Combining financial models may increase the viability and success of SII transactions and offer stakeholders different benefits—but could also increase complexity. Due care needs to be given to ensure SII products are simple, clear and easy to understand. This is important so as not to deter potential investors, service providers or other key actors, and so that the benefits of combining financial models are more likely to be achieved.

SII is not a panacea and it will not be the most appropriate or effective solution in all cases. In some cases the cumulative savings to government may be modest, or the needs of beneficiaries so complex that there is insufficient certainty of achieving improved outcomes to attract SII investors or the costs of support outweighs the economic (but not the social) return. In these instances, SII will likely not be appropriate. It will be important to ensure that sound mechanisms are in place to make these determinations, and where SII is not an appropriate option that people continue to be adequately supported to have and maintain safe, stable, secure affordable housing and the opportunity to be part of and participate in society.

Further, where SII does have a role to play, if we are to make significant progress in improving housing affordability and homelessness, in many cases it will need to be implemented alongside other funding solutions and policy interventions.

## **Opportunities**

There are many ways in which SII could be applied within the housing and homelessness context. Three areas, however, stand out in terms of their potential impact and likelihood of success (assuming the necessary levers are activated and risks appropriately mitigated). These are:

### ***To significantly increase the supply of affordable housing with attractive attributes***

- A total number of 393,000 Australian households in the lowest two income quintiles are currently renting unaffordable housing (paying more than 30% of their gross household income on rent), with 90,000 of those households living in severely unaffordable housing (paying more than 50% of their gross household income on rent) (Hulse, Reynolds et al. 2015).
- As it is likely Australia may have a more significant proportion of long-term renting households in the future, incorporating longer and more secure tenure and more rights/ability for tenants to make a home in any SII affordable housing solution design would have positive benefits.

### ***To significantly increase the supply of fit-for-purpose social housing and support other positive outcomes***

- A total number of 206,000 households are currently waiting for access to social housing units, of which more than a third are classified as 'in greatest need' (AIHW 2015). Further, a significant proportion of the current social housing stock is no longer fit-for-purpose, being at the end of its economic life, poorly maintained, lacking in location and amenity, or underutilised as households have become smaller.
- The SII solution design should promote the construction of additional fit-for-purpose housing units to absorb current and future demand and ideally allow flexibility in managing the underlying housing stock portfolio so that it can be renewed and remain fit-for-purpose over time.
- The SII solution design should aim to ensure effective support services (including coordination and integration with housing solutions) so as to assist tenants to maintain their

tenancy, improve their outcomes, and over time actively support a higher proportion of tenants being able to migrate from social housing to affordable housing, where this is appropriate and realistic.

- Increasing the supply of social housing should also ease the stress on transitional and crisis accommodation—so that those at risk of homelessness are placed in appropriate accommodation early and both the duration and instances of homelessness can be limited to help arrest progression to chronic long-term homelessness.

***To act as an incubator for government to trial new ways of providing services that deliver desired outcomes most effectively, and importing what works back into the government's day-to-day commissioning for social services to maximise its initial investment in SII***

- Current models of government's social service provision and delivery mechanisms are not achieving the desired outcomes. Many of the shortcomings that have been identified in the existing system are key elements that SII is specifically designed to counteract—including: a focus on paying for outcomes rather than paying for activities and outputs; a focus on prevention and early intervention—breaking the cycle before the problems become chronic and entrenched; increased accountability for achieving outcomes through transparent measurement; increasing cross-sector collaboration to find new and better ways to solve old problems; redirecting investment towards evidence-based services, programs and initiatives that achieve the best outcomes most efficiently; and leveraging government's return on investment by attracting other forms and providers of capital.
- Social impact bonds (SIBs) are beginning to play an incubation function as part of a wider trend in public policy to shift public funding of service provision from funding activities and outputs to outcome-based financing (Tyler and Stephens 2016). Designing appropriate mechanisms to transition successful solutions back into government's broader commissioning of services will be important to fully optimise the investment in SII. Seen in this light, government bearing more of the transaction costs of pilot SIB programs would seem reasonable given that the quantum of benefits will ultimately flow back to government through improved commissioning processes.

## **Risks**

SII poses particular risks to government, service providers, investors, intermediaries and most importantly to beneficiaries if it is ill conceived, poorly executed or used in inappropriate settings. These risks need careful consideration in determining whether SII is the most appropriate model in a given context, and in the design of SII solutions. The most significant risks include:

- Beneficiaries are harmed if poor design of SII solutions has unintended consequences (e.g., results in housing stock that is not fit-for-purpose, located in sub-optimal locations lacking amenity and access to services etc.), services are disrupted or cease when SIs mature or are otherwise terminated, and/or the most vulnerable people with the most complex needs are left out or left behind.
- Community housing providers (CHPs) are not provided with sufficient capacity to continue to scale-up; an increase in business risk profile (as a result of increased leverage and operational/financial complexity managing SII and undertaking more complex and risky housing development projects) undermines or threatens the sustainability/viability of CHP's business models; and/or the viability of smaller CHPs is threatened as they do not have the scale and capacity to participate in the new market paradigm.

- Moral hazard risks are inadvertently created by government de-risking investments to the point where the nexus between positive social outcomes and financial returns is severed, and investors alignment of interests with achieving positive social outcomes is weakened.
- Investors' performance expectations are not met, reducing confidence and stalling development of SII in housing and homelessness.

## Policy development options

Government has an important enabling role in developing the SII market for housing and homelessness. It controls many of the levers that can remove barriers that enable other actors to participate, as well as levers in the broader housing market that influence both the size and shape of the housing affordability challenge. The most significant implications of these for policy development and practice change to support realisation of the SII opportunities identified while mitigating associated risks are:

- Addressing related public policies that are putting upward pressure on prices and adversely affecting housing affordability—increasing the size of the problem and the financing gap that needs to be filled. The consequences of not addressing this means that the problem that needs solving is larger than it should be, the financing gap that needs to be filled (most likely be government) is higher, and systemic risks of a property price correction heightens risks to investors who may attempt to address the issues.
- The role of government, as recognised in the *Social Impact Investing Discussion Paper* (The Treasury 2017) and the Council on Federal Financial Relations Housing Working Group (2016b), remains pivotal. SII can support government initiatives, but stable, long-term government policy and funding are essential to attract SII and support the growth of CHPs. All levels of government need to work in concert to bring what they can to reducing risks and costs of delivery. The consequences of failing to provide a stable, long-term policy context are that key actors will not be confident to take risks and will stay on the sidelines, resulting in the challenges not being addressed, and leaving government as the primary actor to resolve.
- The bond aggregator model (Council on Federal Financial Relations 2016b) has industry and investor support and international precedent (e.g. UK), and provides the opportunity for institutional investment at scale and provides an efficient mechanism to finance both social and affordable housing. Without such a mechanism, many of the valid concerns of institutional investors cannot be adequately addressed, making it difficult to attract institutional capital to participate—one of the critical success factors identified in this research given the scale of the problem.
- An improved National Rental Affordability Scheme (NRAS), applying learnings from the original NRAS and combined with the bond aggregator model, provides the opportunity for CHP investment at scale, in targeted fit-for-purpose social and affordable housing stock. Government could also look to other 'in-kind' support mechanisms and broader planning/zoning levers to support the construction of additional affordable housing units. The consequences of failing to provide mechanisms to fill the financing gap are that supply will not increase sufficiently to meet need, or CHP business models become too risky and viability of the sector is threatened (e.g. if CHPs take on additional debt and/or additional development risks and become over-leveraged relative to the development risks and/or relative to the future sustainable cash flows available to support additional debt).
- CHPs have the potential to play a growing role through government support and industry bodies (e.g. Frost and Hamilton 2016) and with international precedent (e.g. UK, Netherlands). If CHPs are not supported to achieve increased scale and capacity, they will

not develop to be seen as viable and attractive counterparties; a lack of scale also undermines viability/efficiencies in the sector.

- Homelessness is a complex issue and SIBs and social enterprises can be part of the solution, with government providing an enabling environment, including frameworks for better measurement of outcomes. These instruments are expensive and bespoke, and the greatest benefit may be as an incubator to test new solutions that can be imported back into broader commissioning and procurement practices. The consequences of not investing in innovation are that we may not be delivering the most effective outcomes or outcomes at sufficient scale. Also, if we fail to invest enough in prevention and early intervention, it usually results in much larger long-term costs to the system and poorer outcomes for people and society.

## The study

The research was conducted to inform and progress housing policy by developing an understanding of the actual, potential and perceived opportunities and risks for SII to improve housing and homelessness outcomes in Australia. It aims to:

- Describe what social impact investing is and its application to housing and homelessness policy in Australia.
- Examine different finance models and structures, SII markets and case studies, both in general and as applied to policies and programs that aim to address housing and homelessness.
- Map SII and its actors in the supported housing system.
- Inform housing and SII finance policies.

A complex systems thinking approach underpins the methodology used in the research. The project used multiple methods to model and hypothesise how to influence change in the current and potential future system enabling SII to address housing and homelessness outcomes in Australia.

Key data collection methods included:

- A critical analysis of literature and policy on SII, housing and homelessness to establish a definition of SII based on existing evidence and to provide a summary of the main instruments and potential models of SII internationally.
- A workshop of diverse stakeholders (financial, housing and SII sector representatives and government) to discuss and come to systems thinking scenarios of the opportunities, risks and possibilities of using SII to address housing and homelessness outcomes in Australia. Thirty-two people participated in the workshop.
- Semi-structured in-depth interviews with diverse stakeholders (financial, housing and SII sector representatives, government and two formerly homeless advocates), asking participants to talk to and map the system of actors and influences involved in SII, including the roles of different groups and players, the levers for change and the barriers, risks and opportunities involved. Twenty people participated in the interviews.
- An online survey to test findings from the workshop, interviews and literature and policy review with diverse stakeholders (financial, housing and SII sector representatives and government). Seventy-two people participated in the survey.

# 1 Purpose and scope of the research

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- Despite an extended period of economic growth and increasing prosperity for the majority of Australians in recent decades (in part due to rising property prices), Australia faces numerous housing policy challenges that negatively impact on health and wellbeing outcomes and increase associated costs, reduce the opportunity for people affected to achieve their potential and contribute fully in society, and have potential broader consequences for social cohesion and economic outcomes for the country.
  - There is growing interest among key actors in Australia in SII's potential to be part of the solution to Australia's housing and homelessness challenges. While there is an emerging body of research at the international level about SII's potential to address social problems, there is a paucity of literature and evidence for the potential, opportunities and risks of SII for housing policy in Australia.
  - This report forms the first and foundational part of the (AHURI *Inquiry into SII for housing and homelessness outcomes* and will be followed by two further Inquiry reports, one focusing in detail on understanding opportunities for SII in the supply of affordable housing and the other on financial models for expanding housing options for vulnerable groups in society.
  - A review was conducted of existing literature on, and case studies of, SII in Australia and internationally. Overall, the review identified that SII is a nascent field. Further, it showed that research has not systematically described housing and homelessness in relation to SII markets and has largely avoided labelling housing provision activities as aligning with an SII framework.
  - To address these gaps and facilitate this research, a complex systems thinking framework was applied through a workshop, interviews and survey. The purpose was to map key SII players and levers to develop an understanding of how SII may contribute more specifically to housing and homelessness outcomes in Australia.
  - The proposition that SII can contribute positively to housing and homelessness outcomes in Australia will need to be tested and refined in practice as the evidence base evolves.
- 

This report is the first of three project reports to be released through 2017 and 2018 as part of the AHURI Inquiry, *Inquiry into social impact investment for housing and homelessness outcomes*. This report primarily answers the first research question for the Inquiry:

- 1 What is social impact investing and how can it be applied to housing and homelessness policy in Australia?

It also begins to answer the second and third research questions for the Inquiry (dealt with in more detail in the following two project reports and in the overall Inquiry report):

- 2 What are the actual, potential and perceived opportunities and risks of social impact investing for housing and homelessness policy in Australia?
- 3 How can social impact investment be operationalised to housing policy in the Australian context?

To respond to these primary questions, the report also focuses on the following sub-questions:

- How has social impact investment been applied (in its infancy) to social policy issues overseas and in Australia, and what opportunities does it create for housing policy? (Chapters 1, 4 and 5)
- Who are the actors in social impact investing in Australia and what are their actual/ potential roles for housing and homelessness policy? (Chapters 2 and 5)
- What are the different financial models, types of capital and different types of investors to address housing and other social issues? (Chapter 3)
- To what extent might social impact investment provide new sources of capital for the housing sector? (Chapter 3)
- What are the risks and returns for investors and over what timeframes? Is there a pool of concessionary and double-bottom line investors? (Chapters 2 and 5)
- What enterprises/interventions/models might be invested in? How will they be delivered and what characteristics will help/hinder competitiveness for receiving funding and effectively delivering services? (Chapters 4 and 5).

In answering these research questions, the report provides a definition of SII and outlines key instruments and models of SII. It also presents evidence from a workshop, interviews and an online survey with diverse stakeholders on how SII can be used in Australia to create opportunities for change and the actual, potential and perceived barriers, risks and opportunities involved. The report uses systems thinking to show how SII might be applied or operationalised to housing policy in Australia, including in addressing issues related to affordable rental housing, social housing and homelessness.

This report will be followed by two further Inquiry research reports, one focusing in detail on understanding opportunities for SII in the supply of affordable housing and the other on financial models for expanding housing options for vulnerable groups in society. These further reports focus on research questions 2 and 3 in further detail, including answering further sub-questions. Appendix 1 provides more detail on the scope and structure of the three projects and about the full set of research questions and sub-questions for the overall Inquiry.

## 1.1 Why this research was conducted

Australia faces significant housing and homelessness challenges that require new, scalable solutions. Growth in median mortgage and rental payments have outpaced increases in median income, making housing less affordable. Between 2001–11 median mortgage and rental payments increased by 100 per cent, compared to 60 per cent for median household income (Reeve, Marjolin et al. 2016). By 2015, more than one million Australian households were in housing stress—spending more than 30 per cent of their gross income on housing costs (ACOSS 2015). According to Hulse, Reynolds et al. (2015), 78 per cent, or 271,000 households in the lowest income quintile were renting unaffordable housing (paying more than 30% of their income in rent) in 2011. Of those households, 26 per cent, or 90,000 lived in severely unaffordable housing (paying more than 50% of household income on rent). One-third of second income quintile households (122,000 households) were living in unaffordable housing in 2011. It is not surprising then that social housing waiting lists are long. According to the



Australian Institute of Health and Welfare (AIHW), in 2014, 154,600 people were waiting for public rental housing, 8,000 for Indigenous social housing and 43,400 for mainstream community housing. Of this group, 75,900 were classified 'in greatest need'—that is at risk of homelessness, of having their life or safety threatened, health worsening, or living in inappropriate housing with very high rental costs (AIHW 2015). Without affordable housing or enough social housing, solving homelessness is a major challenge. Around 1 in 200 people are homeless and rates of homelessness are particularly high for particular groups, such as young people and Indigenous Australians (Reeve, Marjolin et al. 2016). Appendix 2 outlines the scale and components of the housing affordability and homelessness challenges in Australia in more detail.

Governments are increasingly fiscally constrained. Long-term trends such as ageing populations will likely exacerbate these fiscal challenges into the future (The Treasury 2015). Further, despite significant investment by governments, some social policy areas' social outcomes are not markedly improving (Reeve, Marjolin et al. 2016).

There has been an upsurge in interest from philanthropists, social investors, foundations, policy makers, mainstream financial markets and asset managers in Australia (and internationally) in SII as a means to increase:

- 1 The supply of available capital to scale-up financing solutions to social issues (by bringing private capital to bear).
- 2 The return on public capital invested by introducing a strong focus on outcomes (rather than a focus on activities, inputs, and/or outputs), and applying private market discipline to the robust measurement of those outcomes, so that over time, public investment is redirected to programs that have the most impact in achieving the desired social outcomes.
- 3 Cross-sector collaboration to find innovative and more effective solutions to intractable social issues, with a more specific focus on prevention and early intervention.

SIIs are investments intending to generate social and financial returns, while actively measuring both (SIIT 2014a; GIIN 2016). SIIs aim to bring together capital across the spectrum (government, philanthropic and mainstream capital), and cross-sector capability to help address social problems. The definition of SII is the focus of Chapter 2.

Although SII is relatively new in Australia, it presents particular opportunities to address issues like housing and homelessness. In 2013 alone, it was roughly estimated that approximately A\$2 billion was invested in Australian SIIs. It is expected that this will grow to A\$10 billion by 2018, possibly rising to as much as A\$32 billion in the 2020s (Addis, McLeod et al. 2013).<sup>1</sup> Housing and homelessness was one of the key areas identified for SII highlighted in the *Impact Investing Australia 2016 Investor Report*, alongside addressing issues related to children, young people and clean energy. In particular, along with health, housing appeared to be a key area of unmet demand for institutional investors offering both scale and the provision of real asset security (Dembek, Madhavan et al. 2016).

Other policy developments (discussed in more detail in Section 1.2.1) support further expansion of SII, including to housing and homelessness issues in Australia. Recent Australian Government developments include the *Social Impact Investing Discussion Paper* (The Treasury 2017), which proposes that governments create an enabling environment and fund investments that deliver better social outcomes and generate savings, and work by the Affordable Housing Working Group of the Council on Federal Financial Relations (2016a; 2016b), which sought

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<sup>1</sup> There is some uncertainty as to the actual size of the sector given the fact that the total worth changes based on definitions and inclusions/exclusions.

innovative solutions to affordable rental issues and recommends a housing bond aggregator. These build on recommendations to the government from the McClure Report to consider expanding outcomes-based SII models to target financial investments towards addressing social problems (Department of Social Services 2015) and from the final report of the Financial System Inquiry to explore facilitating development of the SII market and encourage innovative funding of social service delivery (The Treasury 2014). At the state level, for example, the New South Wales (NSW) Government has created a A\$1.1 billion fund for social and affordable housing, which will foster the creation of private/public partnerships to supply affordable housing, and the South Australian Government has launched a homelessness social impact bond (SIB) (Social Ventures Australia 2017).

Despite these developments, there is a need to draw together disparate academic and grey national and international literature on SII and its application to housing and homelessness in Australia more specifically. While there is an emerging body of research at the international level about SII's potential to address social problems, which indirectly extends to housing and homelessness, there is little literature and evidence specific to Australia, particularly in housing and homelessness policy. Case studies and grey research literature about the successes and challenges of SII initiatives have been developed in countries such as the US, UK and Canada. In some instances, housing and homelessness has been a specific focus (Thornley, Wood et al. 2011; Schwab Foundation 2013; Dear, Helbitz et al. 2016). There is however also a need to better understand how SII differs from other related areas, such as social investment and social finance, and to more systematically describe housing and homelessness in relation to SII markets and frameworks. Consequently, this report aims to contribute to defining SII in relation to housing and homelessness and to extending the understanding of its practical application to housing markets and homelessness services in Australia.

## **1.2 Policy context**

Australian governments are currently operating in a fiscally constrained environment. Long-term structural shifts such as ageing populations likely will adversely impact government revenues over time, while society's expectations, social needs and the costs of delivering social outcomes likely will continue to rise (The Treasury 2015).

Rising and high property prices and rents exacerbate housing affordability issues, increasing both the costs of social and affordable housing and the risks to investors who attempt to address the issues. While several policy settings strongly encourage residential property as an investment class for individual investors (e.g. the combination of negative gearing and the 50% capital gains tax exemption), they have been less successful in targeting investment in new supply of housing units at the affordable end of the housing spectrum. Arguably, they have exerted further upward pressure on housing prices (Kelly, Hunter et al. 2013). Appendix 3 outlines some of the broader housing market structural and policy considerations that may influence the characteristics of new housing supply and have consequences for housing affordability policy in Australia.

While the need for social and affordable housing has increased in both absolute and relative terms, the total supply of social housing is contracting. A significant proportion of the current social housing stock is no longer fit-for-purpose, being at the end of its life, poorly maintained, lacking in location or amenity, or underutilised as household compositions have shifted to smaller sizes (Kraatz, Mitchell et al. 2015). The ability to maintain properties over time and refurbish or replace stock to meet changing needs over time also remains a challenge.

In considering the policy context for housing affordability and homelessness in Australia, it is important to unpack the underlying sub-issues that different policy interventions need to address. These include:

- The number and proportion of people experiencing homelessness in Australia.
- Integration and coordination of housing solutions for people with complex needs.
- Insufficient supply of fit-for-purpose social housing.
- Challenges in maintaining, refurbishing and replacing social housing stock over time.
- Lack of transition along the social/community/affordable housing continuum and non-portability of housing stock.
- Insufficient supply of affordable private market rental housing with attractive attributes.
- Maintaining the affordability of housing over time.

Chapters 3 and 5 of this report identify when, where and under what circumstances, SII could be used to address these issues. There is a trend towards marketisation of public and social services in Australia. The Australian Priority Investment Approach to Welfare (the Investment Approach) was outlined in the McClure Report (Department of Social Services 2015). As part of the Australian Government's implementation of the Investment Approach, a A\$96 million Try, Test and Learn Fund was announced in the 2016–17 Budget, with a particular focus on trialling programs that could reduce the risk of long-term welfare dependency. In addition, growing innovative investment models (including for SII) and promoting collaborative cross-sector partnerships has been a focus of the Prime Minister's Community Business Partnership set up in 2014 (The Treasury 2017). Section 1.2.1 provides a more comprehensive overview of recent policy initiatives in the field of SII in Australia.

### **1.2.1 Social impact investment and public policy in Australia**

Following examples in other countries such as the US, UK, Canada and Italy, Australian federal, state and territory governments have shown new and renewed interest in SII. Since the early 2010s, SII has been considered in a range of Australian Government policy inquiries. These include: financing the not-for-profit (NFP) sector (Productivity Commission 2010), the Australian financial system (The Treasury 2014), the Australian welfare system (Department of Social Services 2015), and housing affordability (Council on Federal Financial Relations 2016a). In January 2017, the Australian Government also released its *Social Impact Investing Discussion Paper* (The Treasury 2017).

Early feasibility studies of SII were also conducted in some Australian states and territories, notably the NSW Government (CSI 2011). This led to pilot SII models, primarily pay-for-performance contracts known as social benefit bonds (another name for SIBs). SIBs are supported by consortiums of organisations, which has included banks, NFP organisations in human services and social purpose organisations, acting as intermediaries. An early SIB, Newpin, addressed families at risk by focusing on restoring children in out-of-home care to their families (Impact Investing Australia 2017; Social Ventures Australia 2013).

Following lessons learnt from these pilots, further policy development occurred across other Australian states:

- Victoria invested A\$700,000 for market testing and procurement for the development of the state's first SIBs in their 2016–17 budget (Treasury and Finance 2017).
- Queensland began a call for proposals in late 2015, with the expected launch of their first SIB in early 2017 and homelessness as the focus of one of these SIBs (Queensland Treasury 2017).
- South Australia announced details of the state's first SIB in February 2017, with a focus on homelessness (Social Ventures Australia 2017).

- Western Australia explored and reported on applicability of SIBs in September 2014 (Social Ventures Australia 2014).

SIBs or pay-for-performance contracts have been used as a mechanism to fund and improve homelessness services in NSW for particular target groups. For example, the Homelessness Psychosocial Support Program (Innovation New South Wales 2017) and the 'youth foyer model' both aim to tackle youth homelessness and other social issues (Foyer Foundation 2017; Pro bono 2016a; Social Impact Hub 2016).

Consistent with comparable countries, particularly the UK, SIBs have received significant attention from policy-makers in Australia (Dear, Helbitz et al. 2016) and in response an emerging support ecosystem is beginning to develop. SIBs are indicative of a wider trend in public policy to shift public funding of service provision from funding activities and outputs to outcomes-based financing (Tyler and Stephens 2016).

Although SIBs have been a high profile model of SII in Australia, their focus has been principally on services, rather than property, and SIBs' potential has so far been in addressing homelessness issues, rather wider affordability challenges. SIBs, as one policy option to promote outcomes-based funding of service provision, is addressed in Chapters 3 and 5.

NSW is the only Australian government to have developed an overarching SII policy framework (The Office of Social Impact Investment 2015) (although other states such as Victoria have supported the development of intermediaries). In 2015, NSW established an Office of Social Impact Investment within Treasury. Consistent with wider policy, its requests for proposals to date have focused on pay-for-performance contracts.

Until the release of the Australian Government discussion paper (The Treasury 2017), policy-makers have largely focused on SIBs when explicitly exploring how SII can be integrated into public policy. Other major policy initiatives that align with definitions of SII have not been framed as interventions to incentivise SII. This is consistent with other countries, for example the US, where few policies have 'addressed impact investing by name' but a 'number of policies have promoted targeted investment' (Wood, Thornley et al. 2013: 82).

Other supporting mechanisms have also been implemented to facilitate the development of an impact investing ecosystem via social enterprises with some implications for housing. The most high-profile policy initiative in this respect was the Australian Government's Social Enterprise Development and Investment Funds (SEDIF). In 2010, the SEDIF allocated A\$20 million to three fund managers that were required, as a minimum, to match funding with private investment (creating a pool of more than A\$41.2 million) (Barraket, Muir et al. 2016). The SEDIFs have facilitated 10 investments in affordable housing and homelessness social enterprises, with loans totalling A\$5.0 million (Barraket, Muir et al. 2016). Models that provide financial incentives, such as tax credits, to increase supply of affordable housing are addressed in Chapters 3 and 5.

The Australian Government's *Social Impact Investing Discussion Paper* (The Treasury 2017) explores its potential role in the development of the SII market. It proposes governments create an enabling environment and fund investments which deliver better outcomes and avoid future costs or generate savings. The paper recognises the government's roles as both regulator and funder and the SII developments by state governments as reflecting their responsibilities for service delivery (including homelessness).

Generally, while issues relating to social and community housing and affordable ownership and rent are increasingly on the policy agenda, SII has not been referenced as explicitly in recent policy initiatives targeting these problems. Key policy initiatives targeted at scaling up private investment in affordable housing, for example, the Australian Government's National Rental Affordability Scheme (NRAS) (Newell, Lee et al. 2015a; 2015b), did not reference SII. The scheme, which is continuing but no longer accepts new applications, exhibits characteristics of

SII, including intentionality (see Chapter 2 for discussion of SII characteristics), and shares some characteristics of other policy interventions in other countries such as the Low Income Housing Tax Credit (LIHTC) in the US (Blessing and Gilmour 2011).

In 2016, the Council on Federal Financial Relations Affordable Housing Working Group canvassed SII as part of an Issues Paper in its consultation phase (Council on Federal Financial Relations 2016a). The inquiry sought 'innovative solutions' to affordable rental issues, but framed SII largely as SIBs (Council on Federal Financial Relations 2016a: 13). Its recommendations report (Council on Federal Financial Relations 2016b) centred on a housing bond aggregator based on the UK's Housing Finance Corporation. The objective of the bond aggregator would be to attract private and institutional investment through the creation of a financial intermediary that issues bonds on behalf of Community Housing Providers (CHPs) to increase supply of affordable rental housing. The bond aggregator and complementary policy settings is examined in Chapters 3 and 5.

Related policy developments have included increased recognition of the potential of leveraging private-public partnerships to attain the capital needed to address the complex social, economic and housing issues involved. The NSW Government's Social and Affordable Housing Fund, worth A\$1.1 billion, includes the aim of fostering the creation of private-public partnerships to supply affordable housing. The recognition of the role of private-public partnership lays a key foundation for the further development of SII as a tool to address housing and homelessness in Australia.

An additional and recent area of focus has been improving the enabling environment for private and public ancillary funds to provide them with greater certainty when considering investments in SII. Ancillary funds can invest in SII by making program related investments (PRIs). PRIs are below-market return investments that further an organisation's charitable purpose whereby they invest part of their corpus in mission-related programs or make commercial investments that provide a social and/or environmental return. In May 2016, the Australian Government made amendments to both the Private Ancillary Fund Guidelines 2009 and the Public Ancillary Fund Guidelines 2011 to allow ancillary funds to provide loan guarantees over borrowings of deductible gift recipients (DGRs) and provided guidance on calculating the distribution in relation to SIIs (Seibert 2015).<sup>2</sup>

### **1.3 Existing research on social impact investment and housing and homelessness**

This section provides an overview of:

- The structure of SII markets as delineated in previous research.
- References to housing and homelessness in SII research and examples and AHURI and other policy studies that use examples of SIIs.
- A map of the actual and potential SII market in housing and homelessness.

Prior research has not systematically described housing and homelessness in relation to SII markets. The largely embryonic SII literature, while referring to housing as a sub-sector, only engages with housing in a limited way. At the same time, the large literature on funding and financing of housing and homelessness engages with SII in an equally limited way.

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<sup>2</sup> These amendments followed a report prepared by Philanthropy Australia for the Department of Social Services in November 2015 to assist the work of the Prime Minister's Community Business Partnership (Seibert 2015).



### 1.3.1 Social impact investment markets

SII markets are like all markets: they comprise three overlapping sub-systems of *supply* (of capital), *intermediation* (of capital) and *demand* (for capital) (SIIT 2014a). A significant body of prior research into SII has employed variations of this framework (Brackertz and Moran 2010; Jackson and Harji 2013; Mulgan 2015; Nicholls and Emerson 2015; Nicholls and Pharoah 2008; SIIT 2014a; Thornley, Wood et al. 2011; Wilson 2014). The purpose has been to outline the systemic structure of social finance markets and key instruments, models, institutions, and actors in the evolving ecosystem. The market for social outcomes in housing and homelessness to a large extent reflects the same basic market structure, as mapped in Table 1 below.

**Table 1: Market for social outcomes in housing and homelessness**

Capital	SII markets	Housing and homelessness
<i>Supply-side</i>	All providers of capital: the investors (Nicholls and Emerson 2015)	The mix of actors includes governments, individuals (e.g. philanthropists) and institutions (e.g. Private Ancillary Funds (PAFs) and other charitable trusts). Government, however, appears to play a larger role. In housing the role of government is critical, but there is scope to expand the role of institutional investors, particularly superannuation funds (Newell, Lee et al. 2015a; 2015b).
<i>Demand-side</i>	The users of capital (ClearlySo 2011)	Demand-side organisations operate on a continuum from NFP organisations to social enterprises to commercial enterprises. In housing and homelessness initiatives in Australia, demand-side organisations are almost universally NFPs. <sup>3</sup> CHPs have been identified as having potential for SII involving institutional investors (Milligan, Hulse et al. 2015). Homelessness services also show potential for outcomes-based financing such as SIBs (Flatau, Wood et al. 2015).
<i>Intermediation</i>	Intermediaries act as conduits for investment and human capital between the supply and demand sides. They undertake diverse activities: brokering transactions, products and investment opportunities; supporting capacity and investment readiness; capacity building activities; impact measurement and investment performance monitoring, and network building (Nicholls and Emerson 2015).	Intermediaries include community development finance institutions (CDFIs); specialist social investment and enterprise funds, venture philanthropy organisations, consultancies, legal firms and brokerage organisations that facilitate deals and contribute to market development. Mediation is also performed by specialist entities, for example CDFIs, with the objective of mediating finance and funding as well as capacity-building of demand-side organisations to service loans and assist beneficiaries through wrap-around social service provision.  Large CHPs—which own/or manage housing and sometimes provide services—could play a distinctive role in housing by brokering transactions between institutional investors and smaller CHPs

<sup>3</sup> The Australian Taxation Office determines whether an organisation is a Deductible Gift Recipient (DGR). DGRs receive tax benefits including deductible gifts, for instance monetary donations, as well as tax deductible contributions. All DGR item 1s—‘doing charities’—are charities as determined by the Australian Charities and Not-for-profits Commission (ACNC). PAFs are Item 2 DGRs—or ‘giving DGRs’—and are limited to making distributions to DGR Item 1s. Not all charities have DGR status.



### 1.3.2 Affordable housing and social impact investment research

A small number of studies have used examples of affordable housing issues that have been addressed using SII (Thornley, Wood et al. 2011; Schwab Foundation 2013). Key early attempts to define SII incorporated affordable housing as a clear example of SII in practice (Freireich and Fulton 2009). Other early studies noted that affordable housing was the subsector where the field was most established, particularly in the US (Bugg-Levine and Goldstein 2009). Affordable housing continues to be identified as one of the most significant subsectors for institutional investment and one of the subsectors with the most potential for scale (Harji and Jackson 2012; Jackson and Harji 2013; Wood, Thornley et al. 2013). Affordable housing is also cited as one of the clearest ways that philanthropic foundations can utilise concessionary investments (Schwab Foundation 2013) and where specialist intermediaries might facilitate transactions, particularly CDFIs in the US and CHPs in the UK.

Beyond examples of affordable housing SIIs, the literature is limited. Exceptions include studies that describe the regulatory and policy settings that promote investment. For example, in a report on the role of public policy in nurturing impact investing, Thornley, Wood et al. (2011) illustrated policies that stimulated private investment in affordable housing in the US. These include the *Community Reinvestment Act* 1977, LIHTCs, the New Market Tax Credit Program and the Program Related Investment (PRIs) provision of the *Tax Reform Act* (Schwab Foundation 2013: see Chapter 3). These policies work in unison. They are examples where government is an enabler, using a combination of soft and hard policy levers including subsidies, co-investment and regulation to promote 'intentional investment for social ... benefit ... by asset owners' (Wood, Thornley et al. 2013: 75).

Recent AHURI research has considered US models and policy. For example, Rowley, James et al. (2016) reviewed the strengths and weaknesses of NRAS—an initiative largely modelled on LIHTCs. They suggested improvements using a new program for subsidised private rental housing.

In the UK, the government has developed housing policy around a growing interest in SII and the significant presence of CHPs. The government provides debt for the development of new properties and backed the establishment of an intermediary and guarantee for housing supply bonds (HSBs) to raise debt for CHPs (Homes and Communities Agency 2015; Stevens 2016).

Milligan, Hulse et al. (2015) examined CHPs as social enterprises and compared Australian CHPs to those in the UK and the Netherlands to determine improvements in sophistication and size. The potential for HSBs with an intermediary and guarantee, such as in Austria, Switzerland and the UK has been recommended for Australia (Lawson, Berry et al. 2014; Lawson, Milligan et al. 2012).

Overall, previous SII studies that reference housing define affordable housing investments that involve some level of private investment as SIIs. Thornley, Wood et al. (2011) described NRAS as a significant international example of SII. By contrast, research from housing studies, including AHURI research, has tended not to label such examples as impact investment. Although Rowley, James et al. (2016) make reference to SII they do not describe NRAS as an SII. This points to definitional challenges associated with SII. A discussion of definitions is provided in Chapter 2 in order to clarify what is, and what is not, an SII.

### 1.3.3 Homelessness and social impact investment research

SII literature that explores its potential for addressing homelessness issues is limited. As described below, this literature has largely focused on services and service provision and is largely limited to SIBs and social enterprise models.

A number of studies have explored the potential to improve service provision outcomes by increasing the role of private and philanthropic investors in financing services and creating a

SIB 'market' (Dear, Helbitz et al. 2015; Mulgan, Reeder et al. 2011; Ragin and Palandjian 2013). Other studies have taken stock of SIB efficacy and reviewed the international evidence and lessons learned, with some discussion of homelessness (Dear, Helbitz et al. 2016). Flatau, Wood et al.'s (2015) Discussion Paper for the AHURI Inquiry into homelessness services made reference to SIBs as an emerging funding model for homelessness services, briefly reviewing the international evidence. A limited number of academic studies have looked critically at SIBs (e.g. Fox and Albertson 2011). There is also literature that engages with the relationship between social enterprise, homelessness and employment and training (e.g. Teasdale 2010). Flatau, Wood et al. (2015) touched on social enterprises working to address homelessness, such as *The Big Issue* and STREAT.

Overall, the literature on homelessness is predominately policy-oriented and focuses on how policy-makers and other SII actors can address challenges through SIBs and social enterprise (Dear, Helbitz et al. 2016; Fox and Albertson 2011; Wilkinson, Medhurst et al. 2014). Both these models are discussed in Chapter 3.

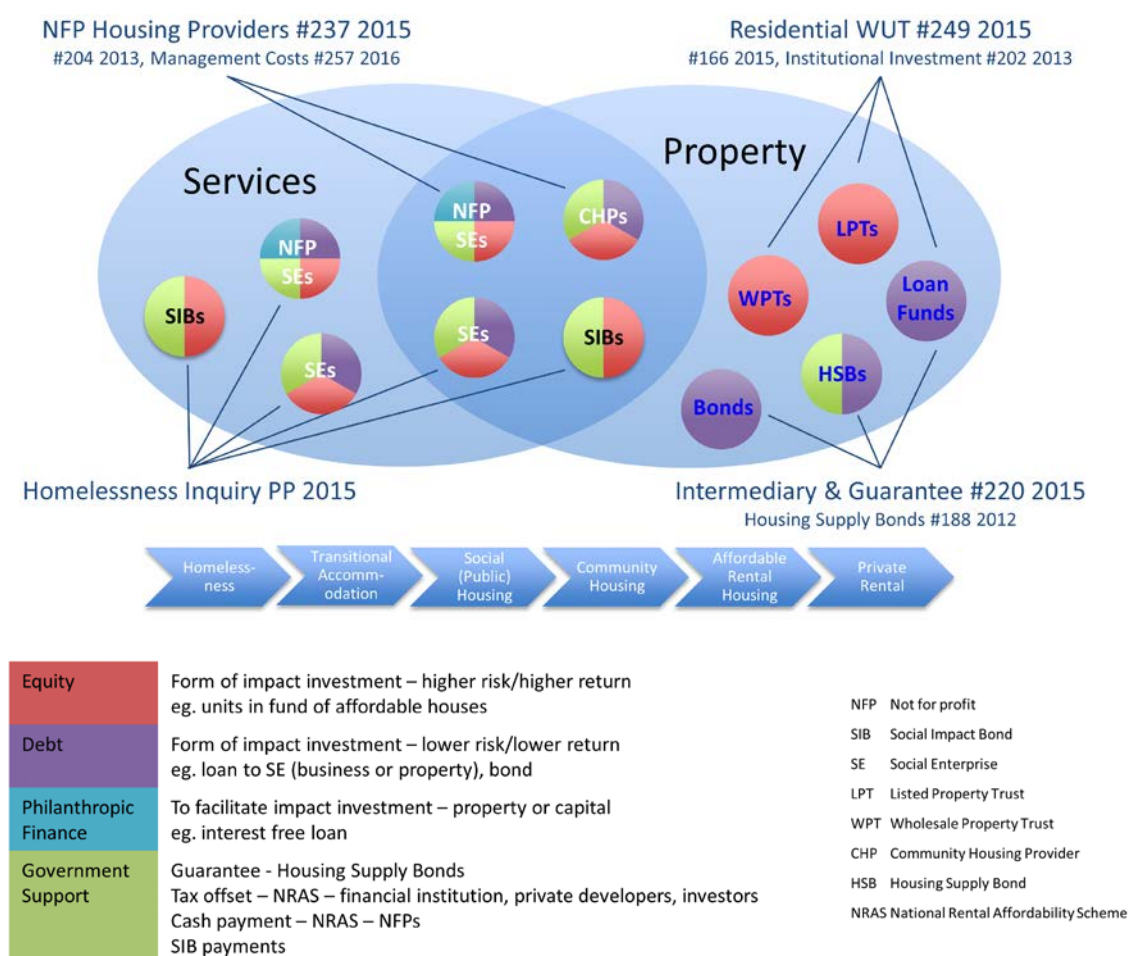
### **1.3.4 Mapping housing, homelessness and social impact investment**

Through an analysis of domestic and international SII examples, the literature and policy review conducted for this report found that the SII market for housing and homelessness can be segmented into two overlapping categories—*housing* (the property structure) and *housing support services* (tenancy support services and specialist homelessness services). Organisations may act in a service or property role. In some cases they may play both a housing and support service role.

The SII market can also be segmented into three forms of SII—SIBs, social enterprises and funds (addressed in Chapter 3). Within these two categories, different blends of capital are targeted at different social intervention points on the housing continuum. SIIs that finance services tend to be smaller than SIIs that finance housing or property, which are often offered through fund structures.

Figure 1 below offers a representation of the overall structure of actual and potential SII markets in housing and homelessness in Australia.

**Figure 1: Actual and potential SII markets in housing and homelessness**



Organisations providing housing support services (NFPs, social enterprises, social businesses) use loans and investment instruments like SIBs. For SIBs, a public agency contracts an intermediary broker who raises capital from social investors (philanthropic trusts, institutions and individuals) to finance the program and contracts social sector organisation(s) for service delivery (Ragin and Palandjian 2013). Alternatively, they may be recipients of loans (debt) with intention from government, mainstream (banks) or specialist (social enterprise and investment intermediaries) lenders, philanthropic trusts or individuals, to support service provision. Many of these organisations are heavily reliant on government grants (Flatau, Wood et al. 2015).

The mixed services and property pool in Figure 1 includes funding and financing of organisations focused on the provision of social, community and affordable housing. This wide range of organisations includes large and small CHPs that own and/or manage housing and provide tenants with some support services (e.g. to improve independent living skills). Large CHPs in Australia are facing reduced government grant funding and are increasing their focus on client diversification and cross-subsidisation (Milligan, Hulse et al. 2015). They have also identified the need for more private financing, both debt and equity (Milligan, Hulse et al. 2015: 41). Although CHPs are far from unanimous in support of private financing, they recognise that they do not need to own properties to provide services and manage affordable housing. Private investment could help to increase the number of affordable dwellings, but private financing is recognised as increasing the cost of supply, which requires increased rental receipt income and reduces housing affordability.

## 1.4 Research methods

A complex systems thinking approach underpins the methodology used in the research. More information on complex systems thinking is included in Chapter 5. The project used multiple methods to model and hypothesise how to influence change in the current and potential future system enabling SII to address housing and homelessness outcomes in Australia. The specific data collection methods used are detailed below, as well as the participant sample.

### *Literature and policy review*

A critical analysis of literature and policy on SII, housing and homelessness was conducted. Over 450 academic journals, book chapters, conference and organisational papers were identified. The research team used a thematic process to determine which publications were relevant to SII housing and homelessness in Australia and subsequently 158 publications were reviewed. The purpose of the review was to establish a definition of SII based on existing evidence and to provide a summary of the main instruments and potential models of SII internationally. The review focused on models with utility of SII for housing and homelessness policy in Australia: property funds, social enterprise and social impact bonds. A separate section of the literature and policy review was conducted of case studies of SIIs in Australia and internationally, to draw on the available learnings about successes and challenges for applying it to housing and homelessness in Australia.

### *Workshop*

The workshop was held, comprising a series of systems thinking discussion activities, designed to ask diverse stakeholders from the financial, housing and SII sectors, as well as government, to discuss the opportunities, risks and possibilities of using SII to address housing and homelessness outcomes in Australia. The workshop began with a short explanation of problems with regard to housing and homelessness in Australia and the background to and definition of SII. Participants then completed the discussion activities designed to establish a housing or homelessness problem to be solved, determine a scenario for using SII to solve it, and come to a hypothesis about what the results might be. The hypothesis was to reflect the following formula:

SII could achieve [a], if [b, c, d] do [x, y, z], but we need to be careful of [1, 2, 3].

- vision / potential / opportunity for change [a]
- three key elements / levers for change and by who [b, c, d]
- actions needed to achieve the change [x, y, z]
- risks / unintended consequences [1, 2, 3].

There were 32 workshop participants and they were divided into groups of five to eight for the discussions (five groups in total), plus a facilitator for each group. Groups were pre-set by the research team to ensure a mix of expertise in each discussion.

### *Interviews*

Interviews were conducted, designed to allow participants to talk to and map the system of actors and influences involved in SII, including the roles of different groups and players, the levers for change and the barriers, risks and opportunities involved. A semi-structured set of in-depth interview questions was used, designed to be flexible for use with stakeholders with different levels of knowledge about housing, homelessness and/or SII. Each interview took approximately 45 minutes and most were conducted by telephone. 17 interviews were conducted in total with 20 people (three joint interviews), including people from the financial, housing and SII sectors, as well as government representatives. The sample also included two formerly homeless people now with roles in tenant and homelessness advocacy.

## Survey

A survey was conducted to test the preliminary findings from the workshop and interviews and insights from the literature and policy review with a larger group of participants. The survey focused on views on the definition of SII, the conditions in which it is best used, potential scenarios for how it can be applied to housing and homelessness in Australia and the roles, responsibilities, risks and barriers experienced by the different actors involved. The survey was conducted online, was designed to take approximately 20 minutes and was open to people across the financial, housing and SII sectors, as well as government—72 people participated.

## Participants

The participants in the study were drawn from a diverse range of contexts. Importantly, some formerly homeless people now with roles in in tenant and homelessness advocacy were included. The sample is broken down by type of organisation (Table 2) and primary type of expertise (Table 3) below, showing how many people of each type participated for each of the data collection methods. The small sample size for the survey (n=72) is a limitation of the study, particularly where the survey findings are broken down by stakeholder group in this report. Future research with a larger sample could assist in further confirming and developing the findings.

**Table 2: Research participants by type of organisation**

	Workshop	Interviews	Survey
Federal Government	0	2	5
State government	6	0	8
For-profit organisations and finance institutions, including banks and superannuation funds	5	2	14
NFP organisations and foundations, including CHPs and NFPs with experience implementing SII	13	3	22
Social enterprises / social finance institutions	1	2	2
Advocacy organisations	4	5	9
Lawyers	0	2	0
Research and consultants	3	2	4
No organisation; includes formerly homeless people now with roles in advocacy	0	2	4
Other (unspecified)	0	0	4
Total	32	20	72

**Table 3: Research participants by type of expertise**

	Workshop	Interviews	Survey
Experience or expertise in SII only	6	4	20
Experience or expertise in housing and homelessness only	13	8	22
Experience or expertise in SII <i>and</i> housing and homelessness	– *	4	13
Current or potential funder of SII initiatives, including banks, superannuation funds, foundations, government and other financial institutions**	13	4	15
Other	0	0	2
<b>Total</b>	<b>32</b>	<b>20</b>	<b>72</b>

\* As less individualised discussion was undertaken with each workshop participant, it was not possible to accurately count how many had dual expertise in both SII and housing and homelessness, although some did. They are therefore accounted for here as having either SII experience only or housing and homelessness experience only, based on the nature of the organisation they represented at the workshop.

\*\* Given the importance of understanding the perspectives of investors to further enable SII, all participants who acknowledged a role as a current or potential investor in SII are included in this category, irrespective of any other experience or expertise they might also have in SII or housing and homelessness. Some investors, however, also had experience in these other areas. Throughout this report, current and potential investors are referred to together as ‘investors’.



## 2 What is social impact investment?

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- The literature review highlighted that ‘social impact investment[s] are those that *intentionally* target specific *social* objectives along with a *financial return* and measure the achievement of both’ (SIIT 2014a). Among the research participants, there was a basic understanding of the main principle of SII being to intentionally improve social outcomes through the use of financial mechanisms, however there was not a clearly articulated understanding of what role measurement plays in SII.
  - The definition above provides a useful differentiation of SII from related terms such as ‘social finance’ and ‘social investment’. This definition and differentiation is also important given that previous research has not systematically described housing and homelessness in relation to SII markets and has largely avoided labelling housing provision activities as aligning with an SII framework.
  - While there was general broad agreement among stakeholders on the defining attributes and other important features of SII (including having a focus on social outcomes, being measurable, clearly defined, robust, sustainable and having a well-defined client group), there was less agreement about how and in which types of programs these outcomes can be best achieved. For instance, there appeared to be some tension between the desire to utilise SII to test new and innovative programs or to fund difficult or expensive programs and the need for evidence that the intended outcomes are achievable.
  - Participant feedback also highlighted gaps in awareness and appreciation for different actors’ perspectives, roles, and needs. For instance, investors appear to perceive more need for balance between social and financial aspects of SII, whereas other actors appear more likely to emphasise the social component. This also underscores the feedback around the important and enabling role of having appropriate intermediaries in the market—particularly at this early stage of the market’s development.
  - The primary actors for SII in housing and homelessness were identified as government (supply side and intermediation), investors (demand side), intermediaries (intermediation), service providers (housing providers) (supply side and intermediation), and beneficiaries (tenants). The key enabling role for government was highlighted as providing a stable policy environment, facilitating affordable and social housing, and controlling several of the levers that could enable SII in housing and homelessness.
-

## 2.1 Literature and policy definition of social impact investment

To enable and facilitate this research, a common definition of SII was needed to:

- Distinguish SII from other similar or related types of investment.
- Articulate SII's defining characteristics, key actors and their experiences.
- Understand the conditions that enable SII to take place.
- Identify attributes of SII that may be advantageous in crafting more effective solutions to address housing and homelessness issues in Australia.

This report defines SII:

- within the boundaries of social finance and social investment
- as requiring intentionality, returns and measurement
- as requiring both financial and social returns.

The boundaries between SII and related terms such as social finance and social investment are often treated as interchangeable in the literature (Floyd, Gregory et al. 2015; Wilson 2014). Until recently researchers and practitioners have not consistently delineated the boundaries (Daggers and Nicholls 2016).

Most definitions hinge on two elements: investment with a focus on *social* returns that are *a priori* and not incidental, and the expectation of, at minimum, the *financial* return of capital (Brown and Norman 2011; Moore, Westley et al. 2012; Social Finance 2016; Wilson 2014). Others offer wider definitions of social finance that incorporate philanthropic grants with no expectation of return as well as other sunk costs such as government grants (e.g. Nicholls and Emerson 2015).

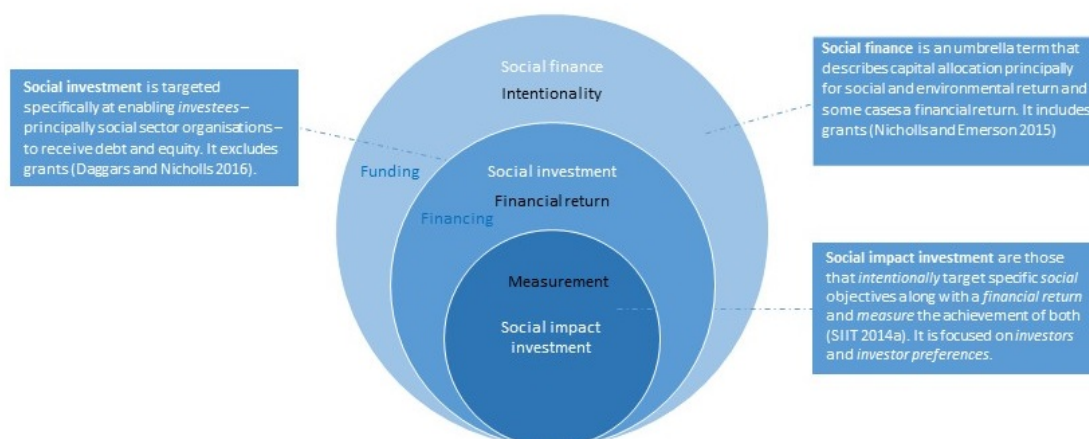
The unclear definitions present challenges for investigating the role and potential role of SII in housing and homelessness. These are areas that have rich histories of hybrid and private funding involving a combination of government and philanthropic grants. They are also areas in which financial institutions and banks play a role in financing social and affordable housing projects that in some definitions might constitute social investment.

For this research, it is important to have a clear definition of SII, including how it is differentiated from other forms of funding and financing that involve private actors. It is also important to understand the core features of SII as understood among stakeholders who might use it or be involved in it to address housing and homelessness. These areas are covered in this chapter.

### 2.1.1 Differentiating social impact investment from social finance and social investment

While recognising that the term is unclear, a significant body of practitioner-led work (Freireich and Fulton 2009; Charlton, Donald et al. 2014; Johnson and Lee 2013) and a smaller amount of scholarly research (Bugg-Levine and Goldstein 2009; Daggers and Nicholls 2016) has been directed at defining SII as a distinct field of investment. Based on this literature, three main related terms or types of investment—social finance, social investment and SII—can be differentiated to set clear parameters for this research (see Figure 2 below).

**Figure 2: Distinction between social finance, social investment and SII**



Most definitions of SII (e.g. Charlton, Donald et al. 2014; GIIN 2016) share characteristics in the definition developed by the Group of Eight (G8) Social Impact Investment Taskforce (SIIT) (2014a), which is included in Figure 2:

*Social impact investment[s] are those that intentionally target specific social objectives along with a financial return and measure the achievement of both. (SIIT 2014a)*

This definition has gained traction in government (SIIT 2014a), investment (GIIN 2016) and philanthropic sectors.

In comparison, *social finance* provides funding for social objectives (and may fund activities or outcomes), but does not always expect a financial return (Nicholls and Emerson 2015).

*Social investment* focuses on a financial return (e.g. public policy interventions that support access to repayable capital), but, unlike SII, does not have an explicit focus on measurement (Graham and Anderson 2015; Daggers and Nicholls 2016). Social investments shift the focus from funding organisations like NFPs or social enterprises through grants to providing them with repayable finance (e.g. loans and equity) (Daggers and Nicholls 2016; Social Investment Taskforce 2000).

### 2.1.2 Literature and policy definition of social impact investment

Three features largely set the parameters of the definition of SII established by the G8 SIIT (2014a) and the Global Impact Investing Network (GIIN) (2016):

#### 1 Intentionality

The principle of *intentionality* requires that social impact investors are not 'socially neutral': they *intend* to attain social (including environmental) objectives as a result of their investment (Brest and Born 2013). They allocate capital with the intention that profit will be 'appropriated' by another party or parties to attain social objectives. This characteristic distinguishes SII from investments that make an incidental or unintended social return.

#### 2 Return expectations

In SII, investors expect a financial return alongside the achievement of social objectives. The return expectations can differ: from below market ('concessionary investments') to market related returns equal or near equal to mainstream asset classes ('non-concessionary

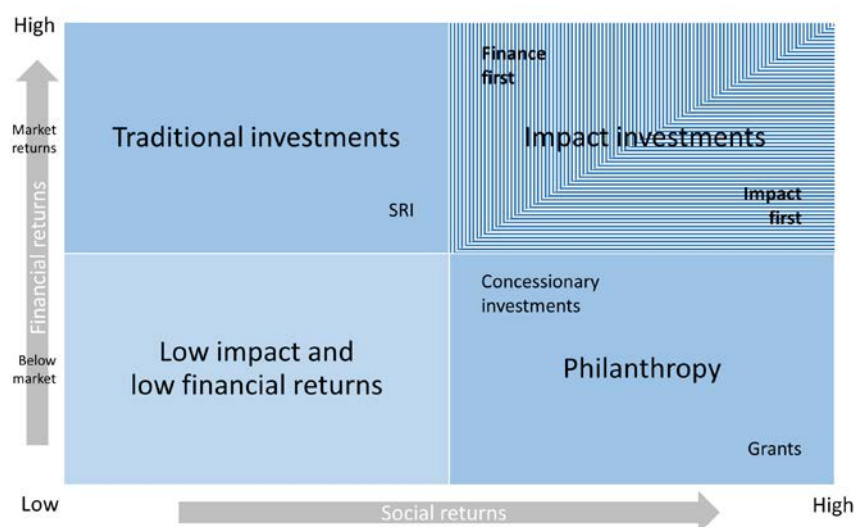
investments’) (GIIN 2016; Brest and Born 2013). At minimum, SIIs must generate a return on capital (GIIN 2016).

As illustrated in Figure 3 below, ‘finance first’ investments seek to obtain market rate and premium returns (Freireich and Fulton 2009; Rangan, Appleby et al. 2011). Comparatively, ‘impact first’ investments privilege the creation of social or environmental value over financial return. ‘Impact first’ investments generally require below-market return, market-related returns or recycled capital. Impact first investors are most likely to be private philanthropic foundations, high net worth individuals and families (Charlton, Donald et al. 2014; Correlation Consulting 2012).

### 3 Measurement

Robust frameworks for measuring and assessing social and environmental impact—alongside financial indicators that inform the investment (Best and Harji 2013)—are critical to SII. The objective is to demonstrate the intrinsic value of the investment for all stakeholders, with a particular focus on data that can be communicated to investors and their fiduciaries for payment and to strengthen accountability and transparency (SIIT 2014b). In practice, this relates to the burgeoning, but complex, area of social outcomes measurement (Muir and Bennett 2014). The Impact Reporting and Investment Standards (IRIS) Metrics and various other frameworks (Graham and Anderson 2015) have been developed and/or are in the process of being developed for measuring the impact of SII.

**Figure 3: Finance first and impact first investments**



These three characteristics are largely accepted in the practitioner-led literature as the foundations of SII and are part of the definition of social impact in the *Social Impact Investing Discussion Paper* (The Treasury 2017).<sup>4</sup> However less research has explored empirically how these three characteristics are weighted by various actors and institutions in practice. The current research therefore sought the perspectives of key stakeholders on defining and other features of SII.

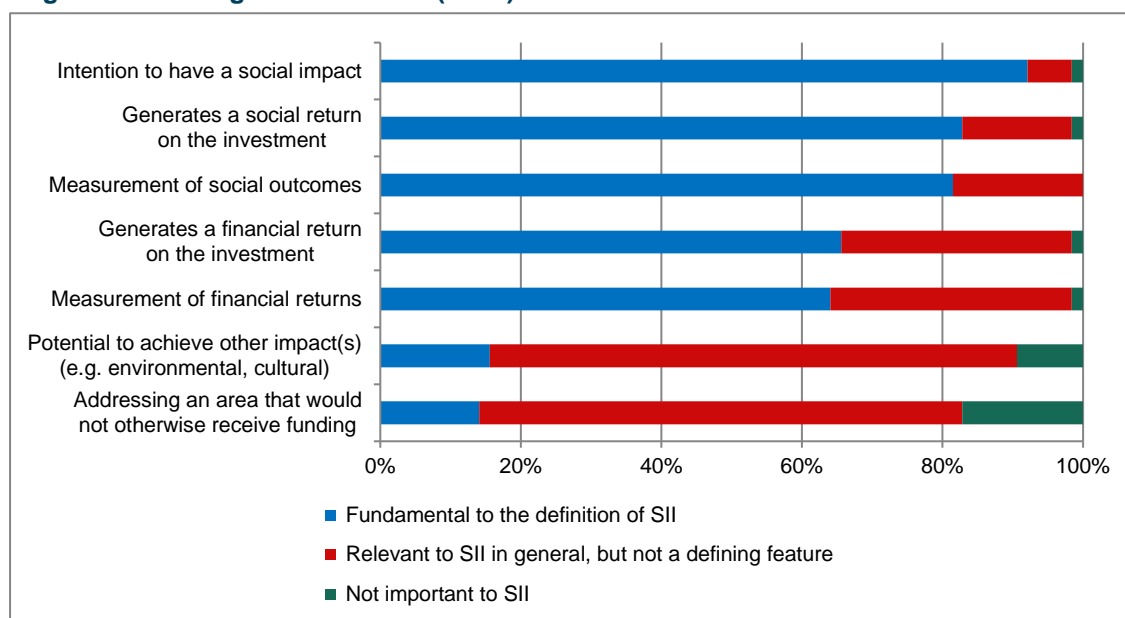
<sup>4</sup> Social impact investments are investments made with the intention of generating measurable social and/or environmental outcomes in addition to a financial return’ (The Treasury 2017: 4).

## 2.2 Perspectives on the features of social impact investment

### 2.2.1 Defining features

On the whole, there was agreement among the research stakeholders with the above definition of SII, although some parts were emphasised more strongly than others (Figure 4 below).

**Figure 4: Defining features of SII (n=64)**



Intentionality to achieve a social impact was described as ‘critical in the definition’ (finance sector participant) and as the key aspect distinguishing SII from other related types of investment. Intentionality was thought to be fundamental to the definition according to 92.2 per cent (9=59) of research stakeholders, including all investors (100%, n=14, missing n=1), all of those with both SII and housing and homelessness experience (100%, n=11, missing n=2), all but one of those with SII experience only (94.4%, n=17) and most of those with housing and homelessness experience only (80%, n=16). For some, social impact specifically meant providing ‘a benefit for individuals, families, communities that would be disadvantaged or in need’ (SII experience participant), however others also highlighted the potential to include impact in environmental or cultural areas.

Dual social and financial returns were commonly emphasised qualitatively—for example, ‘[SII] takes into account financial outcomes as well as social outcomes’ (SII experience participant). However, intentionality for social returns was more commonly seen as fundamental (82.8%, n=53) than financial returns (65.6%, n = 42).<sup>5</sup> Financial returns were emphasised most strongly by investors (71.4%, n=10) and people with expertise in SII only (72.2%, n=13) and least strongly by stakeholders with both SII and housing and homelessness expertise (54.5%, n=71.4).

Almost 89 per cent (n=53) of all stakeholders said that measurement of outcomes was a critical component of SII, although measurement of social outcomes was more commonly seen as a

<sup>5</sup> This view was further supported by the degrees of social and financial return seen as acceptable—72.9 per cent (n=43) thought that lower financial returns would be acceptable if social impact was high, whereas only 38.3 per cent (n=23) considered the extent of social impact less important if securing market-rate or premium financial returns. Further, high social returns were more commonly considered acceptable at the cost of low financial returns, rather than the reverse scenario (86%, n=49 cf. 24.6%, n=14).

defining characteristic (81.5%, n=50) than measurement of financial returns (64.1%, n=41). This was consistent across stakeholder groups, although investors more commonly saw measurement of financial returns as fundamental compared to other stakeholders (78.6%, n=11 compared to 59.2%, n=29 of the other stakeholders when the other stakeholder groups were combined). Notably, less than half (45.5%, n=5) of those with both SII and housing and homelessness expertise saw measurement of financial returns as fundamental to the definition. Further, while the survey responses were generally relatively high in acknowledging the role of measurement, measurement was rarely emphasised when people were asked to define SII unprompted in interviews.<sup>6</sup>

Together these perspectives on intentionality, returns and measurement suggest there is a basic understanding of the main principle of SII being to intentionally improve social outcomes through the use of financial mechanisms, but there is perhaps not yet a clearly articulated understanding of what role measurement plays in the definition of SII. More communication and education about what SII is and how it works is still required, including through accessible language and resources that a range of stakeholders can understand.

Further, investors appear to perceive more need for balance between the social and financial aspects of SII, whereas other stakeholder groups appear more likely to emphasise the social component. This could have implications for other stakeholders' understanding of the needs of investors to enable their involvement.

## 2.2.2 Other important features

Beyond its definition, other important features of SII were also profiled. Stakeholders either agreed or strongly agreed that aspects relating to outcomes were of key importance, including outcomes that are measurable (88.7%, n=55), clearly defined (88.9%, n=56), robust (88.8%, n=55) and sustainable (79.3%, n=50), along with having a well-defined client group (82.2%, n=51) (Figure 5):

*It's about being attributable and being able to clearly define what the reduction in expenditure would be ... you can actually see what the impact is and how the targeting is working and how the investment is directly leading to the benefit. (Housing and homelessness sector participant)*

*You need to see ... an ability to deliver a consistent and high quality service. So there's got to be some evidence that the service delivery is sustainable. (Housing and homelessness sector participant)*

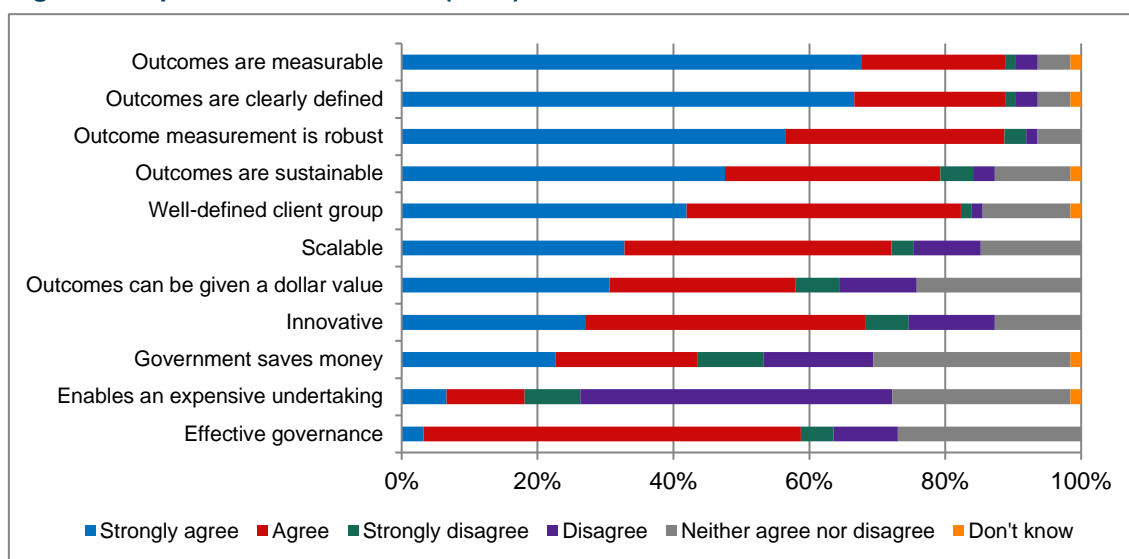
Sustainability of outcomes was particularly important to investors, where all but one agreed or strongly agreed that this was an important feature of SII (92.9%, n=13) (Figure 5). There was a high level of agreement across the stakeholders generally that outcomes should involve quantitative measures (81%, n=47) and qualitative measures (89.7%, n=52). Other aspects relating to outcomes were perceived as less important; for example, across all stakeholder groups, only just over half of participants thought that giving outcomes a dollar value was important to SII (Figure 5), with investors being least interested (46.2%, n=6) and stakeholders with experience in housing and homelessness only being the most interested (70%, n=14).

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<sup>6</sup> Stakeholders emphasised the importance of measurement to SII more generally (see Section 2.2.2).



**Figure 5: Important features of SII (n=62)**



Different views were expressed on whether SII should provide an opportunity to test new and innovative programs. Some people thought that SII ‘enables innovation’ (SII expertise participant) and provides the opportunity to be ‘contracted to particular outcomes and then you are able to then go and deliver things a little bit differently’ (housing and homelessness sector participant); 68.3 per cent (n=43) of stakeholders agreed or strongly agreed that innovation was an important feature of SII. Notably, this included all but one of the investors (92.9%, n=13), whereas participants with either or both of SII and housing and homelessness expertise were more divided.<sup>7</sup> However, other people emphasised the importance of clear evidence behind the SII initiative. They felt that without evidence there was a risk of failed initiatives ‘causing damage in the social impact sector’ (SII experience participant). Almost 85.5 per cent (n=53) agreed or strongly agreed with the importance of evidence of the intended outcomes being achievable (see Figure 6 in Section 2.3),<sup>8</sup> with this high level of support relatively consistent across all stakeholder groups.<sup>9</sup>

Different views were also expressed as to whether SII should enable the implementation of difficult or expensive programs. One perspective was that SII provided a unique opportunity to attract sufficient funds to facilitate expensive programs, which might otherwise be beyond traditional funding mechanisms. However, another perspective was that costly programs could pose a problem for investment returns if the path to achieving outcomes was not clear. While different qualitative views were expressed, when tested in the survey, there was only a low level of support (18.1%, n=11) for SII to enable an expensive undertaking. It was supported by a minimum of stakeholders from all groups.

These views highlight that a focus on social outcomes is a key feature of SII, but that there is less agreement about how and in which types of programs these outcomes can be best achieved. Guidance and clarification is required. Chapter 3 begins this task by exploring the

<sup>7</sup> 52.9 per cent, n=9 stakeholders with only SII experience, 70 per cent, n=14 stakeholders with only housing and homelessness experience and 54.6 per cent, n=6 stakeholders with SII and housing and homelessness experience.

<sup>8</sup> The questions were not set up to be mutually exclusive.

<sup>9</sup> 76.4 per cent, n=13 stakeholders with only SII experience, 85 per cent, n=17 stakeholders with only housing and homelessness experience, 100 per cent, n=11 stakeholders with SII and housing and homelessness experience, and 84.7 per cent, n=11 investors.



types of homelessness and affordable housing programs or initiatives best suited to different forms of SII.

### 2.2.3 Actors involved in social impact investment

The roles of, and risks experienced by key SII actors were identified, further filling out perspectives on what SII is and how it works. The roles and risks of the key actor groups and their relationships to the SII markets (discussed in Section 1.3.1) are detailed below.

#### **Government (supply-side and intermediation)**

Government has a range of important roles, especially controlling several levers that could enable SII in housing and homelessness, including, grants, tax incentives or guarantees and statutory payments, such as rental assistance. The mix of government support varies by type of SII and jurisdiction. While government is not necessarily the key player in all types of SII, the familiarity of the Australian SII sector with SIBs, as well as government's key roles in facilitating affordable and social housing, positioned it centrally in this research.

**Table 4: Roles and risks for government**

Top roles as ranked by research participants	Risks that are so high as to present a possible barrier to SII going ahead (n>2)
<ul style="list-style-type: none"> <li>• Enabling a stable policy context for SII (71.7%, n=38)</li> <li>• Contribution of funds to enable trials/pilots (43.4%, n=23)</li> <li>• Being the anchor investor in unfamiliar opportunities (35.8%, n=19)</li> </ul>	<ul style="list-style-type: none"> <li>• Difficulty of returning funds to investors when savings are spread across multiple government departments (n=4)</li> <li>• Handing over responsibility to SII initiatives when the SII market may not yet be ready (n=4)</li> <li>• Accountability in SII initiatives (n=3)</li> </ul>

*'I think governments are really the only organisation or actors with the scale and the scope to catalyse this kind of investment in Australia.'* (Housing and homelessness sector participant)

#### **Investors (demand side)**

Investors include high net worth individuals and a range of institutional investors, including foundations and philanthropy, superannuation funds and banks. Different investors have a range of different needs, accountabilities and return expectations, which affect their involvement in SII, particularly for housing and homelessness issues. It was noted by some stakeholders that it is often not appropriate to include investors with different requirements (e.g. impact first vs. finance first investors) in the same SII deal, as they might have different assessments of how well the deal was performing and different thresholds of when to apply enforcement measures or to build in greater flexibility to meet the SII goals. Specific considerations for superannuation funds and foundations and philanthropy are profiled throughout this report.

**Table 5: Roles and risks for investors**

Top roles as ranked by research participants	Risks that are so high as to present a possible barrier to SII going ahead (n>2)
<ul style="list-style-type: none"> <li>• Give consideration to the social issues invested in (66.0%, n=35)</li> <li>• Give consideration to the SII investment model (50.9%, n=27)</li> <li>• Forming networks of investors interested in SII (50.9%, n=27)</li> </ul>	<ul style="list-style-type: none"> <li>• Government regulation and red tape (n=7)</li> <li>• Complexity of defining success (n=4)</li> <li>• Returns are not realised or do not meet expectations (n=3)</li> <li>• Intermediaries do not manage the SII deal effectively (n=3)</li> </ul>
<p><i>'Social investors ... may have a different measure of risk [to finance first investors] and a different expectation and appetite, so they can come in and do different things.'</i> (SII expertise participant)</p>	

### **Intermediaries (intermediation)**

Intermediaries were considered important for managing and extending the capacity of SII in Australia and in assisting with structuring appropriate investment vehicles such as wholesale unit trusts (WUTs) for investors (e.g. superannuation funds). Intermediaries were seen as particularly important at present as the Australian SII market is still in development, but a small number of people commented that their role might become less critical as the other actors developed capacity and competency for managing SII deals in the future. People working for intermediaries were usually based in a social purpose/finance role and/or from a legal background.

**Table 6: Roles and risks for intermediaries**

Top roles as ranked by research participants	Risks that are so high as to present a possible barrier to SII going ahead (n>2)
<ul style="list-style-type: none"> <li>• Bridging language and knowledge between investors and housing providers (64.2%, n=34)</li> <li>• Connecting investors with organisations seeking SII funds (60.4%, n=32)</li> <li>• Building investor awareness of SII (60.4%, n=32)</li> </ul>	<ul style="list-style-type: none"> <li>• The cost of managing SII deals (n=9)</li> <li>• Government regulation and red tape (n=4)</li> <li>• The complexity of defining success (n=4)</li> </ul>
<p><i>'... being an intermediary is ... being able to help people have the conversation ... ideally you'd be bilingual or trilingual. You need to be able to speak the language of government. You need to be able to speak the language of the investor, and you need to be able to speak the language of the non-profit ... you are an interpreter, you are an introducer, you're a facilitator.'</i> (Finance sector participant)</p>	

### **Service providers (housing providers) (supply side and intermediation)**

Service providers were understood as important actors for delivering social impact and outcomes within SII. For this group, SII may represent an additional source of finance for their work and an opportunity to have greater impact in achieving their core work of improving the lived experience of clients. For this research, CHPs are the key service providers, although they were expected to work with a range of other service providers.

**Table 7: Roles and risks for service providers**

Top roles as ranked by research participants	Risks that are so high as to present a possible barrier to SII going ahead (n>2)
<ul style="list-style-type: none"> <li>• Working with other service providers to achieve the desired outcomes (54.7%, n=29)</li> <li>• Providing services and infrastructure to achieve the desired outcomes of SII (49.1%, n=26)</li> <li>• Involvement in the design of the SII outcomes framework (45.3%, n=24)</li> </ul>	<ul style="list-style-type: none"> <li>• Inability to deliver on outcomes (n=7)</li> <li>• Payment by results approach may inhibit collaboration (n=3)</li> <li>• Workforce believes investors are profiting from their work (n=3)</li> </ul>

*‘... the real value that housing or service providers can play is to focus on the impact and how that’s best achieved.’ (Housing and homelessness sector participant)*

### **Beneficiaries (tenants)**

Direct beneficiaries are the people whom SII financed interventions are designed to assist. In this research, they are the tenants of affordable or social housing, homeless people and/or people at risk of homelessness. Beneficiaries were not seen as having many roles in implementing SII, beyond living within the housing provided and providing data for measurement of social outcomes. However, the opportunities, risks and levers they experience with regard to SII were described. Indirectly, SII may benefit the communities, families and friends around the direct beneficiaries as well.

### **Other**

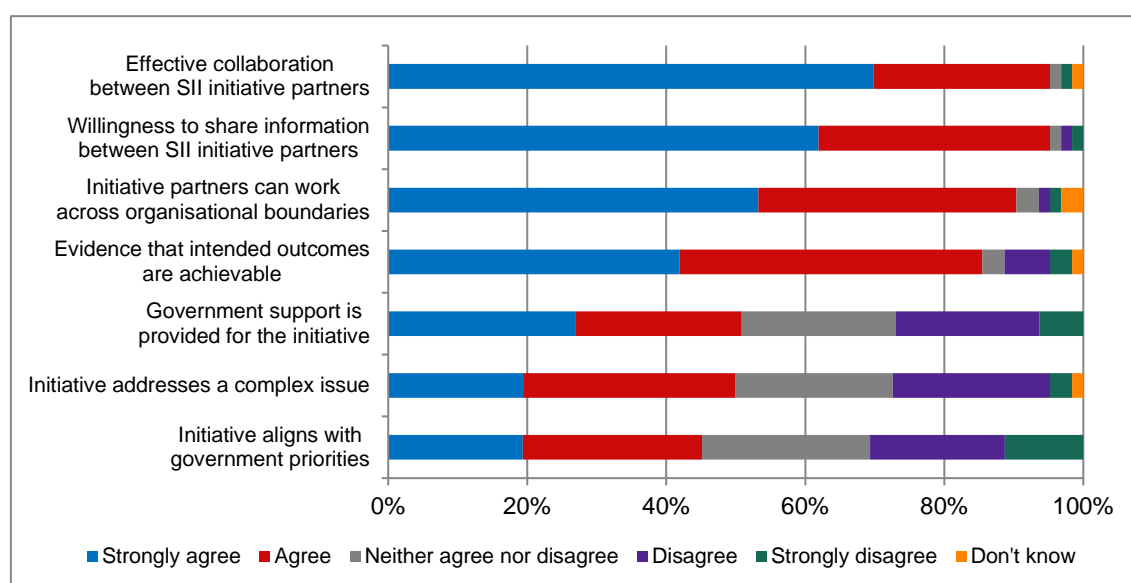
Other actors were identified on the basis that they may play important supporting roles in SII. This included views that the following actors should undertake the following roles:

- Wealth management companies and/or advisors (intermediation) should recommend SII products to their clients (75.5%, n=40).
- Mainstream housing and property development community (e.g. real estate, property developers) (supply side) need to support and get involved in SII (78.8%, n=41).
- Researchers and consultants (intermediation) have a role in third-party measurement of SII outcomes (92.5%, n=49).

## **2.3 Perspectives on the conditions enabling social impact investment**

Participants were asked when, and under what circumstances, SII can best be enabled. Several of the conditions identified were about working together. As shown in Figure 6 below, collaboration, sharing of information and working across organisational boundaries were seen as important by a majority of stakeholders across all stakeholder groups. This suggests that successful SII requires working across silos and for each actor group to understand and respond to the others’ needs.

**Figure 6: Important conditions for successful SII initiatives (n=62)**



As noted regarding the role of government (Section 2.2.3), emphasis was placed on the need for a stable policy environment, where government policy and regulation would remain in place without change during the course of the SII initiative:

*'I think what's really important in relation to that government aspect is that people are clear on what the government positioning is and what their policy is and the longevity of that policy. So if the government is thinking about ways in which they could help this market, it needs to be a policy that has sustainability around it. What I mean by that is, it's not 'here today; gone tomorrow' because that just creates a lot of uncertainty in the market.'* (SII expertise participant)

Long-term policy commitment was required both for SII and for continuity in housing policy. Investors particularly emphasised policy stability, where all but one strongly agreed in the survey that government needed to enable a stable policy and regulatory context for SII (92.3%, n=12). This was also important to other stakeholder groups, but they more frequently agreed or were neutral.

Many stakeholders (85.4%, n=53) saw 'evidence that the intended outcomes were achievable' as a condition of successful SII (Figure 6), with a relatively high level of support across all stakeholder groups.<sup>10</sup> This is consistent with the measurable, clearly defined, robust and sustainable outcomes being seen as key features of SII (Section 2.2.2).

There were mixed views concerning the importance of government support, alignment with government priorities and clear, timely and demonstrable savings for government as important conditions for SII. These factors were sometimes, but less commonly, seen as important (Figure 6). Notably, these areas were most commonly seen as important by those with experience in housing and homelessness (either in combination with SII experience or not),<sup>11</sup> who already

<sup>10</sup> 76.4 per cent, n=13 stakeholders with only SII experience, 85 per cent, n=17 stakeholders with only housing and homelessness experience, 100 per cent, n=11 stakeholders with SII and housing and homelessness experience and 84.7 per cent, n=11 investors.

<sup>11</sup> Government support is provided for the initiative: 65 per cent, n=13 for housing and homelessness only compared to 35.3 per cent, n=6 for SII only and 63.7 per cent, n=7 SII and housing and homelessness, 42.8 per

perhaps had most experience working under government housing and service provision regulations. Further, the relative importance of these areas is set in the context that government funding is a crucial condition for some types of SII (i.e. SIBs), but not necessarily required for all types.

## **2.4 Policy implications for enabling the emerging social impact investment market in Australia**

- Government has an important enabling role in developing the SII market in Australia, having been identified through this research as controlling many of the levers that could enable SII in housing and homelessness. Government needs to:
  - Provide a stable policy environment (which was particularly emphasised by investors)—which includes both long-term policy commitment to SII and to continuity in housing policy.
  - Facilitate data and information sharing across all three government levels (federal state, territory and local) by creating a publicly available bank of relevant cost and outcome indicators to enable innovation in program delivery and assist outcomes measurement and reporting across housing and homelessness issues.
  - Clarify through additional guidance and relevant examples, and/or refining regulatory and legislative rules to remove inconsistencies in treatment across different vehicles and entity types, thus reducing or removing perceived barriers to SII investment, where those investments otherwise meet investors' specific investment mandates.
- One of the benefits of SII is that it may provide innovative and more effective solutions that span different layers of government and cross departmental boundaries. The challenge is that it may be difficult to garner government support for programs where costs and benefits reside within different parts of government. Consideration could be given to taking a whole-of-government approach to SII as was done in the UK, and in NSW, albeit on a more limited basis.
- Collaboration, sharing of information and working across organisational boundaries were seen as important SII enablers. This suggests that successful SIIs require working across silos, requiring each of the actors to understand and respond to each other's needs. More effective communication and education about what SII is and how it works is still required. This could include using accessible language and resources that a range of stakeholders can understand. Government should give consideration to the roles of specialist intermediaries in facilitating and accelerating that process.

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cent, n=6 investors. Initiative aligns with government priorities: 54.6 per cent, n=6 for SII and housing and homelessness compared to 35.3 per cent, n=6 for only SII, 50 per cent, n=10 for only housing and homelessness and 46.2 per cent, n=6 investors. Government saves money: 63.7 per cent n=7 SII and housing and homelessness compared to 29.4 per cent, n=5 SII only, 50 per cent, n=10 housing and homelessness only and 30.8 per cent, n=4 investors.

### 3 Financial models for applying social impact investment to housing and homelessness

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- Three primary SII models have been used globally to address housing and homelessness issues—property funds that finance property or infrastructure used to facilitate service provision, social enterprises that derive a substantial portion of their income from trade which in turn is used to fulfil their mission, and SIBs that are a form of pay-for-performance instrument.
  - In each of the international examples reviewed, supportive (and stable) public policy and active government support were common conditions facilitating these structures. Government support—by way of subsidies, loans, and/or first loss—was identified as a key enabler to SII in Australia by research participants.
  - In Australia, comparatively high and rising property prices and rents have exacerbated affordability issues and widened the ‘financing gap’, making it more challenging to implement viable solutions. Bridging the financing gap requires some form of government intervention.
  - In and of itself, using the bond aggregator model to refinance existing CHP debt will only marginally increase capacity for additional housing supply. This is because underlying CHPs’ revenue streams cannot service significantly higher debt levels without threatening their sustainability and viability (particularly in light of increasing residualisation within CHP tenant portfolios). The bond aggregator model could, however, be extended further and used as a platform along with additional government investment to close the financing gap and, in turn, substantially increase both social and affordable housing supply.
  - Superannuation funds were singled out by research participants as an untapped source of significant capital and scale for SII in affordable housing. Therefore, SII solution design needs to be mindful of institutional investor needs and preferences. This includes generating a competitive risk-adjusted market-based return and providing an attractive risk profile—including recognising that for many superannuation funds, housing is already a significant exposure for their members through member’s equity in their own homes.
  - Combining different financial models potentially enables particular investors with different risk and/or return expectation thresholds to work together, thereby attracting additional sources of capital that may otherwise not be available. In this regard, the important role of philanthropy/foundations is highlighted, as are some of the potential constraints that may currently preclude philanthropy/foundations from utilising PRIs in this way. Further, increased complexity was seen as a risk when combining financial models, which may in turn deter investors and/or present barriers to achieving the intended outcomes.
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### 3.1 Key models and structures: property funds, social enterprises and social impact bonds

Understanding the financial mechanisms (instruments, models and actors) through which SII could be used and applied to housing and homelessness issues in Australia was an important component of this research. This section provides an overview of how SII has been used globally to address housing and homelessness issues:

- The important contributions of government are highlighted.
- The scale and forms of SII are provided.
- Affordable housing and homelessness issues are addressed using three primary SII structures: *property funds*, *social enterprises*, and *SIBs*.
- Within each structure:
  - examples of key international approaches are described
  - outcomes of the SII are provided
  - the policy framework is summarised
  - the status in Australia is described.<sup>12</sup>

The potential utility of various models within the Australian context is discussed, reflecting the perspectives from research participants on the types and combinations of financing that could be deployed in Australia, and implications for policy and Australian financial models for SII considered.

#### 3.1.1 Government assistance

Each of these approaches—funds, social enterprises and SIBs—uses a different form of government assistance (tax credits, funding, guarantees, statutory payments, capacity building assistance), and is enabled through some form of policy framework or intervention. A common condition that facilitates these structures is active *government support*: a finding consistent with prior research that has identified the key role of supportive public policy in enabling impact investment (Thornley, Wood et al. 2011). As outlined in Chapter 1, the role of government is particularly important in Australia due to the current housing market environment.

A long-term structural trend in Australia is comparatively high property prices and rents relative to income levels (Wood and Ong 2015).<sup>13</sup> High property prices and rents exacerbate affordability issues in the home purchase market and create additional pressure in the private rental sector as potential home buyers are priced out of the market (Newell, Lee et al. 2015b). Housing stress is also experienced by a wider proportion of lower and middle income households, particularly in the major capital cities (Newell, Lee et al. 2015a).

It also creates challenges for interventions that are designed to address these issues. For example, rising prices in Australia have exacerbated the ‘financing gap’: the difference between the market returns from private developments and the rates of return from affordable housing developments (Council on Federal Financial Relations 2016b). The gap can be partially addressed by efficiencies in the cost of developments, access to finance and capital, and mixed portfolios of housing types. However, bridging the financing gap requires some form of

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<sup>12</sup> These approaches were identified by the literature review as fitting within the definition provided in Chapter 2.

<sup>13</sup> Over the past 30 years Australian house prices have escalated in a succession of booms, peaking at higher levels than the preceding boom (Wood and Ong 2015). These booms have been punctuated by price stability enabling incomes to advance, but following each peak incomes have not kept pace.



government intervention (Council on Federal Financial Relations 2016b). Potential options to overcome these barriers for affordable housing are described below.

### 3.1.2 Investment and asset types in social impact investment

The investment preferences of active impact investors are shown in Table 8 below which summarises results from two 2016 surveys of investors. Globally, private debt, real assets and private equity have the largest allocations of assets, while private equity, private debt and equity like debt have the largest numbers of investors. Pay-for-performance was lowest by amount invested and number of investors. In Australia, investors specified their preferred top three investment types, with real assets, private equity and pay-for-performance rating highest. These breakdowns probably reflect investment availability within markets.

**Table 8: Investment type preferences of active social impact investors**

Instrument type	Global (GIIN)		Australia (IIA)
	Assets under management US\$77.4b, n=156	Number of investors n=158	Top three active investor preferences n=~40 (on n=123, 41% active, but n=110 for prefs)
Private debt	35%	89	
Real assets	25%	27	18.8%
Private equity	17%	110	17.8%
Public equity	9%	19	
Equity-like debt	6%	55	
Public debt	4%	13	Least
Deposits and cash	2%	26	Least
Pay-for-performance instruments	0.2%	7	17.8%
Other	2%	14	

Source: Mudaliar, Schiff et al. 2016: 19; Dembek, Madhavan et al. 2016: 12, 22–23.

SII can be thought of in three broad asset types:

- *Real assets*—physical assets such as property or infrastructure used to facilitate service provision.
- *Social enterprises*—organisations that:
  - ‘are led by an economic, social, cultural, or environmental mission consistent with a public or community benefit
  - trade to fulfil their mission
  - derive a substantial portion of their income from trade
  - reinvest the majority of their profit/surplus in the fulfilment of their mission.’ (Barraket, Mason et al. 2016: 3)
- *Social impact bonds*—a form of pay-for-performance instrument.

While SIBs are a type of investment vehicle, SII into real assets and social enterprise can be through equity or debt investments.

The 2016 GIIN survey of impact investors identified housing investments of US\$18.6 billion (24%) of all impact investments made by respondents (n=156, US\$77.4 billion). Housing was

the third largest investment sector, with 71 respondents (n=158) reporting having housing allocations (Mudaliar, Schiff et al. 2016). For the subset of real asset investors (n=14), the median housing investment is US\$37 million and the average housing investment is US\$963 million (Mudaliar, Schiff et al. 2016). Furthermore, 32 of the survey respondents planned to increase their exposure to housing, 23 intended to maintain, 6 were going to assess and only 6 were planning to decrease their exposure to housing (Mudaliar, Schiff et al. 2016). The 2016 GIIN survey demonstrates the scalability of affordable housing compared to some other SII areas.

### 3.1.3 Property funds

Property funds provide the opportunity to invest in pooled vehicles investing in equity or debt of the real assets (property) of affordable housing, facilitating the construction of additional dwellings.

#### US—LIHTCs—equity

The Australian Government allocates LIHTCs which apply for 30 years as long as the housing meets tenant eligibility criteria and rent levels. Competitive tenders result in projects that deliver the best social outcomes or are the more cost effective. The Australian Government provides the tax credits and broad policy settings. State governments set finer implementation details. Cities or counties can set additional rules if they contribute funding (Blessing and Gilmour 2011; Gilmour and Milligan 2008).

#### Box 1: LIHTC dwelling construction

From 1987 to 2014, 43,092 projects and 2.78 million dwellings were created under the LIHTC program, which allocates almost US\$8 billion pa. From 1995 to 2014, approximately 1,420 projects and 107,000 dwellings were created each year (HUD User 2016). US\$26 billion was invested in 2007 as a result of the Community Reinvestment Act 1977 (CRA) (Freireich and Fulton 2009). Approximately 80 per cent of LIHTCs are received by for-profits, against a maximum of 90 per cent. The majority of private sector investors are banks. Institutional investment is predominantly through fulfilment of the Community Reinvestment Act (Blessing and Gilmour 2011).

The *Tax Reform Act* 1986 includes the LIHTC program which has operated for 30 years and was declared 'permanent' in 1993. It has resulted in developers (for-profit and NFP), investors, banks and consultants working together on affordable housing projects. The developer identifies the project and is allocated LIHTCs, which are used to raise equity from investors for a fund by a syndicator or manager. Investors may not pay full price for the tax credits. LIHTCs are discounted over 30 years and paid upfront (Blessing and Gilmour 2011).

According to community development organisations, the LIHTC and *Community Reinvestment Act* 1977 have contributed to institutional investment in affordable housing. The *Community Reinvestment Act* compels investment in low-income areas where financial institutions have customers, for those banks to receive federal approval for mergers. The investment is generally debt funding for projects (Blessing and Gilmour 2011).

Projects are for rehabilitating or building long-term rental housing, not transitional housing. The Department of Housing and Urban Development publishes annual criteria based on family size and gross income. Depending on the target income group, rents are set at a per cent of median income, with adjustments for the number of bedrooms. Developers generally target a mix of people with special needs (elderly, disabled, homeless) and different income groups (Gilmour and Milligan 2008).

The New Market Tax Credit Program—administered by the CDFI Fund—incentivises investment in low-income communities by providing a federal tax credit for affordable housing projects certified CDFIs through the CDFI Fund (Guffaston-Wright, Gardiner et al. 2015). Other federal policies include the Program Related Investment (PRIs) provision of the Tax Reform Act that enables private foundations to make patient, concessional investments that support their mission, including low-interest loans to affordable housing developments (Schwab Foundation 2013).

*Australia* Equity financing of new affordable housing is difficult because of low rental returns. By its nature, private rental affordable housing rents are below market rents and the rental yield is below market. In addition, the larger component of residential property returns is from capital appreciation. However, due to the below market rents charged, this cannot be fully realised by investors unless the property ceases to be affordable housing (Frost and Hamilton 2016).

Landlords, such as CHPs, who do not intend to sell these properties and achieve capital gains, could consider this investment as more like debt than equity, as it has a steady, ongoing, government-backed income stream, and a lower rate of return (Council on Federal Financial Relations 2016b).

Barriers to large-scale institutional investment in affordable housing include scale (justify due diligence costs), return (market rate for risk), liquidity (regulatory requirements), investor awareness (low), long-term consistent policy settings (to manage risks and returns), project pipelines (to justify effort to develop expertise), capacity (size of CHP sector) and governance (independent structures) (Council on Federal Financial Relations 2016a).

Newell, Lee et al. (2015a) describe the opportunity for the development of unlisted wholesale residential property funds for institutional investors such as super funds for portfolio diversification. They highlight the preference of super funds for high quality assets, stable returns, low debt, experienced fund managers and scale, and conclude that for the majority of institutional investors, affordable housing residential funds are likely to be less attractive than residential funds focused on housing for middle to high income earners which would have higher quality assets and more secure rental streams (Newell, Lee et al. 2015a).

Affordable housing portfolios may need government to provide tax incentives including stamp duty waivers for the transfer of social housing into the property fund and annual tax relief, to provide the financial returns expected by institutions. The managers could be CHPs, which have track records in managing residential properties and reasonably large portfolios of affordable housing (Newell, Lee et al. 2015a). The proposed structure could differ from most wholesale property funds, in that the properties could be on a sale-and-leaseback arrangement, which would reduce the tenancy risk for the investors. Commonwealth Rental Assistance support from government would provide a stable income stream, reduce the risk and close the return gap (estimated at 2.8% compared to high-quality residential properties (Newell and Lee 2014)). Providing a company tax exemption (tax transparency) on distributions would also enhance the yield and bridge the gap (Newell, Lee et al. 2015a).

Examples of funds which provide investors access to properties assisting in the provision of social purpose include social infrastructure such as early childhood centres and green office funds. However, the difficulty of meeting both investors' financial return expectations and social returns is demonstrated in Impact Investing Australia's *Benchmarking Impact* report. It was not able to include Folkestone Education Trust because it is unclear if it is measuring social benefit, or Investa because it did not meet the intentionality component of the definition as it would acquire buildings without social or environmental benefits (Castellas, Findlay et al. 2016).

The now discontinued Australian National Rental Affordability Scheme (NRAS) was a simpler structure than the LIHTC program; with tax credits received each year of eligibility (up to 10), the role of syndicator was not required (Blessing and Gilmour 2011). The NRAS was discontinued

in 2014 for reasons including complex administration, administrative delays and poor targeting. However, it was discontinued as investor confidence and momentum were growing, and in a relatively short timeframe it had delivered tens of thousands of affordable dwellings. It successfully combined subsidies from multiple sources, engaged both CHPs and private investors, delivered a variety of dwellings in the later rounds and generated innovation (Rowley, James et al. 2016).

The NRAS scheme commenced in 2008 with the final properties admitted in 2016 (these had been allocated but not delivered in 2014) and applied to new housing only. Landlords received a 10-year tax credit in exchange for rent being at 80 per cent of the market rate. As at April 2009, 330 dwellings had been delivered (Department of Social Services 2016) and may cease to be provided as affordable housing in 2019. As at 30 June 2016, 31,368 dwellings were being rented or available for rent and 5,787 dwellings were yet to be delivered, with 137 approved participants of which 86 (62.8%) were endorsed charities. Of the total 37,155 dwellings to be delivered, 21,974 (59.1%) have been allocated to endorsed charities (Department of Social Services 2016). At least 60 per cent of dwelling can therefore be expected to remain as affordable housing after the tax credit expires.

Rowley, James et al. (2016) review the strengths and weaknesses of the NRAS and suggest a new program to deliver subsidised private rental housing should build on NRAS momentum and be introduced as soon as possible. To secure investor support, it should have long-term government commitment and clear, measurable objectives and targets. It could run in parallel with housing supply bonds (HSBs; see below) delivered by an intermediary. This is discussed in Section 5.4.1.

With tax credits as the basis for the subsidy, a secondary market should be developed for trading the incentives. The states should take responsibility for effectively distributing their share of the credits according to market conditions, policy priorities and other resources, such as state-owned land. With national financial incentives and state government involvement, institutions should be more interested in investing in affordable housing. The case for the financial intermediary is strong, with a government guarantee required due to the CHP balance sheets. Tax reform would be required to bring institutions into affordable housing earlier than relying on tax credits that favour small-scale investors, the market maturing and a secondary market developing (Rowley, James et al. 2016).

Rowley, James et al. (2016) see the replacement NRAS operating in parallel with other options, including for other types of affordable housing. To attract institutional investment, the government capital for a subsidised affordable rental scheme could be rebalanced from existing housing outlays and tax subsidies for real estate. These changes would move the reliance from demand-side subsidies to supply-side subsidies (Rowley, James et al. 2016).

### ***United Kingdom—build to rent funding and housing bond aggregator—debt***

CHPs in the UK are significantly larger than those in Australia, reflecting longstanding government policy, although the Build to Rent Fund (BRF) and the Housing Guarantee Scheme (HGS) are more recent initiatives to encourage private investment in affordable housing.

### **Box 2: UK Community Housing Providers**

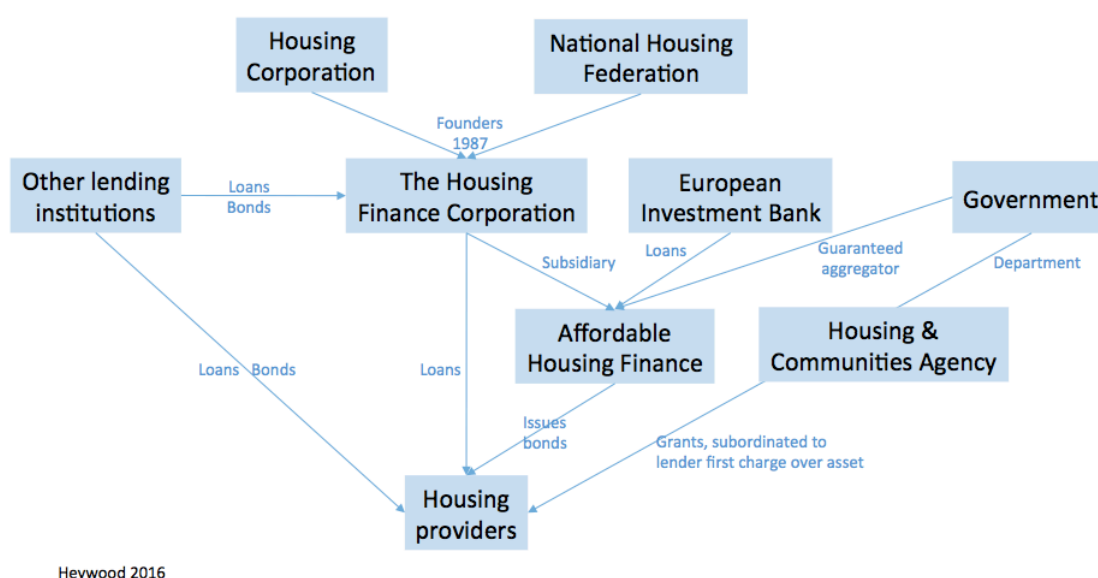
The value of the 2.3 million CHP properties in England was estimated at £70 billion in 2011–12. The average number of properties managed by CHPs was 40,000 in 2010. CHPs manage 10 per cent of housing.

CHPs in Australia manage less than 1 per cent of housing and the average number of properties managed is less than 100 (Milligan, Hulse et al. 2015: 53–54). CHPs managed approximately A\$7 billion of assets (Milligan, Hulse et al. 2015: 1, author calculation).

Governments and policy bodies recognised the potential for large scale development of new rental housing to be financed by institutional investors. In 2012, the government offered financial support to CHPs through the BRF to develop new rental units which could then be sold to institutional investors as an investment with established rental income, and without the development risk which had been inhibiting investment (Stevens 2016). With an increasing number of middle-income renters, the area is expected to be more attractive to institutional investors (Crook and Kemp, cited in Stevens 2016). Local authorities can provide sites and partner with the developers and have an important role in setting policy (Stevens 2016). In January 2015, the Homes and Communities Agency released the most recent prospectus for the BRF. The initial funding of £200 million was increased to £1 billion in 2013 following strong demand. The BRF provides loans to developers to cover up to half the project costs, and expects principle and interest to be repaid within two years of project completion, as the development is sold or refinanced (Homes and Communities Agency 2015). The (new) owners of the operating housing project could then apply to the Private Rented Sector Housing Guarantee scheme, as the BRF loan is repaid. The HGS comprises £3.5 billion government investment to reduce the borrowing cost of housing providers (Homes and Communities Agency 2015).

One of the most significant issuers of bonds for CHPs is Affordable Housing Finance, a subsidiary of The Housing Finance Corporation, and the guaranteed aggregator of the £3.5 billion HGS. Figure 7 below demonstrates various relationships for Affordable Housing Finance, as well as other forms of debt financing available to CHPs (Heywood 2016).

**Figure 7: UK forms of debt financing including affordable housing finance**



*Australia*

The preferred option to attract institutional and private investment for affordable housing at scale arising from the Council on Federal Financial Relations Affordable Housing Working Group (2016b) is the bond aggregator model. The creation of a financial intermediary to aggregate and issue bonds on behalf of CHPs is based on the successful implementation in the UK described above. Notably, this is subject to additional government funding being provided (Council on Federal Financial Relations 2016b).

The benefits of this form of longer term and cheaper finance for CHPs are considered to be:

- Enabling CHPs to finance new developments and refinance existing borrowings for longer tenor and lower cost.
- Creating a private affordable housing investment market that expands and normalises capital flows to the industry.
- Implementing the best model to address liquidity and return barriers through an instrument considered as fixed income by sophisticated investors.
- Easing secondary market trading and attractiveness of a low-risk product given its financial profile (Council on Federal Financial Relations 2016b).

As noted above, the ‘financing gap’ was identified as the major barrier to affordable housing supply. This is the difference between the market rates of return from private developments with similar risk profiles and the rates of return from affordable housing, and relates to capital base, income and expenses. A model of the financing gap highlights operating costs may be covered, but the return is not sufficient to develop new stock or attract institutional investors (and noting income and expenses vary by tenure type and state). The aim of any financing model would be to lower operating and capital costs (Council on Federal Financial Relations 2016b).

Critically, ‘[n]o innovative financing model will close this gap and a sustained increase in the investment by governments is required to stimulate affordable housing production and attract private and institutional investment’ (Council on Federal Financial Relations 2016b: 2).

Complementary reforms are also considered important to create an environment for the success of innovative financial models, including nationally consistent CHP regulation, zoning and planning regulations, and concessions and taxation. These would strengthen governments and CHP capacity to effectively increase affordable housing supply (Council on Federal Financial Relations 2016b).

The recommendation for the establishment of a taskforce for the design of the bond aggregator model noted that it should provide advice on:

- financing gap sizes for the range of affordable housing (public housing to subsidised private rental)
- optimal portfolios to generate cash flows for loan servicing and reduce the financing gap while delivering required affordable housing types (including market-based housing to generate surpluses)
- government investment (form and level) to establish the private financing vehicle and close residual financing gaps
- the affordable housing pipeline, to provide confidence to institutional investors (Council on Federal Financial Relations 2016b).

The other recommendations for the state and Australian governments included:

- Recognition of the requirement for government support to efficiently leverage long-term institutional investment and achieve greater government spending value.
- State investigation of the use, expansion or redesign of housing policies and practices to support the housing bond aggregator, including:
  - existing housing asset redevelopment
  - increased CHP private public partnerships
  - public housing stock transfer

— rental subsidy provision.

- Complementary reforms (as above) (Council on Federal Financial Relations 2016b: 3–4).

Other suggestions to close the financing gap involving government assistance include access to discounted or free land, mandating or encouraging mixed developments, inclusionary zoning requirements, exceptions to zoning and planning regulations, additional recurrent funding and direct grants from government (Council on Federal Financial Relations 2016b: 18).

The ways in which the bond aggregator model addresses barriers to institutional investment are described in Table 9 below.

**Table 9: How the bond aggregator model addresses barriers to institutional investment**

Scale	Institutional investors would seek recurrent bond issuances of A\$100 million to A\$600 million which could be met through refinancing existing borrowing and new developments. The pipelines of projects is not credible without substantial co-investment from government. Bonds could also be used to redevelop existing public housing stock.
Return	3–5 per cent pa. depending on the structure and risk profile, with the financing gap bridged with government assistance and the perception of risk based on the robustness of co-investment by government.
Liquidity	Liquidity through bond trading, either on wholesale market or as an exchange traded bond on the retail market.
Investor awareness	Bonds are a recognised asset class, with strong demand for assets with high credit ratings.
Long-term consistency policy settings	Government commitment to fund: i) closing the financing gap for ongoing pipeline of projects, ii) establishment of financial intermediary and iii) ongoing Commonwealth Rental Assistance payments.
Project pipelines	Investor confidence from government co-investment. Some questions about CHP development capabilities.
Capacity	CHPs need to be able to manage increases in housing stock and tenant levels, and construction of new stock.
Governance	Financial intermediary could be independent body with board of experts or operate through existing or new government body.

Source: Council on Federal Financial Relations 2016b: 28.

The housing bond aggregator would facilitate the replacement of bank finance by institutional investment for asset ownership not construction. Banks would continue to finance construction given the higher risks and banks' experience in assessing and managing this. Institutional investment would reduce refinancing risk following construction (Council on Federal Financial Relations 2016b). The refinancing of all existing CHP debt (over A\$1 billion estimate) could increase borrowing capacity by 65 per cent or A\$0.77 billion, which could fund 2,200 new dwellings (Council on Federal Financial Relations 2016b).

The Council on Federal Financial Relations (2016b) discussed a government guarantee only briefly, noting some submissions stated it would be necessary for securing lowest cost finance. A guarantee should not create additional risks, would need to have transparent policy goals and should be transitional, to establish confidence. It could be a joint guarantee with state governments. Government could guarantee:

- payment of principal/interest payments
- purchase of unpurchased securities
- a tranche of each issuance.



### 3.1.4 Social enterprises

The definition of social enterprises provided in Section 3.1.2 comprises a broad spectrum of organisational types, including credit unions, community enterprises, intermediate labour market companies, CDFIs, cooperatives and mutuals, social firms, and charitable business ventures. As with all businesses, social enterprises require capital to grow and scale their activities. They also require support to ensure they are investment ready and have the required operational and governance capacity (ClearlySo 2011).

Although policy frameworks for social enterprises vary internationally, there are common themes. Based on a mapping study of policy frameworks targeting social enterprises in the European Union, the European Commission has identified six components of an enabling policy framework:

- Social enterprises have unique legal recognition.
- Financing of social enterprises (and SII) through preferential tax treatment or fiscal incentives.
- Infrastructure and specialised support, often through intermediaries, such as targeted mentoring and business development.
- Demand and market access for social enterprises created through facilitation and measures such as social procurement in public service contracts.
- Access to finance supported through measures to grow SII markets and dedicated financial instruments.
- Social value demonstrated through standardised impact measurement and reporting, including systems (Wilkinson, Medhurst et al. 2014: 50).

The world's leading countries for social enterprise combine an enabling policy framework with a coordinated strategy for social enterprises. They highlight the contribution of social enterprises to achieving policy objectives such as economic participation, economic development, social inclusion and service delivery, which cut across departmental functions (Barraket and Moran 2015).

#### *CHPs as social enterprises*

CHPs have been increasingly pursuing social enterprise model development (Milligan, Hulse et al. 2013). This is because 'they have a distinctive organisational character that is neither state nor market but a hybrid form that embraces a mix of the defining values, characteristics and behaviour of public entities, private firms and the third sector' (Milligan, Hulse et al. 2013: 22). One of most attractive features of social enterprise relates to this hybridity. The competing logics of competitiveness and accountability (Mullins, Czischke et al. 2012) foster a culture of entrepreneurship and innovation 'generating surpluses and mobilising non-government resources (leverage) to meet their social goals, such as investment in additional social housing and community development' (Milligan, Hulse et al. 2013).

Social enterprises benefit from SII through the availability of appropriate finance (either debt or equity). However, the delivery of SII into social enterprise is about more than capital investment. Social enterprises, irrespective of business life cycle stage, require professional support, advice and mentoring to assist in business development. Targeted investment and support are often seen as key policy interventions in developing an effective social enterprise sector, as recently seen in the UK (Barraket and Moran 2015).

#### *Australia*

Approximately 16 per cent of the social enterprises in the 2016 Finding Australia's Social Enterprise Sector (FASES) study identified property and business services as the industry in

which they operate (Barraket, Mason et al. 2016). The task of engaging social impact investors with social enterprises has largely been taken up by intermediaries and financial institutions, with some Australian Government support, as was the case with the SEDIFs.

The sustainability of social housing is a challenge. Some observe that operating costs are not covered by rent, or provide for the development of new social housing (Council on Federal Financial Relations 2016a: 4). The stock is ageing and maintenance costs increasing (Council on Federal Financial Relations 2016a: 5). The revenue base (i.e. rent) is decreasing as more residents have greater/special needs and are reliant on income support payments from the Australian Government (Council on Federal Financial Relations 2016a). This is referred to as residualisation, where the result of prioritisation policies has resulted in reduced revenue and increasing costs of service provision, including property and management costs, and wrap-around services (e.g. assistance to accessing education, search for employment and addiction issue programs) (Council on Federal Financial Relations 2016b: 16).

Compared to state-owned public housing, CHPs, and particularly larger CHPs, can offer a wider range of housing and support services to transition across the housing continuum. They have greater access to private finance, tax benefits as charities, and have higher asset management capabilities (Council on Federal Financial Relations 2016a). Institutions have been wary about investing in CHPs because while funding and policy are largely state responsibilities, Commonwealth income support payments are a significant source of revenue (Council on Federal Financial Relations 2016a).

Large CHPs consider their businesses to be sustainable in the medium term, and attribute this to the CRA, stock transfers and mergers providing scale (Milligan, Hulse et al. 2015). A significant concern for CHPs is possible changes to the Commonwealth Rental Assistance. This has been built into rent charges and has contributed to operating costs, such as staff and maintenance, and meeting debt repayments, and is seen as a vital subsidy (Milligan, Hulse et al. 2015). With scale, CHPs are able to adopt more efficient property management models, including maintenance (Milligan, Hulse et al. 2015). However, this has not occurred across the board due to dispersed stock and lack of master contracts (Milligan, Hulse et al. 2015). CHPs have been building reserves to be able to meet their asset responsibilities such as long-term maintenance. These can also be used as working capital for development activity (Milligan, Hulse et al. 2015). This highlights the necessity of CHPs, the government and investors factoring in long-term maintenance requirements and costs. This is a particular issue for smaller CHPs.

Challenges facing CHPs include reduced government funding and increasing focus on client diversification and cross-subsidisation. Smaller scale and lower asset ownership increases vulnerability to changes in government policy (Milligan, Hulse et al. 2015). The 20 large CHPs surveyed identified the need for more private financing, both debt and equity (Milligan, Hulse et al. 2015). Historically CHPs have borrowed from banks to fund development and refurbishment. However, while the finance is readily available, the terms are short and it is at commercial rates (Lawson, Berry et al. 2014).

### ***Smaller social enterprises addressing homelessness***

According to Teasdale (2010), seven models of social enterprise are used to provide services in the homelessness field. Table 10 below provides an overview.

**Table 10: Social enterprise models providing homelessness services**

Model	Description
Revenue generation/mission awareness raising	Organisations that use social enterprises to produce income streams or raise awareness about homelessness issues.
Contracted service provision	Organisations providing homelessness services through the fulfilment of government contracts.
Accommodation providers charging for beds	Hostels and supported accommodation.
Participation-based community	A model that provides homeless people with accommodation, support and the opportunity to earn income through some trading and government-paid benefits.
Employment provider	Social enterprises providing long-term employment opportunities to homeless people in order to earn an income.
Training and work experience	Social enterprises providing work experience and opportunities to transition to longer-term employment elsewhere.
Hybrid	Adopts a combination of models and approaches listed above.

Source: Adapted from Teasdale (2010: 26)

Although social enterprises generate revenue through trade, many also generate income through in-kind gifts, donations, grants and volunteer labour. They rely on NFPs to provide support services as they did not generate sufficient profit to provide this (Teasdale 2010).

#### *Australia*

Approximately 13 per cent of the social enterprises in the 2016 FASES study have homeless people as targeted beneficiaries (Barraket, Mason et al. 2016).

Social enterprises can be identified in each group in Table 10, with the most significant growth in work integration: 'training and work experience' and 'employment participation', examples of which are STREAT and *The Big Issue* respectively. For social impact investors, the former is more likely to be attractive given these enterprises are more readily focused on the creation of a viable, sustainable business model that is able to deliver on its social objectives.

### **3.1.5 Social impact bonds**

Pay-for-performance instruments are most commonly contracts between government and service providers (generally NFPs) where the government pays on the basis of the outcomes achieved by the service provider, rather than only the inputs or outputs to be delivered. Payments are made after the outcomes are achieved, and the service provider requires working capital to fund the delivery of the program (Fox and Albertson 2011).

#### **Box 3: Social Impact Bonds**

There were 60 Impact Bonds on the Social Finance Impact Bond database as at June 2016—12 (20%) relate to homelessness with US\$29.5 million raised (average US\$2.5 million) and average duration of 3.7 years (three in the UK and five to six in the US). There are 3,670 beneficiaries (average 306) and 6 government funders (Social Finance 2016).

SIBs are a type of pay-for-performance where this financing is provided by external investors. SIBs are not fixed income instruments and therefore not bonds, but are a form of quasi-equity.

Having financed the up-front costs, the private investors receive their capital back plus agreed payments if the program achieves the required outcomes. The private investors and service providers have a separate contract (Fox and Albertson 2011). Intermediaries are almost always involved given the complexity of the relationships between government, service provider and investors.

#### **Box 4: South Australian Homelessness SIB**

In February 2016, the South Australian Government announced details of its SIB with the homelessness services provider Hutt Street Centre and CHPs Common Ground Adelaide and Unity Housing to support around 600 homeless people. In the four-year program, over three years people will be assisted to find somewhere to live and receive life skills and training to secure work. Homelessness service utilisation, justice and health outcomes will be measured. Intermediary services are being provided by Social Ventures Australia. \$9 million is to be raised and if the outcomes are achieved, investors could receive 8.5 per cent pa for 7.75 years (2% pa for 4.75 years then performance coupon) (Social Ventures Australia 2017).

#### ***Policy framework***

Governments use a range of approaches to support social impact bonds. Enabling policy generally takes the form of 'soft' instruments including funding to build infrastructure through grants to intermediaries and technical advice. They also develop policy frameworks that place social impact bonds in a central position within government strategies. Occasionally they also authorise activities through instruments that exhibit 'hard' characteristics to provide certainty for budgeting and public finance and enable tax relief for investors.

Dear, Helbitz et al. (2016) identify factors that need to be considered by governments, including:

- Staffing which is dedicated and can champion each social impact bond, and may include external intermediaries or advisors.
- Structures which survive changes in political administration.
- Merging of funding sources, particularly where outcomes are spread across multiple departments.

#### ***Australia***

One of the challenges in analysing the efficacy of SIBs is their novelty. Results are typically interim and most SIBs are only reporting preliminary findings. Even fewer have reported outcomes payments. Dear, Helbitz et al. (2016) found that of the 22 SIBs that shared adequate performance data, 21 had evidence of positive outcomes for beneficiaries, with 12 having made outcomes payments (either recycled and reinvested into the program or to investors). A total of four SIBs have repaid all capital to investors (Dear, Helbitz et al. 2016).

The impact of SIBs has been seen as limited relative to the scale of structuring required due to the bespoke character of these interventions. The lack of a neatly replicable model is also noted due to high transactions costs (Mulgan, Reeder et al. 2011). These challenges have fed a perception that the complexity of the development process limits their utility to social policy (Fox and Albertson 2011).

These barriers are significant. Defining and measuring outcomes is challenging across the social sector, but few interventions are as dependent on rigorous outcomes measures for the development of a 'product' for the market (ICF 2014: 13). Similarly, investor uncertainty and caution associated with complexity remains a significant barrier. Engaging investors—beyond

concessionary investors and governments with a higher risk tolerance and sustained focus on social outcomes—is an impediment to further mainstreaming.

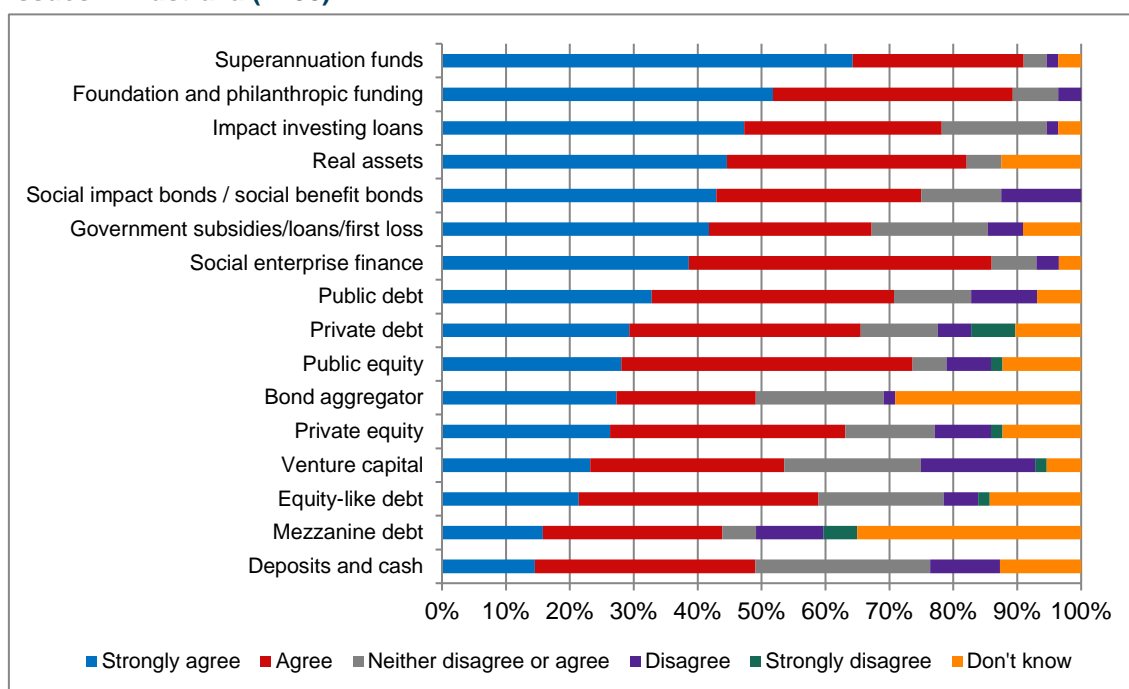
Increasing standardisation and lessons learned across jurisdictions may over time build an evidence-base that provides data to more easily accord value to outcomes. Standardisation might also facilitate replicable models that mitigate complexity associated with implementation and scalability to enhance impact.

Where SIBs might be deployed are as a tool for policy innovation, that may later be redeployed into wider service delivery design (Tyler and Stephens 2016). SIBs have potential for shifting the focus from funding activities and outputs to paying for outcomes (Ragin and Palandjian 2013). Refocusing government towards prevention and early intervention using a sound evidence base lowers government expenditure by reducing future costs (Dear, Helbitz et al. 2016), SIBs can also act as a framework to enable and facilitate cross-sectoral collaboration.

### 3.2 Perspectives on financial models for housing and homelessness

Perspectives were examined on the potential of a range of financial models (investors and investment vehicles) for enabling SII to address housing and homelessness. As shown in Figure 8 below, there were varying levels of support for a range of models.

**Figure 8: Types of financing that can enable SII to address housing and homelessness issues in Australia (n=58)**

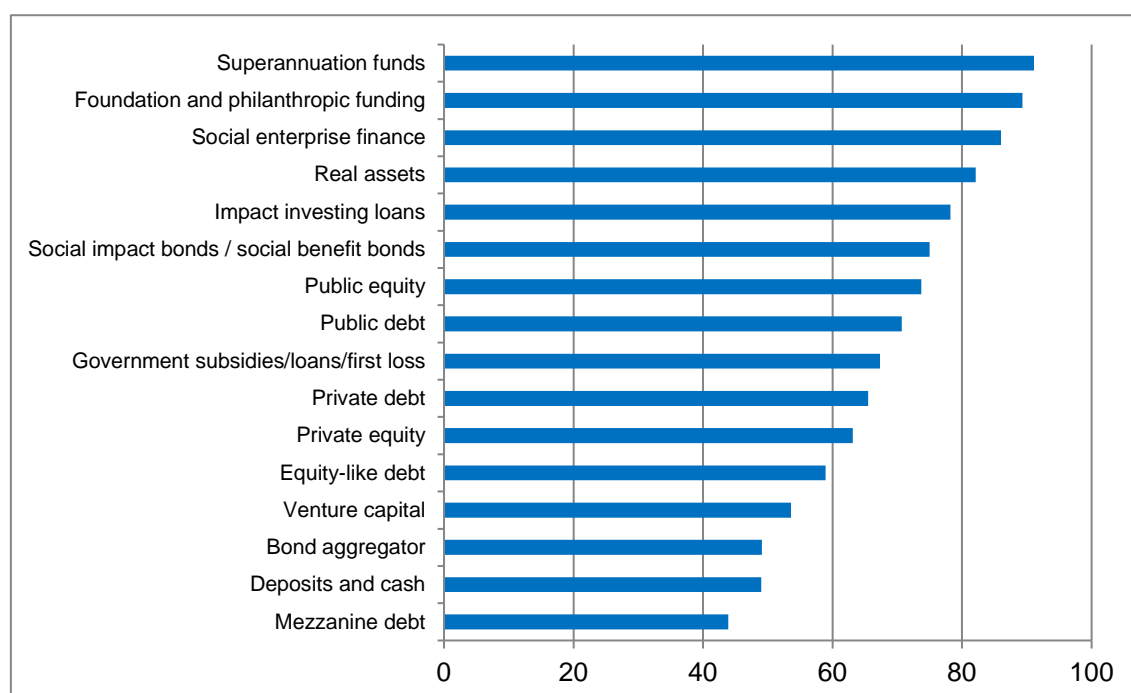


Note: Missing n is between 0 and 3 across the items ranked.

When asked to rank the top three financial models for enabling SII to address housing and homelessness issues, superannuation funds (investor), government subsidies/loans/first loss (government) and SIBs (investment vehicle) were most commonly ranked as the options with the most potential, when the perspectives of the different stakeholder groups were combined (Figure 9 below). As discussed earlier, while government plays many roles in addressing both affordable housing and homelessness, SIBs have more potential to address homelessness

issues, and superannuation funds to address affordable housing issues through property funds. The latter—property funds—have greater potential for addressing housing issues at scale.

**Figure 9: Top three types of financing that have the most potential to enable SII to address housing and homelessness as ranked by stakeholders overall (n=64)**



When examined by stakeholder group, the three financial models noted above appeared across the rankings by the different groups, although sometimes combined with other options (Table 11 below).

**Table 11: Top three financial models with potential for SII as ranked by stakeholder groups (n=56)**

SII experience only	Housing and homelessness experience only	SII and housing and homelessness experience	Investors
<b>1</b> Superannuation funds (n=7) <b>2</b> Government subsidies/loans/first loss (n=6) <b>3</b> Foundations and philanthropic funding / Private debt (tied; n=4)	<b>1</b> SIBs (n=9) <b>2</b> Superannuation funds (n=8) <b>3</b> Social enterprise finance (n=6)	<b>1</b> Superannuation funds (n=7) <b>2</b> Government subsidies/loans/first loss / Impact investing loans / Social enterprise finance (tied; n=4)	<b>1</b> Superannuation funds / Government subsidies/loans/first loss (tied; n=6) <b>2</b> Real assets (n=5) <b>3</b> SIBs / Foundations and philanthropic funding (tied; n=4)

The reasons for favouring superannuation funds, government subsidies/loans/first loss and SIBs are described below, along with some caveats about under what circumstances they might work. The potential of some other models is discussed as they relate these three financial models, including debt finance (loans, public and private debt, bond aggregator) as it relates to superannuation funds. Social enterprises (social enterprise finance, private equity, venture capital) are also discussed in a separate section, as social enterprises relate to both CHPs and homelessness.

### 3.2.1 Superannuation funds

Superannuation funds were perceived as an untapped source of significant capital and scale for SII in affordable housing. Further, involvement in SII would allow superannuation funds an opportunity to meet perceived client demands for more value-based, stable investment options and improve society. There was therefore considerable support for encouraging superannuation funds to become more involved in SII:

*'Superannuation funds is to me one area where they could step up because they probably, I'm thinking scale, and this is one area where you could do something of real scale. A several hundred million dollar fund of some type could be created.'* (Finance sector participant)

However, a superannuation fund stakeholder highlighted that such funds needed to be careful about the SII products they invest in, particularly in housing as the greatest asset belonging to many of their account holders is equity in their own home. Therefore, having too much of their account holders' portfolio invested in property would be a risk if the SII product was not substantially different to personal home ownership:

*... a lot of our members ... the biggest asset they have is their house, so therefore we don't want [them] also having their super largely invested in residential housing as well. So, I think from their perspective, they're expecting that we will be providing them with a different risk exposure than they currently have in their private portfolio, which includes their house ... So if our portfolio is invested in social housing, which is in affordable housing, which is also exposed to the same property dynamics as their house, it means that if the valuation of their house is going down, so is probably their superannuation balance as well.* (Finance sector participant)

Generally, but specifically for superannuation funds, there was significant support for using debt finance in SII, largely because it is a simple type of finance that is well understood and is associated with a different risk profile and lower return expectations from investors:

*Simple finance [is needed]—the more simple the better. Debt funding ... it's clean, simple, understood ... If you put a complex financial product in the mix, even the financing of the social impact project, that complexity is unnecessary for what you're actually looking to fund and looking to achieve.'* (SII expertise participant)

*I think there seems to be more of an appetite for debt finance as a key form for financing in social and affordable housing and from what we've found that seems to be due to the rates of return expectations, particularly from superannuation funds and other institutional investors between debt versus equity financing. So with equity financing we've found that the rates of return expected by funds are very high, with debt financing they're a lot lower.* (government participant)

There was support for the bond aggregator model as a particular form of debt finance:

*'... we've received close to 80 submissions on our work, have been most heavily geared towards the bond aggregator. Now, what that does is look at aggregating the borrowing requirements of community housing providers and then you have some sort of financial intermediary that issues a bond to the market to raise finances and then to promote that finance to community housing providers.* (Government participant)

Given that superannuation funds were considered the top financing option for SII in housing and homelessness, this highlights that product design with respect to investors' existing wealth portfolios is a key issue that requires work and consideration.



### 3.2.2 Government subsidies/loans/first loss

Government subsidies and related financial mechanisms were seen as key financial models for SII. Such subsidies were seen as what was required to make SII deals work: '[w]ithout the government subsidies, the deals just don't stack up financially' (government participant).

This view was often related to government's key role in de-risking investments for other investors and stakeholders. Across the research, stakeholders identified a range of ways that government could play a role in de-risking and/or otherwise facilitating the investments for other partners, including providing:

- income certainty:
  - rental guarantees on housing
  - providing a revenue stream to investors
  - government guarantees or under-writing of losses
  - subsidies or coupons.
- investment:
  - contribution to wholesale funds
  - contribution of a layer of capital through grant funding
  - government first loss or first-loss capital.
- establishment costs:
  - contribution of government funds to enable short term trials
  - covering the transaction costs of SII deals
  - funding the upfront analytic work on social impact bonds, with public release of information to avoid duplication of analysis costs
  - being the anchor investor in unfamiliar opportunities
  - putting in money before investors to enable a track record of deals.
- capital costs:
  - funding a pipeline of deals.

Notably, each of these roles in de-risking SII for other investors and stakeholders holds contingent financial risks for government, with the offset being increased supply.

### 3.2.3 Social impact bonds

SIBs were the current financial model of SII that stakeholders in the research were most familiar with. Some, however, warned against conflating all SII with this financial model, highlighting that SIBs were not appropriate in all situations. For example, one stakeholder with significant experience in assessing SII initiatives around the world highlighted that SIBs held potential as a financial model for pilot programs and/or small-scale implementation, but was not as well-suited to large-scale program roll out:

*Social impact bonds ... work well in a context where you are putting together small service providers who might otherwise not have access to the ability to get funding and to demonstrate that they can actually carry out a program of the kind that the outcome fund is trying to procure ... but social impact bonds are less appropriate for a large-scale replication project, because of the nature of what they are good at doing, in terms of bringing people together, it's something that works well for an intensive activity, not something that works better than a standard government procurement*

*arrangement for a roll out, for instance, of a large program of housing stock. (SII expertise participant)*

### 3.2.4 Social enterprises

While social enterprises were identified as a financial model to address homelessness and affordable housing, two identified issues were the investability of CHPs and high transaction costs.

Investors and those with other SII experience, for example, as intermediaries, mentioned the attractiveness of larger, more efficiently managed CHPs for investment decisions:

*I think consolidation or at least growth of potential buyers which is generally going to be the housing providers. The more we have large-scale operators that are sophisticated, they're run very efficiently the more that private capital will be attracted to lending to those providers. In a perfect world housing providers would be 'investment grade' rated and so all of [a] sudden financiers ... have even greater levels of comfort around providing capital into them. (SII expertise participant)*

*Housing providers need to start thinking differently ... The ones that have an appetite to play are starting to get themselves really nicely efficient and effective. The way that they're running their P&L, their governance structures, risk management, they look good to an investor, and they look investible. ... I think as a capacity building, which will serve them well at attracting impact investors but will also serve them well in running their business over the years. (SII expertise participant)*

Alongside increasing their scale and efficiency, they envisioned that CHPs would also need to shift their mindset to work in areas they might not have previously (e.g. provide both physical residences and services, if they had not done this before). They should also further develop their data collection, measurement and evaluation processes to better demonstrate their efficiency and outcomes achieved to investors.

## 3.3 Perspectives on combining financial models

The potential of combining financial models to enable SII to address housing and homelessness was also examined. Overall, 60 per cent (n=36) of stakeholders agreed or strongly agreed that SII was more likely to be successful when used in combination with other funding/financing sources (with 21.6%, n=13 disagreeing or strongly disagreeing and the remainder unsure). Notably, investors and those with both SII and housing and homelessness experience most frequently thought combining financial models would be successful (71.4%, n=10 and 72.7%, n=8, respectively). The reasons given included that combining different types of finance was seen as a way to de-risk the investment for investors:

*I think that [combining different types of finance] could be useful in terms of de-risking some of these opportunities, because [as] I said earlier, we've invested in opportunities in which half of the capital is provided by a government entity, for example, and the other half is provided by us [an institutional investor] and the other institutional investors ... So I think actually there is room for different types of capital to come in, because they can kind of help each other to achieve their objectives without negating their own objectives. (Finance sector participant)*

Combining financial models would also allow particular investors with different return expectation thresholds to work together, thereby better achieving their social objectives:

*So we think that a foundation can come in and collaborate alongside us with a view that they are only investing to get the capital back, and we are investing to get the*

*capital back plus a return on investment, because we are commission-based. But what that does, it helps the foundation to have additional capital allocated to achieve their social objectives that they would have as a foundation, as an example. (Finance sector participant)*

The example above also shows that combination with funds from foundations and philanthropy was seen as a key option. There was a perception that foundations and philanthropists would be putting grant funding into many of the social issues that SII might address anyway, thus participating in SII through making PRIs would align with their mission. They would also have more patient capital, so would potentially be less concerned with risk and return rates and the timeline of outcomes:

*Philanthropists ... they do represent a key stakeholder ... it's the personal interests that come with that, and the ability to forgive failing that is a little bit different to what's going on with a set of private investors. (SII expertise participant)*

Foundations and philanthropy can benefit from participating in SII via PRIs. Other work has shown that PRIs, for example, can enable organisations to recycle capital either as additional PRIs or grants if the SII is successful, leverage the impact of their investment using private capital on commercial terms, and/or support initiatives that would not attract commercial investors or a traditional grant (Seibert 2015). However, there are also a number of current regulatory constraints to foundations and philanthropy using SII in this way, including that: (a) only the difference between the discounted and market interest rate can be counted towards a minimum annual distribution;<sup>14</sup> and that (b) investments can only be made to registered DGRs, which precludes investment into for-profit social enterprises and a variety of other organisations (Seibert 2015). The Australian Government sought consultation on these issues<sup>15</sup> in its *Social Impact Investing Discussion Paper* (The Treasury 2017).

The group in the interviews who disagreed with combining financial models—often people who had experience in past SII deals—was concerned about the complexity that combined financial arrangements would produce. They were concerned that complexity would discourage investors from becoming involved and would make the SII deals less likely to succeed in achieving their intended outcomes:

*Well, I think, the more straightforward you keep it, the more likely you are to get investors, because this is new and people don't understand it. The harder you make it, the more structured the product is, the harder it is to sell and communicate what you're selling. (Finance sector participant)*

*I think that the more cooks you have in the kitchen, the more difficult it can become, unless you legislate in your arrangements for these different types of funding and what their relative influence is on the project. (SII expertise participant)*

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<sup>14</sup> This adds complexity as investments need to be partly treated as a minimum annual distribution and partly treated as a corpus investment. It also means that foundations may be more inclined to make SIIs that can be treated as PRIs from their minimum annual grant making, than make mission related investments from their corpus—particularly in the earlier stages of the SII market's development and until the financial return aspects of SII have a more established track record.

<sup>15</sup> To allow ancillary funds to count the total loan as part of their minimum annual distribution, with any repaid principal added to the minimum annual distribution that year; to allow ancillary funds to lend to a broader range of organisations beyond DGRs, including registered charities, SIBs issued in partnership with a government agency and investments made through a designated SII intermediary; and whether a broader PRI framework if introduced, could be applied to non-ancillary fund foundations, for example, testamentary trusts.

When asked in the survey, 80 per cent (n=48) of stakeholders agreed or strongly agreed that complex investment structures might deter potential investors. Notably, this included all but one of the investors (92.9%, n=13). It also included 64.6 per cent (n=31) of the people who supported combining financial models, suggesting that some people may not have considered the consequences of combining. A lower 45.9 per cent (n=28) agreed or strongly agreed that complex investment structures would be less likely to achieve their intended outcomes.

Overall, the perspectives here on the utility and potential success of combining financial models are important. Given the concerns highlighted by some stakeholders, particularly investors themselves, the implication is that if combining financial models is to be successful and achieve benefits it could provide, then attention to easily understandable SII products is important. This reduces complexity to encourage potential investors.

### 3.4 Financial models: Policy development implications

- A stable regulatory and funding environment from the Australian Government is crucial for SII:
  - Evidence from the international policy review (e.g. LIHTC, *Community Reinvestment Act* 1977 and New Market Tax Credit Program in the US and supportive CHP environment in UK) and consistent feedback from participants in the workshop, interviews and survey reveals that investors require a stable regulatory environment to consider the sector as an investable and investment ready.
  - A stable funding environment is necessary to consider particular investments, for example Commonwealth Rental Assistance, is an important component in the transition from public housing to social housing as well as generating a stable and long-term source of revenue.
  - Policy change and regulatory uncertainty hinders investment. For example, the discontinuation of the NRAS was seen as premature despite NRAS's limitations. Policy requires time to settle following implementation and can be improved as learnings are addressed.
- Government has roles in supply, demand and intermediation:
  - Government will continue to provide and fund affordable housing and fund homelessness services.
  - Government will continue to be in a position where citizens experience housing unaffordability and homelessness and require support.
  - Government has a key role in providing the enabling environments including acting in coordination roles.
- Government subsidies and related financial mechanism are needed in SII to close the financing gap, de-risk investments to attract superannuation funds and other institutional capital at scale. As noted in the Council on Federal Financial Relations report: '[n]o innovative financing model will close this gap and a sustained increase in the investment by governments is required to stimulate affordable housing production and attract private and institutional investment' (Council of Federal Financial Relations 2016b: 2).
  - Other forms of government assistance could help close the financing gap—including access to discounted or free land, mandating or encouraging mixed developments, inclusionary zoning requirements, exceptions to zoning and planning regulations, additional recurrent funding and direct grants from government (Council on Federal Financial Relations 2016b: 18).

- Complementary reforms could assist further in creating an environment for the success of innovative financial models—including nationally consistent CHP regulation, zoning and planning regulations, and concessions and taxation. These would strengthen governments and CHP capacity to effectively increase affordable housing supply (Council on Federal Financial Relations 2016b: 2).
- Given the complexity of homelessness and affordable housing issues, government should consider models from each of the key SII models—namely property funds, SIBs and social enterprise:
  - For debt property funds—consider the aggregator model (which has a successful precedent in the UK) as per the Council on Federal Relations (2016b) and which provides scale, lower cost finance and longer tenor; has support of investors, intermediaries and CHPs; would somewhat increase social housing supply; and could be used as a platform with additional government investment to substantially increase both social and affordable housing supply.
  - For equity property funds—reconsider the NRAS model, applying lessons from NRAS; consider provision of capital in the form of the UK’s BRF, where capital can be recycled as institutions invest once assets are de-risked, and consider additional subsidies or changes to the tax environment that would make residential property more attractive and competitive as an institutional (equity) asset-class.
  - For social enterprises—develop the enabling policy framework for social enterprises in Australia (leveraging work done in this area internationally and notably the six components identified by the European Commission); provide assistance for increasing the scale and sophistication of CHPs, and promote the sustainability of CHP business models by ensuring adequate flexibility and an appropriate funding and tenant mix for CHPs to provide services, maintenance and development of new stock.
  - For SIBs—enhance the enabling environment including support for initiatives across the states/territories and consideration of contribution to development costs; encourage development of best practices and standardisation across the states/territories, to address issues of high transaction costs and lengthy development timelines; and encourage development of consistent outcomes measurement across the states/territories.
- Combining financial models may increase the viability and success of SII transactions and offer stakeholders different benefits—but can increase complexity. Due care needs to be given to ensure SII products are simple, clear and easy to understand so as not to deter potential investors and service providers and so that the benefits of combining financial models are more likely to be achieved.

## **4 Social impact investment markets in housing and homelessness—case studies in practice and local perspectives for application in Australia**

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- The potential 'market' for SII in housing and homelessness is categorised into two overlapping segments of services and property. Homelessness is a key focus for the services segment, which is predominantly provided by social sector organisations with significant government funding. The mixed property and services segment is primarily focused on the provision of affordable housing with additional support services provided to tenants to support life goals and successful tenancies, often provided or managed by CHPs. The property segment attracts a much broader range of actors who are focused on investment in affordable housing (often enabled by various forms of tax incentives or subsidies).
- Perspectives on preferred models and instruments differed depending on actor's roles, experiences and preferences. Of particular note was that those with direct experiences in delivering services and SIIs were somewhat more circumspect in their views, suggesting greater appreciation for the complexity involved. There was more alignment on the recognised need for more investable products and for government to act on a broad range of policy levers to increase housing supply.
- SII was seen as having potential to increase supply of affordable—and, to a lesser extent, social—housing, although some questioned whether SII could fund construction at scale. While there was broad agreement that SII could fund housing or tenancy support services and specialist homelessness services, the strongest response was to funding support services in areas that intersected with housing to promote and maintain successful tenancies.
- Several benefits of using SII in housing and homelessness were identified, most importantly for beneficiaries, but also for government to potentially attain dual social and financial benefits without bearing the full capital cost upfront. SII poses particular risks to all stakeholders and most importantly to beneficiaries if the initiative is ill conceived, poorly executed or used in inappropriate settings. These risks need careful consideration in determining whether SII is the most appropriate model in a given context, and in the design and implementation of SII solutions.
- In assessing the potential for SII to assist different groups, the research revealed somewhat stronger preferences towards young people, homeless people, women, single parents with children and people with a disability. Reasoning centred on the ability to accrue long-term savings and outcomes to government by intervening early before disadvantage becomes entrenched. Another line of reasoning was that SII should focus on the most disadvantaged groups as this heightened the social commitment and potential impact. However, there was broad acknowledgement of the need to have confidence in the ability to influence



outcomes for the group(s) targeted, which may preclude or add additional challenges for targeting some highly disadvantaged groups with very complex needs.

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## 4.1 Social impact investment markets in housing and homelessness

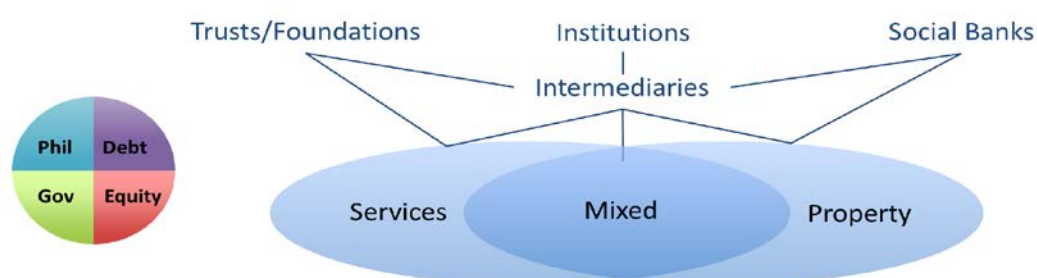
To increase understanding of how SII can be applied to housing and homelessness policy to create better outcomes in Australia, this section examines local and international case studies of SII in practice. It provides insights and perspectives on key risks and opportunities in how SII might be applied in the local context to increase affordable and social housing supply and to provide housing and homelessness support services across the three markets (services, mixed property and services, property).

More specifically, this section identifies the actual and potential SII markets in housing and homelessness. It provides examples of SIIs, spanning the three most relevant SII types as detailed in Chapter 3 (property funds, social enterprises and SIBs) from Australia and overseas, that:

- address homelessness and affordable housing issues
- use services and/or property to address the issues
- illustrate the different SII options available and ways that different actors (and providers of capital) have contributed to each intervention.

As outlined in Section 1.3.4, the potential ‘market’ for SII in housing and homelessness can be segmented into two overlapping categories, *services* and *property*, with different blends of capital (funding and financing) targeted at different points on the housing continuum (Figure 10 below). Transactions have been predominately bespoke and characterised by a diversity of instruments, vehicles and structures. This section describes potential models of SIIs with typical funding and financing mixes and types of investors.<sup>16</sup>

**Figure 10: Actual and potential SII markets in housing and homelessness**



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<sup>16</sup> Of the examples provided, the HSB with intermediary and guarantee and SIBs are examined in more detail in Chapter 5.



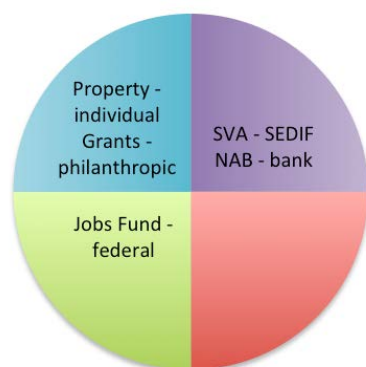
### 4.1.1 Services

The *services* pool includes funding and financing targeted at organisations that provide support to those experiencing *homelessness*. In Australia, service provision is predominately provided by social sector organisations, with significant government funding (Flatau, Wood et al. 2015).

The actors in pure service provision associated with social finance and SII include NFPs, NFP social enterprise, social businesses and vehicles such as SIBs.

#### ***Social enterprise model examples***

**Figure 11: Social enterprise model examples**



Source: Pro bono 2016b; STREAT 2015.

Homelessness social enterprises, may be recipients of loans (debt) from government, mainstream (banks) or specialist (social enterprise and investment intermediaries) lenders, philanthropic trusts or individuals to support services.

A homelessness social enterprise that has accessed a mix of funding and finance is STREAT which has developed a new site called Cromwell Manor.<sup>17</sup> The short-term construction debt provided by NAB and SVA is being refinanced with a longer-term bond targeted at social impact investors, as the operating asset has been de-risked.

#### ***Social impact bond examples***

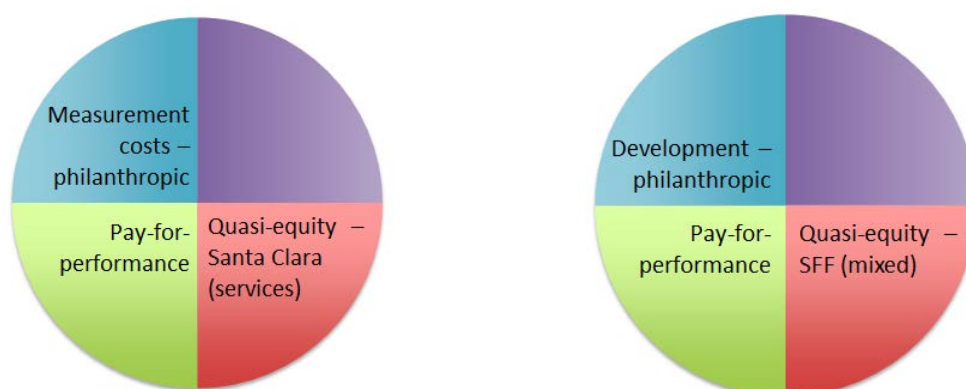
A range of social investors including philanthropic trusts, institutions and individuals, provide capital for SIBs and receive returns from government commensurate with the efficacy of the intervention.

The Santa Clara homelessness SIBs supports the provision of services. The Stronger Families Fund (SFF) has a SIB as part of a larger intervention that also includes development of affordable housing. The financing of SIBs can include additional funding for measurement or development from philanthropic trusts (or financing through funds).

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<sup>17</sup> A separate SII for STREAT involved establishing a new entity (proprietary limited) to facilitate equity investments in a coffee roasting company with two cafes (<http://socialventures.com.au/assets/STREATs-Acquisition-of-SRC-Case-Study-FINAL.pdf>)

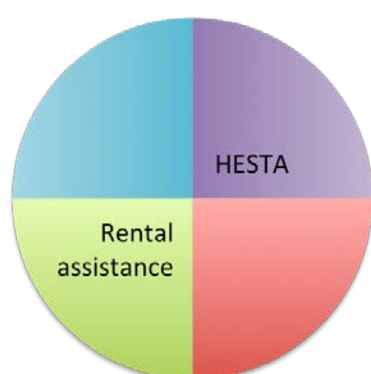
**Figure 12: Social impact bond examples**



Source: The County of Santa Clara 2015; The Kresge Foundation 2015

### 4.1.2 Mixed property and services examples

**Figure 13: Mixed property and services example**



The mixed services and property pool includes funding and financing of organisations primarily focused on the provision of affordable housing. This includes large and small CHPs that own and/or manage housing and provide tenants with support services.

Superannuation fund HESTA (via Social Ventures Australia) recently invested in Horizon Housing, a CHP, enabling it to acquire a portfolio of management rights.

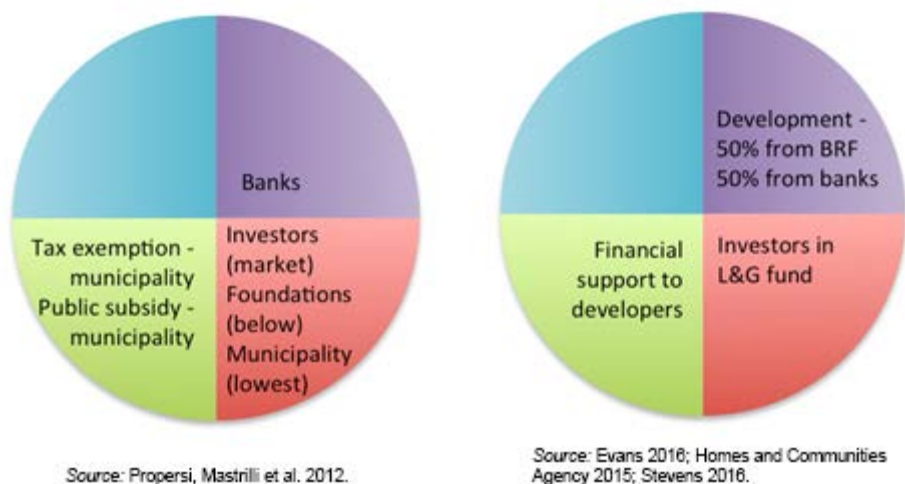
Source: Social Ventures Australia 2015; HESTA 2016.

### 4.1.3 The property pool

The property pool includes funding and financing vehicles in which actors and organisations are primarily focused on investment in affordable *housing*. This has the potential to include a wide range of organisations including high net worth individuals (HNWIs); philanthropic trusts and foundations; diversified financial institutions; social banks; credit unions, and superannuation funds. However, some of these organisations require a degree of government support, in the form of tax incentives or guarantees. Many investors also require intermediaries to structure appropriate investment vehicles. The structure of these vehicles may include some investors which do not receive market returns (impact first), to facilitate the remainder receiving market returns (finance first). This reflects possible low rental yields from affordable housing. Alternatively, mixed-use developments facilitate construction of affordable housing alongside housing that is sold on the property market and delivers market returns. The property pool includes equity and debt investment.

## Equity

**Figure 14: Equity examples**



Property trusts are equity investments, which provide institutional investors with scale and experienced management (Newell, Lee et al. 2015a; 2015b). CHPs could create affordable housing wholesale property trusts using existing assets or partner with a developer and investors to build new affordable housing owned by a fund.

In Italy, local municipalities work with banking foundations and equity investors to develop affordable housing, where different investors in the equity fund receive different returns.

Through the BRF (Section 3.1.3) the UK Government provides financial support for housing providers to develop rental properties that institutional investors can own once they have tenants as many investors do not want the development risk.

**Figure 15: Debt examples**



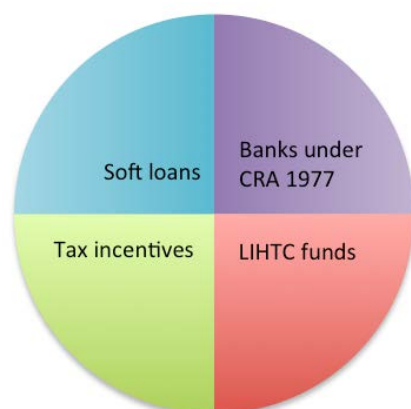
Source: Council on Federal Financial Relations 2016b.

Historically CHPs have borrowed from banks to fund development and refurbishment. While the finance is readily available, the terms are short and it is at commercial rates (Lawson, Berry et al. 2014).

Alternative sources of debt finance are an Australian HSB with government guarantees and a specialised financial intermediary bond (bond aggregator).

## Debt and equity

Figure 16: Debt and equity examples



Source: Blessing and Gilmour 2011.

In the US, external investment in affordable housing has been encouraged by the policy frameworks described in Section 3.1.3. Equity investors receive tax incentives in the form of LIHTCs and mainstream banks are encouraged to provide loans to disadvantaged communities under the Community Reinvestment Act. Affordable housing is often part of a mixed-use development.

In this context, the research examined the extent to which participants thought that SII could be applied to housing and housing support services, to understand more about how it may be used to further develop this housing policy context in Australia.

### 4.1.4 Outcomes measurement and social impact investment markets

SII requires robust measurement of the social and financial aspects. Currently, much of the focus is on the economic return with some limited understanding from some actors about the complexity of the evidence pathways and difficulty of social outcomes measurement. Different outcomes measurement frameworks and indicators are used across the services, mixed services and property, and property pools, which makes it difficult to compare the costs and effects of different intervention types.

SIBs and other SII instruments require robust measurement frameworks. Assessing and measuring outcomes is an area associated with wider funding and financing of social sector organisations and not unique to SII. The promise of pay-for-performance and SIBs is to understand and reward outcomes (Dear, Helbitz et al. 2016). This contrasts with a long-standing focus on activities and outputs among policy-makers in service provision (Muir and Bennett 2014). SIBs are also only appropriate where outcomes are: meaningful and measurable; can be achieved in a reasonable timeframe; there is evidence of successful achievement, and where legal and political conditions are appropriate (Gustafsson-Wright, Gardiner et al. 2015).

Outcomes need to be standardised and calibrated to determine whether these have been met, whether outcomes should be paid for, and the appropriate return on investment (Dear, Helbitz et al. 2016). A number of SIBs have relied on the gold standard of evaluation—experimental and quasi-experimental designs (Fox and Albertson 2011)—to establish counterfactuals. An example of this approach in practice is the Denver homelessness SIB. Other SIBs in housing and homelessness have relied on more traditional output and outcomes measurement including the London Homelessness SIBs, which weights payments around indicators associated with health, stable accommodation and employment outcomes (Department for Communities and Local Government 2015).

Property funds employ a range of frameworks. Some of these are bespoke. Others rely on industry standards developed to provide universal benchmarks. The Impact Reporting and Investment Standards (IRIS) Metrics have been developed by the GIIN. These are specifically targeted at SII. The IRIS Metrics for housing focus on indicators such as 'individuals housed', 'number of units constructed' (IRIS 2016). These are output-oriented indicators. By contrast, Big Society Capital (2016) has developed indicators that are outcomes focused and consider behavioural changes such as secure and suitable living conditions, location, skills and labour

market outcomes (where appropriate). The Centre for Social Impact is currently working with NSW Homelessness, the NSW Housing Federation and NSW Government on developing a shared outcomes measurement framework and a database of indicators to measure outcomes that support safe, stable, affordable housing. High quality shared outcomes measurement frameworks and process evaluations will be needed to demonstrate the efficacy of SIs going forward.

As a nascent field, the evidence for SI interventions compared to other funded intervention types is not yet clear. The evidence-base on SIs, for example, is emergent and their efficacy relative to other interventions remains inconclusive at this early stage (Fox and Albertson 2011).

Further, it is important to distinguish between the outcomes of social innovations (new and improved responses to complex social problems) and financial innovations that support housing and homelessness goals. For example, how do property funds and other financing mechanisms that are principally focused on expanding the availability of capital deliver and intend to improve social outcomes compare to a mainstream loan with no intentionality? There is no current evidence to answer this question.

Additionally, evaluative evidence on whether SI financing structures contribute to unintended consequences and the nature of those consequences if they exist are not yet known. For example, are there negative implications for social outcomes or will SIs displace other programs that may provide comparable or better outcomes? Further research on these critical questions is required. This is particularly important given that SI, including SIs and other forms of pay-for-performance, are not suitable for all areas of housing and homelessness. Opportunities only exist where the investment in the program or intervention can result in financial and social returns (Dear, Helbitz et al. 2016). SI is not appropriate where: the costs of the intervention are higher than the financial and social returns; there is insufficient investment readiness or absorptive capacity; markets are thin and returns low, and outcomes have very long-term horizons, beyond the appetite of investors. Importantly, different mechanisms for funding social services including block grants remain critical. SI does not aim to replace traditional models unless the context and settings are appropriate and outcomes can be effectively measured and compared.

## **4.2 Perspectives on increasing affordable and social housing supply using social impact investment**

### **4.2.1 Potential to increase affordable and social housing supply**

Perspectives were examined on the potential of SI to be used to increase housing supply. As shown in Figure 17 below, 83.9 per cent (n=47) of participants agreed or strongly agreed that SI could, under certain conditions, be used to increase both the availability of affordable housing and the provision of social housing. Investors and those with SI experience only were however more frequently confident of this than those with housing and homelessness experience or combined SI and housing and homelessness experience.<sup>18</sup>

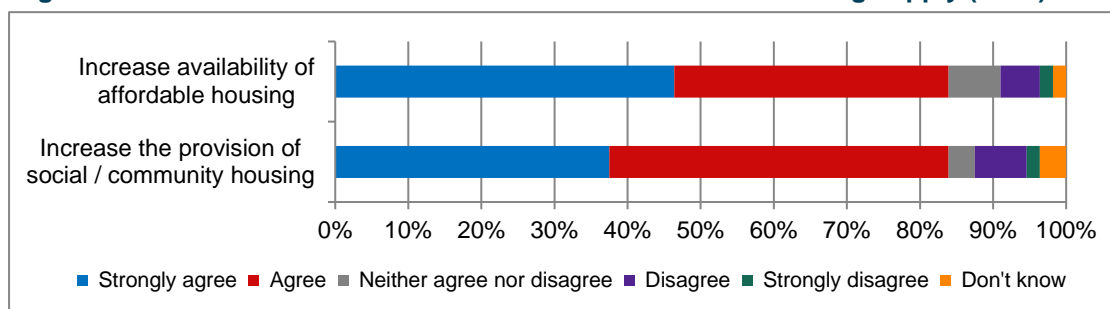
Overall, there was slightly stronger confidence in SI's application to affordable housing, where 46.4 per cent (n=26) of stakeholders overall strongly agreed that it would be successful in increasing availability, as opposed to 37.5 per cent (n=21) in strong agreement for social

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<sup>18</sup> Increase availability of affordable housing supply: 100 per cent, n=13 investors and 92.9 per cent, n=13 SI only compared to 70.6 per cent, n=12 housing and homelessness only and 72.8 per cent, n=8 SI and housing and homelessness; Increase provision of social housing: 92.3 per cent, n=12 investors and 100 per cent, n=14 SI only compared to 76.5 per cent, n=13 housing and homelessness and 63.7 per cent, n=7 SI and housing and homelessness.

housing. However, the proportion of stakeholders who strongly agreed was higher among investors (69.2%, n=9 for affordable housing and 61.5%, n=8 for social housing) compared to only a quarter (27.3%) to half (50%) of the other stakeholder groups.

**Figure 17: Potential of SII to increase social and affordable housing supply (n=56)**



There was some concern that social housing might involve higher costs than affordable housing, more intensive supports and higher risks for investors. The low incomes and welfare payments received by social housing tenants were seen by some stakeholders as potentially insufficient to generate the necessary returns to investors over a reasonable timeframe. Other stakeholders however noted that, while small, welfare payments presented a predictable source of income that could be planned into secure long-term SII deals. This may be reflected in different sizes and mixes of debt or equity SII for social housing and affordable housing.

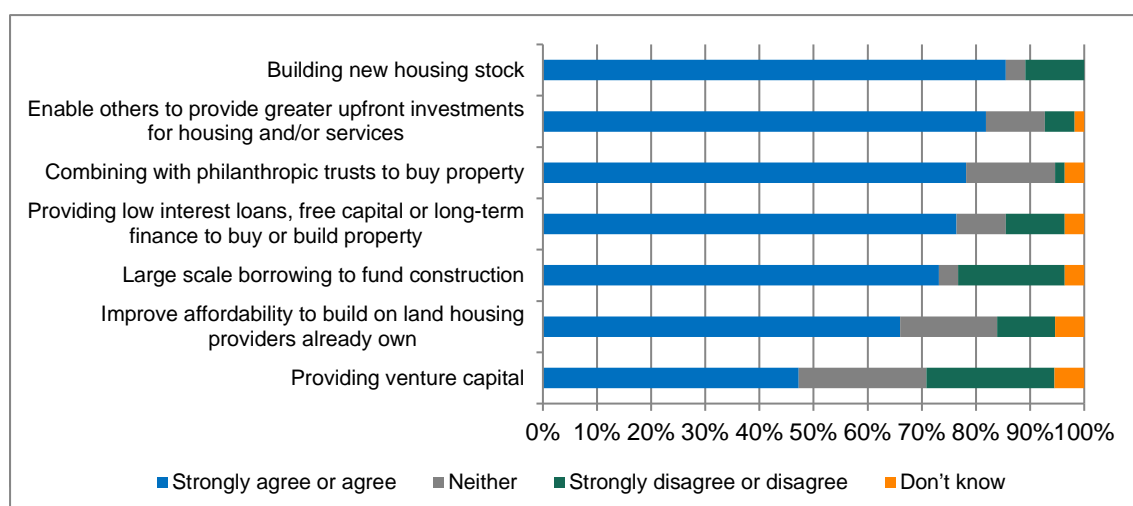
There were a few participants who doubted the current capacity of SII to fund the construction of any housing in Australia, irrespective of whether it was affordable or social housing. They thought that in Australia 'we haven't seen the scale required for SII [to] fund housing construction' (government participant) and SII is so far 'untested' (housing and homelessness sector participant) in the area of funding Australian housing construction. They were keen to see the application of SII to housing development in the future, but remained uncertain that it could happen at present.

#### **4.2.2 Applications to increase affordable and social housing supply**

Perspectives were also examined on the methods by which SII might be applied to increase housing stock (Figure 18 below). Directly funding the building of housing, enabling others to provide greater upfront investments and combining with philanthropic trusts to buy property were the three options that stakeholders most commonly agreed or strongly agreed with. Investors and those with SII experience particularly favoured directly building new housing stock, whereas people with housing and homelessness experience favoured enabling others to provide greater upfront investments.



**Figure 18: Methods for increasing housing supply (n=56)**



Others highlighted particular models that they thought would work to increase housing supply. One of the workshop groups developed a scenario by which SII could fund 10,000 new affordable houses for low to middle income families (see Box below).

#### **Box 5: Systems thinking workshop scenario—increasing affordable housing stock**

Through the use of an existing example called 'The Housing Bank', the group hypothesised that SII could finance new affordable housing in convenient locations for low to middle income families. The Housing Bank would issue notes (debt) to enable superannuation funds to invest in affordable housing, with government guaranteeing or paying the coupon or interest on the notes. If government allocated A\$100 million a year for ten years, then this could cover A\$2.5 billion worth of borrowing. If this amount was lent to CHPs, who came up with 25 per cent equity, it could stimulate almost A\$4 billion of investment, enabling the development of 10,000 affordable houses, at 75 per cent of the market rate in the area. This could accommodate 4,000 low to middle income families. The financial return was projected to be 4 per cent and the group thought it was highly likely to be rated at least at the low end of the investment grade.

To enable these options, there was widespread identification of the need for more investment products and for government to act on policy levers to aid housing development. A large range of possible levers were raised. These included addressing concessional planning, zoning allowances, inclusionary zoning, negative gearing, planning laws, leasing and secure tenancy policies, affordable housing policies, tax credits and incentives, incentives to attract superannuation funds, long-term management leases, providing government-owned stock, planning consents, land availability and borrowing against the 'AAA' rating.

Overall, the top three policy levers that stakeholders thought were critical to implement correctly were affordable housing policies (62.5%, n=35), tax credits and/or incentives for investors (58.9%, n=33) and incentives to attract superannuation funds (53.6%, n=30). There was, however, variation between which policy levers different stakeholders thought were most important. Tax credits or incentives for investors were most often selected as critical by stakeholders with SII experience only (see Table 12 below). Incentives to attract superannuation funds were more often selected by investors and stakeholders with housing and homelessness experience than other stakeholder groups (see Table 12).



**Table 12: Top three critical policy areas for SII as ranked by stakeholder groups (n=56)**

SII experience only	Housing and homelessness experience only	SII and housing and homelessness experience	Investors
<b>1</b> Tax credits or incentives for investors (n=13). <b>2</b> Affordable housing policies (n=9). <b>3</b> Stable policy and regulatory context (n=7).	<b>1</b> Incentives to attract superannuation funds (n=10). <b>2</b> Tax credits or incentives for investors / Affordable housing policies (tied; n=9).	<b>1</b> Affordable housing policies (n=9). <b>2</b> Data collection across multiple departments and agencies (n=6). <b>3</b> Incentives to attract superannuation funds (n=5).	<b>1</b> Affordable housing policies / Incentives to attract superannuation funds (tied; n=8). <b>2</b> Tax credits or incentives for investors (n=7).

#### 4.2.3 Benefits of increasing affordable and social housing supply

Participants cited a range of benefits of increasing housing supply. Benefits were mainly framed for the tenants of the affordable or social housing that would be developed, indicating that it would allow them greater potential to achieve their housing aspirations, with associated quality of life implications. For example, increasing the supply of affordable housing was seen as a beneficial opportunity for low to middle income families: lowering rental costs was seen to hold potential to help families ‘avoid rental stress or having to commute two hours a day, run 12-hour shifts and then never see their kids, [creating] families stress’ (workshop participant; investor).

In the case of social housing, benefits were not only framed in terms of increased availability of housing, but also with regard to property quality. One formerly homeless person, for example, thought that funding social housing from outside the constraints of government might result in ‘nicer’ houses for tenants and quicker entry to housing:

*Obviously [with SII], it's not costing the government as much as it should be. People would be housed quicker. I think they'll get nicer units and units that are a bit more updated, well looked after, that won't be the normal housing units, [that's what I] assume. (Formerly homeless advocate participant)*

Another formerly homeless person hoped that SII might have a role in creating social housing that was more fit-for-purpose for people in a variety of circumstances and life-stages; for example, houses with enough rooms to accommodate a large family or that were in safe locations, close to schools, public transport and other amenities for children.

Benefits were also highlighted for government, including enabling government to address housing without having to bear full capital costs up-front and allowing government to attain dual social and financial benefits. Further, some stakeholders thought that—given the extent of the issues and costs involved in addressing housing supply—if SII could successfully address housing, then this could facilitate the application of SII to other complex social issues.

#### 4.2.4 Risks of increasing affordable and social housing supply

The risks of using SII to address affordable and social housing supply were also noted. A range of risks were explained and are summarised in Table 13 below.

**Table 13: Risks of using SII to increasing affordable and social housing supply<sup>19</sup>**

<i>Risks for tenants</i>	<ul style="list-style-type: none"> <li>• Risk that in building more affordable or social housing, these types of housing are pushed further out of inner-urban centres, creating pockets of disadvantage.</li> <li>• Risk that housing is built that is inappropriate for tenants (e.g. not in the right location or not the right size for families).</li> <li>• Risk of falling into a 'one-size fits all' model for housing, without consideration of the needs of demographically different groups of tenants.</li> </ul>	
<i>Risks for CHPs</i>	<ul style="list-style-type: none"> <li>• Risk in debt and legal commitments being taken on by CHPs when building properties, when their business model does not allow for it.</li> <li>• Risk that smaller CHPs get pushed out of the market, because they do not have the scale to be involved in building via SII.</li> </ul>	<p><i>'... they basically just [explained] all the things you would need to consider as a non-government organisation [entering into an SII], in terms of the contracts that you may be entering into, both with government and with the investors. The risk is largely with the NGOs basically. So, they carry the risk, and the service delivery requirements, but yet the return goes to the investor' (housing and homelessness sector participant).</i></p>
<i>Risks for investors</i>	<ul style="list-style-type: none"> <li>• Risk of changes in the housing market—that the 'housing bubble will pop'—and that this will affect returns to investors (for equity investments).</li> <li>• Risk for investors (particularly superannuation members) of having too much of their wealth portfolio invested in housing/property equity.</li> </ul>	
<i>Risks for government</i>	<ul style="list-style-type: none"> <li>• Risk that funding gets taken out of other housing initiatives to cover SII.</li> <li>• Insufficient pipeline of housing construction projects.</li> </ul>	<p><i>'It's difficult in the current environment to allocate more funding to one area, normally means that another area is getting less funding' (government participant).</i></p>
<i>Contextual and outcome risks</i>	<ul style="list-style-type: none"> <li>• Lack of long-term policy commitment to SII and housing policies; risk of policy changes before construction is complete.</li> <li>• Risk that development of more affordable or social housing through SII distorts the property market and pushes people who do not quite meet the criteria for affordable housing out of the property market.</li> <li>• Risk that SII will provide only the types of housing that are able to be financed, not those that are actually needed (i.e. builds more affordable than social housing, because affordable housing is less costly).</li> </ul>	

These and other risks may need to be addressed in order to enable a further role for SII in increasing affordable and social housing supply. Levers and potential solutions that begin to address some of these areas are included in Chapter 5.

<sup>19</sup> Intermediaries are not included in this table as their risks are about involvement in SII more generally, not specific to increasing social and affordable housing supply.

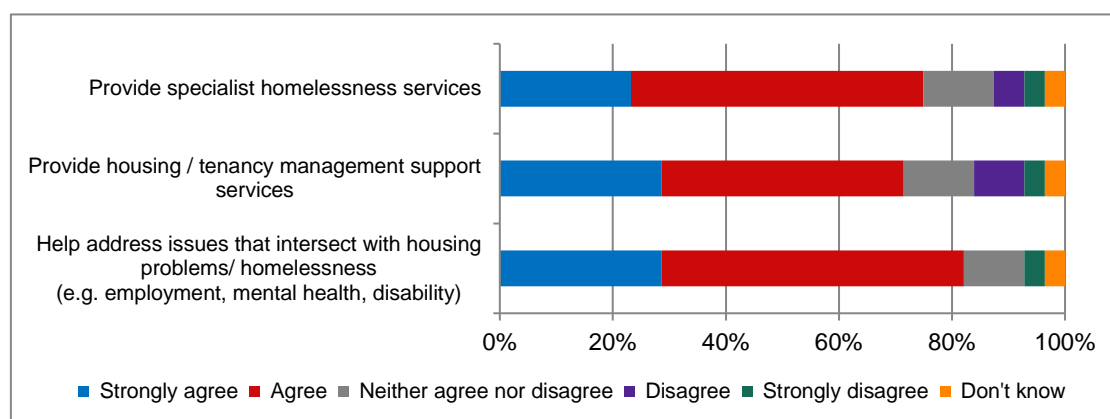
## 4.3 Perspectives on providing support services using social impact investment

### 4.3.1 Potential to provide support services

The potential of SII to fund the provision of support services was examined. As shown in Figure 19 below, 71.5 per cent (n=40) of participants agreed that SII could fund housing or tenancy support services and 75 per cent (n=42) agreed it could fund specialist homelessness services. Further, 82.2 per cent (n=46) envisioned SII could be used to fund support services in areas that intersect with housing and have implications for maintaining a tenancy. For example, this could include employment, training, inclusion, social mobility, mental health and disability support needs and/or recidivism. Overall, there was enthusiasm for application of SII to service types including ‘wraparound services’ (SII expertise participant), ‘specialist support’ (housing and homelessness sector participant) and ‘intensive case management’ (housing and homelessness sector participant).

Perspectives on support services varied by stakeholder group. Overall, while still supporting SII’s application to support services, people with experience in both SII and housing and homelessness had a lower level of confidence for SII being used to provide the whole range of types of support services than the other stakeholder groups.<sup>20</sup> This perhaps reflected their previous experiences, and difficulties, in providing support services. Other than this, investors had more confidence in providing housing and tenancy support services than the other stakeholders,<sup>21</sup> whereas people with experience in SII only were more confident than the other groups in providing support services that intersect with housing.<sup>22</sup> Again, these views perhaps reflect their previous work and experience.

**Figure 19: Potential of SII to provide support services (n=56)**



The importance of providing support services in addition to housing stock was noted:

<sup>20</sup> Housing or tenancy support services: 54.6 per cent, n=6 SII and housing and homelessness compared to 92.3 per cent, n=12 investors, 70.6 per cent, n=12 housing and homelessness only and 71.5 per cent, n=10 SII only. Specialist homelessness services: 63.7 per cent, n=7 SII and housing and homelessness compared to 77.0 per cent, n=10 investors, 82.3 per cent, n=14 housing and homelessness only and 71.4 per cent, n=10 SII only. Intersecting services: 72.8 per cent, n=8 SII and housing and homelessness compared to 84.6 per cent, n=11 investors, 76.5 per cent, n=13 housing and homelessness only and 92.8 per cent, n=10 SII only.

<sup>21</sup> 92.3 per cent, n=12 investors compared to 71.5 per cent, n=10 SII only, 70.6 per cent, n=12 housing and homelessness only and 54.6 per cent, n=6 SII and housing and homelessness.

<sup>22</sup> 92.8 per cent, n=13 SII only compared to 76.5 per cent, n=13 housing and homelessness only, 72.8 per cent, n=8 and 84.6 per cent, n=11.

*... the obvious answer is, yes, social impact investment is crucial to the building and development of more suitable stock on the asset side. I think our view would be that there's also the important role for private capital to play around funding the necessary ... support services needed to deliver better outcomes. (SI expertise participant)*

Particularly with regard to social housing, providing support services alongside housing stock was considered important if improved social outcomes and impact were to be achieved. Without support services, interventions that involved only the provision of properties were not seen to be enough to achieve the desired outcomes. Support services to assist in maintaining housing and addressing the issues contributing to the need for housing were considered integral to success.

### **4.3.2 Benefits of providing support services**

The benefits of using SII to provide support services were noted. The benefit of funding support services was described as elevating the potential of housing and homelessness interventions to contribute to increasing social mobility, independent living skills, employment, community connections and wellbeing. These areas were seen as important in addressing the issues that had led to a need for housing; that would allow tenants to maintain a successful tenancy; and that would possibly enable them to transition along the spectrum of housing support and/or transition out of housing assistance:

*So, it's not just about providing people with a house ... it's about employment and training and the social issues that go around; why they're needing ... housing in the first place. So, what we're thinking about is to get that service layer as well as the infrastructure layer. (SII expertise participant)*

SII was understood to hold particular potential to successfully address these areas, as it was perceived as having the capacity to enforce greater accountability on outcomes, particularly within pay-for-performance models.

Further, two formerly homeless people also noted the benefits they saw of having involvement in and/or provision of support services by parties outside government. One person explained that, in her experience, current support services are 'overloaded' and that if the pressure could be taken off existing services by SII involvement, then it might 'give the people who work at the services more time to concentrate on the people who are going through the service and to give them the service that they need'. The other formerly homeless person explained that many people he knows who have been homeless have had poor experiences with the current government-provided services, do not necessarily trust the existing services and that, because of this, he 'would love to see some services outside the government'. He thought that such services might have 'more empathy, more understanding [and] forgiveness'.

### **4.3.3 Risks of providing support services**

Importantly, while beneficial for the range of reasons outlined above, funding support services was also seen to be a high-risk activity for investors, much more so than investing in housing stock. There was concern, particularly from the workshop participants, that influencing outcomes for tenants through support services could be hard, unpredictable and insecure. For this reason, there was a strong view among the workshop participants, and particularly among investor workshop participants, that funding support services was only likely to be successful if it was part of an investment portfolio also underpinned by property assets. The inclusion of property assets alongside support services was seen as a risk minimisation strategy. Together with the earlier findings about the importance of providing support services in addition to property in order to achieve social outcomes, this suggests that SII deals potentially need to include both property and support services in order to be both effective and present a risk profile that will be acceptable to investors. However, as discussed in Section 3.3, stakeholders'

responses were mixed on combining financial models, which may be required to provide both property and services.

A range of other risks of investing in support services are summarised in Table 14 below.

**Table 14: Risks of using SII to provide support services<sup>23</sup>**

<i>Risks for tenants</i>	<ul style="list-style-type: none"> <li>• Risk of achieving perverse outcomes—cherry-picking the easiest support service cases and the risk that people with complex needs and those unable to transition through the housing support system will be left behind.</li> <li>• Risk of over-promising, under-delivering or poor outcome measures being developed, and not achieving the necessary service outcomes for tenants.</li> <li>• Perception among tenants that investors could back out of providing support services without as many consequences as there would be if government did so, and that there might not be a 'safety net' for tenants in this case, if proper regulations were not in place.</li> <li>• Risks that services to tenants cease or are otherwise interrupted when an SII (e.g. SIB) matures or is terminated early, for instance, if it is not achieving its milestones.</li> </ul>	<p><i>'Government can change their funding and change their mind whenever they feel like it, because they've got the power to do it. I guess the investors, they've got the same power as well ... [but] I guess the government would be more consistent with funding, because if they do pull out funding it's not going to look good on them ....' (formerly homeless advocate participant)</i></p> <p><i>'If it was privately done that way, it might be a bit of a concern that the safety net is not there as much as it would [be otherwise].' (formerly homeless advocate participant)</i></p>
<i>Risks for CHPs</i>	<ul style="list-style-type: none"> <li>• Risk is present in CHPs not having enough input into designing the support service outcomes measures and investors having too much control.</li> <li>• Reputational risk is taken on by CHPs if they cannot deliver on the required support service outcomes.</li> <li>• Risk of passive resistance to the outcomes-based approach from housing providers who are used to working to an outputs model in support services.</li> </ul>	
<i>Risks for investors</i>	<ul style="list-style-type: none"> <li>• Complexity of understanding success in support services and of designing achievable targets to measure success by.</li> <li>• Unpredictability of achieving service outcomes, particularly for some target groups, leading to risks of low or no returns.</li> </ul>	
<i>Risks for government</i>	<ul style="list-style-type: none"> <li>• Risk that it is difficult to measure the return on support service savings, particularly when they are spread across siloed government portfolios and departments.</li> <li>• Risks in sharing responsibility for delivering on social outcomes in human services, and associated accountability and transparency issues.</li> <li>• Insufficient pipeline of appropriate support service projects.</li> </ul>	
<i>Contextual and outcome risks</i>	<ul style="list-style-type: none"> <li>• Lack of long-term policy commitment to SII and housing policies; risk of policy changes before support service outcomes can be achieved.</li> <li>• Risk that there is not enough support for the outcomes measurement process, particularly for complex social outcomes in support services.</li> </ul>	

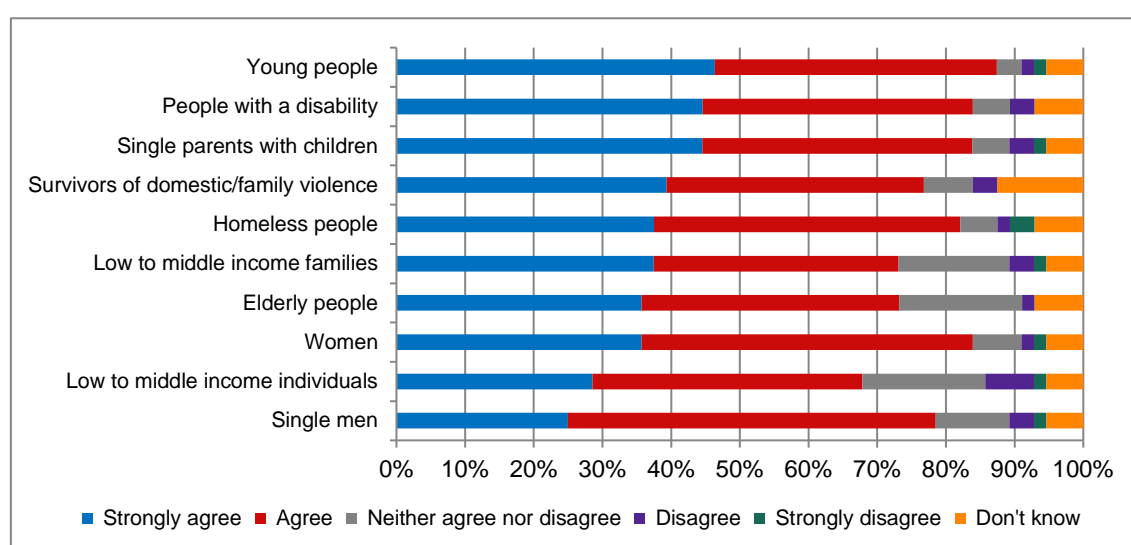
<sup>23</sup> Intermediaries are not included in this table as their risks are about involvement in SII more generally, not specific to providing support services.

These and other risks may need to be addressed in order to allow SII to provide support services. As with affordable and social housing, research stakeholders noted that more investable products would be needed. Levers and other potential solutions that begin to address some of these areas are included in Chapter 5.

## 4.4 Perspectives on the beneficiaries of housing and support services

Perspectives were also examined on who would be the most successful beneficiaries of housing and support services provided through SII. The perspectives on a range of groups are summarised in the following Figure 20.

**Figure 20: Potential for SII to assist different socio-demographic groups (n=56)**



As shown in Figure 20, there was a high level of confidence for using SII to assist young people, homeless people, women, single parents with children and people with a disability, followed closely by other groups. In the workshop, the chosen beneficiary groups for the SII systems thinking scenarios also included young people and rough sleepers (homeless people).<sup>24</sup>

In some cases, the reason stakeholders thought that SII was appropriate for these groups centred on early intervention. For example, one person explained that SII held such potential for young people because, given that this type of investment is premised on savings across government (particularly in a SIB model), intervening early in the life-course, before entrenched disadvantage and crises, provides a clear opportunity for long-term savings and outcomes:

*Where social impact [investment] has the best benefit or the greatest kind of impact is ... in the early intervention and prevention ... particularly with young people, rather than in the kind of crisis space ... So, our understanding is that it is better to focus in the early intervention phases of social disadvantage, rather than at the hard end ... really you need to work with people, who are either at the beginning of having issues or requiring support or young people, because otherwise you're not going to get the*

<sup>24</sup> SEDIF investments include three addressing homelessness, two housing for people with a disability and six affordable housing (one retirement, one affordable rent and four affordable ownership) noting two investments have two SEDIFs involved (Foresters 2014; SEFA 2016; Social Ventures Australia 2016).



*savings that people should be expecting from the process. (housing and homelessness sector participant)*

In other cases, stakeholders thought that SII should be used for particularly disadvantaged groups because of the heightened altruism and/or impact potential involved. This might explain, for example, stakeholders' enthusiasm for using SII to assist homeless people (Figure 20), but also might apply to a range of other groups, for example, women or children leaving abusive households.

Notably however, stakeholders also emphasised that in order for a particular group to be a beneficiary of SII, there had to be confidence in the ability to influence positive outcomes for that group. Some stakeholders were, for example, concerned about whether or not homeless people (particularly homeless veterans) could be successful beneficiaries of SII, because they felt there was less ability to impact the drivers of homelessness at the stage of intervention and deliver outcomes.

## **4.5 Property and services: Policy development implications**

- Government has many roles to play across the continuum from homelessness to affordable rental housing:
  - Progression along the continuum must be considered when developing SII policy as market participants and their roles may vary at different stages.
  - The facilitation of the participation of additional parties (e.g. investors) and increased responsibility of parties (e.g. CHPs) must consider suitable mechanisms and recompense for the transfer of responsibility.
  - Clear demarcation of responsibility between state and federal levels of government; and the role of local governments.
- Government has roles to play in both services and property and different forms of SII are more appropriate for each:
  - Services are smaller scale and SIBs and smaller social enterprises have been used overseas in homelessness.
  - Property is larger scale and property funds (debt and equity) and investment into CHPs as social enterprises have been used overseas.
- SII deals need to include both property and support services in order to be effective in achieving the desired social outcomes (through better coordination and integration of support services and housing availability). They also need to present a risk profile that is attractive to investors (as funding services is seen to be a high-risk activity by investors unless it is included alongside property assets as a risk minimisation strategy).
- Government needs to engage with other market participants and develop policy frameworks to encourage their participation:
  - Foundations and charitable trusts as funders of capacity building for SIBs and social enterprises and investors (impact first and finance first).
  - NFPs as service providers and asset owners and intermediaries for SII.
  - Superannuation funds as investors.
- More investible product (which government can assist with by providing a pipeline of deals) and government acting on policy levers to aid housing development are needed to enable SII. The top three policy areas identified by stakeholders as critical were affordable housing



policies, tax credits and/or incentives for investors, and incentives to attract superannuation funds. Other levers noted included: concessional planning, zoning allowances, inclusionary zoning, negative gearing, planning laws, leasing and secure tenancy policies, long-term management leases, providing government-owned stock, planning consents, land availability and borrowing against the 'AAA' rating.

- SII poses particular risks to government, service providers, investors, intermediaries and most importantly to beneficiaries if it is ill conceived, poorly executed or used in inappropriate settings. These risks need careful consideration in determining whether SII is the appropriate model in a given context, and in the design of SII solutions.

## 5 Mapping the system for social impact investment in housing and homelessness

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- Housing affordability and homelessness operate within the broader housing market and policy context. This broader market and context influence the size and nature of the challenges that SII may address.
  - Housing affordability and homelessness issues and their potential solutions operate within a complex and interdependent system. Deficiencies in one area have follow on effects to other areas throughout the continuum.
  - There is a significant financing gap in both social and (to a lesser extent) affordable housing. Government has an important role to play in filling the gap if it wishes to engage the investment community in collaborating and contributing to solutions or expects CHPs to significantly increase development of new social housing supply.
  - The scale of the social and affordable housing supply challenges requires engagement and participation from superannuation funds in any SII solution. Therefore, SII solutions need to be designed to meet the needs and preferences of superannuation funds.
  - The proposed bond aggregator model (incorporating government guarantees) offers an efficient transmission mechanism to engage superannuation funds through a common platform—especially if it is set up in a way that provides flexibility and the ability to offer debt on a variety of terms. For instance, using the bond aggregator model to finance both affordable and social housing solutions would also create the scale and flow preferred by institutional investors. Further, being able to issue debt on either a guaranteed or on a non-guaranteed basis in the future would potentially offer the government a transition path to reduce the use of guarantees if appropriate while maintaining the benefits of a common platform.
  - There is a need to support the capacity building and sustainability of CHPs. Of all stakeholders, CHPs face some of the more significant risks as a consequence of many of the changes already underway in the social and affordable housing sector and from proposed SII models and solutions. Some SII models could significantly increase the business and financial risk profile of CHPs, others could exacerbate the residualisation risk in CHP portfolios, while some could underpin and improve the viability and sustainability of CHP business models. This is an important consideration because if CHPs fail, the risk will return to government, further exacerbating current challenges and placing tenants at risk.
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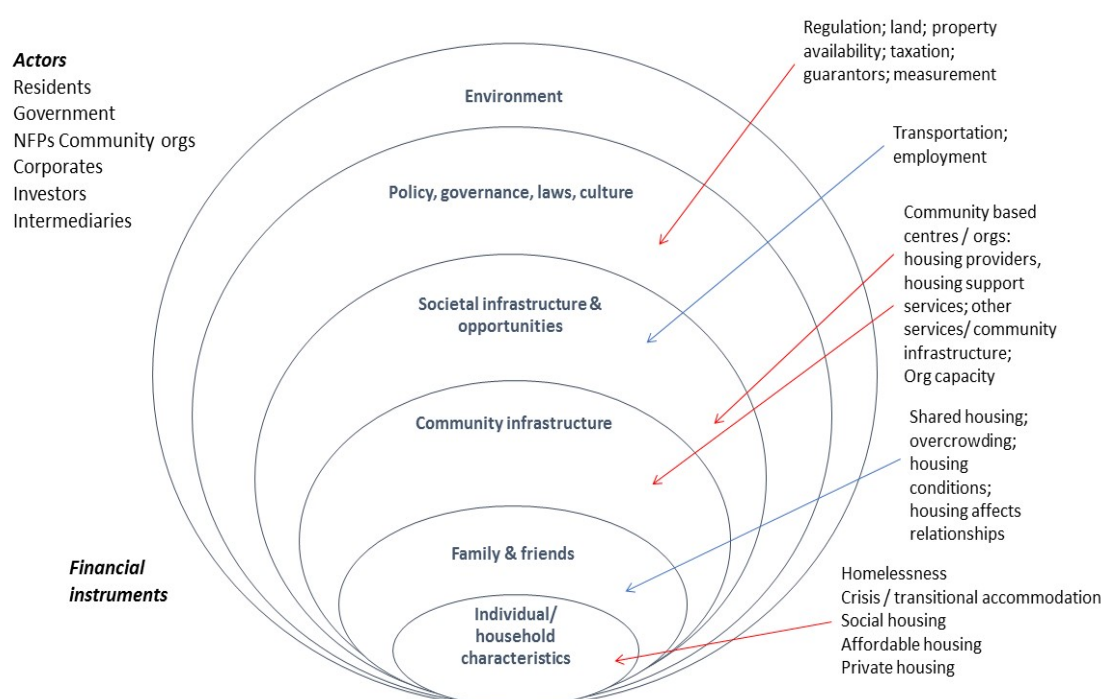
## 5.1 Existing research on complex systems thinking and the system for social impact investment, housing and homelessness

Complex systems thinking identifies how complex problems—such as housing affordability and homelessness—occur within systems. The systems are made up of interconnected, interdependent levers or influences that work together in a non-linear manner and produce feedback loops of change (Simon 1996; Anderson 1999; Boal and Schultz 2007; Van Beurden, Kia et al. 2011). This means that by changing one lever or influence within the system, other parts of the system can and will also change as a result. The feedback loops take into account the different actors within the system, the different roles they play and how they interact with each other, as well as the influence of the immediate and larger economic and social environment in which they are acting (e.g. different investment models, taxation laws) (Bronfenbrenner 1979). To improve outcomes on a complex social issue like housing affordability or homelessness, the key is to identify which levers or influences to address to affect positive change, how to change them, which actors have a role in doing so and what are the barriers, risks and opportunities those actors experience.

## 5.2 The system influencing social impact investment in housing

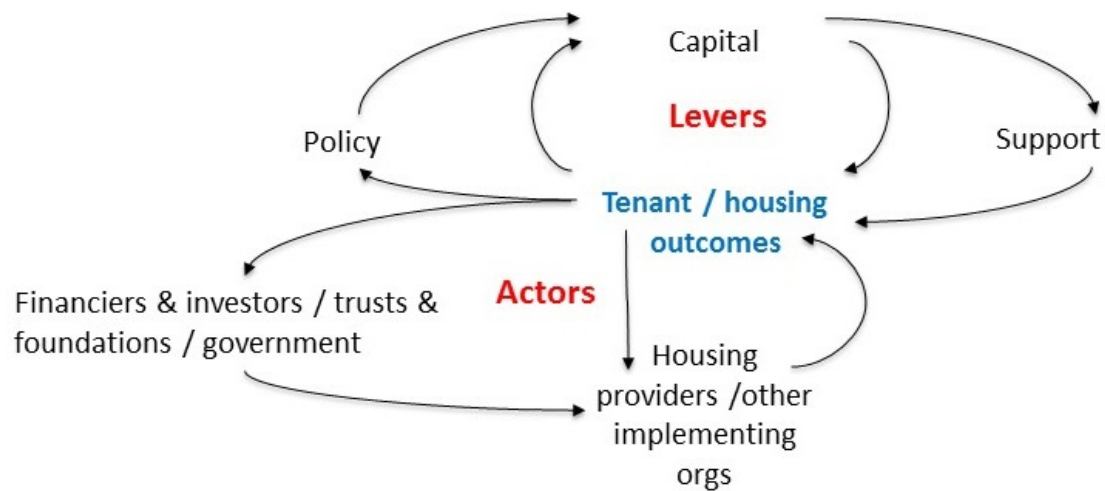
Figure 21 below provides a visual representation of the system influencing SII in housing, which also serves to help identify the key actors and roles they play in the system. This model was used as a frame of reference for the workshop.

**Figure 21: System influencing SII – Examples of actors and roles in the social impact investment system applied to housing and homelessness**



Building on Figure 21, Figure 22 below demonstrates how the various actors and levers influence each other:

**Figure 22: Actors and levers- influences on each other**



The key actors within the Australian SII, housing and homelessness system, the opportunities and risks that factor into each actor's decision-making, and the levers and barriers that may enable or prevent them from acting (which in turn may affect the ability of the system of influences to progress as a whole) are drawn together in Section 5.3. Anchored by the systems thinking framework introduced in Section 1.4, Section 5.3 is then used to consider how SII might contribute to improving outcomes in the specific current Australian housing and homelessness challenges identified in Chapter 1, with a particular focus on identifying key interdependencies, enablers and barriers to achieving desired outcomes.

### 5.3 Mapping roles, opportunities, risks, levers and barriers to actors in the system

The main actors in the system for SII and housing and homelessness, their actual and potential roles, along with the opportunities and risks that will factor into each actor's decision-making have been introduced and explored throughout this report. In Table 15 below, this information is summarised to facilitate a better understanding of key interdependencies across the system and the levers and barriers that may enable or prevent each actor from acting, which in turn may affect the ability of influences to progress as a whole.

**Table 15: Actors in the system for SII and housing and homelessness—roles, opportunities, risks, barriers and levers**

Actor/Role(s)	Opportunities	Risks	Levers and barriers
<p><i>Government</i></p> <ul style="list-style-type: none"> <li>• Source of SII deal pipeline</li> <li>• Leadership role in SII. coordinating &amp; regulating other actors.</li> <li>• Moving towards &amp; supporting use of outcomes frameworks.</li> <li>• Accepting the level of risk to make SII in housing work; being an anchor investor in unfamiliar opportunities.</li> <li>• De-risking transactions to attract other actors, e.g. contribution to wholesale funds, contributing a layer of capital though grant funding, funding trials/pilots, providing subsidies, guarantees, first-loss, being an anchor investor, being first investor to establish track-record.</li> <li>• Not transferring its own risk to investors; creating a stable policy</li> </ul>	<ul style="list-style-type: none"> <li>• Dual social and economic benefits within and beyond issues of housing and homelessness.</li> <li>• SII enabling government to address housing and homelessness without having to bear full capital costs up-front.</li> <li>• If SII successful in addressing housing and homelessness issues, may facilitate application in other complex social issues.</li> </ul>	<ul style="list-style-type: none"> <li>• De-risking SII initiatives (e.g. providing guarantees, first loss) to attract other actors poses contingent financial risks to government.</li> <li>• De-risking SII initiatives may result in moral hazard risks that break down key elements of SII—potentially reducing investor focus on generating positive social outcome as nexus between outcomes and return is negated by government guarantee.</li> <li>• Success in addressing housing and homelessness would generate savings across multiple departments (e.g. social services, health, mental health, justice system, etc., so may be difficult to demonstrate savings and return funds to investors.</li> <li>• Risks associated with transferring responsibility to SII market before it is able to deliver; challenges in</li> </ul>	<p><i>Levers</i></p> <ul style="list-style-type: none"> <li>• More evidence of SII success-effective models &amp; presentation of the evidence in ways that are useable by and useful for government.</li> <li>• More data and understanding of the outcomes needed and how to measure them.</li> </ul> <p><i>Barriers</i></p> <ul style="list-style-type: none"> <li>• Government not homogenous; different layers of government need to cooperate.</li> <li>• Fiscal constraints and budgetary pressures.</li> <li>• Some policy levers may not be politically palatable or would require bipartisan support.</li> </ul>

Actor/Role(s)	Opportunities	Risks	Levers and barriers
<p>and regulatory context to support SII in housing over the long-term.</p> <ul style="list-style-type: none"> <li>Acting on policy levers that may enable SII in housing, e.g. concessional planning, zoning allowances, inclusionary zoning, negative gearing, planning laws, leasing and secure tenancy policies, affordable housing policies, tax credits, tax incentives, incentives to attract superannuation funds, long-term management leases, providing government-owned stock, planning consents, land availability, borrowing against the 'AAA' rating; data collection across multiple departments.</li> </ul>		<p>sharing responsibility, accountability and transparency in delivering on social outcomes in social services.</p>	
<p><i>Investors</i></p> <ul style="list-style-type: none"> <li>Investing capital into SII initiatives.</li> <li>Making it clear when they have capital to invest (including to key distribution channels and to CHPs directly).</li> <li>Providing patient capital (foundations and philanthropists).</li> <li>Providing at-risk capital—concessionary or grant—alongside non-concessionary investors (foundations and philanthropists).</li> <li>Using networks to encourage peers to participate.</li> </ul>	<p><i>For foundations &amp; philanthropy:</i></p> <ul style="list-style-type: none"> <li>Align corpus investments to further the pursuit of their mission—that is, achieve a financial return as well as a social return on their corpus assets, as well as the social return from their grant activities. There may be a possibility to accept concessionary rates of return, by offsetting the differential to market-based return against annual grant making.</li> <li>Ability to recycle capital in certain circumstances—</li> </ul>	<ul style="list-style-type: none"> <li>Returns are not realised or do not meet expectations; capital loss.</li> <li>Regulatory risk &amp; red tape.</li> <li>For superannuation funds, over-exposure of members' to housing (reflecting that for the majority of superannuants their largest asset is their home).</li> <li>Intermediary fails to manage the SII effectively.</li> <li>Counterparty risk of housing providers that lack scale and in-house capability to manage SII effectively.</li> <li>Tenants not supported to maintain stable tenancy.</li> </ul>	<p><i>Levers:</i></p> <ul style="list-style-type: none"> <li>Development of SII products that are easy for investors to understand.</li> <li>Development of SII products that offer a differentiated risk profile to traditional property investments.</li> <li>Capable intermediaries present &amp; active in SII market.</li> <li>Wealth managers fostering investors' awareness of SII, and providing advice, recommendations etc.</li> <li>Government de-risking transactions to attract investor interest (e.g. guarantees).</li> </ul>

Actor/Role(s)	Opportunities	Risks	Levers and barriers
<ul style="list-style-type: none"> <li>• Willingness to invest more in SII, accept concessionary (below market) rates of return, accept longer tenures and be prepared to take more risk.</li> <li>• Lobbying their financial institutions/advisors to get involved.</li> <li>• Giving more thought to social impact in investment decisions, and supporting housing and homelessness as an issue to get behind and support together.</li> <li>• Superannuation funds to increase their understanding of SII to facilitate investment.</li> <li>• Banks to consider use of ethical funds and special loan arrangements that can address housing and homelessness and facilitate SII.</li> </ul>	<p>leveraging grant funds (e.g. a foundation may be better placed to take repayment risk of a SIB as part of its grant making—investing in new and innovative approaches/new ideas—if successful, recycle capital to new venture).</p> <p><i>For superannuation funds:</i></p> <ul style="list-style-type: none"> <li>• Meet growing client demand for values-based investment options.</li> <li>• Possibility of less correlated &amp; more stable long-term returns.</li> <li>• Alignment with long term interests of members—i.e. contribution to the society and environment members retire into.</li> <li>• An extension of existing ESG frameworks and UN PRI commitments.</li> </ul> <p><i>For individual investors:</i></p> <ul style="list-style-type: none"> <li>• Ability to align property investments with personal values.</li> </ul>	<ul style="list-style-type: none"> <li>• Reputation/moral hazard risks.</li> </ul>	<ul style="list-style-type: none"> <li>• Government making contributions that facilitate structuring of deals on non-concessionary basis (and without increasing stress on other actors—e.g. housing and service providers.</li> <li>• Government acting on policy levers to facilitate SII; providing deal pipeline.</li> <li>• Government providing a stable policy and regulatory context.</li> <li>• Housing providers operating at scale (larger, more sustainable, and include in-house financial and SII skills) to effectively manage SII and delivery of outcomes.</li> <li>• Availability of credible impact measurement and management frameworks.</li> </ul> <p><i>Barriers:</i></p> <ul style="list-style-type: none"> <li>• Overly complex transaction structures, transactions do not meet investment criteria (counterparty risk to CHPs, track record, regulatory stability etc.).</li> <li>• Superannuation funds require market-based rates of return; often prefer real asset security.</li> <li>• Foundations annual grant capital relatively small; ability to invest corpus in SII may require allocating any concessional rate differential to annual grant allowance.</li> </ul>



Actor/Role(s)	Opportunities	Risks	Levers and barriers
			<ul style="list-style-type: none"> <li>Many investors rely on third party advisors who may not have SII capabilities, or may otherwise not be prepared to advise on SII (e.g. limited track record, measurement benchmarks etc.).</li> </ul>
<p><i>Intermediaries</i></p> <ul style="list-style-type: none"> <li>Assisting in the development, design and build of SII products.</li> <li>Bridging the language and knowledge gap between actors (government, housing providers, investors).</li> <li>Interpreting and showcasing benefits and risks of SII to potential investors.</li> <li>Connecting investors with organisations seeking SII funds.</li> <li>Building number of investors who are aware of SII.</li> <li>Working with wealth management organisations &amp; fund managers to have SII added to approved lists.</li> </ul>	<ul style="list-style-type: none"> <li>High impact way of achieving social purpose goals related to housing &amp; homelessness.</li> </ul>	<ul style="list-style-type: none"> <li>Reputational risk if SII fails.</li> <li>Cost of managing SII deals.</li> <li>Complexity of managing SII deals.</li> <li>Government regulation and red tape.</li> <li>The multiple stakeholders involved in SII deals.</li> </ul>	<p><i>Levers:</i></p> <ul style="list-style-type: none"> <li>Growing investor awareness of and demand for SII (including for concessionary rates of return and long-term capital).</li> <li>Government providing a pipeline of deals.</li> <li>Government working across silos to calculate and disclose delivery costs of social programs to enable the market to develop more cost effective SII solutions.</li> <li>Government looking across silos in approaches to social policy and measurement of outcomes.</li> <li>Government acting on policy levers to facilitate SII.</li> <li>Government providing a stable policy and regulatory context.</li> </ul> <p><i>Barriers:</i></p> <ul style="list-style-type: none"> <li>Lack of track-record to base recommendations on.</li> <li>Outcomes measurement requires a level of standardisation for benchmarking and comparison purposes.</li> </ul>

Actor/Role(s)	Opportunities	Risks	Levers and barriers
<p><i>Housing providers</i></p> <ul style="list-style-type: none"> <li>• Providing services and infrastructure that will achieve the desired outcomes of the SII and on which the financial return to investors depends.</li> <li>• Working together with other service providers (e.g. in health, mental health, disability, employment, corrections etc.) to ensure desired outcomes are achieved.</li> <li>• Managing relationships in the delivery of services to ensure they run effectively/do not prevent outcomes from being achieved.</li> <li>• Involvement in the design of the SII outcomes framework to ensure measures are realistic, achievable, and relevant.</li> <li>• Increasing their scale and efficiency to have greater operating power within the SII market.</li> <li>• Further developing their data collection, measurement and evaluation processes in order to better demonstrate the outcomes achieved.</li> <li>• Shifting their mindset to have a greater willingness to act in areas they may not have</li> </ul>	<ul style="list-style-type: none"> <li>• The opportunity to have greater impact (both the number of people and the quality of outcomes achieved for those people) in achieving their core mission which is usually linked in some way to improving the lived experience of tenants.</li> <li>• Access to cheaper and longer tenor financing that increases stability and increases the amount that they can borrow.</li> <li>• Access to additional sources of revenue to use and to do their work.</li> <li>• If SII encourages innovative approaches this may allow housing providers more scope to try new ways of achieving outcomes than they may have had previously.</li> </ul>	<ul style="list-style-type: none"> <li>• Taking on more debt than their business models can accommodate.</li> <li>• Negotiating and being held to contracts and instruments that they do not have experience in or fully understand (risk is heightened if they do not have access to the right intermediaries to assist with unfamiliar language, concepts, and commitments from the financial sector).</li> <li>• Relying more heavily on investment capital than core funding.</li> <li>• Having insufficient input into designing the SII initiatives and outcomes; too much investor control.</li> <li>• Smaller housing providers may be pushed out of the market if they lack scale or capacity to be involved in SII.</li> <li>• Reputational risk of SII failing or inability to deliver on outcomes.</li> <li>• Move to outcomes/payment by results/market solutions may encourage housing providers to see themselves as competitors and this inhibits collaboration to achieve outcomes.</li> <li>• Housing provider workforce becomes disheartened in their</li> </ul>	<p><i>Levers:</i></p> <ul style="list-style-type: none"> <li>• Being given the mandate to operate at the scale required to manage SII—e.g. further devolving of public social housing to CHPs.</li> <li>• Capable intermediaries present &amp; active in SII market.</li> <li>• Growing investor awareness of and demand for SII (including for concessionary rates of return and long-term capital).</li> <li>• Involvement of traditional property developers.</li> <li>• More data and understanding of the outcomes needed and how to measure them.</li> <li>• Government providing a stable policy and regulatory context.</li> </ul> <p><i>Barriers:</i></p> <ul style="list-style-type: none"> <li>• Constrained cash flow (capped/declining revenue sources and rising costs) limits debt serviceability to low levels of leverage.</li> <li>• Current shortages of social housing limit housing providers opportunity to target a more diverse tenancy mix, that could increase revenue and business model sustainability.</li> </ul>

Actor/Role(s)	Opportunities	Risks	Levers and barriers
<p>previously, e.g. providing both physical residences and services, if they have not done this before.</p> <p><i>Service providers (health, mental health, disability, employment, corrections, etc.)</i></p> <ul style="list-style-type: none"> <li>• Work together with housing providers to integrate their services and ensure the desired outcomes of the SII are achieved.</li> </ul>		<p>work if they perceive investors making profits from it.</p> <ul style="list-style-type: none"> <li>• For service providers, limited understanding and limited capacity of smaller providers may push them out of the market—but may have specialist/niche skills that add value.</li> </ul>	<ul style="list-style-type: none"> <li>• High transaction costs of SII may be a constraint or barrier for smaller social enterprise CHPs.</li> <li>• Investment in outcomes measurement systems needed For service providers, lack of collateral (real asset security) may deter investors.</li> </ul>
<p><i>Tenants</i></p> <ul style="list-style-type: none"> <li>• Members of the community within their building/area.</li> <li>• Provide data to facilitate the collection of outcomes data for SII measurement.</li> </ul>	<ul style="list-style-type: none"> <li>• Increased potential to achieve their aspirations (in housing and reaching to quality of life implications).</li> <li>• Provision of better quality housing outcomes than government has traditionally provided (securing ‘nicer homes’ from a formerly homeless person).</li> <li>• Increased trust between tenants and housing providers (a formerly homeless person indicated a high level of mistrust of government among users of social housing and a perception of anyone else’s involvement (i.e. investors) beyond government being a good thing).</li> </ul>	<ul style="list-style-type: none"> <li>• People with complex needs and those unable to transition through the system will get left behind, because there is not enough confidence in achieving outcomes for them and because investors and housing providers are worried about not ‘achieving outcomes’ or getting returns if they take these tenants on.</li> <li>• Affordable and/or social housing is pushed further out of urban centres, creating pockets of disadvantage or further entrenching the cycle of disadvantage.</li> <li>• Poorly designed SII or outcomes measures fail to deliver positive social impact.</li> <li>• Inappropriate or one-size-fits-all housing being developed, which</li> </ul>	<p><i>Levers:</i></p> <ul style="list-style-type: none"> <li>• Provision of services that effectively develop life skills and tenancy maintenance skills.</li> <li>• Government acting on policy levers that reduce disincentives to moving along the housing continuum (e.g. leasing and secure tenancy policies, increasing supply of social and affordable housing options so risks of re-entry reduced, and ensuring adequate income to make shifts affordable without housing stress / high levels of financial vulnerability).</li> </ul> <p><i>Barriers:</i></p> <ul style="list-style-type: none"> <li>• Individuals may fall through gaps between stages and into homelessness.</li> </ul>

Actor/Role(s)	Opportunities	Risks	Levers and barriers
	<ul style="list-style-type: none"> <li>Availability of more affordable housing provides a stepping stone out of housing assistance.</li> </ul>	<p>fails to meet tenants' particular needs and/or preferences</p> <ul style="list-style-type: none"> <li>Perception among tenants that investors could back out of providing support services without as many consequences as there would be if government did so, and that there might not be a 'safety net' for tenants in this case, if proper regulations were not in place.</li> <li>Risks that services to tenants cease or are otherwise interrupted when an SII (e.g. SIB) matures or is terminated early, for instance, if is not achieving its milestones.</li> </ul>	<ul style="list-style-type: none"> <li>Major step changes from social housing in terms of costs, risks (e.g. tenure and rent security), access to services and amenity, and loss of place/home, coupled with long waiting lists to re-enter social housing if needed in future reduce incentives to transition out.</li> </ul>
<p><i>Wealth management companies</i></p> <ul style="list-style-type: none"> <li>Consider SII as an option that they can recommend to their clients.</li> <li>Providing information on SII so that clients can make informed investment decisions.</li> </ul>	<ul style="list-style-type: none"> <li>To meet growing demand from HNW millennials for investment options that achieve financial return alongside a positive social impact.</li> </ul>	<ul style="list-style-type: none"> <li>Reputational risks if they provide advice to clients on products that do not perform as expected.</li> </ul>	<p><i>Levers:</i></p> <ul style="list-style-type: none"> <li>Client demand.</li> <li>Track-record of SII.</li> <li>Availability of data, information, analysis and benchmarks on which to base recommendations.</li> </ul> <p><i>Barriers:</i></p> <ul style="list-style-type: none"> <li>Track-record of SII.</li> <li>Lack of available benchmarks on which to base recommendations.</li> </ul>
<p><i>Mainstream housing &amp; property development community</i></p> <ul style="list-style-type: none"> <li>Input, support and involvement from mainstream housing and property development.</li> </ul>	<ul style="list-style-type: none"> <li>A way to implement ethical investment and corporate social responsibility.</li> </ul>		<p><i>Levers:</i></p> <ul style="list-style-type: none"> <li>Government acting on policy levers to increase affordable housing options (e.g. concessional planning, zoning allowances, inclusionary zoning, planning laws</li> </ul>

Actor/Role(s)	Opportunities	Risks	Levers and barriers
<p>community, e.g. peak bodies, real estate, property developers.</p> <ul style="list-style-type: none"> <li>• Provision of more affordable housing solutions.</li> </ul>			<p>tax credits, tax incentives, providing government-owned stock for redevelopment, planning consents, land availability and access to air rights above public use land).</p> <p><i>Barriers:</i></p> <ul style="list-style-type: none"> <li>• Current planning and development processes favour maximising improved value to meet developer required margins (i.e. smaller number of larger properties).</li> <li>• Developers not incentivised to release land from land banks or develop if increased supply will significantly erode profitability.</li> </ul>
<p><i>Researchers &amp; consultants</i></p> <ul style="list-style-type: none"> <li>• Providing third-party measurement of outcomes from SII.</li> <li>• Future research to understand the circumstances under which SII is most effective, where changes should be implemented and other funding models to complement and fill gaps of SII.</li> </ul>	<ul style="list-style-type: none"> <li>• The evidence and reporting requirements inherent in the outcomes focus of SII hold key benefits and opportunities for developing more evidence in the housing and homelessness space in general, which is useful to researchers and consultants.</li> </ul>		<p><i>Levers:</i></p> <ul style="list-style-type: none"> <li>• More data and understanding of the outcomes needed and how to measure them.</li> <li>• Developing shared outcomes measurement systems for benchmarking, comparisons and tracking changes in real time.</li> <li>• Data linkage to increase information, analytic possibilities and decrease reporting burden.</li> </ul>

## 5.4 Application of systems thinking

This section brings together several key aspects of the report. The system thinking framework described in Section 5.1, the information on actors and their roles, opportunities, risks, levers and barriers from Section 5.2 and 5.3, and the preferred financial models identified from Chapters 3 and 4 are applied to some of the specific housing and homelessness challenges identified in Chapter 1. When brought together, this information explores the potential opportunities and limitations of SII to contribute to improving housing and homelessness outcomes in Australia. SII solution designs are presented for affordable rental housing, social housing and homelessness.

### 5.4.1 How might SII be applied to help increase the supply of affordable rental housing?

#### *Context*

There are 393,000 Australian households in the lowest two income quintiles that are currently renting unaffordable housing (paying more than 30% of their gross household income on rent), with 90,000 of those households living in severely unaffordable housing (paying more than 50% of their gross household income on rent) (Hulse, Reynolds et al. 2015).

Australia does not have an established and stable affordable housing market segment that creates a bridge between its social housing and private rental market segments. As discussed in Chapter 3, the most significant contribution to affordable housing in Australia in recent times was the discontinued NRAS that successfully delivered tens of thousands of affordable housing units between 2008 and 2016.

Affordable housing was identified through this research as one of the areas with most potential for SII to play a role. Given the size of the problem, any solution needs to be scalable. In this regard, affordable housing was perceived to be of more potential interest to institutional investors, offering scale and security over higher quality (relative to social housing) assets.

As by definition, affordable housing results in rents that are offered at a discount to private market rentals, some form of government assistance needs to be part of any SII solution design to attract mainstream investors (on the assumption that the scale of the issue means that philanthropic capital would be insufficient to close the financing gap).

#### *Desired outcomes*

Significantly increasing the supply of affordable, fit for purpose, stable rental housing is the primary and most urgent goal. Any solution design needs to incorporate measures that will ensure the total stock of affordable housing options increases, and the housing units appropriately meet individual tenant's needs and support the development of thriving and resilient communities. The housing units should be fit-for-purpose: an appropriate size, design and adaptability; energy efficient; located with proximity to tenants' own networks and community, public transport, jobs, schools, and services; safe and secure; promote tenants' ability to achieve their personal goals and aspirations; and improve health and wellbeing outcomes. Further to increasing the stock of affordable housing, consideration should also be given to sustainability and maintaining its affordability over time.

Since Australia may have a more significant proportion of long-term renting households in the future, it would be beneficial to provide affordable housing options that provide longer and more secure tenure (e.g. lower risk of sudden rent increases) and more rights/ability for tenants to make a home, relative to the current private rental market. These features would have positive health and wellbeing impacts for all tenants and may provide social housing tenants with more confidence to transition to affordable housing options if it becomes feasible for them.

## ***SII solution design***

The solution design comprises closing the financing gap for equity using tax credits and attracting institutional investment for debt via a bond aggregator.

### ***Closing the financing gap***

Any affordable housing scheme by definition involves a financing gap. Private rental affordable housing rents and associated rental yields are below market. Capital appreciation—a significant contributor to the total investment return of residential property—cannot be fully realised by investors unless the property ceases to be ‘affordable’.

Therefore, to attract mainstream investors at scale to the affordable housing market, government needs to provide assistance or incentives to close this gap and enable private market capital to participate. As detailed in Chapter 3, Rowley, James et al. (2016) analyse the strengths and weaknesses of the NRAS and suggest a new program, building on the original NRAS momentum, should be introduced as soon as possible. An improved NRAS using SII principles for defining and measuring desired outcomes could potentially assist in targeting application of funds to mitigate real and/or perceived shortcomings of the original program. While shortcomings of the original NRAS were identified, it was successful in contributing to the delivery of significant levels of new affordable housing stock within a relatively short period of time, combined subsidies from multiple sources, engaged both CHPs and private investors, delivered a variety of dwellings in the later rounds, and generated innovation (Rowley, James et al. 2016). By its design, it also counteracted existing incentives that cause investment in larger and more expensive dwellings as the proportionate value of the tax credits is maximised the more ‘affordable’ the properties are.

Consideration could be given to the term of tax credits under an improved NRAS. The original NRAS provided investors with tax credits for 10 years with the risk at the end that the property ceases to be affordable (reducing stock and impacting tenants with significant rent increases). Although, as noted in Chapter 3, around 60 per cent of NRAS housing units were allocated to endorsed charities and are likely to remain affordable.

Concessional and inclusionary zoning mandates are an important lever to support lower development costs, further improving the viability of this financial model overall.

### ***Attracting institutional investment***

Superannuation funds have a preference for straight-forward debt instruments offering competitive market-based risk-adjusted rates of return, and with a risk profile that is sufficiently differentiated from the broader residential housing market to offer their members diversification in risk profile from their own homes (often their largest investment). Superannuation funds are also keen not to have government transfer its own risks (e.g. as a result of regulatory and policy changes) to them.

It is highly likely the most efficient and viable model that meets those objectives—in the short-to-medium term—would require government to guarantee the timely payment of principal and interest on housing bonds issued by a bond aggregator. A government guarantee could substitute for the current lack of track record on regulatory and policy stability, compensate for the relatively small size and scale of the CHPs (or any new affordable housing property fund lacking track record) as counterparties, sufficiently differentiate the risk profile of the housing bonds from traditional equity property investments, support the tradability and liquidity of the bonds, and provide confidence of the government’s commitment to the sector and intentions not to transfer its risk to investors. Government should look to global examples (e.g. Lawson, Berry et al. 2014) to provide guidance on reducing the risk that such guarantees would be called.

The bond aggregator would align with government incentives for equity, such as a revised NRAS, by directing the utility of the NRAS to housing providers (CHPs or other affordable



housing property funds). This would increase the financial viability of building new affordable housing stock and facilitate access to institutional capital at advantageous rates by tailoring debt issued through the bond aggregator to meet institutional investors' preferences for scale, liquidity (via a tradable platform) and risk profile. The resulting lower risk-adjusted returns should result in cost savings relative to current funding options for housing providers.

### **Benefits**

- While the NRAS was not perfect, it did prove its ability to achieve successful outcomes on a number of measures—including scale, diversity of housing options delivered, supporting cross sector collaboration and innovation.
- Global precedents and case studies for the bond aggregator model exist—reducing risks and implementation time.
- The bond aggregator model can be tailored to meet institutional investors' needs and preferences—resulting in lower risk-adjusted returns and cost savings relative to alternate funding options.
- This solution provides a scalable platform that can be leveraged further (including to support the delivery of social housing units discussed in Section 5.4.2).
- SII principles of defining and measuring outcomes can be used to enhance outcomes for tenants and reduce the potential for unintended consequences—e.g. creation of outer suburban pockets of disadvantage.
- The bond aggregator model builds multi-sector capacity and capability around affordable housing.
- To the extent affordable housing stock is allocated to CHPs, this model affords CHPs the opportunity to more comprehensively provide rental housing solutions across the social and affordable housing spectrum—rather than their current focus on the higher needs end of the spectrum. This would provide CHPs with the ability to cross-subsidise their lower income/higher needs social housing portfolio, afford greater scale, improve sustainability, and increase their ability to assist social housing tenants transition to affordable housing options by correcting for current drawbacks of the private rental market. This would also enable the greatest leveraging of the bond aggregator model, and support the longer term affordability by retaining units in the sector. It may also contribute to reducing the stigma currently associated with social housing.

### **Risks:**

- At the cessation of tax credits, mainstream investors revert to charging market rentals and/or unlock their capital value, and properties cease to be 'affordable'. This requires continuous reinvestment in new stock, and may be disruptive for tenants.
- Housing providers may still need equity injections to cover the capital costs of building new stock—which could take the form of asset transfers for redevelopment, 'free land' or access to air rights above public land.
- At the cessation of tax credits, where housing providers maintain the affordability status of the property, operating income will be reduced. However, this likely would still be higher than their social housing portfolios.
- To the extent CHPs become a larger provider of affordable housing than social housing, higher needs tenants/households may be left behind.
- The CHP sector is not adequately supported and resourced to develop the capabilities and capacity to operate at the scale and complexity that this shift would entail (in particular, property development and financial management).

- To the extent other housing providers enter this space, they may take the more profitable market segments, thus putting further strain on CHPs' business models and longer term sustainability.

### ***Other considerations***

- Increasing the supply of affordable housing to own—in particular for middle quintile households—may reduce competition for existing private market rental accommodation classified as affordable for Q2 income households, potentially reducing pressure on the affordable rental housing segment. While concessional and inclusionary zoning requirements would be the primary lever for development at scale, the emergence of new models is noteworthy. The Nightingale Housing community model, for example, aims to balance financial, community and sustainability elements (Nightingale 2016). This model is attracting SII and has a significant waiting list of interested purchasers. It could be explored further in terms of its design, community, sustainability and engagement models which may have application in the social and affordable housing segments.
- If part of the solution design seeks to attract other types of institutional vehicles (such as unlisted wholesale property trusts, A-REITS or other affordable housing fund structures) to affordable housing, the nature of government assistance and incentives would potentially need to be adapted to provide adequate incentives for those investors. The current tax treatment of residential property for individual investors in Australia makes it a less attractive (and competitive) asset class for A-REIT structures. Likewise, an NRAS type of tax credit scheme is not as well suited to this setting.
- Better targeting/redirection of a range of taxation and other concessions towards affordable housing and towards supply-side interventions could help offset costs to government and improve effectiveness and the quality of outcomes.

## **5.4.2 How might SII be applied to help increase the supply of social housing?**

### ***Context***

There are 206,000 households currently waiting for access to social (public and community) housing units, of which more than a third are classified as 'in greatest need' (AIHW 2015).

A significant proportion of households in this sector have additional complex needs, which requires the integration and coordination of support services to improve outcomes for tenants. Furthermore, a large amount of the current social housing stock is no longer fit-for-purpose, being at the end of its life, poorly maintained, lacking in location and amenity, or underutilised as households have become smaller. Thus, given the size of the problem, any solution needs to be scalable and attract mainstream institutional capital.

Social housing has a significant financing gap (both capital and income gaps are larger than for the affordable housing sector). Consequently, any large-scale solution will need substantial on-going financial and/or in-kind contributions and commitment from all layers of government to be viable.

### ***Desired outcomes***

Increasing the supply of social housing units to absorb current and future demand is the primary and most urgent goal. Units need to be fit-for-purpose. Ideally, solutions should allow flexibility to manage the underlying portfolio of social housing stock for renewal and remaining fit-for-purpose.

Increasing the effectiveness of support services is also desirable, to improve outcomes for tenants, and where possible, support their migration from social housing along the housing continuum.

Reducing stress on transitional and crisis accommodation should also be a priority. Those at risk of homelessness will be placed in appropriate accommodation early and both the duration and instances of homelessness can be limited to help arrest progression to chronic long-term homelessness.

### ***SII solution design considerations***

The solution design comprises closing the financing gap with government funding and attracting institutional investment for debt via a bond aggregator.

#### ***Closing the financing gap***

Any social housing financing scheme by definition involves a financing gap. A high proportion of social housing tenants are reliant on government income assistance, and often have additional complex needs. The costs of maintaining social housing stock tends to be higher than for other segments, and the average life of housing units may be lower.

Significant government and/or philanthropic grant or in-kind (e.g. access to donated land, asset transfers for mixed use redevelopments) capital is needed for CHPs to significantly increase the supply of new social housing units and upgrade existing units that are no longer fit-for-purpose.

The significant gap between the income receipts from tenants and the costs of managing, maintaining, and upgrading housing stock places significant pressure on the future sustainability of CHP balance sheets. This creates operating deficits and maintenance backlogs for public housing providers.

To enable and facilitate SII in social housing at scale, all levels of government need to cooperate and use levers to invest or reduce the costs of developing new housing stock. Further, CHPs require stronger commitments from government on the continuity of Commonwealth Rental Assistance payments and other transfers, and regulatory and policy stability (e.g. supporting a more diversified tenant mix to cross subsidise lower income/higher cost households) before increasing their leverage profile.

Concessional and inclusionary zoning mandates and planning requirements and processes could also be an important lever to support lower development costs, further improving the viability of this financial model overall.

#### ***Attracting institutional investment***

This research confirms that perceptions of SII delivering social housing outcomes were somewhat less enthusiastic than for the affordable housing sector, reflecting the higher financing gap, increased complexity, reliance on regulatory and policy settings, reliance on CHPs as counterparties and lower quality security.

Therefore, to attract mainstream investors at scale to the social housing market, it is most likely any SII solution will need to provide ongoing government guarantees on both capital and income to transform the risk profile. Return expectations of the investment need to be both attractive to superannuation funds and make the transactions feasible and attractive to government and housing providers. The preferred solution arising from the Council on Federal Financial Relations Affordable Housing Working Group (2016b) is the bond aggregator model. Government would guarantee the timely payment of principal and interest on housing bonds issued by a financial intermediary aggregating and issuing bonds on behalf of CHPs, as discussed in Section 5.4.1.

In the first instance, over A\$1 billion of existing CHP debt could be refinanced at cheaper rates and for longer tenures through the bond aggregator, enabling CHPs to increase their borrowing capacity by 65 per cent or A\$765 million that could finance the construction of an additional 2,200 social housing units (Council on Federal Financial Relations 2016b: 39). Delivery of

additional social housing units beyond the 2,200 units will require substantial investment of grant capital.

#### *Better coordination and integration of services with housing provision*

The potential to consider incorporating SIBs as a 'stapled' security into the solution design of larger property transactions to promote collaboration and align incentives with desired outcomes is discussed in Section 5.4.3.

#### **Benefits**

- International precedents and case studies for the bond aggregator model exist—reducing risks and implementation time.
- The bond aggregator model can be tailored to meet institutional investors' needs and preferences—resulting in lower risk-adjusted returns and cost savings relative to alternate funding options.
- This solution provides a scalable platform that can be leveraged further (including to support the delivery of affordable housing units already discussed in Section 5.4.1).
- The bond aggregator has received substantial support in submissions to the Council on Federal Financial Relations Affordable Housing Working Group (2016b).
- SII principles of defining and measuring outcomes can be used to enhance outcomes for tenants and reduce the potential for unintended consequences—such as creation of outer suburban pockets of disadvantage.
- The bond aggregator aims to build multi-sector collaboration, capacity, and capability around social housing.
- The CHP sectors' sustainability and efficiency is supported (although may put pressure on smaller CHPs). As loans are to CHPs rather than against specific properties, affords CHPs greater flexibility to manage the underlying asset portfolios to best meet the needs of tenants throughout time.
- The public good benefit of residual value of portfolio is continued and supported as ownership of stock remains with CHPs and/or government.
- A sufficient supply of social housing that significantly reduces waiting lists may also contribute to tenants being more confident to transition from social housing to affordable housing.
- A sufficient supply of social housing that meets the needs of the majority of eligible tenants/households and does not need to be prioritised to those at the highest needs/lowest income end of the spectrum may have a positive impact on CHP revenues and business model sustainability.

#### **Risks**

- Currently there is not a credible pipeline of financially viable (i.e. government supported) projects behind the refinancing of existing CHP debt to support institutional investors' need for a large scale and continuing opportunity to warrant due diligence processes and associated costs.
- CHPs borrowing capacity is currently limited by cash flow constraints—capped revenue streams and rising maintenance costs. Without further government investment, new supply is limited to vicinity 2,200 units.
- There is a risk that it may be a more expensive solution than direct government funding of CHPs.

- Terms should balance investor protections with flexibility to ensure properties can be effectively managed by CHPs to remain fit for purpose (more easily accomplished with bond aggregator model and government guarantee of housing bonds, as investors will likely not require as stringent limitations on CHPs' ability to deal with the underlying security assets as would otherwise be the case).
- CHPs' tolerance to take on additional debt will reflect their confidence that existing government support will remain in place (e.g. Commonwealth Rental Assistance and the policy context will not be weakened through further residualisation of the revenue base).
- Long-term viability requires capacity building in the CHP sector to manage large-scale property development, increased size of tenancy and property management portfolios, and associated risk/financial management skills.
- CHPs need to allocate cost savings to additional stock or increased sustainability (e.g. adequate provisioning for future maintenance, refurbishment, recycling of housing units to ensure fit-for-purpose through time).

#### ***Other considerations***

- Government needs to act on other policy levers such as planning mechanisms, taxation and other concessions, use of public land, transferring public housing to CHPs for mixed use redevelopment, to reduce financial impost of new housing units to facilitate new supply.

### **5.4.3 How might SII be applied to help improve the outcomes for people experiencing or most at risk of experiencing homelessness in Australia?**

#### ***Context***

In Australia, 1 in 200 people are homeless, and rates of homelessness are particularly high for groups such as young people and Indigenous Australians (Reeve, Marjolin et al. 2016). Evidence demonstrates that breaking the cycle of homelessness early is critical to arresting pathways to chronic long-term homelessness (Flatau, Conroy et al. 2013; Wood, Flatau et al. 2016; MacKenzie, Flatau et al. 2016).

Availability of appropriate transitional and crisis accommodation has become challenged, due to increasing demand and lengthy social housing waiting lists that delay moving from transitional and crisis accommodation to more permanent housing solutions.

Better integration and coordination of homelessness services with housing solutions is needed to improve outcomes for tenants and improve the efficiency and effectiveness of services and housing delivery.

Further, notwithstanding investments made, some outcomes for people experiencing homelessness or with high support needs are not markedly improving, suggesting a need for innovation in service delivery models.

#### ***Desired outcomes***

Those who are homeless and most at risk of homelessness are placed in appropriate accommodation early and the duration and instances of homelessness can be limited (or avoided) to arrest the pathways towards chronic long-term homelessness and welfare dependence.

Elevating the potential of housing and homelessness interventions would contribute to increasing the social mobility, independent living skills, employment, community connections and wellbeing of people accessing these services by improving the integration and coordination of support services with housing and property.

Identifying and testing new and innovative service delivery models may significantly improve the quality of outcomes for tenants.

### ***SII solution design considerations***

SII in social enterprises and SIBs may contribute to improving homelessness outcomes (and outcomes for social housing tenants) by:

- Leveraging the ability to achieve policy objectives that cut across departmental functions such as economic participation, economic development, social inclusion and services delivery.
- Leveraging the hybridity of social enterprise business models that foster a culture of entrepreneurship and innovation in achieving their social goals.
- Capitalising on the higher trust/comfort among recipients to work with social enterprises and community service providers than with government.

However, funding services is seen to be high-risk for investors. Defining appropriate outcomes and how to measure them, insufficient evidence supporting the ability to influence outcomes through services, investibility of social enterprises, high transaction costs and complexity are significant barriers for investors to overcome. In some cases, costs and risks of implementing SII programs may outweigh the benefits, and care needs to be exercised to ensure the most vulnerable people with the most complex needs are not left behind. It may also be challenging to garner cross-government support for SIB initiatives if costs and benefits are not aligned—unless a whole-of-government approach is taken.

Therefore, using SII to fund services through social enterprises and SIBs has an important but more limited role to play in addressing the housing and homelessness issue, for instance, they can be used:

- As an incubator for policy innovation, that later can be redeployed into wider service delivery design to reorient the focus to paying for outcomes, and towards prevention and early intervention (i.e. solving rather than managing social issues). This would increase accountability around delivering desired outcomes by defining outcomes and transparently measuring the impact and effectiveness of specific interventions and service delivery models.
- As a framework to enable and facilitate cross-sector collaboration to bring different types of capital and broader perspectives to bear in finding better ways to solve intractable social issues.
- To align and incentivise providers to better coordinate and integrate services delivery with housing provision to contribute to increasing the social mobility, independent living skills, employment, community connections and wellbeing of tenants.
- As part of larger social housing property transactions as a risk minimisation strategy—for instance, delivering tenancy support services that improve tenants' ability to maintain successful tenancies.
- To encourage social enterprises to develop bespoke solutions to particular issues.

SII will not be appropriate in all settings and may be better suited to some investors than others and therefore needs to:

- Engage with the most appropriate forms of capital given the particular risks/opportunities. For instance, undertaking a SIB to pilot a new and innovative service delivery with a high degree of uncertainty around outcomes may be better suited to foundations rather than mainstream investors.

- Given the focus on generating cost savings to government, SIBs may have more application in targeting young people or other cohorts where early intervention provides more of an opportunity for long-term savings.
- Incorporate appropriate risk mitigants to counter issues such as social enterprise investibility, lack of track-record or strong evidence base. For instance, combining capital from impact first and finance first investors in tranching structures, incorporating capital guarantees from creditworthy institutions in SIB transactions.

### **Benefits**

*The use of SII has the capacity to:*

- Enforce greater accountability on service outcomes and, therefore, potentially to achieve those outcomes.
- Engage philanthropic and impact first investors in broader housing affordability and homelessness solution design and delivery.
- Provide ways for philanthropic and impact first investors to contribute without the perception risk of subsidising returns for finance first investors.
- Provide opportunities for cross-sector collaboration to identify potential new ways to deliver services, and a rigorous measurement process to test and select best options.
- Provide a framework that can be used to shift mind-sets/change culture around service delivery models including improving integration of services with physical housing solutions, focusing on prevention and early intervention, focusing on outcomes rather than activities/outputs and supported by rigorous measurement of those outcomes to inform future investment towards the most efficient and effective programs.

### **Risks**

The risks of using SII involve:

- scale, capacity and investment-readiness of social enterprises (including CHPs)
- scalability and replicability of service models
- high transaction costs and complexity—particularly for SIB transactions and bespoke small social enterprises
- nascent state-of-market development and evidence base for SIBs
- leaving behind the most vulnerable members of the community with the most complex needs
- setting unrealistic or being unclear as to expectations, and not engaging the most appropriate forms of capital given the particular risks and opportunities—for instance, trialling a new and innovative service delivery model versus scaling up a proven intervention—both are valuable but will be suited to investors with different risk tolerances and objectives.



### ***Other considerations***

Another consideration to be taken into account is:

- Ensuring a sufficient supply of social housing to relieve pressure on crisis and transitional accommodation, and enabling people to move into secure and appropriate long-term housing as quickly as possible.

## **5.5 What are the policy development implications of this research?**

- Housing affordability and homelessness operate within the broader housing market and policy context. The size of the challenge—particularly for the housing affordability segment (but having implications that flow on throughout the system)—is exacerbated by the interplay of several broader policies that distort behaviour and exert upward pressure on housing prices. For instance, promoting the construction of larger, more expensive housing units, promoting over-investment in owner occupier dwellings, promoting investment in residential rental units—but not at the affordable end of the spectrum, as well as a series of subsidies and concessions that generally favour the investment rather than the utility attributes of housing, and home owners and residential property investors over renters and aspirational home buyers. Better targeting/redirecting of a range of taxation and other concessions towards affordable housing and towards supply-side interventions (done carefully and gradually over time to avoid market shocks that could have broader economic and social consequences) could help reduce the size of the problem that needs to be solved, offset additional costs of government investment in SII solutions, and improve the quality of outcomes for tenants.
- SII provides government with an additional toolkit that can be used strategically to help support innovation and culture change—such as drive greater integration of services delivery and housing solutions, reorient focus towards paying for outcomes rather than funding activities and outputs, and reorient the focus towards prevention and early intervention.
- SII cannot supplant government assistance and investment but can leverage the return on that investment.
- For both social and affordable housing there exists a significant financing gap, and government has a critical role to play in filling it if it wishes to engage the investment community in collaborating and contributing to solutions. The lack of regulatory/policy stability and track record make government guarantees the most efficient mechanism to counter these gaps while track record can be developed, although consideration also needs to be given to moral hazard risks inadvertently created by government de-risking investments to the point where the nexus between positive social outcomes and financial returns is severed, and investors' alignment of interests with achieving positive social outcomes is weakened.
- The proposed bond aggregator model (incorporating government guarantees) offers an efficient transmission mechanism to engage superannuation funds through a common platform that can be used to finance both affordable and social housing solutions.
- Housing affordability and homelessness issues and their potential solutions operate within a complex and interdependent system. Table 15 highlights this by the presence of other actors as critical levers and/or barriers to enabling actors within the system. The constructed examples for exploring SII solutions further underscores these interdependencies across the housing continuum.

- SII provides a framework for bringing multiple actors together to work collaboratively towards solutions, although a key finding from the research is that there is an opportunity to increase actors' understanding and awareness about the potential roles, expectations, needs and barriers of other actors' within the system and to ensure everyone is 'talking the same language'. In this regard, the creation of a specialist intermediary may assist with and accelerate that process.
- When discussing the role of SII, there is a tendency to group actors by category (e.g. 'government', 'investors'). Actors within these categories can have different roles, objectives and risk tolerances. This oversimplification could contribute to incorrect assumptions forming and a mismatch in expectations between different stakeholders, which may lead to consequences that have the capacity to damage perceptions and confidence in this emerging market.
- When discussing the role of SII, there is a tendency to group housing and homelessness issues together. As highlighted in Section 1.2, there are several distinct but interdependent challenges across the housing and homelessness continuum. This has implications for when SII may present as a viable option, and for which types of SII may be more appropriate and in which context.
- SII will not be appropriate or offer efficient solutions in all cases. Further, in many cases it may form part of the solution, but to optimise impact/efficiency/effectiveness, it will need to be implemented alongside other funding solutions and policy interventions.

## 6 Policy development options

Australia faces numerous housing policy challenges. The waiting lists for social and affordable housing are long (with a significant proportion of social housing stock no longer fit for purpose), large proportions of people are in housing stress and too many people are experiencing homelessness.

At a time of diminishing resources, new solutions are needed to address these complex housing problems. SII is one innovative and growing mechanism for funding solutions to complex problems. It has gained renewed interest from individuals (philanthropists, social investors), institutions (foundations), policy-makers, and increasingly, mainstream financial markets (asset managers, pension funds) in the US, UK, Canada, Australia and other developed economies seeking to address a broad range of social issues, including housing and homelessness.

Findings from this research aim to inform and progress housing policy to move Australia forward—across the homelessness to housing affordability continuum. This is achieved by developing an understanding of the opportunities SII creates for housing and homelessness outcomes using a systems thinking framework to map key SII actors and levers, along with the barriers those actors may face within that system and the interdependencies and risks that need to be considered when considering policy responses.

### 6.1 Is Australia ‘ready’ for social impact investment?

There is a growing level of awareness, interest and momentum around SII in Australia and strong indicators of the preparedness and desire of actors to participate in the SII market in the future—once barriers are removed and the number and value of ‘investible’ deals increase. There is a risk that if barriers are not removed to facilitate and enable the market, momentum and interest may wane.

All of the necessary conditions for SII (intentionality, social and financial returns, measurement) can be met today—although not in a systematic way to be efficient enough without imposing significant resource and cost imposts on transaction parties. In some of these areas—in particular, the development of impact metrics and investment frameworks—significant work and investment is underway globally to fill these gaps. Australia can learn from this work and leverage accordingly.

#### **Government**

Relative to other SII markets, the Australian Government’s role in creating a stable regulatory and policy environment and providing the enabling environment to attract actors to SII is somewhat less developed. Australia lags in terms of government investment in SII—for instance, funding pilots, closing the financing gap, seed funding of significant specialist intermediaries (e.g. Big Society Capital in the UK) and providing a steady and reliable pipeline of ‘investible’ deals. The Australian Government’s investment in the SEDIF funds has played an important role in the development of the market thus far. They do not, however, operate at the scale of institutions such as Big Society Capital or some of the major foundations in the US that have played a significant market development role through large-scale market building activities.

The more limited role of government has been the most significant barrier in the development of the SII market in Australia thus far. That said, recent signals and announcements indicate this may be changing (with respect to both SII and housing and homelessness policy), which would be a positive step for the SII market as a whole—given government’s central role in providing the enabling environment for SII to develop and flourish.

## ***Investors***

Australia has a very large and sophisticated institutional investment market by virtue of burgeoning superannuation assets. Many of Australia's largest fund managers and superannuation funds are signatories to the United Nation's Principles for Responsible Investment, have increasingly sophisticated environmental, social and governance (ESG) frameworks and are experiencing increasing client demand for investment options that align with members' own values. Collectively as managers of a pool of superannuation wealth exceeding Australia's GDP, superannuation funds are increasingly open to the notion of universal ownership responsibilities and the alignment of social issues—such as housing affordability—with their members' long-term interests.

That said, superannuation funds are also subject to regulatory requirements and expectations that they manage their investments to maximise retirement income for their members, and as such need investments that offer competitive market-based risk adjusted returns that also offer an attractive risk profile relative to both the fund's overall portfolio as well as their member's individual portfolios (of which the family home is often their largest asset). More than sufficient capital is available to support increasing the supply of social and affordable housing, so long as government and other grant or concessional capital closes the financing gap, and investments are structured to meet investor preferences and risk tolerances—and in particular, to mitigate the lack of regulatory and policy stability and lack of track record in the sector.

Australia has a much smaller pool of philanthropic and 'impact first' capital available through foundations, HNWI's and philanthropists than comparable countries such as the US and the UK. However, its significance and importance to the SII market as an enabler in the combined financial model SII—in addition to the ability to support capacity building and investment readiness in social enterprises and to bring social sector knowledge and expertise to SII transactions—are critical.

A growing number of 'impact first' investors are becoming more aware of, and interested in, the opportunity to achieve greater impact by better aligning their corpus investment philosophy with their mission, although these investors are usually reliant upon third party wealth advisors to guide their investment activities. Most of these advisors are currently not in a position to offer specialised SII advice—although specialists are now emerging in this space. There is some opportunity to further clarify and improve PAF mechanisms between corpus investments and grant-making to allow the total SII loan as part of the minimum distribution amount—this would remove possible disincentives to investing in SII that are testing new and innovative models with a higher risk of failure (The Treasury 2017).

## ***Social enterprises and other service providers***

The investment readiness of social enterprises (including CHPs) has been raised as a concern by both investors and social enterprises. Investors' concerns can be largely mitigated structurally—for instance, by creating an intermediary bond aggregator and issuing government guaranteed housing bonds. CHPs' concerns centre around sustainability of their business models (in particular, certainty of revenue streams such as Commonwealth Rental Assistance payments, regulatory changes that may cause further residualisation of their revenue streams, and necessary capacity building to manage increased developmental and financial complexity and operating at a larger scale). CHPs' ability to increase their leverage profiles is significantly constrained by their low rental returns and high costs associated with maintenance and stock renewal, and large-scale increases in the supply of social housing will require cash or in-kind (e.g. 'free land') grants from government and possibly augmented (although not replaced by) philanthropy.

Smaller social enterprises that likely may be service providers in SIB transactions, cite transaction costs (including administrative burden) as a major barrier to their involvement in SII.

Social enterprises seeking SII loans or equity often need significant capacity building support to become investment ready, and initiatives such as the NAB/Impact Investment Australia investment readiness fund have been helpful in that regard.

## **6.2 Efficacy of social impact investment in housing and homelessness**

The market for SII is still in its infancy and consequently the evidence base is limited. That said, the research has outlined and demonstrated numerous case studies and examples in Australia and internationally where SII successfully brings together cross-sector actors. The resultant collaborations explore, implement and finance programs and initiatives that create a positive impact on the outcomes for and the lived experience of some of society's most disadvantaged citizens. This includes examples that have successfully increased the supply of fit for purpose social and affordable housing and delivery of innovative homelessness services.

Current models of service provision and delivery mechanisms are not achieving the desired outcomes. Many of the shortcomings that have been identified in the existing system are key elements that SII is specifically designed to counteract—for instance: a focus on paying for outcomes rather than paying for activities; a focus on prevention and early intervention; increased accountability for achieving outcomes through transparent measurement; increasing cross-sector collaboration to find new and better ways to solve old problems; redirecting investment towards services; programs and initiatives that achieve the best outcomes most effectively; a focus on solving rather than managing social problems, and leveraging government's return on investment by attracting other forms of capital (including institutional capital).

Not all social problems can be solved however, and in some cases, the relative cumulative savings to government may be modest (e.g., the financial impact of breaking long-term welfare dependence for young people is far greater than for those approaching retirement), or the needs of beneficiaries so complex that there is insufficient certainty of achieving improved outcomes. In these instances SII will likely not be appropriate. It will be important to ensure that sound mechanisms are in place to make these determinations, and where SII is not an appropriate option that people continue to be adequately supported to improve their lived experience, achieve their potential and personal aspirations, and are not left behind.

Sometimes the most significant value of SII to government may be to act as an incubator to trial new ways of doing things that would be difficult to trial in the ordinary course of business. In these instances, designing appropriate mechanisms to transition successful solutions back into government's broader commissioning of services will be important to fully optimise the investment in SII.

Specifically in relation to housing and homelessness, SII deals need to include both property and support services in order to be effective in achieving the desired social outcomes as identified in the research. Through better coordination and integration of support services and housing availability, SII must present a risk profile that is attractive to investors (as funding services is seen to be a high-risk activity by investors unless it is included alongside property assets as a risk minimisation strategy).

As has been highlighted in the research, combining financial models may increase the viability and success of SII transactions and offer stakeholders different benefits—but can it increase complexity? Due care needs to be given to ensure SII products are simple, clear and easy to understand so as not to deter potential investors and so that the benefits of combining financial models are more likely to be achieved.

SII poses particular risks to government, service providers, investors, intermediaries and most importantly to beneficiaries if it is ill conceived, poorly executed, used in inappropriate settings, or if insufficient thought is given to what happens after an SII transaction ends. These risks need careful consideration in determining whether SII is the most appropriate model in a given context, and in the design of specific SII solutions.

### 6.3 Operationalising social impact investment in Australian housing policy

Government has an important enabling role in developing the SII market for housing and homelessness. It controls many of the levers that can remove barriers that enable other actors to participate, as well as levers in the broader housing market that influence both the size and shape of the housing affordability challenge. The levers with the most potential to support realisation of the most impactful SII opportunities identified, along with the consequences if not enacted are:

- Related public policies that are putting upward pressure on prices and adversely affecting housing affordability must be addressed as these increase the size of the problem and the financing gap that needs to be filled. The consequences of not addressing this means that the problem that needs to be solved is bigger than it should be, the financing gap that needs to be filled (most likely by government) is higher than it may otherwise be, and systemic risks of a property price correction heightens risks to investors who may attempt to address the issues.
- The role of government, as recognised in the *Social Impact Investing Discussion Paper* (The Treasury 2017) and the Council on Federal Financial Relations Housing Working Group (2016b), remains pivotal. SII can support government initiatives, but stable, long-term government policy (both in terms of long-term policy commitment to SII and with regard to continuity of housing policy) and funding are essential to attract SII and support the growth of CHPs. All levels of government need to work in concert to bring what they can to reducing risks and costs of delivery. The consequences of failing to provide a stable, long-term policy context are that key actors will not be confident to take risks and will stay on the sidelines, resulting in the challenges not being addressed, and leaving government as the primary actor to resolve these issues. In particular, policy change and regulatory uncertainty hinders investment.
- The bond aggregator model (Council on Federal Financial Relations 2016b) has industry and investor support and international precedent (e.g. UK) and provides the opportunity for institutional investment at scale as well as an efficient mechanism to finance both social and affordable housing. Without such a mechanism, many of the valid concerns of institutional investors cannot be elegantly addressed, making it difficult to attract institutional capital to participate—one of the critical success factors identified in this research given the scale of the problem.
- An improved NRAS, applying learnings from the original NRAS combined with the bond aggregator model, provides the opportunity for CHP investment at scale in targeted fit-for-purpose social and affordable housing stock. Government should also look to other ‘in-kind’ support mechanisms and broader planning/zoning levers to support the construction of additional affordable housing units. The consequences of failing to provide mechanisms to close the financing gap are that supply will not increase sufficiently to meet need, or CHP business models will become too aggressive threatening the viability of the sector. CHPs have the potential to play a growing role through government support and industry bodies (e.g. Frost and Hamilton 2016) and with international precedent (e.g. UK, Netherlands). If CHPs are not supported to achieve increased scale and capacity, they will not develop to be

seen as viable and attractive counterparties; a lack of scale also undermines viability/efficiencies in the sector.

- Homelessness is a complex issue and SIBs and social enterprises can be part of the solution, with government providing an enabling environment, including frameworks for better measurement of outcomes. These instruments are expensive and bespoke, and the greatest benefit may be as an incubator to test new solutions that can be imported back into broader commissioning and procurement practices. The consequences of not investing in innovation are that we continue to pay for activities and outputs that may not be delivering the most effective outcomes, we fail to invest enough in prevention and early intervention that results in much larger long-term costs to the system (not to mention inferior outcomes for beneficiaries).

Other levers as identified throughout this report that are worthy of consideration include:

- Closing the financing (and risk/return) gap using subsidies and related financial mechanisms to attract superannuation funds and other institutional investors at scale.
- Reviewing other forms of government assistance that could help close the financing gap—including access to discounted or free land, mandating or encouraging mixed developments, inclusionary zoning requirements, exceptions to zoning and planning regulations, additional recurrent funding and direct grants from government (Council on Federal Financial Relations 2016b).
- Recognising that at least in the medium term (and possibly on an ongoing basis) that government guarantees are an efficient mechanism to deal with the valid concerns of institutional investors and better align return expectations of investors with achieving the most cost effective outcomes for government.
- Giving consideration to complimentary reforms that would strengthen governments and CHP capacity to effectively increase affordable housing supply using innovative financial models—including nationally consistent CHP regulation, zoning and planning regulations, and concessions and taxation (Council on Federal Financial Relations 2016b).
- Improving coordination and collaboration across all levels of government, including by providing clear demarcation of responsibility between different layers of government; facilitating and formalising data and information sharing across different layers of government (and government departments); creating a publicly available bank of relevant cost and outcomes indicators; and taking a whole-of-government approach to SII.
- Investing in market infrastructure—for instance, specialist Intermediaries, cost data, outcome measures, etc. to accelerate the development of measurement tools, benchmarks, and investment frameworks that will enable wealth management advisors to advise their clients appropriately on SII, and allow other investors to participate in the SII market with more confidence.
- Giving consideration to the roles of specialist intermediaries in facilitating and accelerating the development of the SII market—in particular that collaboration, sharing of information and working across organisational boundaries were seen as important SII enablers. This suggests that successful SIIs require working across silos and require each of the actors' to understand and respond to each other's needs. More communication and education about what SII is and how it works is still required, including through accessible language and resources that a range of stakeholders can understand—functions that specialist intermediaries could be expected to perform.
- Reducing transaction costs by paying for pilot trials; supporting standardisation of transaction structures, documentation, outcomes measures, reporting requirements, and open sourcing of data and information; and providing a steady and reliable pipeline of deals.



- Removing real and perceived regulatory and legislative barriers—for instance, by clarifying through additional guidance and relevant examples and/or refining regulatory and legislative rules to remove inconsistencies in treatment across different vehicles and entity types, and reducing or removing perceived barriers to SII investment. In the Australian Government's *Social Impact Investing Discussion Paper* (The Treasury 2017) policy-makers should expand the allowance to include: the total loan as part of the minimum distribution for PAFs; extend the treatment to all registered charities including non-DGRs in the PAF distribution; SIBs where government agency is contractor, and those made through a specialised SII intermediary. This may be particularly useful in better enabling the relatively small but important pool of 'impact first' investment and grant capital that in turn, can be an important enabler of combined SII financial models.
- Regularly engaging with other market participants to develop and refine policy frameworks to encourage their participation—for instance, foundations and charitable trusts as funders of capacity building for SIBs and social enterprises and investors (impact first and finance first); NFPs as service providers and asset owners and intermediaries for SII; and superannuation funds as investors.
- Better targeting/redirecting of a range of taxation and other concessions towards affordable housing and towards supply-side interventions (done carefully and gradually over time to avoid market shocks that could have broader economic and social consequences) could help reduce the size of Australia's housing affordability problem, reducing the number of households needing to access affordable housing and reducing the financing gap on delivering social and affordable housing outcomes, offset additional costs of government investment in SII solutions and improve the quality of outcomes for tenants.
- Ensuring appropriate mechanisms are in place to protect beneficiaries, including an orderly transition and continuation of service delivery when SII's mature or are otherwise terminated.
- Ensuring appropriate mechanisms are in place to ensure that people are not left behind—for instance, those people or cohorts that may not be best suited to SII opportunities.

## 6.4 Concluding remarks

SII provides government with an additional toolkit that it can use strategically to help drive better social outcomes and achieve higher returns on investment of public money. SII provides a useful framework to help support innovation through cross-sector collaborations and partnerships. It can also be used to help drive culture and behaviour change by focusing on paying for outcomes rather than funding activities and outputs, by focusing on prevention and early intervention that can break the cycle of entrenched disadvantage, by increasing accountability for outcomes through measurement and increased transparency, and by designing SII to include elements of both property provision and support services, incentivise greater coordination and integration of services delivery and housing solutions.

Government will continue to provide and fund affordable housing and homelessness services. SII cannot supplant government funding and investment. What SII can do is enhance the return on government's (increased) investment in housing and homelessness by attracting other sources of capital (including mainstream capital) with different capabilities and risk return objectives to co-invest alongside it.

SII is not a silver bullet and it will not be the most appropriate or effective solution in all cases. Further, where it does have a role to play, in many cases it will need to be implemented alongside other funding solutions and policy interventions.

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## Appendix 1: Inquiry questions and supporting projects

Across its three projects, the Inquiry into social impact investment for housing and homelessness outcomes aims to develop an understanding of social impact investment's opportunity, capacity and ability to create social change in housing and homelessness.

It will answer the following Inquiry questions and sub-questions:

- 1** What is social impact investing and how can it be applied to housing and homelessness policy in Australia?
  - How has social impact investment been applied (in its infancy) to social policy issues overseas and in Australia, and what opportunities does it create for housing policy?
  - Who are the actors in social impact investing in Australia and what are their actual/potential roles for housing and homelessness policy?
  - What are the different financial models, types of capital and different types of investors available to address housing and other social issues (e.g. scale, risk, market, supply, regulation etc.)?
  - To what extent might social impact investment provide new sources of capital for the housing sector?
  - What are the risks and returns for investors and over what timeframes? Is there a pool of concessionary and double-bottom line investors?
  - What enterprises/interventions/models might be invested in? How will they be delivered and what characteristics will help/hinder competitiveness for receiving funding and effectively delivering services?
- 2** What are the actual, potential and perceived opportunities, risks and/or barriers of social impact investing for housing and homelessness policy in Australia?
  - Under what circumstances might social impact investment improve housing (e.g. affordability, tenancy sustainability etc.) and social and economic outcomes for households, institutional actors and investors?
  - Who might benefit most and who is in danger of being left behind?
- 3** How can social impact investment be operationalised to housing policy in the Australian context?
  - What role can/should different actors, including government, play in facilitating the impact investment market and providing incentives for engagement in housing services?
  - What frameworks, resources and principles need to be considered in measuring social and financial outcomes of social impact investment? (indicators, resources, ethics, rigour etc.)

Three projects intersect to answer the Inquiry questions, while also delivering robust stand-alone policy evidence for developing a better understanding of social impact investment and its potential to address housing and homelessness in Australia.

Project A is the project on which this report is based. Projects B and C will follow later in 2017–18. A combined Inquiry report will also follow in late 2017–early 2018, detailing the overall findings of the three projects and combined policy implications.

*Project A: The opportunities, risks and possibilities of social impact investment for housing and homelessness*

Project A investigates how social impact investment has been applied to social policy issues overseas and in Australia, the opportunities and risks for housing and homelessness policy; the actors, financial and enterprise models and relationships in the social impact investment system; and potential future implications for housing policy and services into the future. Project A is a foundational project that helps inform an understanding of the opportunities, limitations and risks for future housing and homelessness policy. Projects B and C leverage off Project A's background work and add more evidence and depth.

*Project B: Understanding opportunities for social impact investment in the development of affordable housing*

Project B focuses on current affordable housing projects that have used or contemplated using impact investors and not proceeded with it, and outlines the opportunities and barriers for social impact investment in the development of affordable housing. It examines the motivations across the sector and circumstances required for investment and innovation to harness opportunities and overcome barriers.

*Project C: The finance of impact investment: Supporting vulnerable people to achieve their housing and social goals*

Project C provides a finance perspective on the role of impact investing in generating improved housing and employment outcomes for vulnerable people, such as seniors, people with disabilities and homeless people. It identifies how, where and under what circumstances social impact investment could support vulnerable households and individuals. This project is important in informing how social impact investment could be operationalised to housing policy in Australia, the difference it might make to outcomes for households and individuals who are homeless or at risk of homelessness and how to understand whether and where social impact investment is making a difference.

## Appendix 2: Housing affordability and homelessness challenges in Australia viewed by household tenure

### Composition of Australian households by tenure

As of the 2011 census, there were 8,181,750 households in Australia. Of these, 64.3 per cent households owned their homes outright or were mortgaged, 23.5 per cent of households were renting in the private market, and 4.5 per cent of households were renting in the social housing sector (ABS 2017).<sup>25</sup>

Between 2001–11 median mortgage and rental payments increased by 100 per cent, compared to a 60 per cent median increase for household income, making housing less affordable for many people (Reeve, Marjolin et al. 2016)—and disproportionately so for households on lower incomes. This contributes to a growing problem of highly indebted households and to an increasing proportion of households that experience mortgage stress or rental stress. By 2015, more than one million Australian households were in housing stress—spending more than 30 per cent of their gross income on housing costs (ACOSS 2015).

### Home ownership/mortgage market

Home ownership rates in Australia remain relatively high, but are falling for all age groups other than those aged 65 years and over and a decreasing proportion of homes are owned free and clear of a mortgage. Whereas a home purchaser in the 1980s needed to save a deposit equal to one year's average salary to purchase a home at the median house price secured by a loan they could comfortably repay, by 2010 an equivalent deposit was equal to four years of average income (Kelly, Hunter et al. 2013).

It is also relevant to note that Australia's responsible lending framework enshrined in the National Consumer Credit Protection Act 2009 reduces access of lower income households to the mortgage market (as lenders must first satisfy themselves before extending credit that it is reasonable to assume the borrower will be able to meet the repayment obligations of the loan). So, while the proportion of home owners/purchasers in the 25–44-year age range trended lower across all income quintiles between 1988–89 and 2011–12, the trend was much more pronounced in the three lowest income quintiles (Yates 2015). As a result, affordability issues are more concentrated in the rental market, as lower income households—particularly in a high property price environment—are increasingly likely to be locked out of the home ownership market.

That being said, with steadily rising property prices, Australian household debt levels have increased substantially to be among the highest in the world (Creighton 2016; Prime Capital 2014), leaving households with a mortgage more vulnerable to personal shocks, deteriorating economic conditions and/or interest rate rises in the future. There are 17.4 per cent of owner-occupier Australians with mortgages who are classified at risk of mortgage stress (ability to repay their loan at a major bank at an average interest rate of 5.4%) (Roy Morgan 2016).

### Private rental market

The private rental market comprised 23.5 per cent of households in 2011, and is estimated to be the fastest growing segment. Housing stress is much more pronounced in the rental market

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<sup>25</sup> The remaining 7.7% of households comprised other tenure types or did not disclose their tenure type.

compared to the home ownership market. According to earlier AHURI research, conservative estimates found of the 1.735 million privately rented dwellings in 2011, 80 per cent, or 277,600 households in the lowest income quintile were renting unaffordable housing (paying more than 30 per cent of their income in rent) in 2011 and 25 per cent or 86,750 of those households lived in severely unaffordable housing (paying more than 50 per cent of household income on rent). For this income quintile, the major issue was lack of supply of affordable dwellings. One-third of second income quintile households (114,500 households) were living in unaffordable housing in 2011. For this income quintile, the major issue was availability of affordable housing. That is, a sufficient number of affordable dwellings theoretically exist, however these were occupied by households in higher income quintiles (Hulse, Reynolds et al. 2015)—some of whom may reasonably be assumed to be middle and higher income quintile aspirational purchasers—minimising their housing costs while saving towards home ownership.

The rising number of long-term renting households presents a future policy challenge in the context of an ageing population, as current pension funding and policy relies on low housing costs and the ability of retirees to part-fund the costs of aged care (Stone, Burke, et al. 2015).

## Social housing sector

The social housing sector comprises both public and community housing with nearly 370,000 households living in social housing as at the 2011 census. Current demand for social housing far exceeds supply. In 2014, 154,600 people were waiting for public rental housing, 8,000 for Indigenous social housing and 43,400 for mainstream community housing (AIHW 2015). Of this group, 75,900 were classified as 'in greatest need'—that is, at risk of homelessness, of having their life or safety threatened, of their health worsening or of living in inappropriate housing with very high rental costs (AIHW 2015). Around 1 in 200 people are homeless each night in Australia and rates of homelessness are especially high for particular groups, such as young people and Indigenous Australians (Reeve, Marjolin et al. 2016). While demand continues to grow, proportionately the stock of social housing units has been falling relative to total housing units (Reeve, Marjolin et al. 2016).

While for many households occupying social housing or on waiting lists, affordability is the major issue, a significant proportion of households in this sector have additional complex needs, including disability and mental health issues, that require the integration and coordination of support services to facilitate people to lead life to the fullest and increase their capacity to live independently, acquire skills, create and maintain connections in the community and experience personal wellbeing. Supply of housing coupled with coordination of housing with support services is an ongoing area of work that is challenging and continues to require improvement.

The lack of supply of social housing and long waiting lists, coupled with the sometimes significant step-up in rents, reduced security and rights in the private rental market may also contribute to reduced transition out of social housing and along the housing continuum (Stone, Parkinson et al. 2016), which remains a challenge for the social housing sector. For some social housing tenants, leaving the security and familiarity of the home they have created may be an additional barrier to transitioning to affordable housing (Department of Family and Community Services 2015).

A significant proportion of the current social housing stock is no longer fit-for-purpose, being at the end of its economic life, poorly maintained, lacking in location or amenity, or underutilised as household compositions have shifted to smaller sizes (Kraatz, Mitchell et al. 2015). The ability to maintain properties over time and refurbish or replace stock to meeting changing needs over time also remains a challenge.

Over time, stock is being transferred from state governments to NFP CHPs incentivised in part by access to Commonwealth Rent Assistance, which is not available to public housing



tenants—providing CHPs with the ability to charge higher rents and earn higher income relative to public housing departments to manage rising maintenance and other costs. As at 30 June 2015, of the national stock of 403,767 social housing units, 18 per cent were community housing, up from 9 per cent at 30 June 2007, despite a decrease of 5.3 per cent in overall stock (Council on Federal Financial Relations 2016a). While a large number of CHPs exist in Australia, the majority of the stock is managed by a small proportion. In June 2012, for example, over 700 CHPs were registered of which only 5 per cent managed stock of more than 200, and 63 per cent of stock was managed by 45 larger CHPs (Milligan, Hulse et al. 2015). The lack of scale and associated concerns around capacity of CHPs in Australia (e.g. to manage increasing complexity in terms of both leverage and development risks), as well as concerns about the sustainability of their business models in the medium term (in particular, the reliance on government subsidies such as the CRA, and the increasing residualisation of their tenant mix towards higher needs/lower income households) are key considerations for lenders and investors providing finance to CHPs.

## **Homelessness**

Around 1 in 200 people are homeless and rates of homelessness are particularly high for particular groups, such as young people and Indigenous Australians (Reeve, Marjolin et al. 2016). The lengthy waiting lists for social housing is putting pressure on crisis and transitional accommodation, frustrating the efforts and effectiveness of homelessness services, and exacerbating homelessness issues (evidence demonstrates that breaking the cycle—both duration and instances—of homelessness early is critical to arresting pathways to chronic long-term homelessness).

## Appendix 3: Structural and policy considerations in the broader Australian housing market that have implications for housing affordability

Homelessness and housing affordability issues operate within a broader environment and context. There are a number of structural and policy considerations in the Australian housing market that may interact (positively or negatively) with housing affordability issues and potential social impact investing solutions, including:

- High property prices that exacerbate housing affordability issues and increase both the costs of social and affordable housing and the risks to investors who attempt to address the issues.
- Rising number of long-term renting and/or indebted households.
- Housing subsidies and tax concessions that favour wealthier home owning and property investing households over renters and aspirational first home buyers (Lawson, Legacy et al. 2016; Yates 2009).
- Certain policy settings that have a tendency to exert upward pressure on house prices (Yates 2009).
- Certain policy settings that have a tendency to distort behaviour. For instance, stamp duty on property purchases potentially reduces the attractiveness of ownership for some households who value or need mobility for their jobs (Kelly, Hunter et al. 2013); underutilisation of properties as owner occupiers may stay in properties longer than otherwise may be the case to avoid high transaction costs and to fully use the tax exempt status of the family home (Kelly, Hunter et al. 2013; increase investment in owner-occupied housing at the expense of more productive investment (Yates 2009). Favourable taxation treatment of residential housing for individuals that has tended to make it less attractive as an investment class to institutional investors whether through unlisted wholesale property funds or listed A-REIT structures (Newell, Lee et al. 2015a; 2015b). Certain policy settings that have tended to increase demand for investment properties and speculation among wealthier households (Kelly, Hunter et al. 2013—but not necessarily increased the supply of affordable housing options for the rental market (Kelly, Hunter et al. 2013).
- Zoning, planning and approval processes along with building costs, codes and regulations that tend to incentivise property developers (by affording greater profit potential) towards providing higher value properties.
- An absence of planning/inclusionary zoning controls on developers to explicitly mandate an increase in the supply of affordable housing (noting that the NSW Government has recently acted to introduce inclusionary zoning requirements) (AHURI 2016).
- Tenant rights and security, including tenure, exposure to rental price increases, and ability to make a home in the private rental market that are less advantageous than other markets that have a high proportion of long-term renters (Kelly, Hunter et al. 2013) and less attractive than the rights afforded them in the social housing system, potentially acting as a disincentive to move out of social housing.

With price (purchase price or rent) as the primary lever, there is a risk that so-called affordable housing fails to meet tenant needs in terms of both amenity and cost. For instance, transport costs, access to employment opportunities, schools, services, and energy efficiency are key elements of housing affordability (Home and Morrissey 2010).

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