Final Report

Peer Reviewed

Financing rental housing through institutional investment

Volume 1: outcomes from an Investigative Panel

authored by

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for the

Australian Housing and Urban Research Institute

at University of New South Wales

March 2013

AHURI Final Report No. 202

ISSN: 1834-7223

ISBN: 978-1-922075-23-9

AHURI Australian Housing and Urban Research Institute

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Title	Financing rental housing through institutional investment—Volume 1: outcomes from an Investigative Panel	
ISBN	978-1-922075-23-9	
Format	PDF	
Key words	financing, rental, housing, institutional investment, Investigative Panel	
Editor	Anne Badenhorst	AHURI National Office
Publisher	Australian Housing and Urban Research Institute Melbourne, Australia	
Series	AHURI Final Report; no.202	
ISSN	1834-7223	
Preferred citation	Milligan, V., et al. (2013) *Financing rental housing through institutional investment—Volume 1: outcomes from an Investigative Panel,* AHURI Final Report No.202. Melbourne: Australian Housing and Urban Research Institute.	

Note:

This Final Report consists of two volumes:

1. *Financing rental housing through institutional investment—Volume 1: outcomes from an Investigative Panel*.
2. *Financing rental housing through institutional investment—Volume 2: supplementary papers*.

Available at http://www.ahuri.edu.au/publications/projects/p71016.

ACKNOWLEDGEMENTS

This material was produced with funding from the Australian Government and the Australian states and territory governments. AHURI Limited gratefully acknowledges the financial and other support it has received from these governments, without which this work would not have been possible.

AHURI comprises a network of universities clustered into Research Centres across Australia. Research Centre contributions, both financial and in-kind, have made the completion of this report possible.

This report could not have been written without the commitment and keen interest shown by the members of the Investigative Panel established to identify how to achieve institutional investment in affordable rental housing. Panellists gave generously of their time and enthusiastically shared their expertise and knowledge about the lessons arising from their diverse experiences of developing, financing and delivering housing. However, while panel members made the research task much easier interpretation of panellists' contributions remains the responsibility of the authors.

The authors would also like to thank their colleague Dr Shanaka Herath, City Futures Research UNSW, for his valuable assistance with the background research and conduct of the Investigative Panel meetings.

The authors owe a huge debt of gratitude to Professor Christine Whitehead for the interest she took in this project and they are especially appreciative of her critical and insightful comments on the penultimate draft of this report. Valuable comments on that draft were also received from an anonymous reviewer.

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ACRONYMS

ADI	Authorised Deposit Taking Institution
AHURI	Australian Housing and Urban Research Institute
FaHCSIA	Commonwealth Department of Families, Housing, Community Services and Indigenous Affairs
CEFC	Clean Energy Finance Corporation
CHO	Community Housing Organisation
COAG	Council of Australian Governments
CPI	Consumer price index
CRA	Commonwealth Rent Assistance
DoHWA	Department of Housing Western Australia
GFC	Global Financial Crisis
HAF	Housing Affordability Fund
HHMAC	Housing, Homelessness Ministers Advisory Committee
LIHTC	Low Income Housing Tax Credit (US)
LVR	Loan–to–valuation ratio
NAHA	National Affordable Housing Agreement
NAHC	National Affordable Housing Consortium
NBN	National Broadband Network
NFP	Not–for–profit
NHSC	National Housing Supply Council
NRAS	National Rental Affordability Scheme
QRIF	Questus Residential Investment Fund
PPP	Public private partnership
PRS	Private rental sector
RBA	Reserve Bank Australia
REIT	Real estate investment trust
RMBS	Residential mortgage–backed securities
SHI	Social Housing Initiative
SMSF	Self-managed superannuation fund
SWF	Sovereign wealth fund
UK	United Kingdom
WA	Western Australia

FINDINGS AND RECOMMENDATIONS

Preamble

This report has been prepared in response to a research brief commissioned by the Housing, Homelessness Ministers' Advisory Committee (HHMAC) through AHURI Limited. The central question in this brief was how to encourage institutional investment in rental housing to increase the supply of dwellings affordable to moderate and low income households. It did not seek a response to the broader question of whether this was likely to represent a value for money solution for government. The brief specified use of an Investigative Panel (described below) to address its central question.

Institutional investment is that undertaken by large organisations (e.g. banks, unit trusts, superannuation funds or pension funds) with considerable cash reserves to invest. Institutional investors are by far the biggest participants in securities trading and their share of stock market, but not of rental market, investment has consistently grown over the years. It is the growth in the managed funds sector (described in full in Chapter 2) that has prompted consideration of the way in which these funds might be used to facilitate investment in affordable rental housing.

Presented here are the findings and recommendations developed by a panel of experts who, in the latter part of 2012, were asked to provide advice on two core matters:

1. Factors constraining large scale investment in rental housing by financial institutions in Australia.
2. Ways to mitigate these constraints in the short and longer terms.

In particular, advice was sought on how to facilitate institutional investment in affordable rental housing.

Over many decades the primary investors in private rental housing in Australia have been individuals owning one or two dwellings. These small scale investors have financed a steady increase in the total number of private rental dwellings, but the supply that is affordable and available to lower income households in the private rental market has been in long-term decline. Supply has been supplemented by a small amount of social rental housing provided by government, but government investment has been well below that required to meet the housing needs of even those on the lowest incomes.

Many interconnected factors contribute to the need for reliable new sources of investment in the supply of rental housing. These include: strong demand for rental housing, which is forecast as continuing to increase at least in line with population and household growth; wider social and economic changes that are delaying the take–up of home ownership among younger households and contributing to a concomitant increase in those renting long term; adverse changes to the availability and terms of traditional mortgage-backed debt finance for residential development associated with the Global Financial Crisis (GFC); a cumulative housing supply shortfall arising from the failure of dwelling completions to keep pace with projected household growth; and persistent housing affordability problems amongst private renters.

To address growing concerns about rental housing supply and affordability, the National Rental Affordability Scheme (NRAS) was introduced by the Australian Government in 2008. This scheme offers incentives (mainly in the form of a refundable tax offset) to private investors and community organisations to provide newly built rental housing for low and moderate income households, let at below market rents for 10 years. Initially, provision for 50 000 incentives was made. However, 2009 political commitments that scheme success would unlock a further 50 000 incentives have yet to be confirmed. This is causing damaging uncertainty about the future of NRAS.

NRAS and the complementary Social Housing Initiative[1] have begun to generate cross sectoral partnerships, involving private finance (individuals and banks to date), for–profit developers and not–for–profit housing organisations, that are suited to delivering and managing regular supplies of additional rental housing on an ongoing basis.

A key aim of NRAS is to increase large-scale investment and innovative delivery of affordable housing[2]. Although there have been some implementation and delivery issues in its establishment phase, potential investor interest in NRAS has been building. Applications for the NRAS incentives in the latest (2011–12) funding round were far in excess of those on offer. The scheme has stimulated significant private sector finance to underpin affordable rental housing supply and interest among larger institutional investors has begun to emerge, with a number of products currently being tested in the market place (see Chapter 2).

This context formed the starting point for the deliberations of our panel of experts who were drawn from across the finance sector, the housing industry, not–for–profit housing developers, expert consultants and Commonwealth and State governments.

Key findings from the Investigative Panel

Extensive face–to–face discussions amongst panel members in two meetings over two and a half days produced strong alignment in their views about: the need for institutional investment in rental housing; the key factors currently constraining institutional investment; the appetite for such investment; and the broad actions needed to make it happen. However, there were differing views about specific investment options that might emerge under the broad enabling framework suggested by the panel. Different potential solutions need to be market-tested.

The key messages emerging from the panel discussions are summarised below.

Financing need

- Significant volumes of public and private finance will be required to meet the projected need for additional rental housing in Australia. This cannot be met from existing suppliers alone.
- The largest potential source of funding at the required scale is the huge pool of institutional resources controlled by superannuation and other managed funds which, crucially, operate with long-term investment horizons.

Current barriers

- Institutional investors heavily discount capital gains and expect higher rental yields than those typically applying in the rental investment market.
- There is no track record of institutional investment in residential property assets in Australia where this remains a little known asset class. In particular, there is limited data on the aggregate performance of rental residential assets and uneven

[1] The Social Housing Initiative (SHI) was a 2008 economic stimulus measure which resulted in a large–scale increase in social housing supply over four years to 2012.

[2] See http://www.fahcsia.gov.au/our-responsibilities/housing-support/programs-services/national-rental-affordability-scheme.

knowledge of the operational cash flows of affordable rental housing among funds mangers and institutional investors.

- Institutional investor requirements on scale and liquidity have not been met.
- Ongoing uncertainty about the long-term future of NRAS is threatening the momentum generated by this initiative. The level and certainty of government support that is crucial to ensure investor confidence in this market has been insufficient.

Opportunities and potential

- There is a real and growing appetite among institutional investors both locally and abroad for new forms of investment opportunities (beyond share markets and commercial property) that offer a secure form of low-risk investment, with return based primarily on cash flow. Such a product would be attractive to:
  - Superannuation funds holding an increasing share of their funds in the 'pension phase' (through the ageing of their membership).
  - Self–managed superannuation funds requiring steady and predictable returns.
  - Any superannuation funds looking to diversify their investments.
  - Overseas financial institutions attracted to the stability of the Australian economy.
- With appropriate structuring and stimulation by government, there is good potential for rental housing provision to be matched to this large investor interest. Proven demand for both market-priced and affordable rentals contributes to this potential.
- A target broader than just *affordable* rental housing will:
  - Improve the scalability of investment.
  - Help to offset perceived risks with investment in affordable rentals.
  - Contribute to investors' required rates of return.

  Expanded new rental supply may also encourage some higher income tenants to switch to better quality dwellings, vacating some of the existing lower rent housing that they occupy.
- Financial incentives and credit support will be essential to achieve increased supply at the affordable end of the market, to overcome investor perceptions of risk and to meet their yield requirements. The impact of government support is demonstrated by the way that NRAS has catalysed increasing specific interest from the finance industry in investment in the supply of affordable rental housing.
- The scale of investment required to attract institutional players is between $50 million and $250 million for an individual institution and at least $500 million per annum in aggregate to create liquidity and establish a sustainable market.

Strategic directions

- There is a need to consider financing solutions for both the construction and operating phases of a rental housing supply program. It is the operating (take-out) phase that is more likely to attract institutional investment.
- Institutional buy–in to rental housing is most likely to succeed if it is characterised as 'infrastructure–style' investment offering a steady, predictable return from rental revenue. Debt instruments are most likely to meet current risk and return requirements.

- To achieve both competitive pricing and greater liquidity, it will be desirable to promote a market involving a range of investors, consisting of institutional investors, banks and retail (mum and dad) investors. The design of the 2012 Housing Supply Bonds proposal[3] provides one example of how this could be achieved by tailoring bond issues with different characteristics for different investor classes.
- To help deliver scale and liquidity for institutional investors, specialist intermediaries will be desirable to pool together larger portfolios of different types of rental investment opportunities in a range of locations and managed by a variety of providers. Such intermediaries could enhance liquidity by having the capacity to purchase as well as offer any securities issued, but must not add cost.
- To meet the goal of increasing the supply of affordable rental dwellings, a portfolio that includes dwellings for rent at full market value as well as affordable dwellings is likely to be needed to generate the scale and rates of return required by institutional investors.
- A longer term, more dependable housing policy and funding framework will be required to attract and sustain substantial institutional investment in rental housing investment. Under such a broad framework, the components and characteristics of housing that will be required to meet affordability outcomes must be clearly specified and explicitly supported by government.
- Future governments, of whatever political persuasion, must continue down the path that has been laid down through the introduction of NRAS, while making necessary adjustments to the scheme as the market for affordable housing grows and the wider economic context changes.
- Diverse forms of government support will be required to achieve housing policy objectives and to match dynamic market conditions. NRAS, for example, was never intended to operate alone. Additional support will be critical in reconciling new provision at rents meeting affordability benchmarks for lower income earners with the requirement to generate yields attractive to institutional investors.
- Key policy measures to support both the private construction and long-term delivery of affordable rental housing at scale include:
    - equity investment (land and/or capital)
    - a revolving loan fund to finance the construction phase prior to institutional take–out
    - some form of credit enhancement
    - enhanced income support for lower income tenants to improve their access and ongoing affordability.
- To optimise policy outcomes, governments at all levels must give greater consideration to packaging the various policy mechanisms on offer. Allowing investors flexibility in the ways in which the various forms of assistance can be used for specific projects will be critical (e.g. by those bidding indicating what form of guarantee would be preferable).
- Pursuant to the analysis presented in the 2010 Henry Review of taxes and transfers, ongoing tax reform is necessary to reduce distortions affecting the residential property market and to harmonise the tax arrangements that apply to corporate, institutional and individual investors in rental housing across jurisdictions.

[3] See Lawson et al. (2012).

Recommendations

Following from the set of findings above, a set of recommendations to Australian governments has been developed by the research team in consultation with Investigative Panel members.

Strategic policy framework for institutional investment

1. Australian governments should commit immediately to a long-term policy goal to support large–scale institutional investment in affordable rental housing.
2. A Council of Australian Governments (COAG) agreement (or similar) and/or joint Commonwealth and state legislation offer alternative ways of assuring the certainty and continuity of this policy goal.
3. Continuity of, and a longer term commitment to, the National Rental Affordability Scheme will be required to: stimulate increased supply, give certainty to financial markets, build confidence in a new residential asset class for large scale institutional investors, and achieve affordability goals. Any changes to this incentive should be fully negotiated with the investment sector to prevent loss of market confidence and to offset avoidable volatility of private investment.
4. Within the overall additional quantity of rental housing, a minimum annual target of new *affordable* rental dwellings each year for 10 years should be negotiated and endorsed through COAG. This will require a corresponding annual program of NRAS incentives to be offered. The suggested annual target is between 5000 and 10 000 dwellings. This could be varied periodically to reflect cyclical conditions in housing markets and the wider economy.

Support for the development and construction of additional rental housing

5. Appropriately located Commonwealth, state and local government land should be made available for housing developments that offer a significant component of affordable rental housing. Retention of ownership by government or transfer of ownership to a not–for–profit housing provider, deferring payment until post–construction or guaranteeing purchase of a proportion of dwellings on completion are all ways of promoting the immediate construction of rental housing while private finance for the development phase of projects remains scarce.
6. State and local governments should be accountable to COAG for the development of specific annual targets and plans for release of land (both government–owned and private) to support the national affordable rental supply target and to increase certainty for developers and investors.
7. Specific forms of support for housing developments that include affordable rental housing should be provided through the planning system, such as a continuing pool of funds for overcoming development bottlenecks, fast track development approvals, density bonuses and other forms of planning benefit.
8. There is also an immediate need to maintain the capacity of community housing organisations (CHOs) (which has been enhanced through NRAS and Social Housing Initiative activity) to contribute to the affordable housing supply task and over time to leverage further growth. In particular, to support an ongoing pipeline of development projects for registered CHOs with development capacity, a rolling loan fund for construction finance should be established within the National Affordable Housing Agreement.

Strategic advice and administration

9. The Commonwealth Government should immediately establish a Task Force to carry forward the momentum generated by the Investigative Panel. The primary

purpose of the Task Force would be to advise governments on a rental housing investment strategy. Its priority tasks should include:

- → Guiding the next phase of institutional investment utilising NRAS (see below).
- → Advising governments on the longer term policy settings (subsidies, tax adjustments etc.) that would be justified to overcome market failures and achieve the affordable rental housing supply targets.
- → Examining the need for particular institutional and regulatory arrangements, such as financial intermediaries, to specialise in large scale fund raising and aggregation of investment funds.

10. A high profile champion with both public policy and private investment credentials should be appointed for a minimum of three years to head the Task Force, members of which should comprise key stakeholders and experts.

11. Commonwealth and state administrations will require specialised capacity to support the work of the Task Force and to promote closer engagement between governments and the investment industry. The work of such specialists within governments should be coordinated across jurisdictions to:

- → Identify investment programs that can offer the scale and diversity of investment opportunities.
- → Achieve the policy consistency that will be required to reduce administrative complexity and thereby improve rates of return.

Other immediate steps (2013–14)

12. Within the next year and irrespective of electoral cycles, Australian governments will need to seed and further stimulate institutional investment so as not to lose the tenuous momentum that has been built and to allay the attendant risk of reputational damage to the goal of institutional investment in rental housing. Following announcement of the long-term goal and target for affordable housing supply and the continuation of NRAS (recommendations 1 to 4), a two–year national 'proof–of–concept' initiative geared to institutional investment is recommended. This would be designed to:

- → Help to generate a market for institutional investment that will operate successfully over the longer term.
- → Test models that would be suited to institutional investors.
- → Assess and promote the viability of institutional investment in affordable housing.
- → Use the results to develop longer term policy, including the level and forms of government support that will be necessary to achieve desired social outcomes.

13. The proof–of–concept initiative will require government backing. This could take the form of some or all of the following:

- → Actively marketing NRAS incentives to the institutional investment sector.
- → Release of a portfolio of development-ready government sites for take up through a competitive bidding process.
- → Streamlined planning support for the development of projects (e.g. provided under the Social Housing Initiative).
- → Some form of government equity contribution to unlock and underpin institutional finance.

- → Some level of rental income guarantee or other form of cash flow support.
- → Some provision for return of capital after 10 years when the NRAS incentives cease.

14. This initiative should be steered by the specialist Task Force. The Task Force would assist in development of the call for proposals (EOI) and, subsequently, in their assessment. Close engagement with the superannuation industry and fund managers and other relevant stakeholders in developing the EOI should also be pursued. While some forms of government assistance may be included in the EOI (e.g. NRAS incentives or development sites), other forms of assistance could be identified through the competitive bidding process to meet investor requirements for flexibility.

15. To support the development of industry information, within the constraints imposed by the need for commercial confidentiality, there should be an 'open book' requirement for funded 'proof–of–concept' projects with credit ratings agencies invited to assess them. This will help to address outstanding barriers by:
    - → Establishing investor requirements (e.g. their risk/return appetite).
    - → Supporting the development of industry information and performance data.
    - → Increasing understanding across government and the industry of practical requirements for affordable housing procurement and long-term management.
    - → Disclosing the most cost effective options for government support.

16. A modest affordable housing industry seed fund with co-contributions from the Commonwealth and all states and territories should be established to meet the costs of the Task Force; help to meet market development costs, such as establishing a financial intermediary and a market information system; and to allow for evaluation of the appropriateness and viability of different models of investment that emerge from the proof-of-concept initiative.

1 INTRODUCTION

1.1 Genesis and aims

Over the last decade, AHURI researchers have built a substantial body of research evidence on innovations in financing and delivering affordable housing. This research has covered enabling mechanisms, funding models and institutional arrangements (see especially Lawson et al. 2012; Lawson et al. 2010; Berry et al. 2004; McNelis et al. 2002; AHNRC 2001). A number of consultancy reports have also appraised and drawn on this research to form their assessments of the potential for private financing and possible models (see e.g. KPMG 2012a; Deloitte—Access Economics 2011; KPMG 2010). The most recent of the AHURI reports (Lawson et al. 2012) made a specific proposal for a Housing Supply Bond as one feasible mechanism for raising private finance at cost effective rates from diverse sources (via a specialist financial intermediary) for the dedicated purpose of affordable rental housing development. This proposal has generated widespread interest amongst stakeholders, including financial institutions, and is subject to ongoing consideration by Australian governments.

In 2012, to further extend the research underpinning for policy development, the Housing, Homelessness Ministers' Advisory Committee (HHMAC) commissioned this specific study through AHURI Limited. Its broad aims were to:

- Promote cross-sectoral communication on facilitating private financing.
- Explore both policy matters and practical considerations that would enable further private financing, especially institutional investment.
- Obtain expert advice about the set of actions—covering policy development, legislation, program and/or regulatory reform, additional or alternative subsidy support, institutional arrangements etc.—that would be necessary or beneficial to attract more and larger scale private financing into this sector.

An investigative panel methodology was specified as the primary means of obtaining information directly from industry experts and practitioners about the nature and scope of financing responses to the various recent stimuli and about the learning that has arisen from these developments. Accordingly, the study brief required the research team to identify and appoint a suitable panel of experts to consider the terms of reference set out in Section 1.2. Research team responsibilities also involved:

1. Providing panel members with relevant background information on prevailing financing conditions, local and international financing models and housing policy objectives and outcomes.
2. Facilitating dialogue among panellists.
3. Pursuing complementary research that could support the panel's deliberations to the extent that was feasible given the resources and timeframe for the study.
4. Interpreting, synthesising and documenting the findings and recommended directions that emerged from those deliberations in a concise report.

Following negotiation of the study brief and university ethics clearance for the research process[4], members of the Investigative Panel were appointed from August 2012. This report of the outcomes was completed in January 2013.

[4] Ethics approval was received on 12 July, 2012 (Reference 125040, UNSW HREC).

1.2 Terms of reference

The broad questions the study was required to address included:

- What kind of private investment is occurring?
- What is driving this investment?
- Who are the players?
- What organisational structures are being developed to facilitate fund raising?
- What financing models have been successful?
- What issues are outstanding, and why?

These questions informed a set of draft terms of reference negotiated and confirmed initially with HHMAC and subsequently with panel members. The final terms of reference for the study were:

1. The policy objectives for private financing of affordable rental housing and the rationale for seeking institutional investment.
2. Emerging approaches to non-government investment in affordable rental housing and the characteristics of these approaches in terms of financing, organisational arrangements and housing products.
3. Identification of gaps in private financing approaches and the reasons for these.
4. The potential of current or alternative financing approaches.
5. Required adjustments to policy, subsidies, regulation and administrative arrangements to support preferred financing approaches.

1.3 Investigative Panel and research methodologies

The AHURI Investigative Panel model is designed to facilitate direct, structured, engagement between experts from the research, policy and industry sectors to interrogate a specific policy question of immediate practical relevance, drawing on the experience and expertise of panel members.

1.3.1 Selection and membership of the panel

The Investigative Panel for this study comprised hand-picked experts from the banking and financial investment sectors, affordable housing providers (for-profit and not-for-profit) and affordable housing industry specialists, together with nominated senior officials of interested Commonwealth and state government agencies. Panel recruits were identified through consultation with key informants in government, the finance sector, the affordable housing industry and housing peak bodies, including referrals by panel members themselves. Recruitment was a time-consuming process that required personal negotiation between the research leader and around 30 potential panellists known to the research team or recommended by various stakeholders. In making final selections, there was a need to balance the areas of expertise and cross sectoral representation. One desired field of expertise that unfortunately could not be filled was superannuation funds management. As discussed elsewhere in the report, while funds managers are key industry decision-makers, they tend to lack knowledge and experience in relation to affordable housing and do not appear to regard this product as a priority for investigation. It was considered that a future education campaign aimed at this group would be highly desirable.

An initial panel of 15 members was appointed in August 2012. Several additional people who expressed interest and whose credentials fitted gaps in panel expertise were invited subsequently to join, bringing the total to 23. Despite the significant time and resource commitment required (including interstate travel for several), there was a strong take–up on invitations to participate, reflecting the currency and degree of interest in the subject engendered through recent government initiatives, within the context of current investment conditions. In addition to the research team and the facilitator, all members participated directly in at least one of the two panel meetings.[5]

A high quality panel resulted from the selection process. In combination, panellists had imposing knowledge of, and extensive experience in, policy and practice related to: public and private financing of housing and, more broadly, public infrastructure schemes; institutional investor requirements; structuring financial deals; and the challenges of developing and delivering housing at scale under current market and financing conditions. The panel included several executive members of leading financial institutions and senior officials of Commonwealth and state government agencies. Most panellists had recent direct experience of negotiating financing deals for affordable housing. A full list of panellists and a summary of their main areas of expertise and experience relevant to the study are provided in Appendix 1 at the end of this report.

1.3.2 Panel meetings

The panel was convened in Sydney on two occasions, on 25 September 2012 (one day) and 28–29 November 2012 (1½ days). Most panel members were able to attend both meetings; some government agencies were represented by different members at each meeting. One member participated in one of the first panel's sessions via teleconference. In addition to the formal meetings, regular email bulletins were issued by the research leader to inform panellists of relevant developments and invite their comments on records of the panel's deliberations and communiqués to government. Five panellists were also interviewed face–to–face or by telephone on emerging investment models in which they were involved.[6]

In preparation for the first meeting, a Background Paper prepared by the research team was circulated to the panellists presenting desk-based reviews of:

- Housing policy and financial market contexts for financing affordable housing in Australia.
- Recent investigations about private investment in other social services and infrastructure.
- The latest developments in international approaches to financing affordable housing.

Relevant material from the Background Paper is included in this Final Report and in contemporaneously published Supplementary Papers.

Development of the Background Paper was also informed by a meeting with Professor Christine Whitehead (London School of Economics), a renowned international expert in private financing and specialist adviser to the recent House of Commons committee that examined the financing of new housing supply in the United

[5] Australian Treasury were unable to send a nominee to the meetings of the panel but were included in all written correspondence to panel members.

[6] Some of the information obtained during these interviews is commercial-in-confidence. While it has informed understanding of the models being developed, it cannot be covered in specific detail in this report.

Kingdom (UK) (House of Commons 2012). A review of this and related work in the UK, which closely parallels that covered in this report, is provided in the Supplementary Papers.

Discussion at the first panel meeting concerned primarily: the focus of the investigation; emerging models of investment in rental housing; key barriers to large scale institutional investment; and broad directions that could be considered to address those barriers (covering terms of reference 1 to 3 above).

The second panel meeting was more forward-looking in its focus (addressing terms of reference 4 and 5). This meeting considered in more depth the policy settings, finance models and institutional arrangements that would be required to facilitate institutional investment in rental housing at scale. In preparation for this meeting, six brief discussion papers were circulated, each addressing a specific area of policy for the panel's consideration. Relevant material from these discussion papers is included in this report.

Both panel meetings were structured as a mix of presentations by panellists and research team members, roundtable sessions involving the full panel and smaller group workshops. Dr Andrew Hollows (AHURI Limited) facilitated each of the meetings of the panel. Extensive notes of panel discussions were taken and roundtable sessions were recorded with members' permission. For the concluding session, each panel member was asked to prepare and present what they considered to be the three most significant actions necessary to attract institutional investment in rental housing. This exercise was pivotal in helping to hone the findings and recommendations presented at the beginning of this Final Report.

To complement the two panel meetings and interviews with selected panel members, the research team conducted eleven additional face-to-face or telephone interviews with other identified experts unable to participate in panel meetings. A two hour workshop with Westpac Institutional Bank officials was also initiated by one panel member and attended by two panellists, three members of the research team and five banking officials from government relations, capital markets and property finance. The focus of this workshop was on Westpac's experience in financing affordable housing and potential ways to structure financial deals that would help to address the risks inherent in investment in this asset class. The interviews and workshop helped to provide more detailed information about specific models of investment in rental housing and/or to inform the investigations of particular elements of policy requiring special attention, such as options for government guarantees.

The duration of this study coincided with significant activity around, and interest in, institutional investment models in both industry and government spheres.[7] Those activities, which are listed in Appendix 2, presented several opportunities for panellists and research team members to connect to industry informants, to gather additional information and to air and validate views emerging from panel deliberations.

1.3.3 Additional research

Experience reported from around the country suggests that Australian governments have shown reluctance so far to consider any form of government guarantee as a means of encouraging higher levels of cost-effective private investment in affordable housing. Effective credit enhancement provides more access to private finance and leads to more cost-efficient projects. Guaranteeing private investment in affordable housing through a variety of means is widespread practice elsewhere, with the latest

[7] There has been similarly intensive Ministerial and industry interest in this topic in the United Kingdom over the past 1–2 years (summarised in Supplementary Paper 3).

example being found in the UK. To enable more informed consideration of this issue, a limited extension to the research brief was agreed by AHURI Limited. This aimed to ‘unpack’ government resistance to guarantees and to review options for credit support that may be palatable. The outcomes of this additional research task, which were presented to the second panel meeting, are summarised in Chapter 4 of this report and covered in more detail in Supplementary Paper 2.

1.4 Report scope and outline

This Final Report of the outcomes of the panel meetings and associated research reflects, as far as possible, the range of views presented by panellists and highlights key areas where a consensus was achieved and where there were divergences of opinion. Views expressed by panellists and other research participants are cited without attribution to any individual or organisation. Summaries of outcomes of each of the panel meetings were produced by the research team and circulated to panellists for comment. These provided the basis for Chapter 3. A draft version of the Final Report including the proposed set of key recommendations was circulated to panellists for comment following the second meeting. The published version incorporates further input from the panel received at that stage, along with responses to two academic peer reviews.

Following this introduction, Chapter 2 provides contextual information on rental market conditions, housing policy settings and financial market developments that are currently relevant to opportunities for private investment in affordable rental housing in Australia. It also includes an overview of the financing models and other developments that have emerged from the establishment phase of NRAS. Chapter 2 provides an overview of much the material presented to the panel for their consideration and comment in the form of background and discussion papers. More details are presented in the Supplementary Papers.

Chapter 3 presents a précis of the views formed by the Investigative Panel. It covers their position and opinions on:

- Policy objectives for private financing of affordable rental housing and the rationale for seeking institutional investment.
- Key factors holding back institutional investors.
- The broad approach proposed to ‘kick start’ a market for institutional investment in rental housing, including immediate and longer term action that will be required of governments.

Chapter 4 concludes this Final Report. In doing so, it summarises the conclusions drawn from supplementary research undertaken on use of limited government guarantees and provides a brief overview of outstanding issues. It raises the broader question of whether facilitation of institutional investment in rental housing is the most effective way of supplying rental housing that is affordable for low to moderate income households.

Additional supporting evidence that has been collected over the period of the investigation is presented in a set of Supplementary Papers published on the AHURI website.[8] Supplementary Paper 1 expands upon the ways in which private and public finance might be used to increase the supply of affordable rental housing. Supplementary Paper 2 explores perceived obstacles to, and desirable options for, credit enhancement in more depth. Supplementary Paper 3 presents a review of

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[8] See http://www.ahuri.edu.au/publications/projects/p71016/.

recent research and policy developments relating to institutional investment in housing in the UK.

2 CONTEXT AND BACKGROUND RESEARCH

This chapter provides contextual information relevant to the terms of reference for the study. First, it presents a short account of factors driving the need for additional rental housing in Australia, especially rental provision affordable to low and moderate income households. This is followed by an outline of recent initiatives aimed at encouraging private investment in affordable rental housing. The third and fourth sections provide a brief overview of: the potential of individual, corporate and institutional players to invest in rental housing; the range of financing options open to them; and the ways in which these, at least in principle, might be supported with public funding. The chapter concludes with a review of the financing models that have emerged or are being developed in response to the largest government initiative ever directed at stimulating affordable rental housing supply in Australia, the 2008 National Rental Affordability Scheme.

2.1 Rental market context

Over many decades the primary investors in private rental housing in Australia have been individuals owning one or two dwellings. These small scale 'mum and dad' investors have financed a steady increase in the total number of private rental dwellings, but the supply that is affordable and available to lower income households in the private rental market has been in long-term decline (Wulff et al. 2011). In part this has arisen because of the significant changes in the character of the Australia's rental housing sector that have occurred over the last two decades.

On the demand side, delayed access to home ownership for younger households has added to demand and meant that private rental has become increasingly important as a longer term tenure; and increases in temporary and permanent migration rates (particularly from international students) have added to the numbers needing to rent. On the supply side, small scale investors have had greater incentives to invest in established rather than new dwellings (discussed more fully in Section 2.3.1). Hulse et al. (2012) identify the main developments and analyse their drivers.

Overall, supply and demand trends have produced a mismatch between the need for rental housing by a growing number of households, many of whom are renting for longer periods, and the supply of dwellings affordable to lower income households, most of whom have to compete with better off households for housing in the private rental market. The NHSC (2012, p.48) estimates that there is a shortfall of more than 500 000 rental properties that are both affordable and *available* for this group. Properties which are affordable for less affluent households but are already occupied by higher income earners reduce the supply available for lower income households. Projections of historic supply trends and growth in household numbers suggest that the shortage of affordable rental dwellings is likely to deepen (NHSC 2012).

Chronic shortages of affordable rental housing have adverse economic, as well as social, consequences. They affect economic growth by contributing to labour market shortages when workers are restricted in their access to employment because they cannot obtain affordable housing in locations where jobs are available. They also contribute to wage pressures for employers and affect social outcomes by contributing to financial disadvantage and by exacerbating housing insecurity. Each of these social outcomes increases risks of associated family instability and employment and health problems for less well–off households (Bridge et al. 2003; Yates & Milligan 2007).

An increase in the supply of well–integrated, well–located affordable rental housing for low wage earning families, older Australians and those with disabilities, and younger households and newly arrived migrants saving for a home is critical to Australia's economic future and social well-being. Using medium household growth projections and assuming historic demand and supply trends continue, the NHSC projections indicate that at least 160 000 new dwellings per annum will be required to meet growth in household numbers. If an anticipated 30 per cent of these dwellings are to be for rent, an overall annual increase in supply of over 50 000 rental dwellings is indicated. If the total supply of affordable rental dwellings is to be retained at just 5 per cent of the total dwelling stock, an overall annual increase of at least 8500 new affordable rental dwellings is indicated. As discussed in Chapter 3, the Investigative Panel considered that, by using various support mechanisms directed to the different types of rental investors (institutional, individual and not–for–profit investors), governments should seek to ensure that around 5000 to 10 000 new rental dwellings supplied annually would be affordable to households on lower incomes.[9]

2.2 Rental housing policy initiatives

The short-lived and inconsistent nature of policies and programs that have been designed to secure private finance for social and affordable housing in Australia from the 1980s has contributed to the lack of success in securing any large-scale investment in affordable housing. While many innovative schemes have been floated, only a few have come to fruition and none have achieved scale or evoked replication (Milligan et al. 2004, p.12).[10]

From the 1990s, the main policy trajectory has been to utilise independent not-for-profit (NFP) housing companies as vehicles to develop affordable housing. However, in contrast to the housing association sector in the UK (see Supplementary Paper 3), the small scale, limited capacity and insignificant balance sheets of Australian housing NFPs have strictly limited the extent to which these organisations have been able to raise private finance for additional housing developments or enter into commercial partnerships and joint ventures. This situation began to change in the mid-2000s with the Victorian Government leading the way in promoting a new class of NFP housing developers using government capital to leverage private debt, albeit still on a small scale (Milligan et al. 2009). Since 2007 a more consolidated and more broadly conceived national policy effort to generate private investment in affordable rental housing supply has been developing under Commonwealth Government leadership. The list below summarises the main policy changes which have laid some of the foundations for increasing private investment in affordable housing.

- Introduction of the National Rental Affordable Scheme (NRAS) in 2008. This scheme offers financial incentives in the form of refundable tax offsets (or, in the case of NFP organisations, annual grants) to investors in new rental housing supply for ten years subject to them meeting regulatory requirements for letting at below market rents to low and moderate income households. Fifty thousand NRAS incentives have been funded to be rolled out progressively over an eight (originally four) years period.
- Rent restructuring in the community housing sector[11] (comprising some 58 000 dwellings under management) to secure additional revenue and thereby create greater potential for debt servicing by CHOs.[12]

[9] This target is modest when compared to indicators of need as it allows for no reduction in the current shortfall of around 500 000 dwellings. However, the panel was also mindful of government fiscal constraints and emphasised strongly the value of a predictable level of government support.

[10] Berry (2000) provides a summary of the models attempted and floated up until the mid-1990s. Milligan et al. (2004, 2009) review developments after that period.

[11] Community housing providers are able to increase their revenue compared to that of state housing authorities by setting rents so that tenants receive and pass on Commonwealth Rent Assistance to which

- Transfer of a large proportion (typically 75% but up to 100% depending on jurisdiction) of approximately 19 700 new social housing dwellings acquired with Nation Building Funding (the Social Housing Initiative, 2008–12) to CHOs for management and, in some cases, ownership (KPMG 2012b). These transfers are intended to provide an asset and revenue base to enable recipient organisations to leverage further growth using private finance in coming years.
- Introduction of Public Private Partnerships (PPPs) to upgrade and restructure selected public housing estates using public and private co–financing models. The outcomes of these models depend on government specifications. There have been instances where affordable rental housing has been lost through the restructuring process, but in well-chosen and well-designed PPPs, existing public rental housing is replaced with a similar or larger quantity of new and more appropriate affordable rental housing, on- and off-site.
- Introduction of the Housing Affordability Fund (HAF) (2008/09–2012/13). In combination with NRAS, HAF has played a part in the delivery of affordable rental housing in residential developments that were facilitated by HAF seed funding designed to overcome specific barriers to development. This illustrates how packaging of measures can optimise policy goals.

Among the initiatives listed above, NRAS has been central to greater engagement by the financial sector in considering investment in affordable housing. An overview of financing developments under NRAS so far is given in Section 2.4.

2.2.1 Regulatory context

If community housing providers are, potentially, instruments through which institutional investment could be channelled into affordable rental housing, then investors and other stakeholders—including governments—will need to be assured that their interests are protected through provider regulation. This is especially true, given the novel status of the residential sector for large scale investors.

Since the mid-2000s, several of Australia's states and territories have moved to replace project-specific contractual regulation with more broadly targeted community housing regulation systems focused on providers as entities (Milligan et al. 2009). To a large extent, these jurisdictions have adopted a model of regulating provider performance against defined standards, involving initial provider registration and subsequent regulatory oversight. The latest, ongoing, phase of this process aims to standardise provider regulation across Australia through a National Regulatory System for Community Housing. This will simplify regulatory compliance for providers operating across jurisdictional boundaries. The principle of national regulation has been strongly endorsed by the finance sector with the proviso that this should involve no 'watering down' of existing regulatory powers 'to intervene early and address non-compliance before serious problems arose' (Housing Ministers Advisory Committee 2012, p.33).

As in other regulatory contexts, formal oversight systems for community housing emerging in Australia have a number of objectives. In particular, they exist as a form of consumer protection, as a guardian of public (or former public) assets, and as a monitor of providers' financial viability. In this latter area, regulators are seen as

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low income private (but not public) tenants are entitled. This then allows these organisations to negotiate private borrowings which can be serviced from their revenue stream.

[12] In this report CHO designates a registered community housing organisation (see Section 2.2.1). NFP designates the broader class of not-for-profit organisations that may be involved with financing or delivering affordable housing.

seeking to provide comfort to financial institutions that underwrite CHO activity (NSW Registrar of Community Housing 2010, p.5).

The role of regulation in protecting public assets is particularly relevant to possible models for harnessing institutional finance for rental housing provision and where these involve the contribution of publicly owned land or other assets.[13] Other aspects where regulatory assurance will be critical to investors relying on cash flow are management of tenants and assurance of rental income.

2.3 Financial markets context

Individual (or 'mum and dad') investors traditionally have been the mainstay of investment in private rental housing in Australia. However, concerns both about their willingness and their capacity to provide the finance needed for the continued growth of this sector (and, specifically, for the growth of the affordable rental sector) have been one of the key drivers underpinning the push for increased institutional investment in rental housing. Some of these concerns are outlined below. Other drivers have been the growth in the managed funds sector, primarily as a result of the growth in superannuation assets, and their growing interest in alternative assets as a means of portfolio diversification.[14] This section provides a brief review of finance for rental housing from various sources and comments on their potential or otherwise to meet the need for projected growth in the rental sector.

2.3.1 Individual investors

Most individual investors in the private rental market have had a strong reliance on (secured) debt finance from mainstream financial institutions to supplement their own equity contribution in residential rental investment. A vast number make use of generous tax concessions in doing so.[15] During the pre-2007 period of rapid dwelling price inflation, when investors experienced significant and reliable capital growth, debt financed investment in residential property proved a tax effective way of increasing wealth. By 2010, almost 10 per cent of households had outstanding debt on investment property.[16] The favourable treatment accorded to investors in rental property was clearly identified by the Henry Review which saw the asymmetries in the treatment of expenses and receipts as ranking amongst the greatest tax induced biases to the savings choices of households (The Treasury 2010, p.69).

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[13] In states, such as NSW, where asset transfers of this kind are familiar, relevant controls are achieved through bilateral contractual regulation rather than through the wider regulatory systems currently being established. In general, governments will wish to be assured that recipient organisations use such resources as intended.

[14] Despite the growth in superannuation assets, assets held by Authorised Deposit-taking Institutions (ADIs) continue to dominate, having increased from around 50 per cent of total financial system assets in 1990 to around 60 per cent in 2010 (Donovan & Gorajek 2011).

[15] Changes in the tax treatment of capital gains in 1999 (which introduced a 50 per cent discount on realized capital gains for individual investors but retained full deductibility of interest payments) increased the incentives for individuals to debt finance their investment in rental housing when house price inflation was anticipated to be more than double consumer price inflation. Tax Office data (at http://www.ato.gov.au/content/downloads/cor00305922_2010TAXSTATS.pdf) indicate there were more than 1.75 million property investors in 2009-10, with almost two thirds of these being 'negatively geared'.

[16] See, for example, Table B26, http://www.rba.gov.au/statistics/tables/index.html. Almost half of these were households in the top income quintile.

While individual investors are still able to obtain debt finance should they desire to do so, there is evidence that demand for such finance has weakened considerably since its pre–2007 peak.[17] Amongst the factors contributing to this outcome could be:

- Lower anticipated after-tax returns arising from a weak housing market and a slow-down in dwelling price growth.
- A move away from riskier assets arising from a reduction in risk appetite (Black et al. 2012).
- A desire to reduce high household debt to income ratios by reducing total debt holdings (Connolly & McGregor 2011).
- The impending retirement and withdrawal from the private rental investment market of the ageing baby boomer generation who, historically, have been key participants in it. To some extent, their investment might be replaced by the post baby boomer generation's use of self-managed superannuation funds (SMSFs) as a vehicle for investing in residential rental property. This is covered below.

Individual investors driven by tax incentives and capital gains expectations have been, and are likely to continue to be, a volatile source of funds for rental housing. Their current involvement comes at considerable cost to the government budget bottom line in terms of the tax concessions that underpin their investment in the private rental market. Those with shorter rather than longer term horizons, and those who are more interested in trading rather than holding investment dwellings, are likely to be less disposed towards provision of long-term tenancies. Either motivation limits the contribution that investment by individuals will make to providing a stable and secure source of finance for rental housing.

Continuing reliance on individuals as the primary source of investment also may be problematic in terms of encouraging new supply or contributing to affordability outcomes. Firstly, the major tax incentives provided to individual investors do not specifically encourage investment in new or affordable dwellings and finance for investment housing goes disproportionately to established rather than new dwellings.[18] Secondly, the limited supply of dwellings owned by individual investors that are affordable to lower income households are not always allocated to those who need them most (NHSC 2012, p.48).

Despite these limitations, a small number of individual investors have made good use of the additional tax incentives provided by NRAS and have been willing investors in new affordable dwellings delivered and/or managed by CHOs under this scheme (see Section 2.4).

2.3.2 Deposit-taking financial institutions

Traditionally, the prime sources of debt finance for rental housing investors have been the Authorised Deposit-taking Institutions (ADIs). ADIs, primarily through the major banks, have provided secured debt finance in the form of mortgages to individual investors and, to a very limited extent, to affordable housing providers. However, the

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[17] Apart from a pre GFC spike, the annual dollar value of lending commitments to investors has barely increased in the past 10 years. See, for example, Table D06 http://www.rba.gov.au/statistics/tables/index.html.

[18] The proportion of loans to investors for construction of dwellings for rent is less than half of the proportion of loans to owner-occupiers for construction of new dwellings (see 5609011.xls at http://www.abs.au). Tax allowances for building depreciation on new buildings provide a partial exception to this claim but, as with other taxes, they do not provide incentives specifically for affordable housing. State taxes, and particularly progressive land taxes based on cumulative value of land holdings, provide a significant disincentive to large scale investment in rental property.

GFC and the continuing economic uncertainty that has followed have affected the capacity and willingness of Australia's mainstream financial institutions to provide funds for housing. Specific issues here have included:

- The dramatic collapse in dwelling prices in a number of countries and its impact on perceptions of investment risk in relation to Australian residential property.
- The impact of the growth in impaired loans (albeit from a very low base) on bank asset performance.
- The impact of the sovereign debt crisis on the cost, availability and terms of wholesale funds.
- The potential impact of the Basel III rules affecting ADI capital and liquid asset holdings.

Australia saw a significant tightening of housing investment finance lending criteria immediately following the GFC, with a reduction in the numbers of high loan to value ratio (LVR) loans and low-doc loans. Since 2010 the proportion of high (above 80%) LVRs to individual investors has begun to increase. Low-doc loans, however, have continued to decline, reflecting the exit of non-bank lenders from the housing finance market due to the collapse of the market for residential (and commercial) mortgage backed securities (Reserve Bank Australia 2012b).

The NFP sector has begun to attract bank finance but financing levels remain very low and well below that needed to generate a significant expansion.[19] Compared with individual investors, not-for-profit providers of affordable rental housing have been subject to considerably lower LVRs (in the range from 12 to 65%), have been charged an interest rate significantly higher than that charged to individual (or even corporate) borrowers and face much shorter loan terms (Deloitte-Access Economics 2011, p.9). Recent loan terms (at three to five years) are even shorter than those common before the GFC, thereby increasing re–financing risks (Milligan et al. 2013).

Loans for developers also have become subject to tighter credit conditions since the GFC (RBA 2012a, p.49) with greater equity and higher presale requirements being imposed (NHSC 2011, p.93).[20] Credit availability, particularly for multi-unit apartment developments, has been restricted as lenders (and particularly peripheral lenders heavily dependent on raising funds in wholesale markets) have become more cautious (NHSC 2011, p.15).

2.3.3 Managed funds

Concerns, firstly, about the impact of the return to a more sustainable rate of dwelling price inflation and the desire to deleverage on the on-going viability of individuals as the primary source of finance for affordable rental housing and, secondly, about the high cost of finance currently being obtained by affordable rental housing providers from ADIs have contributed to the growing interest in alternative sources of finance.[21] Australia's managed funds sector, with around $1.4 trillion invested in a range of financial and non-financial assets is seen as the source with the most potential as an alternative source of finance. Almost 90 per cent of these funds are held by superannuation funds.

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[19] Even modest expectations of leverage off the public housing asset base would require billions of dollars in loan finance. Recent estimates put the borrowing requirement in Victoria alone at $1–1.5 billion, if half of Victoria's public housing stock was transferred to CHOs with a target of leveraging 10 to 15 per cent growth in supply (interview Victorian CHO chief financial officer).

[20] Citing research by KPMG (2011) Barriers to Financing Infill Property Developments: Supplementary Report, Queensland Government.

[21] These concerns closely parallel recent UK policy debates (see Supplementary Paper 3).

Superannuation funds

Superannuation funds' portfolios are dominated by equities which currently account for around 45 per cent of total assets, down from 50 per cent in 2007. Cash and bonds account for a further 20–25 per cent or so. Direct investment in land and buildings accounts for only about 5–7 per cent of total assets.[22]

Declines in share values following the post 2007 crises have contributed to superannuation funds paying greater attention to diversification into alternative assets such as infrastructure. An advantage of investment in alternative assets in general, and in property investment in particular, is that alternative assets offer considerable diversification benefits when compared with equities and bonds. Property returns, for example, generally are uncorrelated with those from the dominant asset classes held by superannuation funds.[23] As such, property investment tends to reduce portfolio risk.

To date, property investment by superannuation funds has generally focused on commercial and industrial property. Such investment can occur both directly (including through an unlisted property trust) or indirectly through a listed property trust.[24] Although commercial property dominates current property portfolios for managed funds, there is evidence of superannuation funds taking a growing interest in indirect investment in residential property. The Industry Super Property Trust (ISPT), founded in 1994 by four superannuation funds, is one example of an unlisted property trust. It is currently co-owned by 23 key industry super funds and, by acting as a wholesale property fund manager, enables them to invest indirectly in property. Their ISPT Development and Opportunities Fund No. 1, for example, had 42 per cent of its portfolio in residential property. Fund No. 2 is wholly invested within the residential property market with diversification achieved geographically (with investments spread across three states) and by property type (varying from high density inner city apartments to en globo land holdings). Fund No. 2 was established in 2008 with total commitments of $240 million received from five investors.[25]

In the post 2007 environment, however, greater synchronisation in movements of both equity and property markets, and an increase in risk aversion, suggest that superannuation funds are likely to be more interested in debt rather than equity for the foreseeable future. There are several reasons for this, including:

- The extreme share-market volatility of recent years. The post 2007 fall in the value of equities highlighted the volatility and risk associated with this form of investment.
- The impending retirement of baby boomers. This has meant a number of superannuation funds are transitioning from their accumulation phase into a pension phase. This results in a growing appetite for fixed interest and inflation indexed securities to match their pending liabilities (Lawson et al. 2012).

The chief executive of the Association of Superannuation Funds of Australia (ASFA), has been reported as suggesting that, 'a changed investment environment and

[22] See, for example, Table B15, http://www.rba.gov.au/statistics/tables/index.html. This share had fallen from over 50 per cent in 2007 as a result of declining share values.

[23] One particular advantage of property is that global property markets are not synchronised, which means that appropriately developed securities can provide diversification benefits across geographical areas (Nicholas 2011, p.32). This point is returned to briefly below.

[24] See Supplementary Paper 1 for a more detailed discussion.

[25] Information derived from the ISPT website (http://www.ispt.net.au/) and its 2012 Annual Report.

demographics should drive debate on long-term structuring of superannuation portfolios' (Vamos 2012).

The stability of the income return from property investment provides an opportunity for the development of financial products that meet a growing preference for lower risk investment. However, as moves towards traditional income producing assets are likely to result in decreasing returns, consideration may be given to hybrid instruments with characteristics of both debt and equity finance. This may encourage development of new asset classes that generate a secure income stream but take on some risk in relation to return on capital. In devising an appropriate investment product, however, attention must be paid to legislative constraints on trustees that require them to ensure that superannuation funds are invested prudently with consideration given, inter alia, to diversification and liquidity and to the risks and return for the whole entity as well as for each individual investment. Amendments passed in late 2012 have added consideration of the investment return target over a period of 10 years for assets invested in new MySuper products that are to replace existing default products.[26]

In broad terms, the basic requirements for superannuation funds to provide finance for affordable rental housing are not particularly different from those required by banks. These include: a reassurance of adequate cash flows to pay interest (and, ultimately, principal); and the presence of risk mitigating features (e.g. those provided with collateral, guarantees, insurance, and sound evidence of effective regulation and financial management). An appropriately structured investment in private rental housing has the potential to meet the emerging needs of a large number of superannuation funds. In practice, however, institutions have yet to make major incursions into this field.

The views that emerged from the Investigative Panel about barriers to institutional investment in rental housing, and potential ways to address these are the subject of the next chapter. Despite these barriers, there are a number of specialist managed funds that may be more likely than others to be amongst the first to show an interest in investment in what effectively is a new asset class. These include SMSFs, government managed superannuation funds, Sovereign Wealth Funds (SWFs), and global pension funds, each of which is discussed briefly below.

Individual investment through SMSFs

SMSFs allow individuals to control their own superannuation investments and by mid-2012, over $400 billion of the $1.4 trillion in Australian superannuation funds was controlled by individuals running DIY schemes (APRA 2013, p.5).

Rental investment is likely to be attractive to SMSF managers because of their familiarity with the asset. Tax rulings and post-2007 changes in SMSF legislation have increased the opportunities for SMSFs to replace or, at least supplement, individual mum and dad investment in private rental housing. These removed restrictions that previously prevented SMSFs from borrowing to invest in residential property on a limited recourse basis. They are advantageous because:

- Property can be purchased with pre-tax dollars.
- There is access to generous depreciation benefits.

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[26] See Superannuation Industry (Supervision) Act 1993 Act No. 78 of 1993 as amended, p.494 (at http://www.comlaw.gov.au/Details/C2012C00871/Download, accessed 20 February 2013) and Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012, p.6 (at http://www.comlaw.gov.au/Details/C2012A00117/Download, accessed 20 February 2013).

→ There is no capital gains tax liability as long as the property is sold in the pension phase.

Since the relaxation of SMSF rules, holdings of residential rental properties in DIY super funds have grown at about $1 billion per year to more than $14 billion by 2011.[27] At least one NFP charitable organisation has had some success in raising funds from individual retail investors and from SMSFs to deliver NRAS rental dwellings (see Section 2.4).

Government managed superannuation funds

A second group of specialist funds potentially attracted to rental housing investment, and particularly affordable rental investment, are government superannuation funds, or funds associated with the construction industry. This arises because of the broader objectives that might be served, such as providing affordable housing for public employees in the former case and employment opportunities for construction workers in the latter.

However, as with superannuation funds generally, under current legislation, trustees are obliged to act in the best interest of their immediate members, not in the broader interest of potential members. They have no obligation to implement wider government social policy. But legislation can be changed and there is a case for imposing constraints on how funds are invested when governments are making additional contributions to ensure unfunded superannuation liabilities are met. Obvious contenders for consideration are the Australian or Western Australian governments' Future Funds and various state governments' superannuation funds.

The Australian Government's Future Fund was established in 2006 to assist future Australian governments meet the cost of public sector superannuation liabilities. Its investment mandate is set by the Treasurer. By 2012, Future Fund assets totalled $80 billion, of which nearly $6 billion was invested in the assets of the Building Australia Fund (BAF), established by the Nation Building Funds Act of 2008. The BAF, in turn, was established to finance capital investment in transport infrastructure (e.g. roads, rail, urban transport and ports), communications infrastructure (e.g. broadband), energy infrastructure and water infrastructure. Extension of this legislation to include rental housing as infrastructure would facilitate use of BAF for such investment.[28] A recent report suggests that the Future Fund recently has committed to investing in real estate funds targeting middle-market apartments in the US.[29]

The Western Australian Future Fund, established as part of the 2012–13 Budget with at transfer of $1 billion in seed capital over a 3 year period from the Royalties for Regions (RfR) funding, provides an example of a state-based equivalent. Current use of RfR to fund affordable housing initiatives in WA, provides an obvious argument for use of the (albeit currently modest) WA Future Fund for the same purpose.[30]

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[27] See, for example, http://www.wealthprofessional.com.au/article/smsf-investors-cant-get-enough-of-residential-property-142960.aspx. Accessed 31 August 2012

[28] Currently, the investment mandates set a benchmark return on the Nation-building Funds of the Australian three-month bank bill swap rate plus 0.3 per cent per annum calculated on a rolling 12-month basis. Background data on the Future Fund can be found at http://www.futurefund.gov.au/ and on the established and role of BAF in Australian Government (2008). Information on current mandates from Budget Paper no. 1, pp.7–9 at http://www.budget.gov.au/2012-13/content/bp1/download/bp1_bst7.pdf.

[29] Reported on 10 January 2013. See http://www.swfinstitute.org/swf-article/future-fund-bets-on-apartments-in-america/. Accessed 18 January 2013

[30] For background on the WA Future Fund, see http://www.treasury.wa.gov.au/cms/uploadedFiles/State_Budget/Budget_2012_13/2012-13_budget_factsheet_western_australian_future_fund.pdf. For information on the use of Royalties for Regions Funds for affordable housing see http://www.rdl.wa.gov.au/programsandprojects/infrastructure/Pages/Affordable-Housing-.aspx. Both

State governments likewise have sizeable financial assets dedicated to addressing unfunded superannuation obligations of their defined benefits scheme and, at least in one state, have transferred funds to their superannuation schemes. A recent announcement by the Minister for Financial Services has signalled that both state governments and local government bodies will have to accept greater responsibilities for unfunded liabilities associated with defined benefit superannuation schemes.[31] Such contributions open up the possibility of these funds being used as seed funders or foundation investors in a new asset class.[32]

Sovereign wealth funds (SWFs)

Other major potential sources of finance for institutional investment in rental housing are the global SWFs and, more broadly, international pension funds. SWFs are state-owned investment funds or entities commonly established from balance of payments surpluses, fiscal surpluses, or receipts resulting from resource exports. The rapid growth of sovereign wealth funds (from around $3 trillion in 2008 to almost $5 trillion in 2012), their long-term focus, and their emerging interest in infrastructure style investments are key reasons why these funds are seen as an important and large source of capital for alternative investment managers. There were over 60 SWFs operating globally at the start of 2013, with funds concentrated in Asia and the Middle East.

Each fund has its own objective but funding social and economic development is common. SWFs have a long-term focus, they tend to prefer returns over liquidity and most invest globally (SWFI, 2013).[33] Overseas financial institutions are attracted to investment in Australia because of its economic and political stability. In relation to infrastructure investment, for example, SWFs and pension funds view Australia as one of the top four host countries based on their economic and political/legal characteristics (Firzli & Bazi 2011, p. 36).[34] While these funds have yet to show an interest in rental housing, there is growing pressure for them to increase their exposure to longer term assets. Norway's Government Pension Fund, Global (one of the largest sovereign institutions in the world), for example, is reported to have put into place its maiden 0.4 per cent allocation of total assets to real estate and aims to raise this to 5 per cent in the long run (Preqin 2012, p.1).[35]

Global pension funds

Many sovereign wealth funds are a subset of the larger group of world pension funds. From their analysis of 13 major pension markets, for example, Towers Watson (2012)

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accessed 18 January 2013. Similar sources of funding for community infrastructure projects are available in other states, some of which are supported by Australian Government initiatives (e.g. the Regional Development Australia Fund).

[31] 7 December 2012 report at http://www.moneymanagement.com.au/news/superannuation/2012/bill-shorten-warning-unfunded-superannuation.

[32] As discussed in Supplementary Paper 3, government controlled pension funds (and, in particular, local authority funds) are generally agreed as the most likely source of new institutional investment for rental housing development in the UK. Recent press reports have instanced a number of such schemes being progressed.

[33] The SWFI, the Sovereign Wealth Fund Institute, is a global organisation designed to study sovereign wealth funds and other long-term public investors in the areas of investing, asset allocation, risk, governance, economics, policy, trade, and other relevant issues.

[34] The other three countries are the UK, Switzerland and Canada.

[35] This initial investment was in Crown Estate's Regent St portfolio. Crown Estate is a company primarily concerned with a property development but does have a limited range of high quality residential rental properties in its portfolio (see http://www.thecrownestate.co.uk/urban/our-portfolio/residential/).

reported that these markets had a total of over $25 trillion assets under management, with the top 300 representing almost 50 per cent of total global pension assets.

However, these supposedly long-term players have shown recent signs of growing short-termism, with investment holding periods declining, together with shrinking allocations to less liquid, long-term assets (e.g. infrastructure) (Croce et al. 2011, p.2). This has led to calls for more 'responsible' and longer-term investment among institutional pension fund investors. In their paper prepared for a high level 2011 OECD financial roundtable on Fostering Long-Term Investment and Economic Growth, Croce et al. suggest that moving from the current mindset to a longer-term investment environment requires a transformational change in investor behaviour. In their view, this will require:

- Reform of the regulatory framework to reduce the bias for pro-cyclicality and encourage collaboration and resource pooling.
- Government support such as long-term policy planning, tax incentives and risk transfer mechanisms.
- Support for information collection, public awareness and financial education campaigns that promote long-term investment and risk management.

For the most part, infrastructure is seen as the asset class most likely to attract global pension fund investors moving to a longer term mindset. Croce et al. (2011, p.11) argue that institutional investment in infrastructure has been limited. Firzli and Bazi (2011, p.35), however, present a more sanguine view given that the larger, more sophisticated funds (e.g. the Canadian public pension funds and Australian superannuation funds) are investing an increasing (if still small) proportion of their assets in infrastructure.[36] Emergence of new investment opportunities in rental housing along the lines of those presented by infrastructure developments opens up the possibility of attracting some of this budding interest amongst institutional investors into a new rental investment asset class.

2.3.4 *Private financing options*

In order to attract funds from institutional investors, some consideration needs to be given to the financing options that might be relevant for them. This sub-section provides a brief overview of such options and focuses on some of the issues that arise with each. The following sub-section focuses on public funding options. Supplementary Paper 1 provides more detailed background material.

Equity investment

Possibly the least sophisticated, but by no means the least risky, financing option is direct equity investment. However, institutions are wary of direct equity investment in affordable rental housing for a number of reasons. Property is an illiquid asset and direct investment exposes them to property market fluctuations. The perceived risks associated with equity investment generally result in a significant premium on required returns. Concerns also arise because of a perceived reputational risk associated with the need to evict tenants unable or unwilling to pay their rent on time. These concerns are likely to add to the risk premium associated with equity investment in affordable housing.

[36] A recent article in the Australian Financial Review (21 January 2013) reported that Australian Super is considering teaming up with foreign pension funds for the first time to broaden its access to infrastructure investments with a view to moving from unit trust investment to directly sourced investment. At http://afr.com/p/business/companies/australiansuper_seeks_offshore_infrastructure_aFZux6f0nMwsieP7V6WOrI. Accessed 21 January 2013.

Property trusts or real estate investment trusts (REITs) provide a more sophisticated, indirect form of equity investment in rental housing, and one which addresses a number of the constraints arising from direct investment. REITs reduce the cost of entry into the property market, provide investors with access to professional property management skills and allow investors to diversify and spread their risk across a whole portfolio of properties.[37]

Unlike the US, where they have been common since the 1960s, Australia does not have a strong history of residential REITs. This is generally attributed to income returns from residential REITs being too low (Jones 2007, p.385) and suggests that use of REITs for affordable housing will only be possible when there are additional tax advantages or other forms of subsidy to improve the returns available.

Debt investment

Because housing, like infrastructure, essentially is a long-term investment, any equity investment generally needs to be underpinned by some form of borrowing in order to spread the high up-front capital costs over time. Debt can be supplied either directly in the form of loans from ADIs (e.g. banks) or indirectly in the form of securities issued by financial institutions operating through capital markets. Examples of different types of bonds that might be issued for infrastructure investments can be found in the Infrastructure Finance Working Group (IFWG) issues paper (IFWG 2011, pp.9–13). Lawson et al. (2012) provide a specific illustration for rental housing.

One of the risks associated with direct loan finance such as mortgage lending is the duration risk associated with the need to match predominantly long-term assets (loans) and the predominantly short term liabilities (deposits) used to fund these loans. Securitisation and the issue of bonds or asset-backed securities into the capital market provide a way of ameliorating this risk. Both provide an indirect way for institutional investors such superannuation funds with access to long-term sources of funds to finance rental or affordable rental housing.

2.3.5 Public funding options

The absence of institutional investment in rental housing in Australia, regardless of whether or not this is for general or affordable rental housing, suggests there is some form of market failure that needs to be addressed. In general this will mean some form of government funding will be needed to stimulate this investment. Where a lack of institutional involvement is due entirely to temporary constraints, such as inadequate information associated with the development of a new asset class, only temporary forms of assistance may be required. Where it is due to more fundamental market constraints, such as a non-competitive risk return profile of such investment, on-going support will be required. Both forms are likely to be needed: temporary assistance may be required until the necessary information needed is available or until the necessary institutional framework is in place; on-going support is likely to be needed to address inefficiencies in a housing market dominated by owner-occupied housing and characterised by significant planning constraints and tax distortions. For affordable housing in particular, on-going support will be needed because affordable rental housing, by definition, generates a below market return.

The outcomes of research on appropriate forms of credit enhancement undertaken for this study are reported in Chapter 4 of this report and expanded upon in Supplementary Paper 2.

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[37] Global REITs also provide added opportunities for diversification when global property markets are not synchronised (Nicholas 2011, p.32).

Given the likelihood of the need for some form of government support to underpin privately issued securities, the question of whether bonds or securities issued by the private sector are likely to provide value for money for any government committed to increasing the supply of affordable rental housing needs to be addressed. An alternative to private sector issue of bonds is for these to be issued by some level of government.[38] At the very least, the relative value of this public sector comparator needs to be assessed.[39]

2.4 Private financing models

This final section of Chapter 2 provides an overview of the main forms of private finance that have been attracted to affordable housing utilising public support provided through NRAS in Australia. It notes some of the institutional developments that have arisen to support these emerging investment models and briefly describes some of the models under development at the time of writing. It concludes with a brief discussion of experience of attracting institutional investment into affordable rental housing using the Low Income Housing Tax Credit (LIHTC) in the United States (US), and with an indication of emerging initiatives elsewhere.

2.4.1 Current NRAS–supported models in Australia

Since its launch in 2008, NRAS has been a significant catalyst in generating the private finance needed to increase the supply of affordable rental housing in Australia. By October 2012, 10 671 NRAS–supported new rental dwellings had been delivered and 29 367 additional NRAS incentives had been reserved for 137 suppliers. Fifty seven per cent of offers had been allocated to 78 charitable not–for–profit bodies, with the remainder offered to 59 for–profit organisations and universities (Australian Government 2012). Of the total 50 000 NRAS incentives committed by the government, just under 10 000 remained to be reserved or allocated at the end of 2012. In addition, a flow of reserved incentives are being on–sold or returned for reallocation due to supplier failure to deliver—reportedly linked to financing problems in many cases.[40]

In its current form, NRAS is planned to run to 2016. While there have been teething problems with the scheme and delays in delivery, NRAS has succeeded in stimulating a large number of applications for affordable housing supply, far in excess of available NRAS incentives. There has been significant and growing private sector engagement with NRAS (and associated investment in product development and marketing) and

[38] At the start of 2013, 5-year Australian government bond rates were less than 3 per cent and 10-year rates were less than 3.5 per cent, with equivalent TCorp rates generally around 60 basis points higher. At such low rates, the rental yields available from investment in affordable rental housing would require little extra support to render such investment economically viable. Indeed, ex-RBA Board member, Warwick McKibbin believes the government should take a ‘once in a generation’ chance to issue long-term bonds at very low interest rates to fund a large infrastructure program. ‘If foreigners really want to hold Australian assets, we should be giving them long-term government bonds to hold. It would give us access to capital incredibly cheaply which we could then lock in as [infrastructure] investments that would probably give us 10 to 15 per cent return for 50 years’ (quoted in Heath 2013).

[39] Pollock et al. (2001) provide a critical assessment of the assumptions embodied assessing the benefit of private finance initiatives and suggest that ‘the justification for using private finance for social infrastructure is a sleight of hand.’ Sarmento (2010, pp.2–11) provides an overview of the relevant literature on whether the type of public private partnerships that will emerge with the use of public funds to supplement private finance do provide value for money. He suggests that this literature is less than unanimous in its assessment of the value of using ‘off-budget’ operations to avoid fiscal constraints. Issues of how risk is assessed, transferred and best managed are critical.

[40] One source of failure to deliver by those initially allocated NRAS incentives apparently has been an inability to raise equity finance for proposed projects. As they were not the focus of this research, social and physical outcomes of NRAS are not discussed. Some information on those aspects can be found in Australian Government (2012).

several investment models with potential to draw in institutional players have begun to emerge.

The three most successful financing models under NRAS so far have been:

1. Equity investment (sale and leaseback) from so called ‘mums and dads’ investors. Combining the NRAS refundable tax offset, depreciation allowance and other tax benefits, negative gearing of their investment and projected capital growth has been estimated to yield these investors 5–7 per cent real returns (based on rental return and capital growth), subject to local market conditions.

2. Debt financed projects initiated by leading NFP housing providers, many of whom have also had access to some government funding and/or have invested internal revenue surpluses. These NFP providers use the annual NRAS cash payment to assist them to service mortgage–backed loan finance raised through commercial banks. The development model they use also benefits from other tax offsets arising from their charitable status.

3. Student housing developments on university-owned land. Universities have either used or raised their own finance and funded any borrowings which are repaid from rent revenue and the NRAS incentive over a fixed term. These deals have tended to displace infrastructure type deals that were beginning to emerge in the university accommodation sector.[41]

Important institutional developments around NRAS and relevant to the potential for expanded institutional investment in rental housing have included:

- The emergence of more commercially savvy NFP housing providers, partnering with private and public investors to deliver and/or manage affordable rental housing. Approved NRAS providers include both traditional CHOs and new entrants to the sector, such as welfare organisations taking on a housing development function and privately sponsored organisations set up as not–for–profit entities (Gilmour & Milligan 2012). To date, charitable NFPs have delivered 69 per cent of tenanted dwellings in NRAS (Australian Government 2012); several of the larger CHOs also manage an (undisclosed) additional number for private providers who have received NRAS incentives. Key changes in these organisations that have been stimulated through NRAS (and the SHI) include: enhancements to corporate governance, with many directors with private sector experience joining Boards; the development of in-house financial management and property development capacity; geographic expansion of operations; and extension of tenancy services to moderate income clients (Milligan et al. 2013).

- Formation of a new class of intermediaries that specialise in linking investors and suppliers. One example of these is the National Affordable Housing Consortium (NAHC) which is the largest NFP supplier of NRAS dwellings so far having tenanted 1419 dwellings at 31 October 2012 (see Box 1). Another example in the for–profit sector is Questus, a listed boutique fund manager and approved NRAS participant based in WA. This company established the NRAS–linked Questus

[41] Prior to NRAS, several universities had closed deals (or were close to doing so) involving institutional equity finance and bank debt finance for the development of student accommodation on university land. An example is the Campus Living developments at Macquarie University and Griffith University. These are built on land owned by the university and are subject to long-term (30–35 year) ground leases, generally with a zero or minimal rent charged. Dwellings are 100 per cent owned by a Special Purpose Project Company (with Transfield acting as an equity underwriter). Financial structures were designed to produce maximum gearing, with equity provided in the form of ordinary equity and shareholder loan notes. Limited recourse (bank) debt financing over 25 years provided the remainder of finance with interest capitalising until cash flow starts. Facilities are transferred to the university at the end of the lease. As noted in Supplementary Paper 3, parallel developments have been observed in the UK.

Residential Investment Fund (QRIF) for investors in 2010.[42] By October 31 2012, Questus was the approved applicant for 4222 NRAS incentives and had delivered 561 new dwellings (Australian Government 2012). As yet, investment through Questus has been sourced solely from retail investors, but diversification is planned (see Section 2.4.2).

→ A new peak body of NRAS providers (NRAS Providers Ltd) formed in 2012. The broad intent of the peak body is to support NRAS participants and to develop proposals to government for improving the effectiveness and efficiency of the scheme from an industry perspective. The Board of Directors of the new body includes several of the largest for-profit and NFP NRAS suppliers. This development reflects the situation that NRAS has now generated considerable industry buy-in but that there is an ongoing need for coordinated negotiation with government over policy and administrative issues impacting on optimal delivery.

Box 1: National Affordable Housing Consortium

NAHC (formerly Queensland Affordable Housing Consortium) obtains NRAS incentives for approved dwellings and on sells them to investors. NAHC either leases the dwelling from an individual owner or enters into delivery agreement with the owner. In either case NAHC appoints a property manager for the dwelling, who is responsible for selecting eligible tenants and for tenancy management. With its current model, NAHC has raised approximately $1 billion from retail investors and has experienced a growth in interest from SMSFs. It has operations in three jurisdictions so far and a national portfolio of dwellings is planned

Source: Research team interview with NAHC CEO; see also http://www.qahc.asn.au/images2/Disclosure%20Document%20all%20states%20100412.pdf

NRAS has also helped to demonstrate the potential for government incentives to trigger innovation in housing provision. For instance, innovative dwelling types being delivered in NRAS projects include mews developments, courtyard housing, dual key schemes (two dwellings on 600 square meters sites) and small flats and studios (under 50 square meters). Such smaller dwelling types match growing demand from smaller households and, by improving dwelling yield, contribute to urban planning objectives. They can also help to drive wider industry reform by demonstrating the type of product that can be marketed (Rowley & Phibbs 2012, p.35).

One promising project model is mixed tenure developments that utilise NRAS along with other forms of government assistance to produce low cost home ownership and shared equity products, as well as affordable and social rental housing. The Western Australian Department of Housing (DoHWA) has been at the forefront of catalysing larger–scale mixed tenure projects by utilising a variety of government incentives in combination (see Box 2). DoHWA provides a good example of a government agency working with the market to improve the supply of affordable housing because it operates under a broad policy framework that includes land development, home finance and social and affordable rental housing provision.

It is the government's involvement in these projects that gives greater certainty to developers and thereby enables them to obtain private finance. However, according to WA officials, while three to four years ago land input was enough to trigger development, now more support is required. Both NRAS and the SHI, which provided funding for social housing, have been important add–ons that have helped to sustain

[42] The QRIF product disclosure statement for potential investors in the Fund was provided to the research team.

the joint venture model. Expansion of co–financed models at scale will require the mix of policy levers that underpin them to be available nationally on a well–coordinated basis, as discussed in more detail in Supplementary Paper 1.

This section has presented evidence of an emerging investment market in affordable rental housing that has been generated by the introduction of NRAS and state government initiatives, especially joint venturing on state–owned land. While domestic institutional investment has not yet entered the market, some relevant developments were identified in the course of this research, as discussed next. Coverage of these developments is limited to information available at the time of the study and, given that at least some of the products were in a market–testing phase, the information reported may not remain current. It is primarily intended to signal the kinds of market activities that are continuing to emerge in response to NRAS, not to imply that they have been, or will be, successful.

Box 2: One on Aberdeen, Perth, WA

This seven-storey, 161 large–scale mixed tenure apartment dwelling development in the inner city of Perth is an equity joint venture between DoHWA and a private development corporation, Diploma Group Limited. The WA Government contributed the land for the development and will retain 17 units of social housing, purchased at a wholesale price, in return for its investment, along with receiving a share of the profit on market sales to reinvest in its housing programs. A further 12 affordable rental units utilising NRAS incentives will be included. The department's wholly owned subsidiary, Key Start will offer shared equity loans for 17 residents and low deposit, transitory home finance for 13 eligible moderate income buyers. In total, 37 per cent of this development is targeted at below market rentals and low cost home ownership. A wide mix of dwellings from penthouses to studio apartments has been included in the design.

Small–scale mixed tenure developments of (say) four dwellings—one social rental, one affordable rental and two subsidised home ownership—are also being considered in WA.

Source: interview senior staff DoHWA

2.4.2 Emerging models in Australia

Residential Housing Trust Model[43]

In 2012, Questus released its proposal for a new investment vehicle, the Australian Residential Housing Trust (a closed end unlisted unit trust).[44] This announcement followed on from Questus publicising that it had obtained a commitment of $131 million as seed funding from a Singapore–based private equity and fund manager, Crest Capital Asia Pty Ltd.[45]

Under the trust model, Questus plans to provide developers with a guaranteed acquisition of dwellings upon completion, subject to these being sold on a turnkey

[43] Information taken from Questus (2012) Australian Residential Housing Trust Discussion Paper, prepared as an Information Memorandum provided on a personal application basis.

[44] In this, it is similar to many infrastructure funds that have been in operation in Australia for a number of years. Closed end funds raise capital at the inception of the fund and remain closed to new investors until the fund is wound up. Such funds have a specified time frame in which capital is invested before returning all capital to investors at the end of the term (typically 10 years)(Connolly 2012. p.9).

[45] Crest Capital Asia Pty Ltd has acquired a 51 per cent interest in Questus Ltd in return for a $10 million working capital facility, a $20 million Development Loan Facility for the development of NRAS properties; and a $100 million Property Acquisition Funding Facility for the acquisition of property developments with NRAS allocations (Questus ASX Announcement Market update 27 April 2012, at http://questus.com.au/files/ASX270412.pdf, accessed 22 January 2013).

basis at wholesale prices (representing approximately a 15% discount on market price). It plans to hold 50 per cent of properties developed as NRAS–supported affordable rental properties for a period of up to 10 years. It is intended that these will be funded by institutional equity investment with returns generated by NRAS incentives, rental income and capital growth in the assets. The remaining 50 per cent of dwellings will be sold to capture the wholesale margin through a variety of strategies, including sale into their retail residential investment fund (QRIF), sale to SMSFs, and sale to eligible tenants through a rent-to-buy option and, progressively after year six, a shared equity program.

Questus aims to raise a minimum of $100 million and a maximum of $400 million for the first of a proposed series of Trusts. Funds raised for the Trust will be used to invest principally in residential properties and residential development projects. It is intended that funding from the international investor (Crest Capital) will help to attract and underwrite domestic investment. Funds raised may be supplemented by borrowing from financial institutions with a maximum gearing ratio of 50 per cent of the value of assets at acquisition and an expected long-term gearing ratio of 30–50 per cent of the gross value of Trust assets. The Trust plans to acquire a diverse range of residential properties which are geographically spread both across states and regions within each state. The Trust is open to all investors resident in Australia (including superannuation funds) and is designed to allowed superannuation funds to have leveraged exposure to direct residential property without direct borrowing. Retained rental properties will be managed by registered CHOs or private rental management agencies on a fee–for–service basis.

GRAIL Income Fund [46]

In August 2012 Perpetual Investments, a major and well-established Australian investment service provider and fund manager, announced the Grail (Government Rental Affordability Indexed Linked) Income Fund as a new residential rental investment opportunity targeted at financial institutions. The intention of the fund is to aggregate NRAS incentives that have been completed by approved NRAS participants (NRAS recipients, e.g. universities, NFPs and for-profit companies), and where the approved NRAS participant wishes to borrow against the completed stock to finance other NRAS projects. In this approach the NRAS incentive is passed through to the lender as an annual payment in satisfaction of the interest charge on the 10-year debt. Loans would be secured by mortgages with modest LVRs (no greater than 66% of valuation) and fully repayable in a single 'bullet payment' at maturation (i.e. no amortisation). The annual return to be distributed to investors would be the annual value of the NRAS incentive paid by the Australian Government and (possibly) the state government co–contributions,[47] both of which are indexed to the rental consumer price index (CPI). Based on the performance of affordable housing and rental CPI performance over the last 20 years, an indicative annual return to investors of CPI plus 5 per cent has been publicised.

[46] Information taken from Perpetual GRAIL Income Fund Summary Flyer, 8 August 2012, http://www.google.com.au/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CDQQFjAA&url=http%3A%2F%2Fgracemutual.org.au%2Ffile_download%2F1%2FPerpetual%2BGRAIL%2BIncome%2BFund%2BSummary%2BFlyer_8Aug12%2Bcopy.pdf&ei=GgH-UO2aD9GQiAfbjIDwCQ&usg=AFQjCNHRHlsiUtoeVlf_7w5WfjbZFYnVnw&sig2=BOY7bzs3WdumSO2gMXoyPA&bvm=bv.41248874,d.aGc, accessed 22 January 2013.

[47] Some state NRAS co–contributions are made for NRAS developments in–kind, such as through tax forgone, land provision or planning benefit, and so are not available for direct redistribution to investors.

This product provides an example of the investment sector trying to work with and package the NRAS incentive to suit institutional investors. If successful, it is poised to become the first venture of its type in Australia.

Prospective developments

During the course of this research, the research team was made aware of other NRAS–linked products that were at an earlier (non-public) stage of development than those just described. One of these involved a major banking institution, which was seeking a tax ruling on a non–recourse loan product to finance property construction and retention over 10 years for NRAS participants holding NRAS incentives.

Another being investigated by CHOs, working in collaboration with a different major bank, involves a residential asset–backed bond issue to raise finance for their development programs that utilise NRAS incentives and other resources, such as surplus revenue streams from public housing stock transfers. Advent of such a bond initiative in the NFP sector would directly parallel financing models that are rapidly coming to prominence in the UK housing association sector (see Supplementary Paper 3) and are well–established in Switzerland (see Lawson et al. 2010). The possibility of attracting an overseas institutional investor interested in Australian residential assets has been investigated.

These developments indicate the increasing involvement of diverse market players in responding to the opportunities created by NRAS for new rental residential investment activity. A major factor affecting likely success, however, is doubt about the future of NRAS—that is, whether it will be a one–off initiative or an ongoing program that offers certainty and predictability to investors. As discussed in Chapter 3, assurance of certainty and continuity are critical factors, especially for large scale investors.

2.4.3 Future design of NRAS

A number of design, technical and administrative issues that have hindered development or delivery of NRAS projects so far were raised in panel discussions and interviews conducted for this study. Several suggestions were also made about design enhancements for future rounds of the scheme and about ways to streamline and forward commit NRAS allocations, particularly with a view to better suiting institutional investors and avoiding costly delays in approvals. These suggestions have not been the subject of detailed assessment in this study, as they are outside its brief. However, the suggestions made indicate it would be timely and valuable for the program's administrators (FaHCSIA), in consultation with relevant state officials, to conduct a round of targeted consultations with leading NRAS participants, bodies representing institutional investors (e.g. the Association of Super Funds of Australia) and leading funds managers to obtain their views on how to build on NRAS's success to date and how to promote and apply NRAS in the institutional investment market.

2.4.4 International examples of institutional investment in affordable rental housing

United States

The primary example of where government assistance has been successful in financing affordable rental housing through institutional investment is through the Low Income Housing Tax Credit in the United States (US) (outlined in Box 3). The LIHTC is, to some extent, the pre-cursor for NRAS in Australia. One key difference, however, is that recipients of these tax credits are able to trade them on the open market, thus providing a source of development capital. Another difference is that investment returns are gained mostly from revenue not capital growth.

Box 3: The US Low Income Housing Tax Credit

The US LIHTC program was established in 1987 to channel private investment into rental provision at sub-market prices. Subsequently it has facilitated the development of 2.4 million units of affordable housing in the period 1986–2012. The annual cost (or, more accurately, loss of tax income) totals roughly US$5 billion for the Federal Government (ABT Associates 2012, p.2). The LIHTC program has benefitted from bi-partisan political support and has been backed by a broad coalition of for-profit and non-profit developers, banks, investors and consultants (Dreier 2006).

Having identified a site and been allocated tax credits, a developer raises capital by selling the credits to investors, typically through a syndicator. The tax credits have generally been considered by investors as proven low-yield, low-risk investment, which also discharges corporate obligations on banks to invest in community development in under–served markets under the 'Community Reinvestment Act' (Schwartz 2011, p.361).

Developers holding tax credits are required to achieve specified affordability targets for a minimum of 30 years, with either:

- at least 20 per cent units being affordable for households earning up to 50 per cent area median family income, or
- at least 40 per cent of units being affordable for households earning up to 60 per cent area median family income (equivalent to key workers—e.g. teachers).

Typical housing projects are funded by a mix of LIHTC, bank debt and other income sources, which has come mostly in the form of 'soft loans' at reduced or zero rates of interest from state and local governments; land donations; retained earnings; Multi-Family Housing Revenue Bonds issued by states; and various grants (Gilmour & Milligan 2009).

The LIHTC program was made permanent in 1993. This move provided corporate investors with 'greater motivation to invest the time and effort necessary to understanding LIHTC investments' (Abt Associates 2012, p.26), triggering their increasing involvement in the tax credits market. The result has been emergence of a mature market dominated by institutional investors, including banks, propriety funds, multi–investor funds and insurance companies, providing both equity and debt finance.

During the GFC, the market's appetite for LIHTCs diminished sharply. Corporate entities with little or no taxable income no longer benefited from tax credits and a number of major investors failed (Schwartz 2011). Weak demand for tax credits caused their price to fall sharply in 2008–09, creating gaps in the financing of properties that had already received allocations.[48] However, this in turn encouraged the return of syndicators and re–activated the market, stimulating interest from new classes of direct investors (e.g. Google and a grocery store chain) and the return of investors, such as insurance companies, multi investor funds and corporate investors. As a result of this renewed activity, by 2010 investment levels were reported to be near those achieved before the crisis and competition for credits was considered to be robust in most markets (TCA 2011). Nevertheless, wider economic conditions and anticipated policy and fiscal reform on a number of fronts in the US have continued to add to market uncertainty. In this context, strong demand for a guaranteed product has been noted (TCA 2011).

[48] Many of these were subsequently completed with government grants provided under a post crisis recovery package (Schwartz 2011).

Europe

LeBlanc et al. (2009, pp.383–84) provide a range of examples where securitization has been used successfully to harness institutional investment for social housing funding purposes in a number of European countries:

- In Sweden, through the Framtiden issues made between 1995 and 2001, the city of Gothenburg sold a number of portfolios of loans to multifamily housing companies that provide low-cost rental houses for families to an SPV, which raised funds in the asset-backed capital markets.
- Similarly, in Finland through the Fennica issues, funds have been raised in the asset-backed capital markets by the sale of loans made by ARA subsidised by another agency of the Republic of Finland to social housing borrowers for the purchase or construction of multifamily rental housing.
- In Belgium, this is also the case with the Atrium and Eve issues, where loans made to social housing companies for the provision of low-cost single-family housing were securitized.
- In the Netherlands, the Colonnade and Dutch Housing Association Finance issues going back to 1997 have financed the securitization of loans to Dutch housing associations guaranteed by a specially established entity.

United Kingdom

In the past few years, housing associations in the UK have forged increasingly strong links with the capital markets (Pawson 2013). This has come about largely due to the virtual disappearance of conventional, competitively priced, long-term bank finance.[49]

In response, housing associations have shifted towards capital market bond financing, either individually through ‘own name placements’ or collectively via aggregators such as The Housing Finance Corporation (THFC). In 2012–13 bond financing accounted for two thirds of new facilities arranged by providers in England. There have also been moves to private placements, involving a direct relationship between an individual housing association borrower and a specific institutional investor—usually an insurance company or pension fund (Murja 2012). By 2012–13, such transactions made up 9 per cent of all new borrowing facilities arranged in England.[50]

A further recent approach to channelling institutional investment into housing associations has been the sale/lease and leaseback model. In return for an upfront capital sum for portfolio of unencumbered dwellings, the housing association pledges index-linked annual payments to an institutional investor over the term of the deal. ‘In effect, the lease rental payments are a combination of interest and capital amortization such that, at the end of the lease term, the properties will revert to the association at nil cost’ (Murja 2012, p. 33). An advantage of this structure for smaller associations is that threshold size could be as low as £10 million, although the sole instance established prior to 2013 (Derwent Living and AVIVA) involved a £45 million transaction.

More details on relevant developments in the UK are provided in Supplementary Paper 3.

[49] The cost of such finance rose dramatically following the GFC and remained on a rising trend through to 2012. Loan terms also have become significantly less attractive, now typically being set at five years (rather than the traditionally offered 30 years).

[50] Figures reported here are taken from the Homes and Communities Agency (HCA) Quarterly Surveys. At http://www.homesandcommunities.co.uk/ourwork/publications, accessed 15 February 2013.

3 VIEWS OF THE INVESTIGATIVE PANEL

This chapter presents a summary of the key arguments and conclusions that emerged from the Investigative Panel's deliberations. Overall, the panel expressed strong confidence in the desirability, feasibility and potential of large scale institutional investment in rental housing. At the same time, panel members emphasised that achieving this goal will require strong government leadership and sustained policy commitment to underpin investor confidence, and they recognised that it will, in any event, take some time for a robust institutional market in rental housing to develop.

The chapter is structured as follows. The first section presents panel views on the rationale for seeking institutional investment in rental housing and panellists' assessment of the likelihood of this being forthcoming. The second section details perceived obstacles to such investment, with the final section summarising panellists' views on the necessary broad directions for policy and regulatory reform required to overcome such barriers. The chapter incorporates verbatim quotes by members of the panel that have been taken directly from transcripts and notes of the panel meetings.

3.1 Rationale for and opportunities for institutional investment

As discussed in the previous chapter, the need for investment in additional housing is large and growing. Such a requirement encompasses not only affordable rental housing but also other appropriate forms of market housing. Under prevailing economic and political conditions, current sources of public and private investment are likely to continue to fall well short of the need for finance that has been identified, adding to supply shortages and affordability pressures, and with the further likelihood of damaging labour supply and economic growth. As noted by one panel member, 'this task is far too big for government alone.' While government funding contributions will be crucial to achieve affordability, large volumes of additional private investment are clearly needed.

The initial objective of this study was to focus on financing for the provision of additional *affordable* rental housing in Australia. However, in the early stage of their discussions, panel members emphasised the need to consider supply of rental housing as a whole, rather than having an exclusive focus on affordable rental. Having this broader focus would help to address institutions' needs for large scale investment opportunities, as well as offering them a more diversified residential investment portfolio across a number of locations (improving returns and spreading the risk) and helping to allay their underlying concerns about specific risks associated with affordable housing provision (see Section 3.2 below). If investment in rental can be increased, then an increased component of affordable rental can and should be induced to follow through appropriate subsidy arrangements. Additionally, planning policies that support smaller dwellings will assist affordability and would be well–matched to forecast needs.

Based on this discussion, the panel concluded that the policy objectives to be adopted by government should be centred on delivering a target supply of new rental housing including, but not limited to, a substantial component of rental housing that is affordable for low to moderate income households.

Institutional investment was seen as the most desirable source of finance to achieve long-term growth in supply of rental housing for a number of reasons. Views expressed by members of the panel about why institutional investment, particularly from the managed funds sector, is desirable included:

- Demand is so large that no-one else (including government) has access to sufficient funds to provide the finance needed.
- Institutional investment offers efficiency gains from scale and proportionally lower transaction costs for a small number of large investments rather than a large number of smaller contributions.
- Institutions are likely to view longer-term lettings more favourably and to provide a more stable and predictable source of funds than individual investors.
- Institutional investors represent an alternative source of finance for larger scale rental housing providers currently constrained by costly and limited bank finance. Nevertheless, the goal needs to be substantially increased levels of investment not just a change in the sources of investment.
- Institutional investment has the capacity to change the structure of the residential construction industry from a potentially inefficient, small scale cottage industry to a more efficient sector.
- Institutional investment will be needed if a new property asset class focused on income returns rather than speculative gains is to evolve.

Verbatim quotes from panel members underscore these arguments. For example, on the overall benefits of institutional investments one panellist argued:

> Institutional investment brings scale, predictability, stability and for government things are more likely to get built when they were said to be built because the buyer is already in place and pre-approved, and the product is more likely to be negotiated as a portfolio.

Another panellist highlighted the potential for efficiency gains:

> If you're going to mum and dad investors, each sale process is for just one, maybe two, properties. Whereas if you're consolidated, you're dealing with hundreds, maybe thousands and the efficiencies that come off that are huge, so transaction costs come down.

Importantly, panellists were not arguing for moving away from having diverse sources of finance:

> Certainly there's a place for mum and dad investors—don't lose it, foster it—but it doesn't solve the whole problem.[51]

> Do the calculation, it's truckloads of money. And we know we're already reaching the mum and dad investors' thresholds.

As most of the panel saw it, financial institutions currently have a real appetite for new forms of low-risk investment. Factors reinforcing this mindset include the cohort effect in certain pension funds, involving a shift from accounts in the accumulation phase to the pension phase. This is creating demand for a form of investment prioritising sustainable and predictable income–based returns over capital appreciation. This has implications for the structuring of investment in rental housing as discussed further below. There is also enhanced fund manager concern about the security of current investments, given recent volatility in the share and property markets. Adverse trends in returns from commercial property and shares and seen as likely to persist for the

[51] The US offers a cautionary tale in this regard. Individual investment in the Low Income Housing Tax Credit (LIHTC) program effectively ceased following the introduction of new rules in the 1990s eliminating tax benefits for individual investors. Since the GFC, there has been debate in the US about the need to re-engage individual investors in order to achieve a more diverse mix of investors that would provide depth and resilience (JCHS 2010, p.17). (Section 2.4.4.provides information on LIHTC.)

foreseeable future have also heightened interest among superannuation funds in new asset classes. Many Australian superannuation funds have 'socially responsible investment' programs that may be particularly suited to investment in affordable rental housing if there is sufficient confidence that returns are adequate. These shifts are potentially favourable to investment in rental housing, and there has been expressed interest by Australian superannuation funds to enter this market once key issues, discussed below, are resolved (Hurley & Wilmot 2012). Furthermore, confidence among overseas institutions in Australian economic stability and its growth fundamentals may be favourable to offshore investment in Australian property.[52] A huge pool of institutional funds is therefore potentially available for investment products that meet their requirements (as documented in Section 2.3).

The panel concluded that under the right conditions and policy settings, institutional investors could offer the finance necessary to sustain long-term growth of rental housing, including a significant component of affordable rental for low and moderate income households with appropriate forms of government support, in a variety of housing sub–markets across Australia (metropolitan cities, regional growth areas, retirement communities and resource towns).

3.2 Past barriers to institutional investment

In the background paper prepared for the first meeting of the Investigate Panel, the research team listed a number of key barriers to institutional investment in rental housing that had been identified from past research (including Lawson et al. 2012; Lawson et al. 2010; Gilmour & Milligan 2009; Allen Consulting Group 2004; Berry et al. 2004 and AHNRC 2001, as well as the overview of much of this research in KPMG 2010).[53] These, in no particular order, included:

- Low rental yields (with yields from residential property being around 4–5% compared with yields of up to 10% for infrastructure investment).
- Stamp duty and particularly land taxes which undermine already low returns in residential real estate for investment at scale.
- High risk associated with scope for capital appreciation (arising from house price risk).
- Constraints arising from such investment being a new asset class (which means that institutions have no established policies to assess lending options).
- Risks associated with this new asset class (e.g. lack of market information on the returns likely to be available from affordable rental housing or on the performance of organisations able to manage such assets).
- Counter party risks (e.g. associated with the role of community housing providers and the lack of comfort that such charitable organisations can provide to a lender because they either are limited by guarantee or have little contributed equity or retained earnings, but also associated with development and construction of new dwellings when these are undertaken on behalf of an institutional investor).

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[52] 2012 has seen significant growth in the volume of offshore investment in Australian property. Total foreign capital inflows reached $6.3 billion between January-October 2012. Up to 63 per cent—or $1.18 billion– of foreign capital, was made by foreign pension funds, most notably the Canada Pension Plan Investment Board's (CPPIB) $1 billion investment into the Barangaroo development in Sydney. To date, however, such investment targeted the office market, industrial, hotel and retail sectors rather than residential property. See http://www.colliers.com.au/News/News-details.aspx?NewsId=%7B8453F96C-AD6E-49D9-B50E-C188F655C432%7D.

[53] KPMG also identified a number of barriers that arises from the post GFC state of the economy. To a large extent, many of these are cyclical and do not represent fundamental or structural constraints that limit the scope for institutional investment.

- Issues of security enforcement (because of perception of a negative community response to any attempt to take over affordable housing assets in cases of default).
- Scale constraints (arising from the reluctance of relevant players to participate in schemes involving investment packages below a threshold size of possibly around $100 million, and the preference for a number of institutional investors to be involved in any such venture to share risk).
- Lack of liquidity (associated with direct equity investment but also with indirect forms of equity or debt investment when the primary market is too small for a secondary market to develop).
- Policy risks (associated with inconsistency in the level and form of support that might underpin institutional investment and uncertainty about ongoing commitment to this).
- Administrative complexity (arising from the possibility of having to deal with different tax and planning regimes across jurisdictions).

The panel recognised that there has been a number of changes that have served to alleviate or at least ameliorate some of the constraints identified in earlier studies. Track records are beginning to emerge; regulatory arrangements applying to CHOs are providing enhanced information on their management performance; stock transfers and capital investment have increased the balance sheets of many CHOs and hence the security cover they can provide; policy initiatives (e.g. NRAS) have enhanced yield available from investment in affordable rental property, and so on.

3.3 Key outstanding barriers

Following discussion and debate on these past constraints and the factors that potentially have served to lessen their impact, the Investigative Panel identified five factors from their recent experience as being the most important in continuing to inhibit institutional investor interest. These are discussed below.

3.3.1 Risk return profile

The risk adjusted rate of return is the biggest issue for institutional investors. Expectations for investment returns among such players are generally higher than those of individual investors' and banks and, in the case of property, are weighted more to rental yield than capital growth. Institutions' expectations for high returns are reinforced by their perceptions of risk with an unknown asset class, including in this case, reputational risk, development risk, income stream risk and property/tenancy management risk.

> Everything in the superannuation, and more generally the investment, market is judged by its return value. Capital return is discounted very heavily, so the yield from residential property is the first element holding things back. The yield is 200 basis points below where they want it to be.

Low rates of return will be more acceptable if risks are also low. However, there is a gap between the real and perceived risk associated with affordable housing. More importantly, there is a perception of affordable housing as akin to commercial property, but in the view of panellists it should more appropriately be seen as a stable low-risk-low-return asset that adds an 'infrastructure flavour' to investors' portfolio. This has implications for financing the development of rental housing in general and for ways government can reduce risks through credit support options, which are discussed later.

The panel argued that if the rate of return is adequate, the structures and vehicles for investment are likely to be created by the market. Once the first institutions have made substantial investments in the market, the risk profile will change and become more favourable for further institutional investment.

3.3.2 Lack of track record

Rental housing remains a largely unknown asset class for Australian institutional investors and the external fund managers who advise them. In particular, performance of affordable housing projects and affordable housing managers at present is largely an unknown quantity.

> At the moment no one sees it [rental housing] as an asset class at all.
>
> There is a need to actually demonstrate it … as evidence to show them [institutions] that it can work.

Institutional investors and their financial advisors were described by the panel as conservative by nature and averse to change; they do not consider investment where there is a lack of clear evidence of returns and risks. One way to overcome such industry attitudes would be to bring together a number of institutions to co-invest in some pioneering projects as a means of creating a track-record while minimising the risk for individual funds. An education campaign was suggested as another way to address the knowledge gaps of investors and funds' managers.

3.3.3 Scale

Given the high threshold costs for investing in a new unknown asset class (and the associated commitment of superannuation funds to low management fees), the panel advised that the 'package scale' a single large fund would be looking for is between $50 million and $200 million.

The fragmented nature of investment opportunities in the rental market to date has meant there was limited scope for aggregation to the scale required for institutional investment. The numbers of NRAS incentives available in NRAS funding rounds one to four and the process for accessing them also have not been conducive to institutional investment. However, it was noted that specialist intermediaries are now emerging to facilitate the aggregation process. A lack of professional firms to manage large private rental portfolios has been perceived as another barrier, although it could be expected that these would emerge once a market develops.[54]

> There are lots of initiatives all over the place but it's got to be aggregated to a scale where institutions can say 'it's worth the time and the cost of setting it up so that we can chew it up in large pieces' … The problem is big enough, but it's not being pulled together to create the scale that is needed for institutions.

3.3.4 Liquidity

The relative illiquidity of residential property investment—compared to shares and bonds, for example—is seen as having discouraged institutional investment. With affordable rental, in particular, concerns about termination of tenancies (in order to sell assets) reinforce perceptions of illiquidity.

[54] Relevant here is the model promoted in the UK by the Resolution Foundation and under which NFP housing associations would act as both developers and long term managers of market rental assets sold into institutional ownership upon completion. This is covered in Supplementary Paper 3.

> [For institutions] Their risk is 'do I have to exercise my securities and kick that person out? Do I want to show up on Today Tonight? These risks are not really financial and they are largely based on un-educated assumptions.
>
> We like the ability to exit an investment if our view of the opportunity or the manager changes.

For greater liquidity, an ongoing market of $500 million or so worth of investment annually, and housing and finance models that offer exit strategies for investors (including break-up and aggregation options and sales to other investors or to residents) will be needed. In the medium term, a housing supply bond market and real estate investment trusts (REITs) that aggregate investment from diverse sources could be expected to develop, if the policy certainty is there.

3.3.5 Level and certainty of government support

Certainty of government commitment to a viable affordable housing system is crucial to ensure investor confidence in this market. An important aspect of this concerns the government support that underpins rental revenue associated with provision for low income households. A stable policy framework that will generate continuity (including a pipeline of projects at a consistent level) and a predictable rate of rental return will be essential in order to convince institutions that the time, effort and setup costs involved in developing a new investment product will be worthwhile.

> A new investment class that has a very limited horizon, it's not something that institutions can invest in.
>
> Institutions are saying 'Why should we get involved spending our time and money responding to what is actually a band aid solution rather than something that is long-term, sustainable, that we can bank on it being here in the future?
>
> Certainty—I think it is just critical. There's got to be certainty to get confidence and to get investors to actually put in the intellectual firepower to make this work and to marshal funds. Co-ordinated commitment, there has got to be leadership here and the leadership's got to go in the front end.

While NRAS in particular has stimulated institutional interest in rental housing investment, a key factor obstructing superannuation fund commitment to participate has been uncertainty about its long-term future.

Different state policies—for example residential tenancy law and inconsistent applications of property taxes and charges—are also obstacles for aggregation models and for large investors looking for a diversified portfolio of properties across the country.

3.4 Solutions and broad directions

The panel's second meeting focused on how to overcome the key barriers to achieve the goal of institutional investment in rental housing at scale. Overall, a clear set of broad directions for policy and practice has emerged from the panel's deliberations, as outlined below. Drawing on these broad directions and in consultation with panellists, the research team has developed a set of specific recommendations to government, which are listed at the front of this report. More detailed discussion of specific policy options and finance models are contained in the Supplementary Papers.

3.4.1 Continuity and certainty: commitment by the Commonwealth Government to maintain NRAS

Within the panel a strong consensus emerged that a long-term commitment by successive Commonwealth Governments (and their state/territory partners) to the continuation of NRAS is the most important policy direction to enable institutional investment in rental housing at scale.[55] At the same time, concerns were raised by at least one panellist that institutional investors will not rely on policy statements as indicators of long-term commitment

> They've got a policy now? Who cares? That could change next week.

Such prevailing scepticism is one reason that communication of a long-term commitment to NRAS (beyond 2016) was seen as a necessary prerequisite to future calls for applications for the allocation of NRAS incentives (e.g. NRAS 'Round 5' which is expected to be opened early in 2013). Institutional investors were considered to be far more likely to apply in the knowledge that there will be a continuing program.

In support of this view, the panel noted that the 'establishment phase' of NRAS has been successful in generating diverse market interest in investing in affordable housing. While, unsurprisingly, it has taken some time for the financial sector to learn how to work with NRAS, it is now vital to build on the knowledge and skills that have been established, rather than government changing course. Financing new rental supply in the establishment phase has been limited to retail investors and to conventional bank finance. However, an 'institutional phase' is nascent. Currently, as well as lacking in confidence in the scheme's future, wholesale investors are being held back by:

- The limited value of a tax offset to institutions.
- The time taken for a decision to be made on applications for NRAS incentives.

While an institutional phase of NRAS will require some technical adjustments, NRAS should remain and any extension and/or revision should be branded as a continuation and/or enhancement of the existing scheme.[56]

> For all the different players, it takes a certain amount of time to learn and change and to change direction is just counterproductive. So certainty around that program [NRAS] is just paramount for all the players … to get that confidence, that security, that feel that this is something that is there for the long term.

NRAS was never intended to operate alone and will need to be packaged with other forms of government support in order to trigger institutional investment in rental housing and to achieve affordability goals. Various options for government support are discussed below, such as credit enhancements (Section 3.4.4) and seed funding for 'proof–of–concept' projects (Section 3.4.5).

3.4.2 Structuring rental housing as an infrastructure–type investment

Background papers prepared for the panel identified a number of specific finance models that are currently being developed and/or marketed with institutional investors,

[55] This is consistent with the US experience with the LIHTC program. See Section 2.4.4.

[56] There was some debate within the panel as to the specific nature of the required technical adjustments to NRAS. One point of disagreement was the continuation of flat rate incentives. One member considered a flat rate incentive an illogical measure given major differences in land values. Several members held a strong opinion that having locational differentials to the NRAS incentive would add layers of complexity and would be counter-productive to the progress achieved so far in terms of establishing an understanding of NRAS in the market.

each with a different mix of debt and equity, and various partnership arrangements. The panel advised that investors respond to specific investment opportunities, not abstract models. Until tested and proven, therefore, there is no way to point to a single finance model that will be attractive to institutional investors. Cyclical shifts in finance markets also necessitate that there is some level of flexibility over time, rather than locking in a single finance model.

However, panellists also emphasised that institutional investors do not want development risk, construction risk or sales risk. Nor do they seek capital appreciation as a primary component of their return on investment, especially given the degree of uncertainty in housing markets post GFC. Thus, the panel's general view was that a finance model for rental housing should be designed as a low-risk, low-return infrastructure-type investment with return based primarily on cash-flow.

> This is about cash flow … it's got to be looked at as infrastructure not property … Because as soon as you get property involved you start skewing the expectations of the market on the yield and the realisation of value.

> The rate of return expected is relative to the perceived risk. The perception around residential property is that it's speculative real estate—higher return for higher risk. But I don't think rental housing—especially affordable rental housing—should be seen this way. It's more of a lower risk, lower return [asset class] … Low-risk, low-return [investments] are highly acceptable and have a place in the allocation matrix of superfunds.

The panel expressed considerable interest in the housing supply bonds proposal (Lawson et al. 2012), which is consistent with housing being seen as an infrastructure–type investment. However, they also saw housing supply bonds as a medium rather than short-term solution because of the inevitable delays in designing them and in establishing the institutional environment needed to support their delivery. There was a sense of urgency for more immediate action, specifically around the unallocated NRAS incentives, and a commitment to a minimum supply target for new rental housing as an indicator of the scale of opportunity that government was seeking to generate. Announcement of further work on an implementation strategy for the bonds proposal set out in Lawson et al. (2012, pp.76–83) could be timed to coincide with other announcements, such as one concerning the future of NRAS.

3.4.3 Portfolio diversity and affordable housing

Most panellists agreed that, to achieve scale, spread risk, reduce transaction costs and achieve a rate of return adequate to attract institutional investors, a diversified investment portfolio offering a mix of properties from a variety of providers in a range of locations will be required.

> To get a sustainable, large scale, rental housing model that accommodates the full spectrum from the top end, through affordable housing, and down to social housing, is the big picture. And that then provides a model that is big enough for institutional scale investment. That creates the ability for those sub-categories [social and affordable housing] to sit in there.

Some panellists, however, raised concerns that, given the rates of return required by institutional investors, higher risk and lower return projects will be left out of the mix, with negative outcomes in terms of affordability and in terms of the spatial distribution of new supply.

> As different states and different cities go up and down, there'll be a movement [in investment]. That's part of the problem, to be honest, there's a problem about winners and losers.

To offer large scale and diversified investment opportunities will also necessitate coordinated action across governments, especially to promote policy alignment and reduce administrative complexity (e.g. applying consistent property taxes) and to facilitate delivery (e.g. through land supply and planning support). Not–for–profit providers will also need to work collaboratively to offer local management services on a consistent cost and service model basis (see Supplementary Paper 1).

Panel members noted that this way of working has been successfully demonstrated through the Social Housing Initiative, NRAS and the Housing Affordability Fund via projects delivered by consortia involving governments (variously providing land, planning incentives, planning certainty and other concessions), private sector developers and funders, and community housing providers.

3.4.4 Credit enhancements

To allay investor anxieties associated with rental housing, government needs to provide credit enhancements designed specifically to reduce investors' perceptions of risk associated with a new asset class to increase their willingness to invest. Governments more familiar with the existing affordable housing industry are more likely to recognise its relatively low risk.

One critical example is development risk, as explained by one panellist:

> Take-out is fine if you've got a completed property. You can't get a completed property if you haven't sold enough of the properties in advance through pre-sales because you won't be able to get the funds. So there's a role for government in here to actually take on part of that development risk … pull it together and just make the model work.

Options to overcome barriers to the initiation of development include: a revolving public loan fund to enable construction; de-risking construction sites by having development approvals already in place; and governments (at all levels) contributing equity (especially serviced land) as part of the investment mix.[57]

For institutional investors another key risk factor will be certainty of the income stream. Options to address this risk include some form of guarantee of rental income (e.g. by guaranteeing minimum Commonwealth Rent Assistance (CRA) payment levels or a component of rental income—say 80%) or incorporating rent cascades in deals, whereby substitute tenants can be housed if there is low demand from the preferred target group.

The panel argued that governments need not and should not absorb all risks—some level of risk retained by investors will ensure greater efficiency and value add by the private sector. In addition, some elements of credit enhancement (e.g. income guarantees) could be time–limited and withdrawn as the market matures and risk premiums fall.

> Once it's up and running and you've proven the model it will generate a life of its own … and the government can step back.

Credit enhancement options are further elaborated in Chapter 4 and Supplementary Paper 2.

[57] The ongoing policy debate in the UK likewise highlights the importance of separating the development phase from the operational phase and has identified the desirability of a revolving fund to finance the former (see Supplementary Paper 3).

3.4.5 Government leadership and seeding

Government leadership must be committed and well–informed and the policy framework must be enduring while also being responsive to changing market conditions. Skills shortages and capacity constraints evident in the implementation of recent initiatives must be overcome.

> Who should take the lead? Can it work with private sector taking the lead? Probably not, because it's disjointed.

> Government is really the place where you have to create the momentum and the certainty.

While Government must be very clear about its objectives and provide the incentives that will necessary to achieve its goals, the market must be free to find the solutions.

Accordingly, the panel considered that a crucial role for governments in the immediate future would be to seed and stimulate a suite of 'proof-of-concept' projects to help generate a market for institutional investment in a new asset class. This could be achieved by offering a significant share of NRAS Round 5 incentives and other seed funding (e.g. public housing stock transfers or provision of development-ready government owned sites) for projects including institutional investment. Following on from a long-term government commitment, targeting NRAS and other opportunities to the institutional investment sector can also be used to road test model(s) that will both fulfil policy objectives for affordable rental housing and meet investor requirements.

> Let's actually get the start that everybody wants, get some projects started, and see how they operate in practice, see what we learn from that. Then we'll build more.

3.4.6 Institutional arrangements

Financial intermediaries

Scale requirements of institutional investors point towards the need for 'pooled financing' rather than bilateral deals. Superannuation funds need to be brought together so that 'they can all jump into the pond holding hands', as one panel member put it. This makes clear the role for an intermediary, which will aggregate projects and bridge between investors, housing providers and developers. An intermediary could enhance liquidity by having the capacity to purchase as well as offer any securities issued. In addition, an intermediary body will provide the initial drive necessary to champion requisite policy adjustments.

> In any of these things, in any project I've been involved in, you had one guy, a project director, who drove the thing. If you don't have that, the project falls on its head.

The cost of an intermediary should be offset by—and must not exceed—the savings achieved through resulting efficiencies.

Some intermediary bodies have already emerged (see Section 2.4.1), and others may be created by the market once rates of return are seen as attractive. Consideration could also be given to having a single independent national financing agency. However, panel members emphasised that centralised effort should not prescribe rigid structures and must support, rather than obstruct, existing or new initiatives and innovations in the market.

> Models will vary—there are three or four financing models already tested by people sitting around this table alone—we don't want to get in the way of that.

Some options for, and models of, financial intermediaries are discussed in Supplementary Paper 1.

Community Housing Organisations (CHOs)

Panel members noted the challenge for institutional investors in finding suitable managers of large, mixed rental housing portfolios, which may discourage investment, particularly in the form of equity. The panel recognised CHOs as managers of affordable rental housing that are growing in scale and capacity and welcomed the development that they will be subject to consistent national regulation in the near future. Building on recent experience, a preference for CHOs to deliver high quality and appropriate management services could be built into future financing models.

Some larger CHOs could also be developers and suitable vehicles for holding assets, although some protection for investors will be required. Using CHOs as developers and holding vehicles offers some significant tax advantages under present policy settings and these provisions have been critical to the delivery and targeting of many NRAS funded projects to date.[58] However, the scale of investment envisaged (compared to the currently still limited size and financial capacity of CHOs) means that other delivery models, such as special purpose vehicles and PPPs will also be needed in future.

> There's a couple of obvious roles [for CHOs] in property and tenancy management … and in developing in some models.
>
> The focus of a lot of community housing organisations in recent times has been on developing property, and not on developing the business itself and their management capabilities. They have to reach that next level to actually be part of the game.

3.4.7 Tax policy

Changes to the way rental housing providers and financiers are taxed will be essential to improve rates of return and reduce uncertainty among investors. Presently, the added costs of land tax and transaction taxes, differences in the application of tax arrangements between classes of investors and between jurisdictions, and the need to obtain separate tax rulings for individual deals all constitute stumbling blocks for large scale investment.

More generally, there is need for greater certainty around tax without creating additional layers of complexity in an already convoluted tax system. There is also a need for 'micro fixes' to enable institutional investment in rental housing in the immediate term, while recognising that these will need to be aligned with a wider set of macro reforms to the Australian tax system over the medium to long term, following from the Henry Review (The Treasury 2010).

> The State component [of the NRAS subsidy] which goes through one door to the investors goes out the other door straight to the Australian Tax Office—that's not particularly helpful.
>
> We would like to see that a passport for charitable tax concessions at a Commonwealth level is a passport to charitable tax concessions at a state and local government level and it's harmonised nationally. Then for people looking around for not-for-profit partners they can know what those benefits are worth

[58] UK experience deriving from its more mature housing association sector also demonstrates how this mission driven sector can lead innovation in response to changing market conditions (see Supplementary Paper 3).

> and factor them in as another implied subsidy for the social benefits that we get out the other end.

In the next (proof–of–concept) phase, consideration could be given to specific forms of tax concessions that would suit large scale investors, such as disaggregating land tax or stamp duty concessions for affordable rental supply. Further thought should also be given to the form of tax offsets under NRAS and to harmonising the benefits that arise for institutional and individual investors.

3.4.8 Independent assessment

Independent assessments—such as assessment by credit ratings agencies—will assist in marketing rental housing to institutional investors. In the UK, affordable rental housing enjoys high credit ratings as a result of having extremely low default rates. There is a need for government and providers to work with the rating agencies at an early stage to develop a comprehensive matrix of risks and risk mitigants. Obtaining a credit rating for the industry would have an upfront cost—potentially absorbed by government—but may advance the objective of attracting institutional investment.

> A comprehensive rating will cover a lot of issues.
>
> You get an independent assessment … You fix the parameters around it [for specific projects] … and you can actually get projects off the ground quite quickly through that.

3.5 Panel overview

The generally agreed viewpoints of a panel of housing, finance and public policy experts presented in this chapter have given rise to a clear set of strategic directions designed to draw large-scale institutional investment into the supply of additional rental housing in Australia. The substantial investment of time and effort contributed by the 23 panel members in developing these directions reflects their strong interest in the issues before them, their willingness to pursue collaboration and consensus around a shared purpose and a general mood of optimism on the potential for channelling large scale institutional investment into rental housing.

The panel's deliberations were strongly influenced by what are widely known to be the most significant barriers to institutional investment—requirements for adequate rates of return, greater scale and liquidity, and demonstrated track record, especially for affordable housing. An assured, well-informed and coordinated policy response to these persisting hurdles is critical in achieving future progress. Panel members acknowledged the significant efforts that have been made by Australian governments in recent years to generate an investment market for affordable rental market, triggered especially by the introduction of NRAS. However, in the panel's view, it has now become urgent that the resulting momentum is consolidated and built upon quickly, especially to entice in institutional investors who have yet to take up NRAS incentives.

The optimal way for this to occur would be for the Council of Australian Governments to make a long-term policy commitment to the goal of increasing rental housing supply in order to generate certainty for investors. There was agreement among panel members that confirming NRAS as an ongoing scheme with bipartisan support is the essential immediate step required to signal to institutional investors that rental housing will be a sustainable investment option for them to pursue. However, while such a commitment is a necessary step it will not be sufficient. It needs to be one part of a package of government support on offer in ensuring not only that institutional investment is channelled into rental property, but that a significant component of that housing is made available at an affordable, submarket price to approved tenants. Other elements of the package should include, for example, credit enhancement products, government equity investment, and provision of public land on favourable terms. Application of this mix of policy options should be flexible and responsive to market conditions—for example, the shortage of finance for construction being experienced at present requires specific policy attention.

Institutional investment is intended to supplement rather than replace existing sources of finance and models of investment (especially from 'mum and dad' investors). The magnitude of finance and the efficiencies that can be generated through institutional investment are essential to the task of tackling the large shortage of affordable rental housing. While rental affordability was acknowledged as the principal policy objective, the panel considered that in order to achieve a steady increase in the supply of affordable rental housing (between 5000 and 10 000 dwellings per annum), a wider solution which involves institutions investing in the full spectrum of private rental properties—in order to generate scale, spread risks and improve returns—would be desirable and an important contribution to the broader housing supply challenge facing Australia.

The panel concluded that no one financing model should be recommended to government. If the risk-adjusted rate of return is attractive, and if there is certainty about the level and durability of government support, then the market will respond and develop appropriate models and solutions. Therefore, panel discussions were centred on high-level policy directions rather than on developing specific policy suggestions or financing models. However, a general consensus also emerged that an infrastructure-style investment product, offering a predictable, low-risk revenue-based return was likely to be preferred by institutional investors in the prevailing economic climate. Seeding a diverse cohort of projects, incorporating a component of affordable rental, over the next two years was also specifically recommended as a suitable way to catalyse market responses and to demonstrate to the investment industry and to government the performance of rental housing as an asset class.

Strengthening government leadership and capacity, and working more closely with finance industry experts, will be essential to take forward the broad approach recommended by the panel. Appointing a high level cross sectoral Task Force with an independent chair was specifically suggested as a means to steer and promote action and policy development over the next two years.

The panel's conclusions have provided the basis for the specific recommendations presented in the opening section of this report Findings and Recommendations.

4 ADDITONAL RESEARCH AND OUTSTANDING ISSUES

Before finalising the recommendations that were developed in consultation with the Investigative Panel members, additional research was undertaken to check on the robustness of the conclusions drawn. The need for this additional research highlights potential limitations of the investigative panel methodology. Some of this additional research was covered in Chapter 2 and is expanded upon in the Supplementary Papers. More results of the additional research undertaken are presented in the first section of this final chapter. The chapter concludes by reflecting on issues that could not be addressed through the brief or the methods adopted for this study.

4.1 Potential forms of credit enhancement

One of the key messages that emerged from the consultation with the Investigative Panel members was the need for some form of credit enhancement if the goal of financing rental housing through institutional investment is to be achieved. Effective credit enhancement provides more access to private finance and leads to more cost-efficient projects. Guaranteeing private investment in affordable housing through a variety of means is widespread practice elsewhere, with the latest example being found in the UK (see Supplementary Paper 3).

However, experience reported from around the country suggests that Australian governments have shown reluctance so far to consider any form of government guarantee as a means of encouraging higher levels of cost effective private investment in affordable housing. To enable more informed consideration of this issue, a limited extension to the research brief for this project was agreed by AHURI Limited. This aimed to 'unpack' government resistance to guarantees and to review options for credit support that may be palatable. The outcomes of this additional research task, which were presented to the second panel meeting, are presented below. They are discussed in more detail in Supplementary Paper 2, where design options for credit enhancement are also covered.

The most efficient public component for stimulating institutional investment in a new rental housing asset class may be the extension of a limited government guarantee—a highly adaptable form of credit enhancement. Such an undertaking would address several of the investment sectors' barriers described earlier in this report. The credit enhancement provided by a guarantee need not be a blanket, limitless 'quick fix', but rather a carefully structured and contained answer to financial institutions' misunderstandings or concerns regarding affordable housing cash flows. It must be designed to allocate risk efficiently in consultation with institutional investors, governments, and their ratings agencies.

In order to unpack government resistance to a guarantee and fine-tune structural options, AHURI Limited commissioned a focused analysis between the first and second meetings of the Investigative Panel.[59] This work engaged further experts in treasury, housing policy and financial industry roles who were not otherwise involved in the Investigative Panel.

The key conclusions from discussions with these experts were that:

→ The impact of a government guarantee on public accounts is a subjective analysis of risk and likelihood, not an automatic impairment. Though guidelines exist for the

[59] The research on which this section is based was conducted by Carrie Hamilton, a member of the Investigative Panel with specialist expertise in financing affordable housing.

management of indemnities, guarantees, warranties and letters of comfort, assigning their accounting treatment is a matter of informed but subjective interpretation.

- Government guarantees may be closely tailored to specific investor concerns. Likewise, guarantees may be time-limited; competitively allocated to kick-start initial investor activity with a pre-determined term for reduction on future years' projects. Experience shows that five to six years of track record are required to enable capital markets to assess and become comfortable with a new financial mechanism.
- A guarantee should not be a transfer of risk to the government. It should be an underpinning of investor confidence in areas where risk is perceived, but where government can stand by its broader knowledge that risk does not exist to the extent assessed by the investor. As an example, governments actively regulate the non-profit CHOs who may sponsor affordable housing projects. Financial institutions are unfamiliar with this sector, and may have concerns about their risk management or small balance sheets. A limited government guarantee pledging the performance of the CHO, founded upon regulatory familiarity, comforts investors while not transferring this risk premium of the unknown onto government. This is a risk already mitigated by regulation.
- Analysts assess the chance of a guarantee being called upon (and by extension its impact on government's balance sheet or ratings) based largely on how quickly they think government would be aware of a problem and able to act. The earlier an issue with cash flow is identified, the greater chance of cure without resort to credit enhancement. Therefore, robustness of administrative policies and financial monitoring are key metrics analysed by ratings agencies, not solely risk profile.
- While superannuation funds have stated their preference for risk-free investments benefitting from full guarantees, other capital markets professionals have less appetite for 'vanilla', risk-neutralized instruments. They seek a competitive edge where there is risk that they can innovatively manage and price. Therefore a targeted and limited guarantee is more suitable that a broad backing of all obligations.
- Credit Agencies have spent considerable time analysing the credit risk of the social and affordable housing sector overseas and see parallels in Australia. Standard and Poors have assigned an overall background risk rating to the sector of 2, where 1 is lowest risk, 6 is highest (Standard & Poors plc. 2012). They are open-minded about the feasibility of this housing given positive overseas track records and underlying demand fundamentals.
- State treasuries are more motivated by credit rating concerns than Commonwealth Treasury. State government credit ratings are based on complex metrics, but one component is adequacy of infrastructure in maintaining underlying productivity and economic competitiveness (e.g. this varies widely between the states, but is an issue in NSW). Adequate housing supply is relevant to that metric. Therefore, because states may see impact to their ratings by *not* acting to address housing supply, it follows that providing credit enhancement to overcome market failure is justified.
- Commonwealth Treasury follows finance guidelines whereby an internal finance division analyses the likelihood of a guarantee being called. If this is assessed to be over 50 per cent, it is reflected on balance sheet and will impact surplus; if below 50 per cent, it is noted as a contingent liability on the Statement of Risks but not provisioned for on balance sheet. Treasury will remain 'mindful' of the

exposure and periodically reassess this likelihood. This is a ‘harmonisation’ of Government Finance Statistics guidelines and Australian Accounting Standards.

→ The Commonwealth is concerned whether the complexity of a guarantee is justified relative to providing outright grants, and that the guarantee represents value for money in producing outcomes. Understandably, the Treasury is also aware that their exposure is not always limited to the strict terms of a guarantee—that there is an implicit expectation that they will step in to cure defaults due to the social nature of the endeavour, regardless of the conditions or limits of the original credit enhancement. Ratings agencies are mindful of this ‘moral hazard’ potential also. This can be addressed by emphasising the private ownership and operation of this new rental housing asset class.

4.2 Concluding observations

To conclude this report, this section raises potential issues that arise from the brief set for the study and from the methodology employed.

The broad aims for this study were: to promote cross-sectoral communication on facilitating private financing for affordable rental housing; to explore both policy matters and practical considerations that would enable further private financing, especially institutional investment; and to obtain expert advice about the set of actions that would be necessary or beneficial to attract more and larger scale private financing into this sector.

Currently, private rental housing provision is dominated by individual investors who are encouraged by generous income tax concessions and anticipated capital gains to use debt finance to invest in one or two properties but, at the same time, are discouraged by land taxes to invest in more than this number of properties. Under this financing arrangement, the private rental market has failed to generate an adequate supply of affordable rental housing for those on the lowest incomes and has failed to ensure that the supply that is affordable to those on low to moderate incomes is allocated to them. The report points to concerns about the future capacity and willingness of small scale investors to address these failures.

Institutional investment has been seen as a potential solution to the current shortfall in affordable rental housing and the lack of institutional investment in residential property assets is seen as indicative of some form of market failure. In a housing market dominated by tax concessions to owner-occupiers and individual investors, the risk return trade-off for investors faced with a different system of incentives has been a significant contributing factor. Other sources of market failure have been the lack of information available on what, to date, has been an unknown asset class; the coordination issues associated with aggregating investment opportunities to the scale required for large scale investors; and the uncertainty surrounding the future of incentives designed to increase returns and/or decrease risks associated with the new form of investment.

By design, the question addressed in this report was not whether private finance was the most appropriate way of ensuring an adequate supply of affordable rental housing. Not only was the solution of private financing taken as a given but the preferred way in which this might be provided (viz. larger scale private financing through institutional investment) was also specified. The main focus of this study was, therefore, how larger scale and institutional investment might best be facilitated.

Use of an investigative panel largely made up of those stakeholders most likely to benefit from any government support to facilitate private financing through large scale investment does raise some questions about the objectivity of the information obtained. The issue of whether private financing is the most cost effective solution to the question of how the supply of affordable rental housing might be increased is a question that must be asked. This issue has been raised in relevant places throughout the report, but has not been addressed.

The answer to this broader question will depend on the cost of providing the support needed to stimulate institutional investment compared with the cost of alternative sources of finance. It will require detailed financial modelling of the various solutions proposed. It will need to address the rationale for, and impact of, the existing tax, planning and regulatory interventions that influence the operation of the housing market in general and the rental housing market in particular. It will need to take into account the reasons why private financing was sought as a means of generating increased investment in affordable rental housing.

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APPENDICES

Appendix 1: Investigative Panel members

Members	Position	Expertise	Location
Non-government			
John Avery	General Manager Taxation, Australand	Housing development and construction, taxation policy	Sydney
Daniel Berger	Investment Manager, Australian Super	Institutional finance, funds management, private finance options for housing	Melbourne
Phillip Frost	Non– Executive Director Evolve Housing Ltd Retired senior bank executive	Institutional and investment finance, privately financed public infrastructure, affordable housing	Sydney
Carrie Hamilton	Consultant, Housing Action Network Member Social Housing Advisory Committee	Affordable housing financing, US low income housing tax credit finance deals, NRAS structures and models	Sydney
Andrew Hollows	Deputy Executive Director, Australian Housing and Urban Research Institute (AHURI) Ltd.	Facilitator	Melbourne
Chris Jones	Director, Government, Infrastructure and Utilities, Westpac Institutional Bank	Bank finance, government relations, finance for public infrastructure , public-private partnerships	Sydney
Caryn Kakas	Executive Director Residential Development Council, Property Council of Australia	Housing development industry, urban planning and housing, housing and public policy, government relations	Melbourne
Mick Lilley	Managing Director, Infrastructure and Natural Resource Advisory, National Australia Bank Member Social Housing Advisory Committee	Public and private finance, infrastructure financing, public-private partnerships	Sydney
Jeff Logan	Chief Financial Officer, Foundation Housing PowerHousing (industry trade body) nominee	Not-for profit housing development and financing, fund raising and financial management	Perth

Members	Position	Expertise	Location
Andrew Mihno	Executive Director, International Capital Markets Division, Property Council of Australia	Capital markets financing, housing development	Melbourne
Mike Myers	Chief Executive Officer, Queensland Affordable Housing Consortium	Not-for profit housing development and management, NRAS structures and models, retail investment models	Brisbane
Rebecca Oelkers	Business Development Manager, Brisbane Housing Company	Not-for profit housing development and financing, NRAS investment models	Brisbane
David Somerville	Executive Chairman, and Managing Director Questus Ltd Chair NRAS Providers Ltd	Housing investment aggregation and management, NRAS investment models	Perth
Greg South	Chief Operating Officer, Landcom NSW	Land and housing development financing and marketing, rental housing property trust models	Sydney
Andrew Tyndale	Director, Grace Mutual Ltd	Investment banking, institutional fund raising for NFP organisations and social infrastructure	Sydney
Government nominees/ alternates			
Mike Allen	Executive Director, Housing NSW, Department Family and Communities, Chair Housing Homelessness, Ministers' Advisory Committee (HHMAC)		Sydney
Greg Cash	Director Market Innovation and Partnerships, Department of Housing, Western Australia		Perth
Phil Fagan-Schmidt	Executive Director, Housing South Australia Member HHMAC		Adelaide

Members	Position	Expertise	Location
Sean Innis	Group Manager, Housing, Homelessness and Money Management, Department of Families, Housing, Community Services and Indigenous Affairs (FAHCSIA) Member HHMAC		Canberra
Kathryn Mandla	Director Housing Affordability Programs, FaHCSIA		Canberra
Allan Neate	Director Policy, National Rental Affordability Scheme, FaHCSIA		Canberra
Bryan Palmer	Principal Adviser, FaHCSIA		Canberra
Graham Searle	Director General, Department of Housing, Western Australia Director AHURI Limited Member HHMAC		Perth

Appendix 2: Contemporaneous activity

The list below gives details of a range of activities focussed on the financing of affordable rental housing that coincided with the duration of this study and in which panellists and the research team were actively involved:

- A Roundtable on housing sector finance initiated by the Federal Minister for Housing and Homelessness, the Hon. Brendan O'Connor in Melbourne on 18 October 2012. This invitation only event was attended by around 30 people from the banking, superannuation, property development, academic, Commonwealth Government, and not-for-profit sectors as well as National Housing Supply Council. Included amongst these were several panellists and three research team members. There was strong alignment in the views put forward at the roundtable with those expressed by the Investigative Panel. In particular, participants highlighted the need for a pipeline of projects and greater government commitment and sharing of risk under a bipartisan policy framework.
- The National Housing Conference held in Brisbane from 30 October 2012 to 2 November. A full session of the conference was allocated to financing affordable housing, including discussion of the housing supply bonds proposal, ways of providing credit support for institutional investment, and government support provided to obtain institutional investment in the US. Three members of the research team and a number of panel members attended.
- A Forum on Social and Affordable Housing, convened by Westpac Institutional Bank, to provide an industry update and networking opportunity. Around 100 people (including four panel members and two members of the research team) attended this one-day event in Sydney on 5 November 2012. Topics included governance and national regulation of community housing organisations (CHOs), government policy, how banks assess financing risk in relation to affordable housing, international practice in housing finance and public private partnerships. A key message was the need to promote investment sustainability and reduce volatility in order to reduce risk.
- The National Affordable Housing Summit Group[60] convened a series of roundtables with industry, not–for–profit and government stakeholders to obtain feedback on recent affordable housing programs, such as NRAS, the Social Housing Initiative (SHI) and the Housing Affordability Fund (HAF). (See Section 2.2.) Both team and panel members attended. An important concern of these meetings was how effectively these initiatives had combined to increase affordable housing supply.
- National Shelter began a series of consultations with invited stakeholders in different jurisdictions about future directions for national housing policy, with a focus on the National Affordable Housing Agreement (NAHA) and associated National Partnership Agreements. How to make affordable housing investment attractive to not only 'mum and dad' investors but also institutional investors was a key consideration at the forum held in NSW on 23 October 2012, attended by a member of the research team.
- A Social Housing Advisory Committee of experts appointed by the former Senator and Minister for Housing, Mark Arbib in 2011 was convened to advise Minister O'Connor about ways to strengthen the NAHA, including public and private co-

[60] The National Affordable Housing Summit Group is a broad coalition of industry, union and non-government organisations founded in June 2004 to lobby for action on affordable housing in Australia. The Summit Group played a key role in the development of an NRAS-type instrument and has advised on aspects of the implementation of NRAS

financing options for social and affordable housing. Two panel members served on this Committee.

The clear message concerning institutional investment that emerged consistently from these various forums attended by the researchers was that, while there is keen interest in and strong potential for institutional investment, government commitment and leadership to date has been insufficient to break through perceived and real barriers.

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