



Understanding opportunities for social impact investment in the development of affordable housing

Inquiry into social impact investment for housing and homelessness outcomes

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AUTHORED BY

Andrea Sharam
RMIT University

Michael Moran
Swinburne University of Technology

Chris Mason
Swinburne University of Technology

Wendy Stone
Swinburne University of Technology

Suzanne Findlay
Swinburne University of Technology

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Authors	Andrea Sharam	RMIT University			
	Michael Moran	Swinburne University of Technology			
	Chris Mason	Swinburne University of Technology			
	Wendy Stone	Swinburne University of Technology			
	Suzanne Findlay	Swinburne University of Technology			
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Christine Fitzgerald	Department of Housing and Community Development, NT Government
Trina Geasley	City of Sydney
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Paul McBride	Department of Social Services, Australian Government
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Contents

List of tables	vi
List of figures	vii
List of boxes	viii
Acronyms and abbreviations used in this report	ix
Executive summary	1
1 Introduction	6
1.1 Introduction	6
1.2 Defining social impact investment	7
1.3 Why this research was conducted	9
1.4 Policy context	9
1.5 Research methods	10
2 SII in social and affordable housing in the US and UK	12
2.1 Introduction	12
2.2 The United States	12
2.3 The United Kingdom	20
2.4 Conclusion	24
2.5 Policy implications	24
3 SII in community housing in Australia	25
3.1 Funding of community housing	25
3.2 Financing development of community housing	26
3.3 SII in community housing	28
3.3.1 Limitation on borrowing: cash flow of CHPs	28
3.3.2 Rent subsidies, allocation policies and income support	30
3.3.3 Housing supply bonds	31
3.3.4 Government grants to grow the CHP sector	34
3.3.5 Competition for CHP business	34
3.4 Policy development implications	35
4 Social impact investment in housing other than community housing	37
4.1 Understanding the role of SII in other forms of social and affordable housing	40
4.1.1 Sub-market rental housing models	40
4.1.2 Sub-market home ownership models	42
4.1.3 Alternate market ready models	44
4.1.4 Implications of the non-community housing models	45

4.2	Policy development implications	45
5	Land	47
5.1	Policy development implications	48
6	SII in CHP social enterprises	49
7	SI investors in social and affordable housing in Australia	51
7.1	Impact investors and the features of SII: a qualitative analysis of the views of market participants	51
7.2	Towards a new typology of investor	57
7.3	Policy implications	59
8	Conclusion	60
8.1	Policy Development Options	60
8.2	Key questions answered through this research	61
8.3	Final Remarks	62
	References	63
	Appendix 1: Research methods	75
	Appendix 2: Interview guide	77
	Appendix 3: Participant consent form	82
	Appendix 4: Participant information statement	84
	Appendix 5: Credit assessment in relation to property development	87

List of tables

Table 1: Completed interviews	11
Table 2: Affordable rental housing projects	38
Table 3: Home ownership projects	39
Table 4: Housing supply social enterprises	49
Table A 1: Completed interviews	76
Table A 2: The 'Five Cs' of Credit Assessment	87
Table A 3: Credit assessment: for profit /not-for-profit /deliberative developers	88

List of figures

Figure 1: An Australian SII typology	3
Figure 2: Finance-first and impact-first investments	8
Figure 3: An Australian SII typology	58

List of boxes

Box 1: Community Sector Banking

38

Acronyms and abbreviations used in this report

AAHS	Australian Affordable Housing Securities
ABS	Australian Bureau of Statistics
ACOSS	Australian Council of Social Service
AHLF	Affordable Housing Loan Fund
APRA	Australian Prudential Regulation Authority
ANOA	Australian National Office of Audit
BSC	Big Society Capital
BTR	Build to Rent
BRTF	Build to Rent Fund
CDCU	Community Development Credit Unions
CDF	Community Development Finance
CDFI	Community Development Financial Institutions
CHP	Community Housing Provider
CLT	Community Land Trusts
CRA	Commonwealth Rent Assistance
CRF	Community Reinvestment Fund
CRAct	Community Reinvestment Act
CSPIF	Cheyne Social Property Impact Fund
CSR	Corporate Social Responsibility
DGR	Deductible Gift Recipient
ESG	Environmental Social and Governance
FASES	Finding Australia's Social Enterprises Survey
FCF	Foresters Community Finance
FHA	Federal Housing Administration
FHOG	First Home Owner Grants
GAO	Government Audit Office
GFC	Global Financial Crisis
GIIN	Global Impact Investing Network
GST	Goods and services tax

G8	Group of Eight
HFH	Habitat for Humanity
HNWI	High Net Worth Individuals
HSB	Housing Supply Bond
IIA	Impact Investing Australia
IIG	Impact Investment Group
IRR	Internal Rate of Return
LMCF	Lord Mayors Charitable Foundation
LIHTC	Low-income Housing Tax Credit
LVR	Loan to Value Ratio
MRI	Mission-Related Investment
NAHA	National Affordable Housing Agreement
NAPF	National Association of Pension Funds
NDIS	National Disability Insurance Scheme
NGLF	New Generations Loan Fund
NHIFC	National Housing Finance and Investment Corporation
NPAH	National Partnership Agreement on Homelessness
NRAS	National Rental Affordability Scheme
NFP	Not-for-profit
NSW	New South Wales
NYCAF	New York City Acquisition Fund
OVAG	Office of the Victorian Auditor-General
OHR	Office of the Housing Registrar
PBI	Public Benevolent Institution
PBR	Payment By Results
PFPC	Pay For Performance Contracts
PAF	Private Ancillary Fund
PRI	Program Related Investment
REIT	Real Estate Investment Trusts
RCH	Registrar of Community Housing
SGCH	St George Community Housing

SMSF	Self-managed superannuation fund
SEA	Social Enterprise Australia
SEFA	Social Enterprise Finance Australia
SIB	Social impact bonds
SI	Social impact
SII	Social impact investment
SIIT	Social Impact Investment Taskforce
SITF	Social Investment Task Force
SEDIF	Social Enterprise Development & Investment Fund
SHAF	Social Housing Affordability Fund
SHS	Specialist Homelessness Services
SRI	Socially responsible investment
SVA	Social Ventures Australia
THFC	The Housing Finance Corporation
UK	United Kingdom
US	United States of America
WPI	Women's Property Initiatives

Glossary

A list of definitions for terms commonly used by AHURI is available on the AHURI website www.ahuri.edu.au/research/glossary.

Executive summary

Key points

- This research examined social impact investment (SII) in social and affordable housing in Australia, concentrating on the opportunities for, barriers to, and risks to SII. The research utilised key understandings from the US and UK to inform the analysis.
 - SIIs are those that intentionally target specific social objectives along with a financial return and measure the achievement of both (SIIT 2014a: 2). Financial returns may be concessionary (impact-first) or non-concessionary (finance-first).
 - SII in social and affordable housing reflects government investment. In the UK and the USA government financial support of social and affordable tenants and NFP housing organisation provides an implicit government guarantee for investors. In Australia, the gap in funding between the tenant's capacity to pay and the cost of provision is the most significant barrier to SII.
 - SII in social and affordable housing in Australia does not fit the simple 'impact-first' versus 'finance-first' investment typology found in the literature. Adopting a new typology which includes investor reconceptualisation of risk and modified lending criteria, in addition to return requirements, we find most investment can be described as 'partial finance-first' reflecting a combination of non-concessionary returns and modified investment parameters. A far smaller proportion is 'fully impact-first' in that concessionary returns were accepted and investment parameters were modified. There was no evidence of fully finance-first or partial impact-first investment.
 - Bank SII in community housing providers (CHPs) constitutes the largest component of SII in social and affordable housing and it is estimated to be in the order of \$1.5 billion. \$20 million of non-bank SII was invested in non-community housing models.
-

Key findings

This is the first study examining the opportunities for, barriers to, and risks for SII in the development of affordable housing in Australia. It considers both social housing and affordable housing supply.

Social impact investment (SII)

SIIs are those that intentionally target specific social objectives along with a *financial return* and *measure* the achievement of both (SIIT 2014a: 2). SII funds can be placed directly by investors or through intermediaries who specialise (sometimes exclusively) in placing SII funds. Intermediaries often, but not always, pool funds. Intermediaries take responsibility for measuring and reporting of impact.

The return expectations and assets classes can differ: investors willing to accept concessionary returns (i.e. a below market return) are considered 'impact-first' investors while those requiring non-concessionary returns equal or near equal to market are considered to be 'finance-first' investors (Brest and Born 2013). Deals can be complex, involving other SI investors, concessionary and non-concessionary investment, non-SI investors and philanthropic and other grants. Such deals are termed 'layered' investments. Investment can involve debt, equity or both.

The SI investors

Westpac Banking Corporation, Community Sector Banking and Bank Australia are the largest SI investors in social and affordable housing in Australia, by virtue of lending to CHPs. Westpac has \$1.05 billion invested in the CHP sector (Westpac 2016). Total bank SII in the CHP sector is possibly as much as \$1.5 billion at present. This investment is all debt investment. Returns are non-concessionary.

Historically, access to capital has been difficult for CHPs and investment has required reconsideration of risk and a shift in credit assessment. This change may or may not have been led by SI investors (further research would be required to answer this question). The participation of bank SI investors however adds competition ensuring all CHPs gain more competitively priced capital and more suitable conditions on finance. Given the concentration of the Australian banking sector (Bryant 2012) this competition is important. This bank SII therefore could be said to be providing 'additionality'.

A far smaller \$20 million is invested in housing models outside of the registered CHP sector, by non-bank SI investors. These include the Lord Mayors Charitable Foundation (LMCF) who provided \$3 million to the Affordable Housing Loan Fund (AHLF), small superannuation funds, high net worth individuals (HNWI), other individuals, philanthropy, self-managed superannuation funds (SMSF), and not-for-profit (NFP) organisations. This \$20 million is equal parts debt and equity investment. The equity investors in these models were the only investors to accept concessionary returns. They were supporting innovative models that have the potential for systemic change rather than simply providing housing.

Intermediaries

Three intermediaries, Foresters Community Finance (FCF), Social Enterprise Finance Australia (SEFA) and Social Ventures Australia (SVA) are currently responsible for the placement of the majority of non-bank SII in social/affordable housing in Australia. These intermediaries have attracted funds from HNWI, NAB, Triodos Bank, Community Sector Banking, Christian Super, HESTA, and the NSW Aboriginal Land Council. These intermediaries are highly respected. All three funds were established following an Australian Government initiative, the Social Enterprise Development and Investment Funds (SEDIFs) that provided \$20 million in matched funding. Christian Super recently established its own intermediary, Bright Light.

Demand side for investment

CHPs are the largest source of demand for funds and represent the only established system of social and affordable housing provision that comprises an at-scale opportunity for expanded SII, which meets the requirements for verifiable impact over time. The opportunity for SII is limited however by CHP sector constraints (issues well documented, see Milligan, Hulse, et al. 2013; Milligan, Pawson et al. 2017) including limited free cash flow (to support borrowings), uncertain tenant housing assistance and income support, and reduced discretion over tenant allocation. Government policy change is viewed as a key source of risk affecting investment (current and future).

Two other models were able to access mainstream finance but were not part of the CHP sector. There were a number of organisations currently outside the CHP sector unable to access mainstream lending. These projects span income cohorts—from households eligible for public housing to middle income households—and provide both rental and home ownership opportunities. These non-CHP models expressed dissatisfaction with the existing CHP model and with market provision.

A new SII typology

SII in Australia does not fit the simple impact-first versus finance-first investment typology found in the literature. Investor reconceptualisation of risk and modification of lending practices occurred in addition to consideration of return requirements. This was not a case of accepting greater risk but rather of reviewing the generally accepted credit assessment practice.

Figure 1 describes this new Australian SII typology, which adds whether the investor adopted an orthodox or ‘reformed’ approach to credit assessment in addition to their approach to returns.

Figure 1: An Australian SII typology

Full impact-first Concessionary returns Reformed credit assessment	Full finance-first Non-concessionary returns Orthodox credit assessment
Partial impact-first Concessionary returns Orthodox credit assessment	Partial finance-first Non-concessionary returns Reformed credit assessment

Source: Authors.

Using this new typology, we find that most SII in Australia can be described as partial finance-first, reflecting a combination of non-concessionary returns and modified investment parameters. A far smaller proportion of SII is full impact-first, in that concessionary returns were acceptable and investment parameters were modified. We found no fully finance-first or partial impact-first investment.

Barriers and opportunities

The CHP sector is the target of most SII, and most existing and potential SI investors wish to see the sector greatly expanded. Government capital grants are regarded as necessary to grow the sector and enable SII at a greater scale. Investment is currently constrained by the lack of CHP free cash flow, rather than lack of collateral required for security. Adverse changes to welfare and housing assistance, and government policy restricting housing allocations to the highest priority applicants on public housing waiting lists were identified as affecting CHP cash flow and as such presenting a risk to investment.

Policy development options

SII in social and affordable housing reflects government investment. As private investment, there is an expectation of returns on investment. Investment therefore only occurs when the housing organisation is able to generate a positive cash flow to support debt repayment or disbursements to equity holders. This requires the gap between tenant’s capacity to pay and the

cost of housing provision to be funded by government. The funding of this gap provides an implicit government guarantee.

In the Australian context, this requires:

- An annual funding stream for CHPs to close the gap between rental revenues and cost of provision.
- State and territory governments to permit CHPs discretion in who they house so that investor confidence can be maintained (in the absence of a funding stream to meet the gap between rental revenues and cost of provision).
- An annual capital grants program for CHPs to grow the sector.
- Growth of the sector to create the conditions for bond financing—bonds lower the cost of capital and provide for long tenure debt.
- Welfare entitlements and housing assistance to provide sufficient income to all household types to ensure the most vulnerable households will be attractive to house. Social security entitlements need to be stable in order to provide confidence to investors regarding their existing investments as well as future investments.

Housing supply bonds were viewed as a key opportunity for reducing the cost of capital and enabling long tenure debt.

Land is a critical issue affecting affordability of housing and access to employment and services by vulnerable households.

- Government are frequently owners of well-located land that is surplus to their requirements. Governments could grant such surplus government land to CHPs (as is envisaged by part 21(k) of the National Affordable Housing Agreement (NAHA)).
- Inclusionary zoning could be implemented to provide a new source of social and affordable housing on existing redevelopment sites. Inclusionary zoning would provide the opportunity for layered investment models, common in the US.
- Governments could consider capturing the uplift in value when re-zoning land, through making part of rezoned sites available to CHPs or other NFP housing providers.

SII in new home ownership models is able to generate affordable housing supply for both low-income and intermediate income cohorts. The growth of some of these models could be assisted through:

- Government guarantees to permit debt financing and negate the need for substantial equity contributions.
- Revolving funds to provide equity to development projects. The equity would be returned once mortgage loans are issued.

The market price of housing for purchase is affected by many factors. However, there has been little scrutiny of the development process and particularly of multi-unit residential development. Profit margins in this sector are high, suggesting competition is less effective than it could be. There is a need for policy-makers to gain a detailed understanding of residential property development and possible industry reforms to improve efficiency.

SII would be assisted by:

- As fiduciary duties of superannuation fund managers appear to be open to interpretation, government could review this aspect of superannuation fund management to provide legal clarity for concessionary SII.

The study

This report presents findings from a research project conducted as part of a broader AHURI *Inquiry into social impact investment for housing and homelessness outcomes* (Muir, Findlay et al. forthcoming). The purpose of this research is to investigate what contribution SII can make to increasing the supply of affordable housing through providing a detailed analysis of: i) SII in affordable housing internationally and in Australia, ii) opportunities and risks for SII in Australia, iii) barriers to investment, iv) potential for innovation and v) measures government and other parties can take to encourage investment.

To date there has been no review of SII in the development of social and affordable housing in Australia. While SII is increasingly of interest in relation to homelessness and housing vulnerability, its application to housing supply has not attracted the same kind of policy attention, despite international and Australian examples. Little therefore is known of investments, the quantum of investment, who the investors are, their motivations or the impact arising from their investment. The registered CHP sector is often presumed to constitute the demand for SII funds. Intermediaries have been established, and many are keen to funnel SII into housing. Much of the advocacy for SII has centred on superannuation funds and on housing supply bonds as a means to attract superannuation funds with CHPs. It is a discussion that reflects a deep concern about the lack of affordable housing stock and mounting frustration at the lack of opportunities for investment.

In order to appreciate the implications of private investment including SII, in the supply of social and affordable housing it is necessary to understand residential development financing, and specifically project finance. As we will outline however, private investment in social and affordable housing is not a straightforward matter.

This research involved:

- a review of national and international literature on SII in affordable housing
- analysis of in-depth interviews with experts in government, and with SI investors and intermediaries, and CHPs about the definition of SII, its purpose in relation to social/affordable housing, how it has been applied and its benefits in regard to the supply of social and affordable housing in Australia.

1 Introduction

- Housing affordability and housing stress are major issues in Australia.
 - Home ownership is declining, particularly among younger households, resulting in a third of households residing in the private rental sector. A third of these are long term tenants (defined as 10 years or more) (Stone, Burke et al. 2013). In 2011:
 - There was a supply shortage of 187,000 dwellings nationally for households with weekly household income in the lowest equivalised income quintile, and when availability was considered the shortage increased to 271,000. 78 per cent of these tenants were in housing stress, that is paying more than 30 per cent of their income in rent (Hulse, Reynolds et al. 2015).
 - The second lowest income quintile also experienced a deficit of affordable and available housing of 122,000 with 29 per cent in housing stress.
 - Housing stress is common among rental households in the third income quintile.
 - Housing stress among recent home purchasers is common, reflecting housing price inflation.
 - The stock of social housing has fallen to an historical low—4.4 per cent—and is tightly rationed to those with high, multiple needs.
 - Advocates of SII identify social and affordable housing as a key area of interest to SI investors and potential investors. Governments in Australia have variously expressed interest in the potential of SII in social and affordable housing.
 - Little is known about SII in social and affordable housing in Australia.
-

1.1 Introduction

Since the early 2010s, SII has been considered in a range of Australian Government policy inquiries. These include: financing the not-for-profit (NFP) sector (Productivity Commission 2010), the Australian financial system (The Treasury 2014), the Australian welfare system (Department of Social Services 2015), and housing affordability (Council on Federal Financial Relations 2016a). In January 2017, the Australian Government also released its *Social Impact Investing Discussion Paper* (Australian Government 2017).

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

Reflecting the decline in housing affordability and increase in housing stress in Australia, the Council on Federal Financial Relations Affordable Housing Working Group in 2016 canvassed SII as part of an Issues Paper in its consultation phase (Council on Federal Financial Relations 2016a). The inquiry sought 'innovative solutions' to affordable rental issues, but framed SII

largely as SIBs (Council on Federal Financial Relations 2016a: 13). Its recommendations centred on a housing bond aggregator based on the UK's Housing Finance Corporation (Council on Federal Financial Relations 2016b). The objective of the bond aggregator would be to attract private and institutional investment through the creation of a financial intermediary that issues bonds on behalf of Community Housing Providers (CHPs) to increase supply of affordable rental housing.

Related policy developments, such as the NSW Government's \$1.1 billion Social and Affordable Housing Fund, recognise the potential of leveraging public private partnerships including SII to attain the capital needed to address the complex social, economic and housing issues involved.

The interest of governments in SII to address social and affordable housing supply needs is mirrored by a purported interest by SI investors in addressing the shortage of affordable housing (Dembek, Madhavan et al. 2016). Government interest in SII in housing is part of a broader policy agenda, to increase private investment in the provision of community housing through leveraging of CHPs assets. Yet, while private debt financing of community housing development is now common, surveys of impact investors and potential impact investors have revealed little investment in social or affordable housing (Castellas, Findlay et al 2016). An obvious rejoinder to this is that there are no SI investors in this space, however the research team were aware of both SII in affordable housing and cases in which CHPs had declined SII in favour of non-SII.

The purpose of the research therefore was to investigate what SII in affordable housing is occurring in Australia and determine what the barriers, risks and opportunities for SII may be in this sector. As SII is an emerging market, the research examined the supply and demand sides of the market, and the role of specialist intermediaries in enabling deals. Data was obtained through qualitative interviews with investors, potential investors, and recipients of funds, intermediaries and government officials. A desktop review of the literature was undertaken. We looked to the USA, where SII originated, and to the UK, where the Government enthusiastically embraced it (the research methodology is provided in Appendix 1). Of particular interest at the outset was the potential for SII to promote innovation. There are important policy implications, primarily the interdependence of finance, welfare and housing systems to SII in social and affordable housing.

1.2 Defining social impact investment

The field of *social impact investment* is nascent with the term 'impact investing' coined in 2007 (Rodin and Brandenburg 2014) to describe a range of disparate activities including investment whose intention is to achieve a mix of social and/or environmental and financial returns, but which is distinct from the more established fields of ethical and socially responsible investment (SRI).

In 2007 the Global Impact Investing Network (GIIN) was established by the Rockefeller Foundation in the USA as a non-profit organisation dedicated to increasing the scale and effectiveness of impact investing (GIIN 2016a). In 2013–14 the United Kingdom (UK) Government, in its role as president of the Group of Eight (G8) nations, established the Social Impact Investment Taskforce (SIIT) with the aim of catalysing a global impact investing market (SIIT 2014a). A key immediate aim was to define and establish the legitimacy of social impact investment.

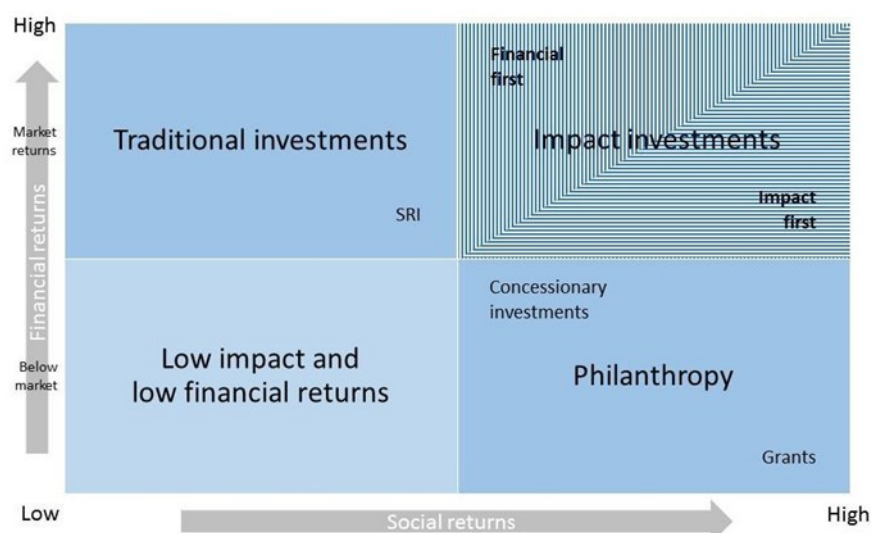
SIIs are those that *intentionally* target specific social objectives along with a *financial* return and *measure* the achievement of both (SIIT 2014a: 2). Three key features that are integral to the definition are:

- **Intentionality**—SI investors are not ‘socially neutral’: they intend to attain social (including environmental) objectives as a result of their investment (Brest and Born 2013). This characteristic distinguishes SII from investments that make an incidental or unintended social return.
- **Return expectations**—Investors expect a financial return alongside the achievement of social objectives (GIIN 2016b). The return expectations and assets classes can differ: investors willing to accept below-market returns (‘concessionary investments’) are considered impact-first investors while those requiring market-related returns equal or near equal to mainstream (‘non-concessionary investments’) are considered to be finance-first investors (Brest and Born 2013).
- **Measurement**—Robust frameworks for measuring and assessing social and environmental impact—alongside financial indicators that inform the investment (Best and Harji 2013)—are critical to SII. The objective is to demonstrate the intrinsic value of the investment for all stakeholders, with a particular focus on data that can be communicated to investors and their fiduciaries for payment and to strengthen accountability and transparency (SIIT 2014b).

A further feature that is sometimes considered in discussions of definitions of SII is *additionality*—a concept derived from the social sciences that considers whether an intervention results in an outcome that otherwise would not have occurred (Saltuk and El Idrissi 2015). In SII literature, the term is associated with intentionality. It is also sometimes used to understand whether the SII outcome would have occurred in the absence of the SII. That is, it seeks to understand ‘the additional impact achieved by the presence of an impact investor’ (Impact Investing Australia 2017). Within the Australian affordable housing supply context, the major thrust of impact investment advocacy is for institutional investment, which has broad support among affordable housing providers and government.

Figure 2 provides a common depiction of the relationship between finance-first and impact-first investments (Freireich and Fulton 2009: 32; Jackson and Harji 2013: 10).

Figure 2: Finance-first and impact-first investments



Source: Adapted from Freireich and Fulton (2009).

SII draws on social investment, but is different in that social investment involves the provision of capital to the social sector to support the creation of social impact. This approach is common in Europe and tends to focus on domestic activity. Impact investing involves direct investment in the activity that creates the social impact. This approach is more common in the US (Daggers and Nicholls 2016: 6–7; Wilson 2014). SII is also distinct from social finance. Social finance provides funding for social objectives (and may fund activities or outcomes), but does not necessarily expect a financial return or return of capital (Nicholls and Emerson 2015). Social investment focuses on a financial return but unlike SII, does not have an explicit focus on measurement (Graham and Anderson 2015; Daggers and Nicholls 2016). Social investment shifts focus from funding organisations such as NFPs and social enterprises through grants to providing finance (e.g. loans and equity) (Daggers and Nicholls 2016; SITF 2000).

SII is also distinct from socially responsible investment (SRI) and ethical investment (SIIT 2014a). The most common form of responsible investment is through 'negative screens' which avoid investments in high negative impact companies such as tobacco producers and 'positive screens' integrating environmental, social and governance (ESG) factors into traditional investment analysis and decisions, because these factors are believed to drive value and mitigate risk (Responsible Investment Association Australasia 2016). Thus, this form of investment delivers indirect and not necessarily quantifiable returns whereas impact investing requires a direct and quantifiable financial and social return (SIIT 2014a).

1.3 Why this research was conducted

Internationally, social impact investment (SII) has emerged as a new approach influencing private investment, and has been given impetus through decision-making bodies such as the Group of 8 highly industrialised economies. Social and affordable housing is viewed as a key area of social need warranting the attention of SI investors (Addis, McCutchan et al. 2015; Australian Government 2017a).

Within Australia the SII market is valued at \$2 billion with green bonds comprising the majority investment type (Dembek, Madhavan et al. 2016). Advocates for SII argue SII could make a meaningful contribution to addressing the undersupply of affordable housing (Dembek, Madhavan et al. 2016). In particular large institutional investors such as superannuation funds are viewed as being able to invest on the scale required to address this housing need.

SII in Australia is relatively recent and little is known of SII in social or affordable housing supply in Australia. This research therefore investigates what contribution SII can make to increasing the supply of affordable housing through providing a detailed analysis of: i) SII in affordable housing internationally and in Australia, ii) opportunities and risks for SII in Australia, iii) barriers to investment, iv) potential for innovation and v) measures government and other parties can take to encourage investment.

1.4 Policy context

Housing affordability, housing stress and a lack of social and affordable housing are major issues in Australia. In their wide ranging review of increasing housing cost pressures in Australia, Yates and Milligan (2007) define 'affordable housing' in terms of the relationship between household financial resources and necessary expenditure on housing costs:

Typically, housing affordability indicators rely on a ratio measure that specifies the acceptable proportion of income to be spent on housing, or on a residual measure that refers to an acceptable level of absolute residual income once housing costs have been met. (Yates and Milligan 2007: 4)

Affordable and social housing provision is a response to lack of affordability, and social housing specifically to homelessness, family violence and/or other vulnerabilities. Social housing refers to housing programs allocated to the lowest income, most vulnerable households in the form of public or community housing in which governments or community organisations funded by governments own and/or manage the housing. Rent setting is on the basis of a percentage of income. The stock of social housing stands at 4.4 per cent nationally (Productivity Commission 2017).

Affordable housing is a term that is less readily defined by tenure form, and captures housing that is affordable to lower and moderate-income households, whether in public, community or private rental or ownership. Formal affordable housing programs set rent as a discount on market rent, thus the subsidy provided is lower and rental revenues higher. This requires eligible households to have higher incomes.

The extent of housing assistance provided however is determined by tenure. The Productivity Commission (2017) for example identifies social housing tenants as obtaining a larger subsidy than tenants in similar circumstances in private rental.

The rate of home ownership, especially among first home buyers and lone person households has declined as a result of housing price inflation (Wood, Ong et al. 2014; Burke, Stone et al. 2014). The increasing generational housing debt burden reported by Burke, Stone et al. (2014) indicates housing affordability stress is widespread among home purchasers. The flow-on impact is that the availability of affordable rental stock for low to moderate income households living in private rental is affected not only by absolute supply shortages, but also by availability shortages, whereby lower income households are displaced by higher income households (Hulse, Reynolds et al. 2015). In 2011, there was an overall supply shortage of 187,000 dwellings nationally for households with weekly household income in the lowest equivalised income quintile, and when availability was considered there was a shortage of 271,000 dwellings (Hulse, Reynolds et al. 2015: 47). 78 per cent of these tenants were in housing stress. Households in the second lowest income quintile also experienced a deficit of affordable and available housing of 122,000 with 29 per cent paying unaffordable rent, and a further 4 per cent paying severely unaffordable rent (Hulse, Reynolds et al. 2015: 21). The 2016 census data is yet to be analysed to provide an update, but the latest Household, Income Labour Dynamics Australia Survey suggests the situation has deteriorated further (Wilkins 2017).

1.5 Research methods

The field of SII is nascent and academic literature on the topic, especially in relation to housing, is scant. As a result, this report is highly reliant on grey literature.

The study utilised qualitative interviews with investors, housing providers, intermediaries and government representatives (Table 1). In total 26 interviews were conducted, with a number of informants occupying more than one nominal role, thus providing multiple perspectives. More detail on the research methods is provided in Appendix 1.

Table 1: Completed interviews

Participant category	No.
Intermediary	6
Investor	11
Social/affordable housing provider	11
Government	6
Total interviews	26*

*Note: *Total of interviews is smaller than number of participants as some participants held multiple roles.*

This investigation into SII in social and affordable housing in Australia is supported by a review of analogous investment in the US and UK.

2 SII in social and affordable housing in the US and UK

- SI investors are financiers not funders. SII in social and affordable housing in the US and UK reflects the extent to which government financially supports tenants and social and affordable housing providers.
 - Financial support for households and housing providers must meet the gap between the tenant's capacity to pay and the cost of provision in order for housing providers to generate positive cash flows that can sustain returns to investors.
 - Investment confidence can be damaged, as occurred in the UK when welfare benefits were changed.
-

2.1 Introduction

SII has a range of historical antecedents that pre-date the relatively recent ascendancy of a 'purely financial idea of investment' (Mulgan 2015). The notion that investment decisions can be value based has its origins in religious traditions including the seventeenth century Quakers (Emerson and Bugg-Levine 2011). More recent influences have been the cooperative movements of Europe (including the UK), which led to the development of cooperative and mutual finance (Michie 2015) and community development finance in the US (described below) (Zigas 2013).

Building on these traditions and interest generated by the international networks described in section 1.2, SII has emerged as the dominant term to describe a broad range of diverse activities including microfinance, green-tech investment and low-income housing (Emerson and Bugg-Levine 2011).

Although much of the activity in the SII affordable housing space in the US substantially pre-dates the emergence of SII as a specific concept, SII in affordable housing has gained attention from policy-makers because it is a potentially large pool of private capital that can be harnessed for the provision of public goods. Reflecting this the Obama Administration in the US supported the development of the SII market. SII however has been more overtly nurtured in the UK with the UK Government supporting SII market development through a range of initiatives since the early 2000s.

2.2 The United States

In contrast to the UK (discussed below) and beyond a sophisticated (and complex) public policy framework for private investment in affordable housing, SII has not been as explicitly central to public policy. Nonetheless, there has been some activity. At the federal level the Obama Administration established the Office of Social Innovation and Civic Participation within the White House to act as a 'policy advisor to the US President' and 'to champion social finance and social enterprise' (Schwab Foundation, 2013: 22). At the UK's G8 Social Impact Investing Forum, the Obama Administration also announced the establishment of the National Impact Initiative to act as an umbrella for policies and programs established at the federal level. The initiative covered a broad range of activities including a \$1 billion Impact Investment Fund managed by the federal agency, the Small Business Administration, through SBA's Small Business Investment Company. The Impact Investment Fund was part of the Obama Administration's broader *Start-up America* initiative and aimed to promote public and private alliances to facilitate entrepreneurship.

State legislatures have played a role in facilitating regulatory certainty for equity financing with the establishment of a modified legal form, the low-profit limited liability company (L3Cs), to simplify raising equity from foundations by providing certainty that investments are aligned with the Program Related Investment provision of the Tax Reform Act. A number of US states have also established specialist legal forms to facilitate private investment in social enterprises including the benefit corporation, a modified for-profit structure that enables directors to consider interests of stakeholders other than shareholders, thereby privileging mission.

However, the US has a long history of community development finance—sometimes seen as ‘one form of impact investing’ (Thornley 2013)—and has developed a robust CDFI sector that works in association with federal, state and municipal governments. CDFIs have their origins in local level community-led initiatives and are supported by a robust system of legislative and policy instruments that stimulate private investment in affordable housing. This system works in parallel with philanthropy and is often identified as both an antecedent to, and contemporary example of, SII.

US policy framework for the supply of affordable housing

Just under 70 per cent of US housing stock is privately owned and approximately 5 per cent is social housing. Private home ownership and private rental are prioritised by national housing policies, predominantly through state support for mortgage interest deductions. Government provided public housing is marginalised and there is limited supply-side assistance. As a consequence, public housing numbers have been eclipsed since 1990 by a growing NFP housing sector (Blessing and Gilmour 2011: 455–56).

The US has a mature public–private affordable housing supply policy framework that operates through a combination of tax incentives for equity investors, regulatory requirements for banks to provide development loans into low-income areas, supportive tax and investment rules for philanthropic foundations and regulatory support for community development finance. The US system encourages partnership between investors, community housing providers, philanthropic foundations, financial institutions and banks, and local, state and federal governments, with intermediaries playing a key role in the delivery of affordable housing by bringing them together.

US incentives—Low-income Housing Tax Credits

The low-income housing tax credit (LIHTC) program was established in 1986 by the US Government to encourage private construction of rental housing for low-income households. The program has provided more than two million dwellings. The tax credits are administered by the US Department of Treasury and local and state housing finance agencies, which allocate the credits to developers of eligible projects (Rowley, James et al. 2016). Tenants must meet eligibility criteria and rents are set in relation to the area median income. The developer will initially use his or her own equity and take on debt for construction, but on completion will sell the tax credits to equity investors using the funds raised to retire the project debt (Peiser 2017).

Project finance is relatively expensive and short tenure, hence the need to attract equity. Equity investors seeking a safe investment will look to completed projects as they have a lower risk profile. The developer will retain an equity stake but also assume the role of manager, which attracts a management fee. Having purchased the tax credits the equity investors offset the credit against their federal tax liabilities. The tax credit itself is of 10 years duration and originally the housing was required to be held for 15 years but this has been subsequently extended to 30 years and some states have imposed longer holding periods (Zigas 2013). The tax credit is an indirect subsidy to support the yield on the equity investment. The tax credit permits a low capital cost and long tenure investment, essential elements for the provision of affordable rental housing. Development costs are frequently reduced by state and local government concessions.

SI investors have emerged as a key source of equity in both private and NFP projects. Collaboration occurs between developers (for-profit and NFP), investors (including philanthropic), banks, and intermediaries, with layered investment being common.

Criteria for LIHTC allocations are set annually by the Department of Housing and Urban Development (HUD). Rents are controlled at 30 per cent of 50–60 per cent of median income, adjusted for bedroom number and are based on family size, gross income and target group. The target beneficiaries are a combination of elderly, disabled and homeless and specific income groups (e.g. at least 20% earning less than half the median income of the area, or at least 40% earning less than 60% of the median income) (Gilmour and Milligan 2008: 5). The LIHTC as a scheme therefore has flexibility to respond to supply shortages for varying types of households across different housing markets, although new housing may not be located in areas with the most acute shortages (Blessing and Gilmour 2011: 464) due to market changes or state allocation priorities (Kormon-Houston 2009: 6–8). Between 1987 and 2014, 43,092 projects and 2.78 million dwellings were constructed utilising LITHCs and between 1995 and 2014, approximately 1,420 projects and 107,000 dwellings were created each year (HUD User 2016). The LIHTC program allocates almost US\$8 billion per annum.

While individuals were initially active purchaser of LIHTCs, the onerous application procedures and restrictions on depreciation allowances has led to very low individual participation (Blessing and Gilmour 2011: 460). The LHITC however has provided strong incentive for institutional investment.

The income from LITHC projects is as noted, determined by rent setting controls, with rents reflecting a proportion of the median in the area. This income can deteriorate with voids (reflecting weaker housing markets) or declining income levels. With project income constrained, close attention is required in relation to operating costs. Reviews of the program (Kormon-Houston 2009) found a strong majority of projects have operated successfully through the initial 15 years, with only 1–2 per cent of projects foreclosing. Foreclosure would adversely affect the tax credits so investors (or managers) prefer to fund operating deficits. Tight operating margins however have implications for maintaining the physical condition of the buildings, and payment of insurance, taxes and utilities. The key issue is capital improvement as the buildings age, and whether the housing will remain as affordable housing once the tax credits cease. It is common for properties to shift to market housing at the end of the compliance period. Former LIHTC properties are among the housing subject to attention by SI investors as in need of preservation, and which via property funds and REITs are increasingly addressing.

Community Reinvestment Act

The Community Reinvestment Act 1977 (CRA) was a response to 'redlining'—a form of racial discrimination that resulted in entire low-income communities being subject to blanket exclusion from financial services (Blessing and Gilmour 2011). Affected households were effectively denied mortgages and insurance. The CRA requires federally insured depository institutions to provide loans, investments, and services in low and moderate income neighbourhoods where they operate, consistent with safe and sound banking operations (Williams 2015: 24). A key form of reinvestment has been low cost housing, principally debt financing for affordable housing projects.

US\$26 billion was invested in 2007 as a result of the CRA including US\$1.1 billion by Location Initiatives Support Corporation for revitalisation of low-income communities and US\$1 billion by Enterprise Community Partners in community development and affordable housing (Freireich and Fulton 2009: 7).

Federal regulators have considerable discretion in evaluating banks' CRA performance, and concerns have been raised about banks being denied CRA credits for key worker and affordable housing preservation projects that are not exclusively intended to serve low-income

households or which do not have some sort of federal subsidy (Williams 2015: 24). The preservation of existing affordable housing has emerged in response to gentrification, poor maintenance and lack of renewal. Much of the housing in need of preservation is 'naturally occurring' in that it is old, in poor condition, offers lower amenity (design and efficiency) and in poor locations. It may never have been subsidised or subsidies have ended, thus potentially disqualifying reinvestment from obtaining the CRA credits. SII seeking environmental outcomes as well as social impact are a key source of funds for renewal of this stock. The other potential disqualification concerns urban renewal development projects that involve mixed income households and mixed tenure. These projects (often undertaken by property funds) rely on the cross-subsidy from higher income households (in addition to various grants and concessions) to enable the inclusion of lower income households.

Philanthropic foundations

Philanthropic foundations are significant actors in the provision of affordable housing in the US, through disbursing grants and investments, which may be structured to deliver concessionary or non-concessionary returns.

Concessionary impact investments are those where the investor accepts a sub-market return in order to facilitate social outcomes, and include loan guarantees, subordinated debt or equity positions, longer terms before exit and flexibility in adapting capital investments to the enterprise's needs. The difference between the non-concessionary return and the actual return is considered a grant or donation. These are program related investments (PRIs) (see below).

Non-concessionary impact investments require a full market return but are distinguished from non-impact investment by intentionality, requirement for measurement of outcomes and are notable for discerning investment opportunities ordinary investors do not see. This form of investment is known as mission-related investments (MRIs) in US philanthropy (Brest and Born 2013: 25). The types of activities undertaken by MRIs includes:

- Providing a housing agency with an interest free loan to finance pre-development costs (planning application) which is repaid if the project is approved and construction finance secured.
- Securitisation of a pool of low and middle income household home mortgages.
- Establishment of real estate funds to undertake mixed use development in targeted areas to stimulate economic development (Cooch and Kramer 2007: 29).

The FB Heron Foundation for example provides both concessionary and non-concessionary impact investment in affordable housing. It makes non-concessionary investment through provision of fixed income securities backed by pools of loans aggregated by the Community Reinvestment Fund (CRF) (Swack and Giszpenc 2009: 32–33). It provides concessionary investment through the provision of credit enhanced subordinated loans for affordable housing development, an example being the New York City Acquisition Fund (NYCAF). The CRF 'provides new loan capital to community-based development organisations by creating a secondary market for community development loans' including for affordable housing (Swack and Giszpenc 2009: 14).

The NYCAF provides flexible bridging loans for developers to create or preserve affordable housing. It is a partnership between the City of New York, foundations (Ford, Heron, MacArthur, Robin Hood, Rockefeller, Star and Enterprise Community Partners) and commercial banks and has resulted in US\$279 million being invested in 7,590 units (New York City Acquisition Fund 2016a). Concessionary and non-concessionary investments are simultaneously layered, with concessionary investments encouraging the non-concessionary investments. Foundations provide subordinated debt and loan guarantees and mainstream banks make non-concessionary investments (Brest and Born 2013: 25). When the NYCAF was established in

2004, it comprised US\$32 million from foundations (low-interest, subordinated loans) US\$8 million from a NYC charitable trust (similar terms) and over US\$160 million from commercial banks (commercially priced debt). This is described as a yin-yang deal (Freireich and Fulton 2009: 3, 34). The NYCAF has supported 112 projects in New York and one in Cleveland. Of these, 17 were new developments, 73 preservations of affordable housing, 14 supported housing and nine mixed-use (New York City Acquisition Fund 2016b).

The *New Generations Loan Fund* (NGLF) demonstrates the degree of collaboration between multiple parties that is a common feature of SII engagement in affordable housing provision in the US. The NGLF was established by the City and County of Los Angeles with Enterprise Community Partners, including financial institutions, foundations, banks and CDFIs (see community finance below) to stimulate housing development aimed at affordable and permanent supportive housing (Burt 2009: iv). By offering pre-development and acquisition finance to developers targeting low and middle income households, it is designed to reduce homelessness and housing stress. Of the initial US\$100 million raised, the City of Los Angeles contributed US\$10 million and five banks and the Enterprise Community Loan Fund the remainder. Three foundations and the City of Los Angeles provided credit enhancements of US\$14 million. Developers apply for funding from any of the participating lenders (including Enterprise Community Loan Fund) (Burt 2009: 17). The Bay Area Transit-Oriented Affordable Housing Fund and The Denver Regional Transit-Oriented Development Fund are further examples of where SII concessional investment plays an important role.

The NYCAF and NGLF demonstrate the importance of philanthropic foundations and government in providing grants and concessions to reduce the loan quantum required for development and to provide the mechanisms necessary to attract low cost capital.

Between 1968 and 2006, MRI in housing totalled US\$236 million. Of this housing investment, community foundations contributed 19 per cent, corporate foundations 31 per cent and private foundations 16 per cent. 41 per cent of the housing MRIs were made directly to NFPs and 35 per cent through intermediary NFPs (Cooch and Kramer 2007: 29–30).

Program related investments

In addition to disbursing grants, foundations are able to invest their corpus into PRIs. The Tax Reform Act 1969 stipulates private foundations avoid high risk investments, to avoid the potential for the loss of the foundation corpus and hence inhibit their ability to undertake their mission. An exception is made for PRIs. Private foundations can make higher risk investments if their purpose aligns with those of the foundation, is not political and the appreciation of property or production of income is not significant (Seibert 2016). The entire PRI amount is treated as a qualifying distribution in the year it is made (the same treatment as for grants) under the tax code. Although grants can generally only be made to NFPs, PRIs can be made to for-profit entities whose business advances the purpose of the foundation, such as those building affordable housing (Gustafsson-Wright, Gardiner et al. 2015: 134).

Despite almost four decades since the PRI provision was adopted, uptake of PRIs remains low and foundations slow to embrace the model (Qu and Osili 2017). In 2009, the most recent year data is available, 244 PRIs, with a total value of US\$389 million, comprised only 1.4 per cent of qualifying distributions (Seibert 2016: 9). The average size of each PRI was US\$1.5 million and only 97 US private foundations of over 80,000 used PRIs that year (Seibert 2009: 9). The primary barriers to take-up are complexity associated with due diligence, costs associated with management, and capacity limitations of the foundation and the demand side for funds (Qu and Osili 2017). Disaggregated data is not available, but using data from the Foundation Centre, Qu and Osili (2017: 308) found that 'housing, economic development, and education' were the top three priority areas, accounting for more than two-thirds of PRIs invested in the 2000s.

Community finance

Community finance refers to member-based financial institutions such as credit unions. Credit Unions are community-based, democratically owned, government regulated, NFP financial institutions. Their purpose is to provide high quality, affordable financial services to their member-owners. Community Development Credit Unions (CDCUs) service low-income, underserved communities by partnering with government and commercial banks, in particularly through loans and grants under the CRA (Nembhard 2013: 465). CDCUs are a form of community development financial institution (CDFI), and can be owned by consumers, producers or workers, depending on who uses their services, and be NFP or for profit (Nembhard 2013: 463–64).

The founding of the CDFI Coalition in 1992 and the subsequent establishment of the CDFI Fund in 1996 catalysed these forms of community development finance (CDF). The CDFI Fund was established to increase the availability of financial services, investment capital and credit in distressed districts and functions under the auspice of the Department of the Treasury. The CDFI Fund is the largest source of capital (debt and equity) for CDFIs and attracts a substantial level of private investment, with US\$27 of private investment for each US\$1 of government investment in 2005 (Freireich and Fulton 2009: 7, 26–27). The Riegle Community Development and Regulatory Improvement Act 1994 (RCRDIA) had bipartisan support and contributed to the success of CDCUs through access to large sources of funding (Nembhard 2013: 466). The Bush Administration decreased funding during the 2000s (Nembhard 2013: 466).

CDF has played a significant role in mobilising capital for affordable housing in ‘unserved’ (redlined) communities in the US for the past 30 years, but the sector is relatively small and faces specific challenges in addition to the broader economic and capital market climate. Bugg-Levine (2012) argues three adverse forces affect CDF. Firstly, bank consolidation has meant CRA is no longer a significant driver of investment. Secondly, demand for funds has softened reflecting the decline in government subsidises. Thirdly, despite decades of sector and enterprise level investment, the lack of community-wide approaches means that the neighbourhoods they have been serving are faced with high unemployment, frozen credit and declining real estate values. Bugg-Levine contends that the CDF sector has the opportunity to utilise impact investment capital and the knowledge and expertise associated with SII funds for the social purposes that are the *raison d’être* of social finance, and CDFIs could become SII intermediaries or expert advisors.

In addition to LIHTC, CRA and CDFs there are a range of programs that promote the supply of affordable and social rental housing and affordable home ownership. The Federal Home Loan Banks’ Affordable Housing Program provides members with access to low cost capital guaranteed by the Federal Government. Federal Housing Administration (FHA) Mortgage Insurance program endorses mortgages provided to low-income households by FHA approved lenders. Fannie Mae and Freddie Mac buy mortgages from lenders and either hold these mortgages in their portfolios or package the loans into mortgage-backed securities (MBS) that may be sold, providing increased liquidity into the market. Fannie Mae and Freddie Mac have specific targets in relation to low-income households. The HOME Investment Partnership Program provides gap financing and other support to local housing projects. Section 4 Capacity Building for Community Development and Affordable Housing Program similarly provides grants and support for local affordable housing projects. Section 8 Project-Based Rental Assistance and Project-Based Vouchers cover the difference between market rent and the rent the tenant can afford to fund private low-income rental housing. State and municipal governments also raise funds for housing through bond issues.

Property funds

Property funds are mutual funds that purchase or develop real estate for sale or lease. Investors purchase units in the trust, which is managed by the fund manager. Investors receive periodic

distributions derived from the earnings on the assets held by the fund. Property funds have become an increasingly important means by which existing affordable housing in the US is being preserved and additional stock created via urban renewal.

Property funds present the opportunity for affordable rental housing provision through attracting equity investment that is long tenure and liquid for the investor (the unit holder can sell their holdings). The return expectations of investors are tempered by the lower risk profile of this housing asset class. Affordable housing is regarded as less risky than renting to higher income working households who will vacate if their financial circumstances deteriorate. Returns, however, are lifted through various subsidies (e.g. LIHTC, CRAAct, economic development funds, and grants), and by cross-subsidisation by higher income households in mixed income developments. As a result, funds deliver varying amounts of affordable housing with varying rates of return.

Funds, such as JPMorgan Urban Renaissance Fund (JOURF) are finance-first impact investment funds. JOURF seeks to achieve social, and where possible, environmental aims. It targets market returns of 15 per cent per annum after fees and is focussed on urban renewal projects that include key worker and affordable housing (Bridges Ventures 2010: 23). Other examples of finance-first funds are Turner Multifamily Impact Fund and the Canyon Multifamily Impact Fund III.

Real estate investment trusts

Real Estate Investment Trusts (REITs) were created by the US Congress to provide the opportunity for small scale investors to invest in commercial, industrial and residential property. REITs operate in much the same way as property funds, and there is a large residential REIT sector in the US that provides rental housing. Two examples, which expressly invest in affordable apartment developments, are:

- The *Housing Partnership Equity Trust* (HPET)—a US\$100 million REIT that owns 880 units through five acquisitions of rental properties, which were at risk of not remaining affordable. Launched in 2012 by the Housing Partnership Network, it is owned by 12 of its members who are NFP housing and community development organisations (Swach and Hangen 2015: 21). HPET targets unsubsidised medium to large multifamily properties in good physical condition with positive cash flow, and its members operate the acquired properties. It expects to grow to US\$2 billion (Carlson 2014: 10–11).
- The *Community Development Trust* develops and preserves affordable housing. It seeks non-concessionary returns, depending on location and is privately held (Williams 2015).

Programs to stimulate the supply of affordable housing, such as the LIHTC and CRAAct pre-existed the advent of SII, but have been instrumental in attracting SII. SII in affordable housing in the US can be characterised as often complex collaborations between government, philanthropy, SII and mainstream and member-owned finance institutions. Finance-first impact investment, like impact-first investment, is supported by various subsidies, concessions and guarantees. Impact-first investment however more often assumes higher risk in order to catalyse investment. Affordable housing is also being developed and preserved by non-impact investors taking advantage of the same incentives.

SII is viewed positively in the US where there are antecedents in social finance and private investment in affordable housing. It is viewed as providing a new source of capital at a time when demand from distressed communities is acute. Moreover, SII is regarded as more than just finance, with new types of private sector expertise and energy providing innovative solutions. Mechanisms such as the LIHTC enable SII to make non-concessionary returns. Like social financiers, some impact-first SI investors are willing to take concessionary returns, in effect making a donation to the project. Such investments are often critical to catalysing finance-first SII or non-SII investment by underpinning the project's viability and ongoing operations.

Again, like social finance some impact-first SI investors take greater risk in order to support providers unable to access funds, or to demonstrate new models; they may or may not expect non-concessionary returns.

Prospects for SII on a larger scale than is possible with social finance are good. While pension funds are a key source of funds that remains relatively untapped, property funds are successful in obtaining low cost equity. Still, the majority of SII in social and affordable housing is dependent on government investment in programs, and some mechanisms (e.g. CRAAct) are unravelling in the face of economic change. The lack of political commitment to programs that make private investment in social and affordable housing possible is a more immediate threat to SII.

Government is seen as having a vital role in leadership and coordination which extends from encouraging and supporting SII, to providing seed funding and supporting existing enterprise development such as the CDFIs, to increasing funding to existing programs (Grace, Griffith, et al. 2015; Bugg-Levine 2012; US National Advisory Board on Impact Investing 2014). Given that longstanding government programs have created the conditions for private investment and are necessary for continuing investment, this encouragement for government intervention is not surprising. The conditions permitting relatively cheap long tenure private equity investment are particularly important. These include direct subsidies to affordable housing providers (e.g. grants), concessions to equity investors (e.g. tax credits) and welfare transfers directly to tenants. Each improves the cash flow position of providers, enabling either debt repayment or distributions to equity holders.

Despite the maturity of the US affordable housing system there are barriers to SII. Bugg-Levine (2012) argues that 'impact investors operate in an inhospitable set of systems. Chief among them is a regulatory and policy system built on the twin assumptions that only charity and government can address social issues and that the only purpose of investment is to make money'. A specific measure advocated is change to the PRI guidance in relation to rules for foundation investments (Bugg-Levine 2012, The US National Advisory Board on Impact Investing 2014). The US National Advisory Board on Impact Investing (2014) and Grace, Griffith et al. (2015) recommend changes to legislation concerning the fiduciary duties of private pension funds would provide pension fund managers with an unambiguous legal footing for impact investment. Grace, Griffith et al. (2015) argue that while current law does not prevent SII, pension fund managers interpret the legislation conservatively. Aside from government support for SII and government support for programs targeted by SII, advocates acknowledge that SII is an immature market which requires strengthening the expertise and capability of intermediaries, standardisation of investment opportunities and/or asset classes, and improved measurement and reporting.

SII advocates continually underline the role of government in supporting and catalysing investment. Given the role of government support for affordable housing programs the Trump Administration's fiscal year 2018 Budget Request, *A New Foundation for American Greatness*, proposed dramatic spending cuts to housing and community development programs (Kerchof 2017) and would mean a reduced scope for SII in the future.

The chief argument for SII providing additionality is that it brings new investment capital to an existing system of private investment in affordable housing, and can thus expand supply. It is argued that legislative support to create certainty for PRI and pension funds would enable SII at considerable scale. In the next section, we examine SII in affordable housing in the UK, where the government has been diligent in removing barriers and incentivising SII, yet SII in affordable housing has been limited.

2.3 The United Kingdom

Unlike the US, SII in the UK has been a central pillar of public policy supported by successive central governments. In 2000, the Labour Government launched the Social Investment Taskforce—a review of charity funding and financing that aimed to facilitate private investment through new models that promoted access to capital to NFPs and social enterprises (Haugh and Kitson 2007). Since then there has been considerable investment in market infrastructure as well as supportive public policy to enable SII.

Beginning in 2002, tax relief was accorded to community investments through recognised CDFIs and a new legal form, the Community Interest Company, was established to create a hybrid legal structure to create an institutional vehicle to grow investment in social enterprise.¹ The subsequent Conservative-led coalition extended public investment in SII (Floyd, Gregory et al. 2015). Building on an initiative begun under the previous government, it established Big Society Capital as a wholesale investment institution in 2012; introduced Social Investment Tax Relief², and in 2014 initiated the Law Commission’s consultation on fiduciary duties of investment intermediaries and pension funds (UK National Advisory Board to the Social Impact Investment Taskforce 2014). A Social Investment and Finance team within the Cabinet Office was established specifically to address gaps and barriers to market development (Wilson 2014: 23–24). The UK Government in responding to the Social Impact Investment Taskforce report stated

As a market builder, we have focused on constructing an ecosystem that supports social impact investment. As a service commissioner we are focused on creating the space for innovation, prevention and improved outcomes for the most vulnerable. As market steward, we can look to remove legal and other barriers to social impact investing (Maude 2015).

As in the US there is a significant social finance tradition in the UK, and social finance organisations have been supported to become SII intermediaries. While new organisations (fund managers and intermediaries) have been formed, existing organisations such as CDFIs and charity banks have evolved within the new policy environment. The Government identified NFPs, as social enterprises, as key demand-side organisations.

While there are a large number of charities and social enterprises few operate at scale, so support is required in order to make them investment ready (UK National Advisory Board to the Social Impact Investment Taskforce 2014). The financial sector is identified as being far too concentrated and new models of financing are seen as desirable (UK National Advisory Board to the Social Impact Investment Taskforce 2014). Finally, outsourcing of public services has also enabled growth of the charity sector (UK National Advisory Board to the Social Impact Investment Taskforce 2014). The UK National Advisory Board to the Social Impact Investment Taskforce estimated there was £202 million investment per annum with 90 per cent made to charities and social enterprises. The Labour and Conservative governments invested over £300 million in public and private intermediaries between 2004 and 2013 (Floyd, Gregory, et al. 2015: 37). The most prominent institution to emerge was Big Society Capital—an independent wholesale ‘social investment bank’ seeded with £400 million from unclaimed dormant bank accounts and £200 million from the UK’s largest retail banks—which invests in a portfolio of 14 intermediaries (Big Society Capital 2015).

¹ Entities can issue shares and deliver returns subject to a dividend cap, but with an asset-lock that prevents it from distributing assets when wound up.

² Affordable or social housing activity is specifically excluded from Social Investment Tax Relief.

In the UK, as in the US, there is an existing, mature system for the provision of social and affordable housing that includes substantial private investment. In the following section, we briefly outline that system before turning to SII in housing in the UK.

Social and affordable housing provision

The UK has historically had a significant social housing sector (at its peak comprising almost one third of all housing stock) (Berry, Whitehead et al. 2004). From the late 1980s the gradual transfer of public housing from municipal control to NFP landlords saw an estimated 1.4 million dwellings under the ownership or management of ‘for the most part financially robust’ CHPs by 2008 (Pawson, Martin et al. 2016: 7). Large CHPs have been able to obtain long tenure bank debt to support development and ongoing operations, although liquidity issues arising from the global financial crisis (GFC) has meant debt has been harder to obtain for some time thereafter (Lawson 2013).

Gilmour, Washer et al. (2012) describe the English social housing system as largely ‘a corporate model for funding’ which ‘utilises the strength of a housing association’s cashflows and balance sheet to raise debt finance’. This contrasts with a project finance system in which lenders look at the borrower’s assets and cash flows associated with a specific housing development (Gilmour, Washer et al. 2012: 7). The biggest CHPs in the UK are large enough to be able to raise debt via the issue of bonds and private placements with insurers (Williams and Whitehead 2015), with pension funds the key source of demand. Since 1987 smaller CHPs have been able to access bond finance via the Housing Finance Corporation (THFC), an entity established by government (Lawson, Berry et al. 2014).

Social housing is directly supported by government grants and indirectly supported via the Housing Benefit, which until recently funded the gap between market rent and the rent affordable to the tenant, with the gap amount paid directly to social landlords. Housing Benefit payments provided the cash flow required to service debt and formed an implicit government guarantee for borrowings. Overall the UK system was underpinned by a robust system of grants and rental assistance, allocated directly to landlords, as well as what Lawson, Berry et al. (2014: 21) describe as ‘appropriate sector regulation and secured financing’.

Since the GFC and consequential austerity measures grants have been severely curtailed, and reoriented towards provision of discounted market rental housing. Social landlords are now able to charge ‘affordable rent’ (80% of market rent) and now serve an intermediate income group as well as the lowest income households. The outcome has been a large increase in the provision of affordable rental housing at the expense of social housing dwellings (Williams and Whitehead 2015; Wilson 2017). Two measures however create uncertainty for social landlords and undermine cash flow:

- 1** The welfare benefit cap, which sets an upper limit on the benefit a working age welfare recipient can receive, impacting the amount of Housing Benefit payable. Some beneficiary groups such as single parents with two children living in social housing are now required to meet the gap between the Housing Benefit and their rent. Alternatively, the social landlord may meet the shortfall.
- 2** Restrictions on rent setting, with social landlords required as of August 2016 to reduce rent by one per cent per annum for the following four years. This ‘efficiency’ saving was framed by the UK Government as social landlords ‘playing their part’ in reducing the national welfare bill (Wilson 2017). By 2020-21 this measure is anticipated to deliver an average 12 per cent cut to rents. Housing associations argue this change has made it more difficult to borrow and has reduced investment in new supply (Apps 2017). The Government has indicated they will set out a new rent policy for the period after 2020 to enable them to borrow again.

These changes to welfare benefits and rent setting undermine a critical condition required to attract private investment—cash flow—and introduce policy change as a significant risk for

investors. Such measures are at odds with the Affordable Homes Guarantee Program, which in the aftermath of the GFC underwrote some bond issues (managed by the THFC) in order to address the liquidity issue affecting capital supply for affordable rental housing (Lawson 2013). A temporary measure, the Affordable Homes Guarantee Program closed in March 2016.

As noted, large housing associations have been issuing their own bonds or have received investment from insurers (who seek long tenure investments). Despite the threat posed by welfare changes, bonds are still being issued, with investment houses such as TradeRisks arguing the social housing sector is 'fundamentally undervalued' and that lack of competition in the banking sector meant bond issues were not delivering the optimal price or structure of the bonds (TradeRisks 2012). In 2016 TradeRisks managed the issue of bonds for Herefordshire Housing. Pension Insurance Corporation purchased the bonds, reflecting the historical and continuing interest of UK pension funds in social housing. The National Association of Pension Funds (NAPF) identified social housing bonds as providing returns 'much higher than those currently available on inflation-linked gilts. Here, and elsewhere in the world government inflation linked bond yields are negative or approaching negative real yields' (NAPF 2012). The low yield on gilts has been sustained and UK pension funds are major investors in social housing, providing vital long tenure debt to the sector. Nevertheless, as Williams and Whitehead (2015) observe, short term debt (and especially loan facilities) largely issued by banks remains important for addressing short term development needs.

With access to both short and long tenure debt, UK CHPs in the social housing sector do not appear to have been the recipient of SII. Some SII into housing supply however has occurred, with two foci.

Firstly, SII has been made into sub-market NFPs who have been unable to secure mainstream finance. Four examples include:

- The *Real Lettings Property Fund* (RLPF), which yields a commercial risk adjusted return from a residential property fund providing transitional housing in London for homeless people who are ready for independent living but struggle to access private rental housing. RLPF raised £56.8 million from foundations, a local authority, a housing association and two HNWI's (Resonance 2016). The model centres on the acquisition and later sale of residential properties with the capital appreciation delivering the return on investment (Real Lettings 2015).
- *Homes for Good*, a Scottish lettings and property management agency that bridges the divide between the private housing market and those who cannot afford home ownership and are ineligible for social housing, supported by Impact Ventures UK.
- The *Affordable Homes Rental Fund* (AHRF) provides community-led organisations such as Community Land Trusts (CLTs) with development capital and medium term finance to facilitate grant-free affordable rental housing (Resonance 2016). The AHRF provides advice alongside either pre-development financing, up to 100 per cent financing for housing ready for construction or flexible loans for existing housing.
- *Intermediary Social and Sustainable Capital* placed funds with Giroscope, a NFP, which buys and renovates empty properties to provide homes for those in need, and engages and trains a large cohort of volunteers, many of whom are at risk of social exclusion. The investment has enabled Giroscope to purchase three properties, one of which will provide land for 4–6 self-build house projects.

The second area of activity is within the Build to Rent (BTR) program, which seeks to rapidly expand private rental housing through encouraging institutional investment. The UK Government created a £220 Build to Rent Fund (BTRF), which provides equity for up to 50 per cent of the development cost for projects of 100 dwellings or more (the principal and interest are repaid over a two year timeframe, once the development has been sold or

refinanced (Homes and Communities Agency 2015: 3). This scheme recognises the additional risks in the development phase of housing as a barrier to raising private finance (Stevens 2016: 113). CHPs were incentivised to undertake BTRF development that could then be sold to institutional investors, a move to counteract the concentration of private housing development companies. In order to encourage institutional investors to buy the projects the government offers a loan guarantee (the Private Rented Sector Housing Guarantee Scheme) to support investment that is leveraged.

An example of SI equity investment in the BTR market is a £600 million BTRF created by Legal & General Capital and PGGM (a Dutch pension fund). The fund is expected to attract further equity investors for future developments and over time may be split into a development fund and a completed asset fund. The rental yield is expected to be 3–5 per cent on completed assets (Evans 2016).

The most active SII housing fund is Bridges Ventures, but the extent to which their projects take advantage of the BTRF or guarantee is unknown. Bridges Ventures CDV Fund is a mission-driven investor specialising in regeneration projects located in the most deprived 25 per cent of the UK (Bridges Ventures and Parthenon Group nd: 21). Projects include:

- Chesterfield House—a mixed-use development in Wembley, which includes 239 homes. Almost half of the homes for rent will be let at affordable prices.
- A mixed use development adjacent to the Abbey Wood Elizabeth Line (Crossrail) station which will provide approximately 230 plus mid-market (relatively low cost) residential units.
- The redevelopment of Taberner House, the old Croydon town hall. Of the 500 odd units proposed, 30 per cent will be affordable housing.

Another property fund, the Cheyne Social Property Impact Fund (CSPIF) has a large French pension fund, a UK pension fund, a European family office and BSC as investors. CSPIF has entered into sell and leaseback arrangements with CHPs, who, constrained by dwindling grants, loan covenants and interest cover, are selling existing assets to generate cash flow to fund new assets. The leases are provided at substantially below-market rates. *Funding Affordable Homes*, an initiative of BSC, also intends to buy and build affordable housing, which it will lease to mid-sized housing associations that are capital constrained.

BSC and CSPIF are also currently raising funds for a REIT. CSPIF founder Shamez Alibhai argues the fundamentals of affordable housing provision do not require government assistance and that independence from government is important 'because governments and government policies change' (Investor Strategy 2015). There is not enough data available to determine whether these examples are finance-first or impact-first, and how many involve concessionary returns. Bridges Ventures projects are analogous to the impact-first property funds operating in the US, and Bridges Ventures has expanded into the US market.

Godsall and Sanghvi's (2016) assessment of SII in the UK reflects the experience of US SII. They identified four major areas where further work is required to create a robust SII market: the need for proven and self-sustaining economics (a mature market should not rely on government); a clear, consistent way of describing products (standardisation of measurement of impact); a range of well-defined offerings (specialisation of investment sectors), and a high degree of professionalism (fund management).

SII in social and affordable housing in the UK has been limited, but both impact-first SII (providing capital to NFPs unable to access mainstream finance), and finance-first SII (institutional investment by pension funds in CHPs) are evident. The latter occurs in the context of substantial institutional investment by non-SII pension funds in CHPs.

2.4 Conclusion

Both the UK and US have mature systems of funding for social and affordable housing, and in both countries SII has either forged a role within the existing system (the US case) or outside it (in the UK). SII is more extensive in the US than in the UK owing to the historical commitment to social housing in the UK and the relative underdevelopment of private rental housing. It is abundantly clear that, despite calls for independence, SII in social and affordable housing is highly dependent on government funding. The income cohorts from whom most 'impact' is derived are by definition those who require subsidisation in some form. This makes SII highly reliant on government housing and welfare policy, as without subsidies these lower income cohorts do not provide a viable investment even if concessionary returns are taken.

SII as an investment class is aimed largely at PRI and pension funds, with the latter regarded as able to deliver the scale of investment necessary to address the need for social and affordable housing. There is a high degree of consensus in both countries regarding the barriers to SII, with the fiduciary duties of pension fund managers commonly cited as a specific barrier to pension fund SII. Nevertheless, Vishkin's 2016 study of pension fund impact investing in the UK found fiduciary duty was not the reason for lack of investment, but rather issues concerning SII market infrastructure. UK pension funds are already active investors in social and affordable housing, as are many European funds (Lawson, Berry et al. 2014). US pension funds are also active investors in affordable housing (GAO 1992; Woelfel and Dixon 2016). This suggests SII has unique features that impose barriers to investment.

2.5 Policy implications

SII in social and affordable housing in the UK and US reflects government funding of the gap between tenant's capacity to pay and the cost of housing provision. This funding ensures housing providers have positive cash flow to support debt repayment or disbursements to equity holders, and forms an implicit government guarantee. In the absence of government subsidies to meet this funding gap, private investment in social and community housing in Australia will be constrained by the limited free cash flow generated by CHPs. While some SI investors accept concessionary returns, it is not the norm and should not be assumed. This suggests that SII will be constrained by lack of government investment, as is private investment in the community housing sector. Secondly, government and housing providers in Australia should not be looking to SI investors to fill funding gaps.

3 SII in community housing in Australia

- Private investment in CHPs, including SII, is a reflection of government investment in CHPs. Lack of government investment constrains SII.
 - There is a funding gap between tenant capacity to pay and the cost of housing provision.
 - Investment in CHPs is accordingly constrained by the limited free cash flow generated by CHPs.
 - This gap needs to be addressed to ensure the success of a HSB. A HSB is required to obtain a lower cost of capital and enable long tenure debt.
 - There is an estimated \$1.5 billion of SII in CHPs in Australia.
 - Westpac, who denominates all its investment into CHPs as social impact, has invested \$1.05 billion. Social banks, such as Community Sector Banking and Bank Australia, are important SI investors in CHPs.
 - SII in CHPs is provided on a non-concessionary basis.
 - There is no known non-bank SII in CHPs.
 - Non-SII lending to CHPs by banks, while unquantified, is important.
 - SII provides much needed competition, lowering the cost of capital for CHPs.
 - Over time both SI investors and non-SI investors have reconceptualised the credit risk posed by lending to CHPs.
-

Interest in SII in Australia reflects the establishment of the Social Impact Investment Taskforce (SIIT), which aims to catalyse impact investing globally (SIIT 2014a). Governments in Australia, although interested in SII in relation to housing, have not yet instituted specific support mechanisms. Thus, SII in social and affordable housing is shaped by the existing institutional arrangements for housing rather than for SII. As the institutional arrangements supporting social and affordable housing in Australia differ from the UK and US, there are important lessons for impact investors and governments considering how they might catalyse SII.

3.1 Funding of community housing

Australia has an evolving not-for-profit community housing sector comprised of community housing organisations (CHPs) who are subject to state-based housing legislation. These CHPs predominately own and/or manage social rental housing, although some also provide affordable rental housing and more rarely support affordable home purchase. Social rents are set as a percentage of household income, whereas affordable rental is set as a discount to market rent.

The main source of capital funds for CHPs to date has been capital grants provided by state, territory and Commonwealth governments on an ad hoc basis. A small stream of funds is delivered via the National Affordable Housing Agreement (NAHA). Local governments and philanthropy provide small ad hoc contributions. These non-recurrent capital grants have enabled CHPs to acquire assets, either through developing their own housing or via purchase of housing (often through 'turn-key' arrangements with private housing developers). The Commonwealth's Nation Building Economic Stimulus Plan, Social Housing Initiative, for

example, injected over \$5 billion into CHPs and boosted social housing dwelling numbers by around 19,500 (Murray, Bertram et al. 2013). Grants provide the assets required as collateral for loans, reduce the loan quantum necessary to deliver housing, and reduce the free cash flow required to service debt. Lack of capital grants restricts private investment once existing assets and cash flows are committed.

The National Rental Affordability Scheme (NRAS) provided tax credits (for private providers) and rebates (for NFPs) for a period of ten years in exchange for a minimum discount on market rent of 20 per cent for tenants able to meet income-related eligibility criteria. While NRAS was aimed initially at private investors, CHPs are the most significant providers, with the rebates providing a source of cash flow support to permit increased leveraging of assets and thus enable them to add to their housing stock. At 30 June 2017, 86 of 133 providers were NFPs who had been allocated 52.8 per cent of the incentives (Australian Government 2017b). The NRAS delivered 38,000 dwellings at a cost of \$3.3 billion (ANOA 2016). In 2014 the Australian Government discontinued the scheme.

Access to government grants by CHPs requires them to formally register as a provider and public policy aims to grow the registered CHP sector by targeting funding to organisations that operate at scale. Accordingly, the sector is dominated by a few larger CHPs (who have thousands of houses) and many smaller CHPs who may have as little as one house. Many CHPs only manage public housing stock and hold no assets. A key growth strategy has been to require CHPs to leverage assets to utilise private finance to increase supply, hence grants and stock transfers are increasingly tied to leveraging requirements (Lawson, Milligan et al. 2012). While the policy basis for requiring assets be leveraged seems a logical way of bringing private capital into the supply of affordable housing, experience has shown that CHP financing is far from straightforward (Gilmour 2010; Lawson, Berry et al. 2014).

CHP recurrent revenue is derived from rental recipients. Rent payments include the capture of Commonwealth Rental Assistance (CRA), a payment provided by the Australian Government to income-eligible private and community housing tenants. CRA is a vital source funds for CHPs (Community Housing Peaks Policy Network 2014). Rents are set at 30 per cent of gross assessable household income and accordingly reflects the type of household. Some households, such as those with younger children are eligible for family assistance payments provided via the social security system as well as CRA, making them financially more attractive as tenants than a single person. The CHP receives no additional payment to meet the gap between the rent and the cost of provision unlike in the UK, which has a Housing Benefit. The means CHP's rental income is vulnerable to adverse changes to welfare payments. The primary means by which this can be managed by CHPs is through selection of tenants. State governments however, anxious to target public expenditure to the most needy, require CHPs to accept a higher proportion of their tenants from urgent cases on the public housing waiting list—the Victorian Government requires 75 per cent of new tenants to be taken from their priority waiting list and the South Australian government 90 per cent. In a double blow to CHP finances these tenants are not only those who yield the lowest rents but are also the highest cost tenants as a result of having high and complex needs.

3.2 Financing development of community housing

Development of property means the acquisition of land and the construction of real property on that land. In contrast to property finance, which is concerned with the purchase of an existing asset, development finance 'is a form of project finance; a type of specialised lending whereby the credit risks are assessed and tranches of borrowing instruments are structured to deal with specific risks of the project' (Bryant 2012: 118, after Weaver and Kingsley, 2001).

Development funding may be provided for all stages of the development process, from land acquisition through to construction, although lenders may require the project proponent to contribute equity to the project with debt used for construction only. Projects are heavily geared with the only collateral being the land and the project (represented by its intellectual property, associated contracts and agreements and company director's personal guarantees), providing for limited recourse. The gearing is a ratio of the loan to cost (LCR) of the project, rather than the value of the completed asset. Cash flow is negative for the period of the loan. Interest on the loan is capitalised into the repayment of the principal, which is due at the completion of the project. Lenders are compensated for the additional risk by a higher return on capital.

Development finance is by definition short term lending. Once an asset is completed refinancing can occur via a property loan. The property loan maximum is based on the loan to value ratio (LVR), with the loan typically a percentage of the property value. The cost of capital is lower reflecting the greater realisable value of the asset used as collateral, and the lower gearing. Cash flow during the period of the loan is positive with the income associated with the asset used to service the loan. Property loans can be refinanced at the end of the loan period, subject to revaluation of the assets provided as collateral and income projections.

The provision of credit for property development, including for affordable housing, is subject to significant negotiation and information exchange, centred on what Bryant (2012) describes as the five 'Cs' of credit assessment—*character, capital, capacity, collateral, and conditions* (detail on the five 'Cs' and the application to social and affordable housing is provided in Appendix 5).

In the UK housing associations were able to set cost based rents because the Housing Benefit (until recently) covered the gap between rent and cost of provision (Williams and Whitehead 2015). In Australia (unlike the UK) rents are set in relation to income and there is no mechanism to meet the gap between 'affordable rent' and the income required to ensure a CHP remains solvent. Australian CHPs therefore juggle high fixed costs and variable revenue, a problem highlighted in a succession of reports (e.g. McNelis, Hayward et al. 2001; McNelis, Hayward et al. 2002a, 2002b; McNelis 2006). Milligan, Pawson et al. (2017) in a recent study on the sustainability and prospects for growth of the community housing sector argue affordable housing providers generally lack control of

the quantum of cash flows required to underpin large-scale borrowing for investment. Cash flow-based lending (which is more suited to the requirements of institutional investors) is impaired by the prevailing rent subsidy regime (Milligan, Pawson et al. 2017: 26).

The rent subsidy regime and a reluctance to accept social housing as collateral for loans were hurdles to obtain private loans in the past, and this is still the case, although significantly, financiers have modified their lending standards in order to progress investment into the CHP sector. A primary difficulty faced by CHPs and their lenders is the absence of a suitable credit product. The CHP business model with its small surpluses is suited to long tenure loans that enable amortisation of principal and interest over lengthy periods at a set interest rate. Banks on the other hand prefer loan tenures to match their own wholesale borrowing commitments, which are typically of short duration.

This leaves financiers with development finance, which assumes housing will be sold within a relatively short period, providing a lump sum of revenue with which to retire the debt. Development finance thus presents difficulties for CHPs who wish to retain the housing. Financiers have responded to this dilemma by allowing development loans to be refinanced with property loans that are then repeatedly refinanced. The capacity to service debt is of course limited by the free cash flow available. Conversion to property loans however is not without other problems. Refinancing involves the risk of interest rates being reset, and requires

properties to be re-valued, which is expensive. Having multiple loans relating to multiple projects adds to costs.

Loan facilities (a line of credit rather than a project specific development loan) have become more common in response to these problems. These facilities provide CHPs with working capital for development but also function partially as property loans. They enable greater certainty over cash flow and reduce transaction costs although the lender takes fixed and floating charges over the assets of the company (rather than over the project, as in the case of development finance). Unity Housing in South Australia has a \$50 million loan facility with the Commonwealth Bank of Australia (Evans 2016) and St George Community Housing Ltd (SGCH) has a \$40 million facility with the Clean Energy Finance Corporation (Corrs Chambers Westgarth 2017). SGCH's debt facility was increased to \$130 million on the back of their successful tender for social and affordable housing funds (SHAF) in NSW (Corrs Chambers Westgarth 2017). The SHAF involves guaranteed monthly payments from the NSW Government thus providing a revenue stream with which to service debt. The significant increase in the size of SGCH's facility underscores the issue of CHP cash flow as a borrowing constraint. The SHAF, however, supports a very limited number of CHPs, leaving the balance of NSW CHPs with project financing as their sole option.

The extent of private investment in social and affordable housing is difficult to determine. Data provided to the Housing Registrars in Victoria and NSW indicate interest bearing loan liabilities held by registered CHPs of \$313 million and \$136.9 million respectively (OHR 2015-16; RCH 2014) (data from other states is not published). Westpac reports \$1.05 billion of investment in social and affordable housing (Westpac 2016), but just as the quantum of private investment in social and affordable housing is unknown, who the investors are is not available. Bank lenders however account for the vast bulk of lending, although the Australian Government's Clean Energy Finance Corporation has emerged as a new source of non-bank finance for CHPs (Corrs Chambers Westgarth 2017).

In short, the size of the current market for private financing of community housing is unknown. Only a proportion of this existing private finance is SII.

3.3 SII in community housing

Banks were the only identified source of SII in the registered community housing sector. We estimate the quantum of SII at \$1.5 billion. Westpac denominates all of its community housing loans (\$1.05 billion) as SII, making it the largest SI investor in social and affordable housing in Australia. Community Sector Banking and Bank Australia are also SI investors in the sector.

3.3.1 Limitation on borrowing: cash flow of CHPs

CHPs providing rental housing, especially social rental housing, traditionally aim for minimum surpluses as this permits them to set rents as low as possible. Increasingly registered CHPs are being required to leverage the assets they hold as a condition of obtaining grant funds (Lawson, Milligan et al. 2012), requiring additional free cash flow with which to service this debt. The public policy justification for stock transfer from public housing authorities is to provide CHPs with assets that can then be leveraged, thereby enabling private investment to drive growth in the provision of social and affordable housing—the rationale is that assets provide the collateral required for securing loans. The Victorian Government required CHPs to leverage 25 per cent of their assets as a condition of accessing \$300 million in funds in 2007–08 (Lawson, Berry et al. 2014). The Victorian Auditor-General's Office (2010:15) found however that 'the transfer of assets did not increase their [CHP] rental income and hence does not provide any greater capacity to service interest and capital repayments for borrowings'. The Victorian Government later imposed a leveraging requirement as a condition for obtaining Nation Building Economic

Stimulus Plan Social Housing Initiative funds, and more recently the NSW Government set leverage targets for CHPs (Lawson, Berry et al. 2014).

The level of gearing of Victorian CHPs is nevertheless relatively low compared to the value of the assets held. Victorian debt levels did not reach the 25 per cent target and gearing sits at 13.8 per cent in 2015–16 having fallen from 14.7 per cent in 2013–14 (OHR 2015–16). The target could not be reached because the value of assets able to be used as collateral for loans is only one element of credit assessment. The purpose of collateral is to provide assets that can be sold in order to recoup loan funds in the event of non-repayment of the loan. (In the build-to-sell development model collateral is often only the project itself, the value of which is quite low until project completion, which is why director guarantees are sought.) The ability of the borrower to service the loan is a more fundamental consideration. Cash flow evidences the borrower's ability to service loans and hence is instrumental in determining the size of the loan.

For CHPs whose model is to build and retain or to receive and hold, revenue is limited to rental receipts, which by definition are constrained by the capacity of the low-income households they serve. Furthermore, rental revenue is not guaranteed (some properties may also be hard to let and/or subject to tenant turnover or default) and the quantum of rental receipts is subject to change reflecting variations in household income (e.g. the propensity of family households to convert to single person households over time). Lenders typically 'stress test' cash flow assumptions as part of the credit assessment process.

Current policy settings in Australia means CHPs can be asset-rich but remain income poor. This income constraint is a major barrier to achieving the surpluses required to be able to leverage assets. As Gilmour (2010: 8) argues, CHPs are 'constrained more by weak cash flows from tenancy management rather than by a lack of asset values'. CHPs naturally are acutely aware of the problem, as are lenders, including the SI investors.

Because you can only leverage off your cash flow ... and their leveraging is somewhere between 20 and 25 per cent. (19, investor)

In addition to seeking collateral for loans lenders also require security over cash flows and impose an interest cover ratio. This is a requirement that a portion of revenue be held as cash in case of default on repayment. In effect, it means a surplus must be generated and held, with these funds unavailable for other uses, which exacerbates the problem by further constraining free cash flow.

CHPs and lenders, including SI investors, are acutely aware that the current CHP model cannot support much growth.

At the end of the day, you need to somehow shift the economics of the sector for capital to flow into it, because otherwise, it will be constantly constrained. (15, intermediary)

It was argued by most interviewees that recurrent subsidies in some form are needed to support the cash flow necessary to enable investment in social housing and affordable housing. The NDIS and the NSW SHAF were seen as providing such support.

Basically, what the New South Wales Government is doing is they would be providing a monthly service payment for you to develop and manage [housing] over a 25-year period ... [the] top up payment from the NDIS should make it commercial for you to build disability housing. (6, Investor)

Government recurrent funding also provides additional security for lenders. In contrast to NSW the Victorian Government announced the establishment of a loan guarantee fund that addresses the risk of non-repayment (by recourse to government) without tackling the most likely underlying cause for default (an unanticipated cash flow shortfall).

Milligan, Pawson et al. (2017) identify lack of control over assets and lack of assets as impeding investment—particularly institutional investment in CHPs. SI investors in our sample said that although they would always seek assets as collateral for loans they did not consider such assets as actually providing lending security.

[The thing] with community and affordable and social housing is you can't actually sell those properties. It's just that they have to be transferred to another community housing provider. (6, bank)

Increased understanding of the regulatory environment has meant lenders' fear of reputational damage in foreclosing on CHPs and the consequential eviction of low-income tenants (the 'Ray Martin test') have abated.

Increasing familiarity with CHPs and understanding of the regulatory environment provides investors with detailed knowledge of the risks they face in lending to CHPs and in particular the variables that affect free cash flow. Lenders therefore are highly sensitive to government policy because changes not only affect future investment decisions but also can materially damage existing investments.

Government policy decisions removing CHP discretion over housing allocations, and adverse changes in income support undermine the capacity of CHPs to manage cash flow and hence are a major risk to private investors.

3.3.2 Rent subsidies, allocation policies and income support

Despite the attention of SI investors to the cash flow of CHPs and a high degree of consciousness of the rent-subsidy impact of the NRAS and NDIS, SI investors did not focus on the rent-subsidy problem itself, although some such as SVA have publicly advocated for changes to CRA (SVA 2016:6).

State and territory government officials and CHPs raised the possibility of adverse changes to CRA and the risk this would present for CHP cash flow.

It's a pretty risky proposition to hang the whole business model off a Commonwealth payment, which is not actually about supporting supply of community housing. (26, Government)

In addition, lack of adequate indexation of benefits (such as unemployment benefits) was raised as an example of how small changes could over time become a significant problem for CHPs.

While cost recovery through rent setting is not possible, tenant selection by CHPs must balance the need for revenue against tenant need. The tenant profile of a CHP is typically the largest determinant of CHP cash flow—if the tenant profile changes, revenue from rental receipts will shift.

General trends can be factored into financial forecasts but exogenous factors (e.g. an increase in the unemployment rate) have consequences for cash flow that can be difficult to manage. An exogenous factor such as state and territory governments requiring a greater proportion of tenants to be taken from public housing priority waiting lists further constrains rental revenue (Lawson, Milligan et al. 2012). CHPs argue increasingly restrictive allocation policies seriously undermine the CHP financial model, which is to have a larger low needs/low cost cohort of tenants cross-subsidise a smaller number of high needs/high cost tenants.

We had a cross-subsidisation model where there's probably 60 per cent of our tenants are tenants that are fine; they're just low income. We only need to see them every couple of years and there's very low risk that they're going to damage their property and we're going to have maintenance issues. But there's 20 per cent of our tenants that are at the opposite extreme, and for reasons that we're very sensitive to; which

are everything from mental illness to addiction to different forms of disadvantage and disability ... the latter group, we have to see every week or every second week. (16, CHP)

The shift to higher need tenants typically involves a shift to households that are less likely to participate in the labour market, and if they are a single person on unemployment benefits the very low level of income support translates into very reduced rental receipts when compared to a family. If the tenant is permanently out of the workforce it removes the potential for revenue growth (through rising incomes). Higher need tenants are also more likely to be lone person households, who on a per person basis are more expensive to house and have lower household incomes, thus providing lower rental returns.

The new requirement for Victorian CHPs to take 75 per cent of new tenants from the public housing waiting list (Victorian Government 2017) is likely to reflect the political challenges of growing public housing waiting lists and a record shortage of affordable private rental housing (although CHPs report this policy change is presented as a need to prevent CHPs cherry picking waiting lists). However, unlike public housing systems CHPs cannot run deficits. Other state governments however are cognisant that the current rent-subsidy model requires CHPs seek higher income households.

The biggest challenge is really about the community housing organisations being able to repay the debt, and getting the...balanced portfolio that mixes up probably the big subsidy stuff along with the NRAS or other models which might generate a reasonable surplus so that they can actually service the debt that they're taking on, is obviously the most important thing' (26, Government)

SI investors understand the need for cross-subsidisation and also support the social diversity that cross-subsidisation creates, with diversity seen as a key to sustainable communities. While SI investors took a minimalist approach to measurement of impact, with housing provision to target groups generally the only indicator, intermediaries in particular advocate for mixed communities in order to realise impact beyond shelter itself (see SVA 2016).

One of the consequences of the current rent setting policy is that key groups of interest to SI investors, such as homeless youth, are particularly disadvantaged by it. The requirement to charge 'affordable rent' (being 30% of income) results in not only a very small rental income stream but effectively means little CRA can be captured.

I've complained about that because ... there's no incentive for any community provider to house a young person. It's a perverse system. (24, Government)

Government officials and CHPs identify income support measures as inadequate to support a sustainable community housing sector and adverse changes a source of risk that affects private investment. The SI investors however were not focussed on these issues (that is, they recognise constrained cash flow but not the volatility of cash flows arising from these broader policy settings).

3.3.3 Housing supply bonds

There was considerable interest across CHPs and SI investors in housing supply bonds (HSB), and familiarity with existing Australian research into HSB. HSB were the opportunity most commonly identified by interviewees. Lawson, Milligan et al. (2012:9) describe bond financing as follows:

A bond is a debt security issued by governments and private companies to meet their financing needs. While bonds have many different characteristics, they all involve the obligation to make regular payments or coupons (at either a fixed or floating rate) over a defined term to bond holders. On maturity, the bond is redeemed. The yield to

maturity is determined by all interest payments received plus any gain or loss on the purchase price of the bond. In general, the higher is the yield, the greater is the risk. Investors buy bonds to receive regular interest payments and to diversify risk in their portfolios.

HSB are viewed as a means of CHPs obtaining cheaper debt thus freeing up more cash flow to service debt and consequently enabling greater leveraging.

It costs an enormous amount of money for community housing providers to keep going back to their bank every three years to get a loan on a house, which has a 30-year life span. And they have to start six months out, and they have to pay fees, and they have to get valuations, and they have to do all the transaction costs and plus opportunity costs of their time. So, it is a real benefit if even if the rates stayed the same, but the maturity happened every six years instead of every three years, it would be a material saving. Is that savings enough to change the model so that the 25 per cent discount on rent's available? I don't think so. (24, government)

There's only two ways that I see they're going to be able to increase the leveraging from what they do. One is to have a debt instrument that has lower debt servicing requirements, longer term debt, which is like the housing bond. So, that allows them to drop their servicing requirements down to a point where they can take up some construction finance. (19, investor)

HSB were seen as applicable to affordable housing provision rather than social housing because of the surpluses that could be generated to enable debt servicing. Three elements were identified as essential for the success of a HSB: a flow of subsidies to meet the gap between tenant capacity to pay and the cost of provision; a government guarantee to support investor confidence; and yield enhancement (government subsidisation of investors) such as through a low-income housing tax credit or 'some NRAS mark two ... that will send a clear signal to the market that there's a subsidy in place or payment system in place that is going to attract private capital' (15, intermediary).

However, there were differences of opinion. One SI investor argued that while a HSB would support the largest CHPs and help supply, these providers had ready access to cheap debt, and that smaller providers who currently had difficulties accessing capital markets would not be able to access HSB funds.

I think there's a little bit of a gap in the understanding there in terms of why the investment is not going there. And I think it's because the ones that really need the capital don't have a strong enough balance sheet or a big enough scale to attract capital from institutional investors. (25, investor).

This comment goes to the function of HSB. Analysis and debate on HSB tends to ignore or give the briefest attention to the purpose of development finance, and perhaps inadvertently suggests HSB would replace development finance. The cost of capital provided for development finance reflects the risk of construction. It is not clear at this point in time whether HSB would be used to fund development as well as operations (as occurs to some extent in the UK). A bond that covers both would be priced higher than a bond that pays out the development loan at project completion when construction risk is no longer an issue. If the latter, the risk the aggregator assesses is whether CHP revenue will exceed costs enabling the delivery of the surplus required to make loan repayments. The higher cost of capital for development finance still applies but it is capitalised into the new loan. The benefit to the CHP of bond finance is that repayments are effectively interest only for a long period; repayment of principal at maturity is deferred through later refinancing.

Bank debt will always be used for construction finance. But [the affordable housing] model is to take that construction debt and turn it into core debt, and hang onto it ... And they'll just keep taking debt out for as long as they can. Debt that matches the asset's life, effectively. And that allows them to do that so that their asset management strategies and their finance strategies actually reflect each other. (19, investor)

As noted in sections 3.3.1 and 3.3.2 a key concern is the economic model for affordable housing. While some SI investors suggested schemes such as the US LIHTC or a new NRAS (schemes that increase reliance on government expenditure/foregone revenues), another SI investor argued the need

... to change the business model from building and holding, to building holding and selling. So that you've got the capacity to support more construction by selling off some [housing]. (19, investor)

Just as CHPs have cross-subsidised high needs/high cost tenants with surpluses from low needs/low cost tenants, development of housing for sale was viewed as a necessary shift in the CHP model. It was argued that the ability to generate larger surpluses would mean the yield required by bondholders could be supported, in which case a bond issue (by a market actor) could take place, and the sector would not have to wait for government action.

Bonds were perceived as the mechanism to tap into the large quantum of capital required to overcome the large deficit of affordable housing. The main sources of capital cited are institutional investors such as superannuation funds. Superannuation funds argue there are a number of conditions that would need to be met. The larger funds require minimum investment lots (hundreds of millions rather than tens of millions) and investment must provide for liquidity. Bonds fulfil the latter requirement, as they are tradable in secondary markets, and could fulfil the first, if the market were large enough. Bonds are, in effect, a means of obtaining long tenure debt utilising short term investment. Credit enhancement is advocated by the superannuation industry (ISA 2016), as a means of providing confidence to the market. Fiduciary duty (the need to maximise returns) is argued as restraining investment as affordable housing is not viewed as providing requisite returns for the risk. The yield on bonds therefore would need to be subsidised by government (through means such as a tax credit).

Government interviewees however rejected the suggestion that institutional investors should be subsidised this way in order to support affordable housing. Investor (19) argued that if the CHP model changed to developing and selling some housing in order to fund housing provision superannuation funds could invest without bond yields being supported. This investor further argued that the yield sought by superannuation funds is too high when the low cash rate was considered and the price of debt had fallen; that affordable housing diversifies the portfolio held by superannuation funds and hence mitigates risk, and thirdly that affordable housing represents a safe asset class. Institutional investors such as superannuation funds invest in a wide variety of asset classes providing them with a portfolio of investments with a mix of duration and risk/return characteristics. They adopt such strategies in order to diversify risk in order to ensure stable returns over a long period.

In relation to arguments concerning returns on investment, the National Association of Pension Funds (NAPF) in the UK advocates for investment in social housing, arguing returns are higher than those available on inflation-linked gilts (that is, on government bonds), with yields on government inflation-linked bonds being negative or approaching negative (NAPF 2012). Gilmour, Washer et al. (2012) state bonds have long been a feature of social housing finance in England with rating remaining relatively stable (although affected by the GFC). The CHP sector currently has debt commitments of as much as \$2 billion. This debt is for established housing (i.e. it has a lower risk profile than development projects). If a bond were issued this existing debt would be immediately re-financed.

One superannuation fund's interest in SII was being driven by member concerns about lack of affordable housing. This superannuation fund however had not contemplated changing its credit assessment practices or funding guidelines in order to facilitate the creation of a HSB. An active SI investor superannuation fund however very specifically viewed its mandate as assisting CHPs to become market ready (and thus treated credit assessment and fiduciary duties differently) demonstrating that superannuation funds often see barriers to investment in affordable housing as legal in nature when they are in fact policy positions.

While superannuation funds have the capital to invest they will not do so unless their conditions are met. In the short term this will not happen, so superannuation funds will remain only potential SI investors until a HSB is realised or a CHP can propose a deal worth at least \$100 million.

3.3.4 Government grants to grow the CHP sector

Social housing is viewed as being a government responsibility, with little opportunity for SII unless there is a payment stream to support borrowings as with the NSW SAHF.

The social housing business model is not self-sustaining ... for most social housing developments you need something else and I think that's where government has an essential role to play. If you look at what in New South Wales is happening with the Social Affordable Housing Fund, they've got a clear recognition that government needs to step in to make these models stack up if you're going to expand the supply of social housing. (1, intermediary)

The SI investors are very conscious that there is a large gap between the cost of supplying social housing and rental revenue, if rents are to be affordable to low-income households. Capital grants to CHPs were viewed as a key means of supporting SII. The closer alignment between cost and rental income means the provision of affordable housing is a better proposition but is nevertheless viewed as marginal. The prospects for growth of social housing and of SII in affordable housing,

... still requires government to prime the pump ... we still need a government subsidy of some kind. (14, intermediary)

3.3.5 Competition for CHP business

The interviews indicate that CHPs are able to attract development finance on competitive terms, satisfying lender's requirements relating to credit provision. Larger CHPs use loan facilities for larger development projects and when they have a pipeline of developments.

So, to small providers it's project specific debt. So, "I want to go and buy a property" and we'll give them an according loan, whereas at the larger end ... they will approach us and say, "Right, here's 500 properties, we need a \$50 million facility against those" for them to go and run whatever projects they need to. (13, investor)

Bank lenders are interested in both providing debt to CHPs for development and providing transaction accounts. Competition for loan provision therefore also involves competition in regard to transaction accounts, with CHPs able to hold out the prospect of banking with the lender, and banks able to hold out the prospect of cheaper debt. Relationships with lenders are considered to be valuable in obtaining both cheaper debt financing and lower cost banking facilities, but competition amongst lenders means CHPs can and do shop around for the cheapest debt. The implication for SII is that SII debt needs to be price competitive.

As discussed in section 3.2 CHPs are frustrated by the limitations of development finance. While projects can be re-financed the costs of and risks of doing so are considerable. Some of the non-SI investors remained competitive by modifying their terms to reduce such costs and

risks. For example, by accepting that only a proportion of properties are re-valued when refinancing occurs, as the excerpt below illustrates:

It's not just the pricing ... you might look at your interest [cover] ... ratios ... the length of the term and whether you could fix some of the borrowings at a fixed cost ... because it [takes] some of the risk ... out of the equation. (3, CHP)

The most significant innovation revealed through the interviews was SII bank lenders offering loans of 10 and 20 years tenure, which in due course may be refinanced. While the cost of this capital is not at a bond level, these loan products are a significant improvement on existing development finance and permit the CHP a greater element of control over their cash flows.

Given the concentration of the Australian banking sector, competition between lenders is undeniably important and cannot be taken for granted. Bryant (2012) found a serious reduction in lenders and hence opportunity for development financing as a result of the GFC. SII therefore may be seen as providing additionality by giving CHPs the opportunity to obtain the best possible finance deals whether or not the SI investor is the actual investor, by providing competition in the market. Further, it could be argued that SII bank lending to CHPs has encouraged lending per se. Until recently it was difficult for CHPs to obtain loans so while SII banks have been only part of that change, the competition they provide may have helped the shift. SII highlights path dependencies in financing property development involving rigid adherence to norms based on past successes.

There is definitely market failure ... because certain approaches have worked in the past and for all stakeholders have been profitable, they get repeated ... I have no criticism whatsoever of mainstream finance. If they have a very successful profitable business supporting small businesses through standard lending criteria, why on earth would they change? ... Now I think impact investing can provide finance to do things differently because it is looking beyond a pure profit motivation. So, it will naturally encourage innovation in how things are being developed. (1, Intermediary)

Finally, we found that SI investors were required to offer competitive rates and terms in order to be more attractive than non-SII, however there was no evidence that they accepted concessionary returns. According to the accepted SII typology, this means these bank lenders are finance-first investors, yet these SI investors along with their non-SII competitors also amended their credit assessment frameworks in order to facilitate investment in the first instance.

3.4 Policy development implications

Private investment in community housing, whether SII or not, is fundamentally about whether the combination of capital grants, subsidies and rental income is sufficient to fund construction of new stock and maintain existing stock, pay the cost of capital (that is, provide the capacity to service debt) while enabling rents to be held at a level that is affordable to the lowest income households. CHPs have taken on debt to enable growth but leveraging of assets is fundamentally constrained by their ability to generate positive cash flows. This reflects the lack of subsidies to fund the gap between affordable rents and the cost of housing provision. Australian CHPs therefore represent a limited opportunity for private investment, including SII, as free cash flows are constrained by lack of government investment. Provision of affordable housing rather than social housing generates greater free cash flow reducing the reliance on subsidies and permits larger borrowings. But other than housing delivered as a result of NRAS there has been little growth in the affordable housing sector.

The first policy issue is the lack of a subsidy stream to close the gap between rental revenues and cost of provision. In the UK Housing Benefit performs this function and acts as an implicit

guarantee. Commitments to capital grant funding in the UK, until recently, meant private investment could be leveraged enabling substantial growth in social housing. Together these created the conditions for bond financing, lowering the cost of capital and providing for long tenure debt. Investor confidence has been damaged however by cuts to the Housing Benefit.

The second issue for policy in Australia is that welfare entitlements are subject to cuts aimed at reducing public expenditures, which have material impact on CHP revenue. A key method of mitigating the impact is to adjust the tenant profile in favour of households, which have higher incomes and return higher rents. Some state governments, in an effort to target public funding to the most vulnerable, have imposed requirements on CHPs to take a high percentage of tenants from the priority public housing waiting list. These tend to be low return, high cost tenants, and such measures risk, in time, CHPs being unable to generate positive cash flow, reduce the capacity of CHPs to borrow and limit growth, and conflict with leveraging targets.

Thirdly, the viability of CHPs needs to be assured through an ongoing capital grants program and a subsidy stream that meets the funding gap between affordable rents and the cost of housing provision in order to provide the foundation for a future HSB. A HSB will only be successful if CHPs are an attractive investment proposition.

4 Social impact investment in housing other than community housing

- **Most SII in housing other than community housing reflects:**
 - Housing providers inability to access mainstream lending and the investor's objective to support such organisations to become 'market ready'.
 - A reconceptualisation of credit risk by SI investors.
 - SI investor dissatisfaction the CHP model of provision.
 - **There is an estimated \$20 million of SII, which is provided by non-bank investors.**
 - This investment is provided by small superannuation funds, philanthropy, not-for-profit organisations and individuals.
 - Half of this investment is debt provided on a non-concessionary basis.
 - The other half is equity investment provided on a concessionary basis.
-

While SII in the registered community housing sector constitutes the largest component of SII in social and affordable housing, by virtue of SII bank lending, there are non-bank debt and equity investments in social rental housing and in home ownership schemes for both low and middle-income households.

The non-bank SI investors include the Lord Mayor's Charitable Foundation (LMCF), Christian Super, high net worth individuals (HNWI), other individuals, family offices and NFP organisations. Self-managed superannuation funds (SMSF) are an important, if unquantifiable, source of non-bank SII funds. Superannuation fund HESTA finances social enterprises that provide revenue for CHPs to support new supply, but as of the publication of this report had not directly invested in housing although the funds are available to do so. HNWI, other individuals and SMSF were the only providers of equity finance. While definitions of SII impinge on what may be included in any compilation of SII in social and affordable housing to date, we estimate there has been non-bank SII of \$20 million.

Three intermediaries—Foresters Community Finance (FCF), Social Enterprise Finance Australia (SEFA) and Social Ventures Australia (SVA)—are responsible for the placement of the vast majority of non-bank SII in social/affordable housing in Australia. These intermediaries have attracted funds from NAB, Triodos Bank, HESTA, Christian Super, Community Sector Banking, NSW Aboriginal Land Council and HNWI.

Box 1: Community Sector Banking

Community Sector Banking

Community Sector Banking (CSB) is a joint venture between Bendigo and Adelaide Bank and Community 21, a coalition of not-for-profit organisations including Jobs Australia, Oxfam Australia, Scope and ACOSS. CSB became Australia's first banking service to gain B Corporation certification. B Corps seek to solve environmental and social problems through the power of business and profit for purpose. CSB is a major lender to CHOs and is pursuing a number of innovative programs to deliver of social and affordable housing, including issuing affordable housing bonds (Jobs Australia 2015), which they argue would be attractive to offshore investors, such as pension funds seeking 20 year plus tenures (CSB nd).

Source: Jobs Australia (2015); CSB (nd).

To date non-bank SII in Australia has been small scale with intermediaries playing an important role in placing funds. The following details are what is publicly known about these investments, drawing on grey literature and Internet searches.

Table 2 outlines what is known about four affordable rental housing projects, each of which involves debt financing by one or more of the three SEDIFs (SEFA, SVA and FCF). Each investment was for construction. Other than Sustain Housing rental income is intended to service borrowings. In the case of Sustain Housing property sales are used to retire debt leaving the remaining units debt-free for social or affordable rental.

Table 2: Affordable rental housing projects

Borrower	Connect Housing	Lifestyle Solutions	Myrtle Park	Sustain Housing
Purpose/rationale	4 homes for low-income/disadvantaged	Construction of 1 home for 4 autistic youths	Construction of 4 retirement units	Construction of homes for physically disabled
Investor	FCF	SEFA	SEFA	SEFA, SVA
Where	Queensland	NSW	Tasmania	NSW
Grants	Council land grant	Unknown	Tasmanian Government	Unknown
Funding arrangement	\$675,000 loan 15 years NRAS rebates	\$1.2 million loan	Loan approx. \$500K	\$2 million loan 1 year 4 homes to be sold on private market to fund retention of 2 debt-free houses
Why SII rather than mainstream finance	Unable to secure mainstream finance	Better values match than mainstream financier	Unable to secure mainstream finance	Less difficulty in securing funds

Source: Alembakis 2013, Foresters 2016a, Foresters 2016c, SEFA 2016a, SEFA 2016b, SEFA 2016d, IIA nd.

In 2015 the LMCF and SEFA established the Affordable Housing Loan Fund (AHLF) to address affordable housing and homelessness in Victoria. The AHFL is an example of program related investment (PRI). LMCF contributed \$3 million in capital and SEFA its financial knowledge and expertise as an intermediary.

Table 3 provides the publicly known details of two home ownership models supported by funds placed by intermediaries. The first model is HFH in which future owners contribute five per cent sweat equity (labour) with the home purchased by them for 95 per cent of market value. Purchasers are provided with a no interest loan by HFH with repayments capped at 25 per cent of gross household income (SEFA 2016e). HFH Victoria accessed AHLF funds in Victoria, HFH SA FCF and SEFA funds, and HFH NSW SEFA funds. Nightingale Housing Ltd is a NFP company, which licenses architects as developers to undertake limited profit development projects that provide apartments for sale.

Table 3: Home ownership projects

Borrower	Habitat for Humanity SA	Habitat for Humanity Victoria	Habitat for Humanity NSW	Project4change	Nightingale 1
Purpose/ rationale	Construction of 6 homes for low-income/ disadvantaged	Construction of 13 homes for low-income	Construction of homes for low-income	Construction of homes for households eligible for public housing in Queensland	Construction of 20 apartments
Investor	Foresters SEFA	SEFA (AHLF*)	SEFA	Equity	Debt syndicate including SEFA, SVA, Christian Super and two private family foundations Equity investors
Where	SA	Victoria	NSW		Victoria
Grants	Various Donations and in-kind contributions	Various Donations and in-kind contributions	Various Donations and in-kind contributions	None	None
Funding arrangement	FCF \$250,000 loan – 5 years SEFA loan facility	\$2,000,000 loan		Equity investors (concessionary returns) with non-concessionary debt	Equity (concessional) and debt
Why SII rather than market	Flexibility, appropriate finance	Flexibility, appropriate finance			Carbon-neutral financing, better understanding of objectives

*Note: *LMCF investment in AHLF is a Program Related Investment (PRI).*

Source: Foresters 2016b; Foresters 2016c; Nightingale 2016; SEFA 2016c; SEFA 2016e; SEFA 2016g; SEFA 2017; Spelitis 2017.

Project4Change (P4C) is a public benevolent institution (PBI), 'operating as a Community Enterprise property developer' (Project4Change nd). P4C raises equity with return expectations based on historical return (currently 8%) (P4C 2017), being a concessionary return. Minimum investment is \$5,000 (Project4Change 2017). The equity is used to obtain debt financing. A proportion of homes (one third in the first project) are sold to the market to provide a cross subsidy, while the remainder will be sold to households who are eligible for public housing in Queensland. Some of the retained earnings will be used for post-occupancy support. Retained earnings will also reduce the need for equity raising in the future. P4C plans to build 200 new dwellings in each of the eastern states within two years. The households are also provided with assistance with the deposit, with P4C providing a five-year interest free loan for 50 per cent of the deposit secured via by a second mortgage and a tripartite agreement with first mortgage holders (Community Sector Banking and other banks). At the end of the five years the property is re-valued. The capital appreciation is used to fund the retirement of the second loan. The second loan enables a LVR of 80 per cent, negating the need for mortgage insurance and saving the borrower thousands of dollars.

In addition to the above home ownership projects Bank Australia has partnered with Horizon Housing for the Horizon Second Mortgage Scheme. The scheme provides a new mortgage financing option for households in Queensland and northern New South Wales purchasing their first home. Eligible buyers service only 75 per cent of the mortgage with Horizon Housing servicing the remaining 25 per cent, with the 25 per cent recouped by Horizon Housing only when the property is sold (Bank Australia 2016).

4.1 Understanding the role of SII in other forms of social and affordable housing

In this section, we turn to SII in housing other than in the registered CHP sector. The research reveals differing responses to problems of affordability and different approaches to housing provision. In relation to registered CHPs (Chapter 3) financing proceeded on the basis of the organisations being 'market ready', that is, being financially credible borrowers able to access mainstream investment. Some of the non-community housing models however found access to mainstream finance difficult reflecting an inability to meet creditor's conditions. Accordingly, we describe these models as being 'sub-market'. These include both rental housing and home ownership models. Two examples were able to attract mainstream finance but sit outside of the CHP sector for other reasons. These are discussed in section 4.1.3.

4.1.1 Sub-market rental housing models

The inability of the sub-market rental housing models to attract mainstream lending typically reflected not having assets available as collateral, limited cash flow or not having a track record in development. A typical scenario would be where a housing provider currently manages social housing³ but does not own any assets and wants to build housing for the first time.

The projects and the quantum of loan funds provided by SI investors for sub-market housing activities are typically small (less than \$1 million, often far less). The aim of investing in this group of providers according to SI investors was to make organisations 'market ready'.

There's an issue with some people with no track record not being able to get commercial loans so this [investment] gives people the track record. (9, investor)

³ Some of these organisations could be registered CHOs but as 'providers' or Tier 3 organisations.

One superannuation fund viewed its mandate as including supporting small housing providers to become market ready, thus approached credit assessment and fiduciary duties differently to other superannuation funds, which indicates superannuation funds often see barriers to investment in affordable housing as being legal in nature, when they are in fact policy positions.

Some SI investors are keen to increase the capacity of sub-market housing providers to attract mainstream lenders, thus permitting social impact funds to be recycled into other sub-market projects, although they are also ready to have an ongoing relationship.

[Intermediaries] introduce debts to us that are bank ready after they've sort of brought them out of that not quite conforming space. (13, investor)

Intermediary SEFA received funds from NAB specifically to grow organisations that could in the future potentially become NAB customers. At the same time placement of funds in intermediaries tests and grows the market for SII, a market banks such as NAB have an interest in.

The deals with sub-market housing providers however involve more work for the lender, affecting the rate of return on capital they seek, which is typically higher than the market, although intermediaries tend to partially offset higher interest rates with lower fees and are conscious of the need to be competitive. The borrowers however are less concerned about the cost of capital than access to capital.

The sub-market projects funded by SI investors clearly deliver social impact and build the capacity of the project proponents. There have been however just a handful of projects funded, and SI investors report placing of funds a challenge. It is likely that sub-market housing lending will remain a very small albeit valuable niche market. These funded projects are particularly valuable because of how risk was treated and the implications this has for innovation.

Mainstream lenders consider the five 'Cs' of credit provision when assessing a credit application—*conditions, collateral, capacity, capital and character* (see Appendix 5 for definitions of each of these). The SI investors however interpreted the five 'Cs' less orthodoxly. In particular the SI investors viewed strength of NFP mission as enhancing 'character' and 'capacity' rather than posing a greater risk, as conventional lending practices dictate.

We have a fundamental belief that a mission-driven organisation is more resilient than a pure profit driven organisation ... there's enough emerging evidence internationally ... you can see their default rates equal or outperform conventional pure commercial debt portfolios ... the likelihood of them throwing the towel in because things get tight for a couple of months, we believe it's much lower than if an equivalent organisation is purely profit driven. (1, intermediary)

[We] looked at the security of—the risks attached to the people that are running it, and their skills, and their competencies, and focus on those two things. (16, housing provider)

Resilience was connected to community support—a factor not considered in conventional financial lending analysis. Further, while mainstream lenders are inclined to see a problem with 'capacity' as tenants pay low rents, SI investors were highly cognisant of the source of tenants' incomes being underpinned by government backed welfare transfers.

The surety of the income, given this is very low-cost housing and it's all backed by government, if you like, pensions of different sorts. (16, housing provider)

They [SII] understood that we had a very, very steady tenant base and very low arrears, and even though while our income, you know, because of the low rents was low, it was a very secure income stream. (3, housing provider)

The ultimate source of funds to provide cash flow to housing providers reassured SI investors but there was also recognition that the level of demand for low rent housing provides security for lending.

[There is] security that comes with a waiting list of 200,000-odd people queued up waiting to get into it. (19, investor)

In one case the model of provision was development of housing where the majority of units are sold permitting a minority of units to be retained debt-free. These units are then head leased to a CHP or disability organisation. The retained units then provide collateral for subsequent mainstream loans. As a new NFP without assets this organisation struggled to obtain project finance although the principal also owns a large for-profit development company able to attract mainstream finance. The proponent was able to demonstrate he had the necessary track record (character), had attracted private equity (at a non-concessionary rate) via personal networks, had an appropriate LVR and a satisfactory internal rate of return but lack of existing assets precluded obtaining mainstream debt-finance so a SII intermediary filled the gap. The proponent in this case also contributed personal equity so he is also a SI investor. The motivation for doing so was a view that the supply of affordable housing could be increased dramatically by a focus on developing dwellings for sale as a means of funding social rental housing—that is cash flow to support development should be derived primarily from property development rather than from rental receipts. This view is supported by one of the SI bank investors.

4.1.2 Sub-market home ownership models

Recognition of the very high level of demand for affordable housing also unpinned SI investor thinking in regard to investment in home ownership projects. Some SI investors were particularly interested in projects aimed at households eligible for public housing. They were also keen to pursue models that have the potential to disrupt existing housing provision.

Habitat for Humanity

The Habitat for Humanity (HFH) model targets households reliant on income security, seeking to build their wealth via equity in housing, and in doing so reduce welfare dependency. The model involves production of housing using a considerable level of donations (materials and labour) with the purchaser contributing sweat equity. HFH provides interest-free vendor finance to partner families' purchasers with the market purchase price discounted to reflect their sweat equity. Repayments on loans cannot be more than 25 per cent of the household's income. Alternatively, in some states (e.g. South Australia) partner families are able to access government backed mortgage schemes for low-income households. The model recognises that if these households were in the private rental market they would be paying the equivalent or more in rent. The HFH model overcomes the market barrier faced by low-income households seeking home ownership by dramatically reducing the deposit required to purchase and by providing access to no cost mortgage finance. Repayments are also pegged to the household's own cash flow needs so can be reduced at times of financial stress. This sensitivity to the needs of households provides a form of 'insurance' as outlined by Stone, Sharam et al. (2015) and Sharam, Ralston et al. (2016)

Although HFH attracts a considerable level of donations, the model requires financing to enable land acquisition (in particular). Unlike CHPs providing rental housing, HFH will never have assets it can provide as collateral, which means mainstream lenders will remain unwilling to lend unless their views on risk change. What HFH has is positive cash flow (mortgage repayments) backed by borrowers who do have assets. If a partner family defaults on payments HFH can theoretically foreclose (there have been no defaults to date and HFH sees no benefit in eviction). SII has enabled growth and improved economies of scale by lending against the

cash flow (capacity), viewing the deep community support for HFH (character) as providing 'security' for loans.

Nightingale Housing Ltd

Nightingale Housing Ltd is a home ownership model aiming at providing high quality, well-designed apartments to moderate income households, and in particular to first home purchasers seeking to live close to the city centre. The Nightingale Housing model involves architects being licensed by Nightingale Housing Ltd (a NFP company) to use Nightingale intellectual property (legal and financial templates), access to a waiting list of buyers and assistance with obtaining project finance. Licensees in return are required to conform to high design standards and provide the apartments at close to cost. Buyers on the waiting list are surveyed and interviewed about their preferences. There are four Nightingale projects in progress in Melbourne's inner north, with the first (Nightingale 1) under construction.

Development financiers typically provide only a proportion of the costs of a project, requiring the proponent to bring a significant capital contribution. As the target cohort is unable to bring this capital the Nightingale model is based on the need to raise external equity as well as debt. Equity investors provide 30 per cent and debt funding is sought for the remaining 70 per cent of costs. The four Nightingale projects have been able to attract equity investors willing to receive concessionary returns. These SI investors are primarily motivated by environmental concerns, with an interest in architectural and urban design but many are also concerned about housing affordability. A consortium of SI investors coordinated by SEFA ultimately provided debt financing for Nightingale 1.

The mainstream debt financiers initially canvassed wanted an internal rate of return (IRR) of no less than 15 per cent, preferably 20 per cent. Nightingale also wanted to take presale deposits of five per cent (to assist in overcoming the 'deposit-gap' problem for buyers) and this too was rejected. Mainstream lenders also sought personal guarantees from the company directors (a demand that reflects the limited value of the project assets as security). The architect-as-developer as sole director was unwilling to provide such a guarantee.

The SI investor consortia providing the debt however supported a reduced IRR and five per cent pre-sale deposits, recognising these measures represent savings for buyers and improve access to home ownership. Nightingale resolves the requirement for 'profit' through investing the profit in the owner's corporation or potentially via disbursement to purchasers after settlement. The SI investor did not require the director guarantee. The model also involves caveats being placed on titles that limit the extent of possible capital gains at resale. Both equity and debt financiers have supported this measure. The caveat works to deter would be property investors and encourages owner-occupiers to view their housing as shelter rather than a means of making money.

The higher valuation (reflecting the high design and quality) combined with the lower purchase price means the loan to value ratio for mortgage lending is less than 80 per cent, permitting purchasers to avoid mortgage insurance. The sustainability features also mean the owners will have reduced living costs.

While the aim of Nightingale is to provide affordable home ownership, the savings are relatively modest, but Nightingale Housing Ltd and the SI consortia recognise that changes to the model could deliver far more substantial gains. While the debt to equity ratio for Nightingale 1 was determined in response to mainstream financing requirements, and prior to the involvement of SI debt financing, future Nightingale projects will seek to increase the proportion of debt to lower financing costs and thus the cost of the housing. Modelling changes to the debt to equity ratio on Nightingale 1 indicated a shift from 30 per cent equity to 10 per cent equity (and 90% debt) would save around \$100,000 per apartment. Higher equity requirements however are means by which lenders traditionally mitigate risk.

Nightingale Housing Ltd argues settlement risk can be addressed to compensate for the increase in debt exposure. Settlement risk refers to the risk that buyers will renege on their pre-sale contract. Presale contracts are settled as soon as titles are created (at the completion of construction and once the certificate of occupancy is granted), which happens to be when all the project funds have been expended and proponents (and their debtors) are most exposed. Nightingale Housing Ltd argues on the basis of Sharam et al. (2015a; 2015b) that consumer engagement and inclusion of their preferences mitigates settlement risk while the Nightingale waiting list ensures a replacement buyer should settlement failure occur. The waiting list also reduces marketing costs further, reducing the cost of provision and increasing the attractiveness of purchasing a Nightingale property, and ensures demand remains high.

The SI debt consortia accept these arguments for increasing the debt to equity ratio as legitimate. For their part, the SI debt consortia would like to see buyers form cooperatives to become 'deliberative developers' (groups of intending owner-occupiers undertaking multi-unit development who are able to internalise the developer margin and thus procure more affordable housing (Sharam, Bryant et al. 2015a)) in place of the architect-as-developer. The advantages of this shift in the model would be to permit presale deposits to be transformed into equity; the IRR would accrue to the home owners; enforceable capital gain restrictions; and cooperative assets could be used as collateral for further developments. The SI debt consortia are also interested in how the existing model or future variations could be used to provide housing for those with disability, and/or involve partnerships with CHPs to include some social rental housing to increase the diversity within developments. In response Nightingale Housing Ltd has included disability housing as an objective in their constitution.

4.1.3 Alternate market ready models

Affordable Homes

A third home ownership model (which we call 'Affordable Homes' as they wished to remain anonymous) has elements of both Nightingale and HFH. The impetus for Affordable Homes, a NFP company developing inner city apartments for sale, was concern about the growing number of homeless persons and the lack of social housing. On becoming aware that a proportion of public tenants pay market rent but prefer to remain in public housing the proponent looked to ways these tenants could be convinced to exit the public housing system and thereby free up social rental stock for those more in need. Affordable Homes believes barriers to exit from public housing (arising from lack of secure tenure in private rental and lack of affordable home ownership in inner urban areas) can be resolved by providing apartments at cost, as there is a significant difference between the cost to produce apartments and their market value. Further savings accrue as NFPs do not pay the full GST applicable to for-profit development. The proponent believed Affordable Homes can provide housing at a 40 per cent discount to market.

The scheme does not oblige purchasers to retain the apartment and they can sell immediately if they wish. However, they are required to pay the difference between the original purchase price and the original market valuation to Affordable Homes. Affordable Homes obtained a debt financing commitment from a non-SII bank lender, having rejected SII debt lenders as uncompetitive. As an existing for-profit developer, the principal was able satisfy the credit assessment requirements (through having a track record and providing security). The principal of Affordable Homes is providing a 30 per cent equity contribution on a concessional basis (zero return). This can be considered a SII. The public tenants however faced discrimination in obtaining mortgages—many mortgage providers assumed these public tenants are not credit-worthy and were not willing to proceed to assessing their capacity. Some of the bank SI investors who provide mortgages have agreed to offer mortgages, demonstrating credit risk is often focussed on norms rather than assessment, and how nuanced impact-creation can be.

Affordable Homes identified a gap in the market and in policy but its solution is dependent on credit assessment of its buyers by mortgage providers.

STEPS

An entirely different NFP housing model was adopted by registered training organisation STEPS who built housing as part of its trades skills program (Milligan, Gurran et al. 2009). Undertaken prior to SII becoming an established form of investment in Australia, it nevertheless met all the SII criteria. Most of the housing was initially sold but they realised that some of the housing could be retained, debt-free, as social housing, thus providing another much-needed service for the community. A REIT was created to progress the venture. The REIT attracted 20 investors with the majority holding (51%) of units held by local NFPs (in order to ensure the trust maintained its focus on the mission), and 49 per cent owned by individuals and SMSFs who supported the initiative. The unit holders were provided with returns that were higher than term deposits. The cost of the equity capital was on par with the cost of bank debt at the time. These investments were made on the basis of non-concessionary returns. The trust was wound up however when liquidity became a problem as a result of the GFC, and debt funding could not be obtained from banks. This model is different from CHPs because of the equity investment and the sole focus on generating revenue from development activities to fund social housing rather than relying on capital grants from government. The model demonstrates how social impact equity investment can catalyse the supply of social housing. The former CEO argues CHPs need to increase their cash flow via development activity, and that this along with cheaper debt financing (via HSBs) would enable CHPs to be financially sustainable.

In addition to these initiatives, SII banks are offering various new shared-equity home ownership products. These products again demonstrate the multiple points of intervention the impact-first SI investors identify as spaces for investment, outside of credit norms.

4.1.4 Implications of the non-community housing models

Sustain Housing, Affordable Homes, Nightingale Housing, STEPS, and Project4Change are examples of impact-first SII in which a vehicle for investment has been specifically created to further the impact objectives of the investor(s). The SII market is typically conceived of a supply-side and a demand-side, but we see in these examples that this distinction does not hold. These SI investors take a far greater role than being suppliers of capital. One of the reasons for doing so was dissatisfaction with the CHP model and its reliance on capital grants and/or negative perceptions of CHP governance and management. Another key theme was that social housing fosters welfare dependency. This latter sentiment also characterises H4H's philosophy. Nightingale Housing's concerns are somewhat different being focussed on households that are not eligible for social housing—while the other models challenge social housing provision Nightingale is critical of market provision of housing.

SII in this non-community housing space is supporting new actors and new ideas regarding the nature of housing assistance. The entry of these actors reflects deeply held concerns about housing affordability and the impact on individual welfare and society, and herald mainstream interest in what was once the preserve of the welfare sector. The implications of these models are profound: housing can be obtained at cost.

4.2 Policy development implications

The home ownership models are able to generate affordable housing supply for both low-income and intermediate income cohorts. Home ownership provides low-income households with an alternative to public housing and insecure private rental. Creating increased opportunities for home ownership for intermediate income cohorts reduces their occupancy of

cheaper rental housing that is affordable to the lowest quintile households but is not currently available to them (Hulse, Reynolds et al. 2015).

- Government guarantees would permit the raising of debt finance for a greater proportion of the costs of projects, reducing overall costs. The savings would be passed on to buyers.
- Alternatively, a revolving fund could be established, by government and/or SI investors, to provide equity to NFP, cooperative or deliberative developer home-ownership projects. The equity would then enable debt financing. The rate of return could be the same as competitively priced debt, but much lower if linked to provision of housing for lower income households.
- Deliberative developers are able to access lower cost housing by supplanting the developer. However, they still require the same professional services used by developers. These services, and assistance with group decision-making processes could be provided by CHPs on a fee-for-service basis. Thus, deliberative development is an opportunity for CHPs to generate a new source of revenue while providing improved housing affordability outcomes.
- SI investors are proving adept at identifying solutions to market and policy failures. A key area of interest is enabling sub-market CHPs to become market ready. By doing so they are expanding the number of organisations capable of providing housing supply and the diversity of households able to be served by CHPs. Government policy aimed at the growth of a few large-scale CHPs, while offering limited support to small CHPs, for example in Victoria (VAGO 2010: 4) and WA (Gilmour 2013), fails to maximise the opportunities for leveraging equity investment and donations (e.g. when a local government is willing to provide land to a local CHP). Governments could provide grants aimed at smaller CHPs who are able to attract equity and/or donations.
- The key policy implication of these non-community housing models is that they demonstrate the profit margin on market housing is a significant factor affecting housing affordability. Profit is rarely, if ever, the focus of housing policy reform. Indeed, despite numerous inquiries and reports on housing there has been little scrutiny of the development process, with commentary typically restricted to planning and taxation, and to a lesser extent labour and material costs (Sharam, Bryant et al. 2015b).

5 Land

- The cost of well-located land is an impediment to delivering social and affordable housing.
- Lack of access to well-located land will exacerbate the increasing socio-economic spatial polarisation of Australia's major cities.

CHPs and the non-community housing providers, investors and intermediaries were concerned about the impact of land costs on housing costs and the ramifications for where lower income households could afford to live.

Land was identified in relation to all types of development as a critical issue affecting affordability of housing, a problem previously identified by Lawson, Milligan et al. (2012). SVA cite the social impact of addressing the land component of delivering affordable housing as 'high' (SVA 2016:12). Land price as a cost component of development is viewed as having a major impact on where affordable housing can be built. With limited surpluses, affordable housing providers are acutely aware of the need to manage development costs and thus how much they can afford to pay for land. While well-located land is sought to provide households with labour market opportunities and access to services, project viability is increasingly dependent on increased distance from central city areas.

Inclusionary zoning is seen as one means of addressing of this problem (Spiller and Anderson-Oliver 2015; Gurran, Milligan et al. 2008; Sydney Alliance 2017).

If you're going to offer the housing at a 25 per cent discount on market rents where the underlying land value creates, of course, a rent value because ... the more expensive the land the closer it is going to the centre of the city, so rents are generally higher. So, that value of that subsidy really is going to be a reflection of where the housing is sited, isn't it? (14, intermediary)

Government control of land (via zoning and taxation) and access to surplus government-owned land were regarded as essential measures for the provision of affordable housing.

The biggest issue is land. (4, CHP)

Some affordable housing providers see opportunities for well-located land when inner urban industrial sites are re-zoned, arguing government could effectively ensure CHPs obtained such land at the old industrial price rather than the new residential land price. Others suggested surplus government land to be granted to CHPs rather than sold for private housing development.

If you look at, in New South Wales, Urban Growth ... they sell all their land for top price because the government needs the money, but they put no restrictions on five per cent or two per cent or ten per cent for social and affordable housing. (20, CHP)

CHPs were far from suggesting that land always be granted. Preferential access and option agreements (to reduce the costs of holding land while permits are obtained) were viewed as valuable means by which government could obtain policy outcomes. Nightingale Housing for example argue that not having to compete in the market for land would enable them to include some social or disability rental housing, and would be a small price for government to pay to achieve its policy goals.

Taxation was seen as a measure to address escalating land prices, but not one government were regarded as likely to endorse.

There's a hothouse developing in our cities which is fundamentally driven by the price of land ... But most of the benefits are going to the landowners. (16, CHP)

Underlying land values drive a shift from social housing to affordable housing and from income-based rents to market discount rents, but with both needing to be further from the city centre. Market discount rents moreover do not fully compensate for the extent to which market rents have increased. For SI investors rising land prices increase the amount of investment required and reduce impact (through housing not being located in areas of employment or services that could improve household outcomes). While the impact of rising land prices concerned housing providers and intermediaries, SI investors did not raise land cost and access as an issue. In part, this reflected involvement in projects where land had been gifted or obtained some years previously or which was located in regional or city fringe suburbs where costs were not such an issue.

One intermediary, CapitalAsset, saw access to affordable land as critical and in effect was attempting to bring SII to bear on a wider problem of underutilised or surplus community-owned assets.

We hear from the not for profit organisations and the charitable organisations ... who either own land and it's sitting causing a drain to their bottom line or who have land and need housing but don't have any capital. (12, Intermediary)

This approach reflects the strategic asset management problems encountered by NFPs identified by Sharam, McShane et al. (2016), who also argue many NFPs are deeply concerned about Australia's affordable housing crisis and are willing to repurpose property assets for affordable housing. CapitalAsset's ambition reflects a strategy of not merely bringing SII into affordable housing provision but of providing for a far deeper degree of additionality. In this impact-first view land and the commitment of broader civil society need to be harnessed in addition to capital if the large deficit in affordable housing supply is to be addressed.

5.1 Policy development implications

SII and housing proponents identified land as a critical issue affecting housing affordability and reasonable access to employment and services by vulnerable households.

- Government are frequently owners of well-located land that they have determined, or will determine, is surplus to their requirements. Governments could grant such surplus government land to CHPs (as is envisaged by part 21(k) of the NAHA).
- Inclusionary zoning could be implemented to provide a new source of social and affordable housing on existing redevelopment sites. Inclusionary zoning would provide the opportunity for layered investment models, common in the US.
- Governments could consider capturing the uplift in value when re-zoning land through making part of rezoned sites available to CHPs or other NFP housing providers.

6 SII in CHP social enterprises

SI investors financed social enterprises operated by CHPs or in non-core CHP business activities that are able to generate profits. We make a distinction here between social enterprises whose mission is to trade and make profit, which is then disbursed, to causes in line with a core mission and CHPs. The examples described here are of the former (who just happen to be social housing providers), with the social enterprises' mission being raising funds for the supply of new affordable housing.

A number of CHPs have social enterprise real estate businesses (Table 4). This includes Homeground Real Estate, which received a substantial grant through the corporate responsibility program of Realestate.com.au (Nissim 2017). Heaney, Flatau et al. (2017) describe the landlords in this venture who take concessionary returns as 'micro' SI investors.

Table 4: Housing supply social enterprises

Borrower	Property Initiatives Real Estate	Horizon Housing
Investor	RE Ross Trust	HESTA (placed by SVA)
	Social Traders	SVA (equity) in AAHS
Purpose/ rationale	Full service real estate agency to provide revenue stream to support future property development.	i) Management rights of 995 existing NRAS properties, ii) stake in Australian Affordable Housing Securities (AAHS) (NRAS accreditor). Income derived from these businesses to support development of 60 new homes.
Where	Victoria	Queensland
Grants	Yes	
Funding arrangement	RE Ross Trust loan Social Traders (patient capital)	\$6.7 million loan
Why SII rather than market		Innovative partnerships leveraging different sectors' skills and experience

Source: Cranston 2016; HESTA 2016 ; SEFA 2016f; Social Ventures Australia 2015; SEA 2016.

These examples of SII in CHP social enterprises are drawn from publicly available sources and involve business loans rather than development finance. The first investment is a loan provided by the RE Ross Trust and Social Traders to Property Initiatives (a real estate agency owned by Women's Property Initiatives (WPI)) (Social Traders 2015). Social Traders is an intermediary specialising in social enterprises, which disburses grants and places investments. The loan enabled the purchase of a 'rent roll' (private rental properties under management by a real estate agent). The loan was part of several financial and support components constituting a layered investment model. All profit from Property Initiatives is disbursed to WPI to enable WPI to develop or purchase social housing.

The second example is of a loan made to Horizon Housing, placed by SVA (with loan funds originating from superannuation fund HESTA's Social Impact Investment Trust), for the purchase of a rent roll (the management rights to 995 privately owned NRAS properties). In addition, the loan enabled Horizon Housing to secure (together with SVA as an equity investor) a majority stake in Australian Affordable Housing Securities (AAHS), an entity responsible for

managing compliance of incentives for over 2,500 properties. The rent roll business is projected to provide revenue to support the future development of up to 60 new social and affordable homes. SVA and Horizon Housing through AAHS plan to develop innovative financing products to assist low-income earners to achieve home ownership (HESTA 2016a). The NRAS, as indicated in section 3.1, is time limited, so the credit assessment for the loan would have taken account of the cessation of NRAS tax offsets/rebates in 2018.

The intention of AAHS to establish innovative financial products reflects how existing standard credit assessment (for mortgages) limits access to capital by households deemed a credit risk. As with direct investment in housing provision made by SI investors described above, the AAHS objective signals a revision of thinking in regard to credit assessment.

7 SI investors in social and affordable housing in Australia

- SI investors are comprised of a mixture of commercial and social banks, smaller superannuation funds (SMSF) not-for-profit organisations and individuals who provide debt and less commonly equity.
 - SI investors' objectives for investment and returns do not conform to the SII typology that presents the only difference between investors as their approach to returns (whether these are concessionary or non-concessionary)
 - We propose a new typology of investors that includes their approach to credit risk. Some SI investors reconceptualised credit risk rejecting the orthodox approach to lending.
 - Some major superannuation funds are interested in, but have not made, SII in social and affordable housing, arguing the conditions they must place on investment for social impact cannot currently be met.
 - Measurement of impact was very much a secondary concern, with dwelling completions commonly taken as evidence of impact.
-

7.1 Impact investors and the features of SII: a qualitative analysis of the views of market participants

The preliminary research project for the overall Evidence Based Policy Inquiry into SII explored the definition of SII and its relationship to housing and homelessness in Australia at an empirical level (see Muir, Moran et al. 2017: 25–29). The project found broad acceptance of the established definition. The research also found that some features were emphasised more clearly than others, while different types of market participant privileged different components of SII (Muir, Moran et al. 2017: 25–29).

Muir, Moran et al. (2017) also noted particular challenges with defining SII in the context of the supply of affordable housing at a conceptual level. Affordable housing supply is an area in which mainstream banks as well as specialist lenders have been active for decades, for example, the provision of loans to CHPs. Drawing the boundaries between what is and what isn't SII is complex and not always clear-cut.

While the tripartite features of intentionality, returns, and measurement in combination are generally used as the key signifiers of defining SII, this does not always address the ambiguities. Above we have suggested that the concept of additionality might be another significant marker to resolve the challenges in defining SII in affordable housing. This section explores the definition of SII within the context of the interviews with participants on affordable housing. Participants shed light on core questions about the definition and directly and indirectly addressed the core elements of intentionality, return and measurement. Additionality was addressed infrequently.

Overall the analysis revealed general support for the term, particularly among SII sector professionals. For example, one former investment banker who shifted focus to SII linked the three features:

[SII] is an intentional measurable social impact as well as an intentional measurable financial impact. (14, funder)

Others were wary of the term.

I don't like that term ... I invest into things I believe in. So, it's a personal interest and choice. (20, investor)

However, in recognition of the nascent stage of SII an experienced intermediary noted:

I think in a very fragmented and dispersed market ... there is no real definition of what social impact investing is ... it's still not mainstream. It's still not seen by the likes of boutique super funds or major investors as a viable alternative investment. (2, intermediary)

Intentionality and the supply of affordable housing

Intentionality—or specifically targeting social objectives—grounds most definitions of SII (GIIN 2016b; SIIT 2014). For an experienced SI investor:

Intentionality is at the core of every single one of our loans, we want to unpack impact. (1, intermediary)

It was also an important feature in differentiating SII from mainstream or traditional investments. Brest and Born (2013: 3) note investors can unintentionally obtain positive impact as measured 'by their own values or someone else's'. This is an important point in the context of the supply of affordable housing where mainstream investors play an important function (e.g. loans to CHPs). While these have positive social outcomes, they do not always constitute SII.

Intentionality was the point of differentiation for lenders and what separates SII from regular lending practices.

Why the word intentionality is critical is because it's really around what is the express purpose of that investment decision being made ... lots of investments can be made where this social benefit or social impact derived, but often it can be unintentional. (15, intermediary)

This had implications for reporting. For example,

So, it's not necessarily a not for profit borrowed, that doesn't tick the box. It needs to be outcome driven. So, in the event that the outcome is a positive social impact, then it meets the requirement. (13, social bank)

As a consequence, measurement is often seen as a proxy for, and way of, evidencing intentionality.

[D]efinitely, and we know we can't just say it's going to bring a social return—we need to be able to absolutely demonstrate that it's the case' (12, intermediary)

Social and financial returns in the supply of affordable housing

As noted in Chapter 2 impact investments are characterised by a range of return expectations. This has produced a widely utilised, if contested, (Nicholls and Emerson 2015) distinction between 'finance-first' and 'impact-first' investments (Freireich and Fulton 2009).

The objective of finance-first is to obtain non-concessionary returns. The creation of social and environmental value is intentional, but fiduciary duties are seen to dictate a focus on non-concessionary returns (Rangan, Appleby et al. 2011). This came out strongly among participants that would be characterised as finance-first.

[W]e are a fiduciary so we wouldn't invest in below market opportunities...A lot of super funds would be in the same boat. (25, funder)

Brest and Born (2013: 25) have categorised these as non-concessionary investors given they are effectively unwilling to 'make financial sacrifice to achieve their goals'.

[T]here are some who do[n't] have ... bv[the] constraints of a need [for] market returns ... but ... we're here to generate return to members. (6, funder)

Fiduciary duties were broadly seen as setting the parameters around which institutional investors were prepared to engage with SII.

[I]t is a legal requirement for them to think, first, second, third, fourth and fifth about shareholders ... we've had a couple of hundred years of that culture building up, that for profit companies are programmed to put shareholders about everybody else ... (18, funder)

In the US, finance-first investors have identified opportunities for 'outsized returns' that 'create some social value' by responding to regulation and tax policy (Freireich and Fulton 2009: 4). In Australia however, SI investors were circumspect about similar opportunities in the current environment. They noted there were several barriers for institutional investors—perceived or real. The first relates to residential property as an investment class and the need for portfolio diversification. One funder with experience in developing SII products targeted at institutional investors noted:

[T]he superannuation funds were uncomfortable investing in residential real estate as an equity owner ... they didn't like the idea that there might be a housing bubble, they didn't like the idea of managing tenants, they didn't like the idea of having to keep occupancy high and their risk might be impacted by occupancy. (14, funder)

Other institutional investors expressed similar sentiments, noting that superannuation funds needed to be cognisant that member's principal residence was often their most significant asset outside of their superannuation. Investment in housing by a superannuation fund concentrated risk. Nevertheless, superannuation funds expressed willingness to examine any housing investment proposal that would otherwise meet their investment criteria.

Another barrier pertained to perceived reputational risks for institutional investors of investing in community housing and the possibility that investors might need to recourse to assets provided as security:

[I]t's very unpalatable to step in and exercise your rights over a not-for-profit community housing provider. (15, intermediary)

However, the same participant noted that this was highly unlikely:

the likelihood of exercising security as financier is very low. (15, intermediary)

What came through strongly was that institutional investors were particularly focused on scale and perceived that at present the Australian market did not present sufficient opportunities to meet institutional investor's needs.

It's easier just to send \$200 million off overseas to do something with it over there or put it into this or put it into that. When you're looking at social or affordable disabled housing, it's not easy. (20, funder).

A government participant noted that they had attempted to work with superannuation funds in affordable housing but that despite producing independent research that showed favourable rates of return on investment in affordable housing the appetite was not there:

Certainly some of our superannuation funds ... wanted to explore how they could help in this space but they also had fiduciary duties around returns to their investors that mitigated against that ... [W]e were a little surprised at that, because certainly one of the things that we provided to them, which was some work, we did in Victoria ... was looking at the rates of return of investment in residential housing. (21, government)

A superannuation fund manager outlined its justification:

[at] the forefront is to maximise returns for members and act as a fiduciary ... we need to ensure that we are getting the maximum return we can depending on the risk that we're taking on board ... therefore our impact portfolio, not just needs to have a measurable social impact but we also need to ensure that the returns of whatever we're doing and the risks that we're taking on we're getting the appropriate return for it, and where we would be getting it elsewhere in the market ... So, we're not seeking a better return than what we get elsewhere but it needs to be comparable from what we would get elsewhere. (6, funder)

As a consequence, most SI investors were variants of impact-first investors: those that privilege social or environmental value creation over financial return if they perceive there is a commensurate social return.

The SII literature defines these types of investors as accepting concessionary returns, accepting higher risk or simply recycling capital. Brest and Born (2013: 25) categorised these as concessionary investors in that they will accept 'financial sacrifice by taking greater risks or accepting lower returns'. The literature categorises this group as private foundations, high net worth individuals (HNWIs) as philanthropists, and family offices (Charlton, Donald et al. 2014; Correlation Consulting 2012: 5).

One participant noted that the division between investor types is clear in affordable housing based on risk-return expectations:

[A] foundation may choose to discount the interest rate significantly, because the recipient is part of their mission ... [b]ut if we're going to tap into institutional investors, or any other commercial investors, like insurance companies, then we provide rates ... as fiduciaries they must apply their capital to make market returns. (14, funder)

An affordable housing provider noted further:

We call them impact investors, ethical investors, angel investors. But fundamentally it's someone that's prepared to look at their investment in two ways: one is, it has a financial return, the other thing is, it has a social return. (8, CHP)

In conceptualising these motivations Nicholls and Emerson (2015: 5) observe that conventional investments are in essence 'extractive'. Investors capture the value of an investment (excluding fees, transaction costs etc.) for self-interested reasons. By contrast in impact-first investment investors allocate capital with the intention that profit will, in some way, be 'appropriated' by another party or parties (in the case of public goods such as environmental preservation) (Nicholls and Emerson 2015: 5).

We ended up talking to [intermediary] ... they saw two things out of this project. They saw a financial return, but they also saw an ethical or social return, an environmental return...which made it an appealing investment for them ... from a financial point of view ... it's not great ... for the amount of work they've got to do, they're not getting that much. (8, CHP)

We thus found evidence that investors in this grouping were in relative terms more flexible on the question of returns and also motivated by a desire to contribute to organisational and sector capacity building.

With our funds, the measurement is through the return to investors, and the fact that they're lending to a social enterprise that wouldn't have a got a loan from a bank or another finance provider to enable them to grow ... to build their expertise to be in a position that they may be able to borrow from a bank or buy a property ... there's definitely a measurement of return to investors. (2, intermediary)

There was also evidence of layered investments that relied on philanthropic contributions.

If you look at those [CHP] deals, whether it's a cross-subsidy ... the only reason why we've been able to do those is because ... each of those organisations have built up ... an asset base ... through historic philanthropic contributions ... it's almost like cross-subsidisation. (1, intermediary)

Philanthropic motivations were also seen as important as drivers of SII.

[Y]ou're going to have philanthropists who want to achieve a certain outcome in the disability space ... maybe a deeper passion for a philanthropic organisation which can then help ... [in] ... unlocking capital. (1, intermediary)

My motivation for the philanthropy comes from my father who says, all the problems start with children and where they're living ... that's for me where I want to work then ... there's no one-bedders, it's all families. Pretty easy though. I made money out of property development so not like I'm risking everything. (4, funder).

Others saw potential in philanthropically motivated investors operating with purpose:

I think there is a huge amount of potential investment which is in the grey area between commercial and philanthropic ... there's a huge market there. (1, intermediary)

I think there are a lot of opportunities. It's also about philanthropy learning what it can do. And there are some foundations in the US you would know, the Heron Foundation, they're 100 per cent impact investment ... (9, funder)

[Y]ou know philanthropy is only 8 cents in the social change dollar. Philanthropy doesn't have enough money to deal with this unless we see a real kick-up the use of capital by from super funds and non-profits and corpuses ... in which case there would need to be a financial return of some sort. (18, funder)

Measurement and affordable housing

Broadly, measurement was identified as important for evidencing social returns and as a signifier of intentionality. What was notable however was that although seen as important, discussions of measurement generally needed prompting. Even experienced SI investors only raised the topic when the interviewers broached it. Across the board data required by SI investors for measuring impact was minimal, with investors stating there was balance to be struck in imposing a requirement that added costs. Typically, measurement simply involved the number of dwellings delivered, while impact was considered as self-evident.

Among the intermediaries the general view was that social impact measurement practices are in their infancy and early phases of development.

So, there's no set measures if you like. I know there are various tools that you can use to establish that. (12, intermediary)

Yes, we often do some measurement, but it's difficult to make quantitative ... and acceptable to everybody who might be reviewing it so, in many cases, the measurement is very qualitative. (2, intermediary)

In contrast to other areas such as homelessness, supply of housing was seen as presenting relatively simple output measures that were sufficient proxies for social outcomes:

[F]ortunately, with affordable housing, the social goals are quite straightforward and simple ... so I think we get by with ... the number of people housed ... the amount of rent saved ... to some degree that becomes self-evident. (14, funder)

The majority of evidence reported was output oriented. In the main participants were also resistant to the notion that SII and other forms of investment in housing required sophisticated measurement frameworks to demonstrate outcomes.

[I]t's ... obvious that providing more homes on the ground is going to be beneficial. I don't need someone to tell me what the value of that is or put any great metrics around it. (24, government)

I mean it's housing it's quite easy to show the people who've actually moved into the house and where they were before and where they are now, and the opportunities they now have. (9, funder)

Funders and intermediaries were also seeking to reduce the burden on borrowers, many of which were small and micro affordable housing organisations and CHPs that lack the resources and capacity to undertake in-depth impact assessments.

Increasing the burden in terms of measurement. Getting the data is problematic which is why ... some of the things we capture are really quite simplistic. (1, intermediary)

In many ways, this runs counter to wider trends in the NFP sector where there is an increasingly heightened focus on measuring outcomes as opposed to outputs. Ease of reporting was seen as appropriate to deal and investment size, organisational capacity, and to determining impact.

[W]e ask each of our clients to choose the indicators [so] that they themselves measure their success rate. So how do we know that our loan is unlocking additional impact through looking at those indicators? ... it might be something as simple as number of people moving through the crisis accommodation, number of people being housed, number of people being provided with training or employment. (1, intermediary)

Others reported that intermediaries also effectively undertook measurement by proxy through extensive due diligence:

[N]o social outcomes have been discussed at this stage, but they did their due diligence on our company before they lent us money to find out what sort of difference we were making in out in the community and with the families who are needing help. (10, CHP)

This approach was seen as consistent with the effectiveness of specialist intermediaries, their focus on capacity building, and attentiveness to client needs:

Actually understanding who we are and doing lots of due diligence on us, making sure we're who we say we are, and we're delivering on what we say we're trying to deliver on ... I guess, the only real thing that they've ... asked for is a list of professions ... so we know that 14 per cent of our waitlist are key workers. (8, CHP)

Others reported that measurement was also not central to discussions. For example, those demand-side organisations that had been required to provide data (a minority) noted that:

It's not actually written into our loan document or anything ... I think it was probably annually ... they contacted us and basically asked a series of questions around what we'd delivered ... we're only five months into our new facility so we haven't had to report back on those things but we will. (11, CHP)

[N]ot really. They're requiring us to report on a few things, obviously around borrowing and loan portfolio ... I haven't actually got a good measure of the social impact of what we're doing. (17, CHP)

Experienced SI investors made a distinction between outputs and outcomes. Among this group, movement toward more sophisticated approaches was seen as important. While the respondent below identified output indicators as sufficient, the impact that safe, secure and well-located housing can have on individuals, families and communities was self-evident.

[W]e've been talking about ... getting a more sophisticated measurement framework for social and affordable housing and what is the impact of the built environment, what is the impact on those individual's lives in terms of their future starting with a safe household, educational impact for kids, employment impact for the individuals, I think secure housing has a fundamental impact on people's lives. (1, intermediary)

This approach is consistent with the outcomes focused approach of Big Society Capital (2016) that has developed a set of indicators for affordable housing investments. The framework aims to capture how outputs (e.g. number of houses) leads to improved social outcomes (e.g. labour market, educational etc.). By contrast the IRIS (2016) offers a framework that is consistent with those reported by participants: it is output oriented and focuses on number of dwellings and individuals/families housed.

Finally, a minority reported aversion and resistance to measurement.

... I know what the outcomes are because you're providing houses ... I don't have the resources ... the more things you've got to do the more time you get bogged down in stuff that doesn't make—I know it's important for people who do measure [but], for an organisation like [CHP] to keep just constructing, I know we make impact. What impact I couldn't tell you but it's not a high priority for [CHP]. (20, funder)

Perhaps the most cogent insight however to emerge from the data related to the categories typically used to define investor preferences—finance-first and impact-first. Our analysis of the qualitative findings combined with exploration of available case studies revealed a clear divergence between types of investors. This broadly affirmed the utility of the typology as traditionally understood in the literature (a typology appropriately questioned as too rigid, given investors and investments, e.g. layered investments may transcend boundaries) (Oleksiak, Nicholls et al. 2015). Our analysis also revealed novel insights—specifically, we observed an adaptation of the typology. Potential finance-first investors remained rigid with respect to non-concessionary returns. When combined with conservative credit assessments this stymied their propensity to invest. By contrast impact-first investors modified credit assessment parameters and demonstrated that investments were viable (including with non-concessionary returns).

7.2 Towards a new typology of investor

In Chapter 1 we provided a definition of SII based on the literature, which referred to intentionality, measurement and social as well as financial returns as being hallmarks for SII as an investment type. We noted return expectations differ, with 'impact-first' investors accepting

concessionary investments and ‘finance-first’ investors requiring non-concessionary investments. This investor typology relies on a single characteristic (returns), and is in effect, binary. This research suggests such a dichotomy is of limited use in understanding why and how SII occurs in Australia, and may reflect a significant gap in the literature, and that investment decision making is influenced by other factors apart from return on investment.

A key difficulty for us in fitting our case studies into the existing typology is that most of the investors were finance-first, in that they received non-concessionary returns, yet it was also clear they were ‘mission-driven’, suggesting impact was the overriding concern. The contradiction can be explained by moving beyond the return on capital as the sole determinant of investment type. As the empirical evidence highlights, access to capital (rather than its cost) is often the issue. The evidence suggests these investors reframed the ‘five Cs’ of credit assessment in order to achieve a deal. They shifted their own practices after critical reflection on investment orthodoxy, and considered how they could respond to the needs of their borrowers, rather than assuming investment proposals conform to their own needs. In doing so they recognised long held assumptions concerning credit assessment could shift, reflecting new understandings, particularly of risk. They are not taking on more risk for less return, so it is not analogous to concessionary returns (providing a donation). Rather it is the difference between adherence to a convention (orthodox credit access) and challenging the convention (reformed credit access).

In Figure 3 we reconceptualise concessionary and non-concessionary returns as the sole difference between impact and finance-first investment by adding orthodox versus reformed credit access into the mix.

Figure 3: An Australian SII typology

<p>Full impact-first</p> <p>Concessionary returns</p> <p>Reformed credit access</p>	<p>Full finance-first</p> <p>Non-Concessionary returns</p> <p>Orthodox credit access</p>
<p>Partial impact-first</p> <p>Concessionary returns</p> <p>Orthodox credit access</p>	<p>Partial finance-first</p> <p>Non-Concessionary returns</p> <p>Reformed credit access</p>

Source: Authors.

Using the typology in Figure 3, most of the SII identified in this research falls into the ‘partial finance-first’ sector and happened to be all debt investment. A much smaller group fell into the ‘full impact-first’ sector. This was all equity investment. No ‘partial impact-first’ or ‘full finance-first’ investments were made. A further subtlety can be introduced—the modification to credit access can be weak or strong. In the case of Westpac’s SII, we could suggest it is ‘partial finance-first’ investment, but that the ‘reformed credit access’ component is relatively weak in that the changes required to permit lending to CHPs is not great, whereas the debt provided by SII for Nightingale, while also being partial finance-first, displays an extensive rethinking of risk.

7.3 Policy implications

The new typology of SI investors assists our understanding of SII in social and affordable housing in Australia by revealing the lack of full finance-first and full impact-first investment, and then raising the question of why there should not be full finance-first investment or partial impact-first investment. The two international perspectives provided in Chapter 2 highlight the importance of a system of government investment as the foundation for private investment in social and affordable housing. Private investors in those jurisdictions can seek deals involving non-concessionary returns on standard credit terms because of the implicit government guarantees. In the US and UK this provides the opportunity for full finance-first SII. Australia's comparatively rickety system of community housing does not provide an analogous opportunity.

The lack of partial impact-first investment is likely to reflect the limited number of actors on the supply side. In the US, the breadth and depth of the philanthropic sector has facilitated a partial impact-first investor class. However, it is possible that partial impact-first and full finance-first investment has occurred in the US and the UK but that the literature simply lacks the detailed analysis required to identify it.

As fiduciary duties of superannuation fund managers appear to be open to interpretation, government could review this aspect of superannuation fund management to provide legal clarity for concessionary SII.

8 Conclusion

8.1 Policy Development Options

This report examined SII in social and affordable housing in Australia, concentrating on the opportunities for, barriers to, and risks to SII. The research utilised key understandings from the US and UK as well as data from Australian examples.

SII is a type of private investment that in some cases also provides for a donation (concessionary returns), however such donations cannot be assumed.

SII in social and affordable housing reflects government investment. As private investment, there is an expectation of returns on investment. Investment therefore only occurs when the housing organisation is able to generate a positive cash flow to support debt repayment or disbursements to equity holders. This requires the gap between tenant's capacity to pay and the cost of housing provision to be funded by government. The funding of this gap provides an implicit government guarantee.

In the Australian context, this requires:

- An annual funding stream for CHPs to close the gap between rental revenues and cost of provision.
- In the absence of a funding stream to meet the gap between rental revenues and cost of provision, state and territory governments will need to permit CHPs discretion in who they house so that investor confidence can be maintained.
- An annual capital grants program for CHPs to grow the sector.
- Growth of the sector, to create the conditions for bond financing. Bonds enable a lower the cost of capital and provide for long tenure debt.
- Welfare entitlements and housing assistance need to provide sufficient income to all household types to ensure the most vulnerable households will be attractive to house. Social security entitlements need to be stable in order to provide confidence to investors regarding their existing and future investments.
- Housing supply bonds which were viewed as a key opportunity for reducing the cost of capital and enabling long tenure debt.
- Land is a critical issue affecting affordability of housing and access to employment and services by vulnerable households.
- Government are frequently owners of well-located land that they have determined, or will determine, is surplus to their requirements. Governments could grant such surplus government land to CHPs (as is envisaged by part 21(k) of the NAHA).
- Inclusionary zoning could be implemented to provide a new source of social and affordable housing on existing redevelopment sites. Inclusionary zoning would provide the opportunity for layered investment models, common in the US.
- Governments could consider capturing the uplift in value when re-zoning land, through making part of rezoned sites available to CHPs or other NFP housing providers.

SII in new home ownership models is able to generate affordable housing supply for both low-income and intermediate income cohorts. The growth of some of these models could be assisted through:

- Government guarantees to permit debt financing and negate the need for substantial equity contributions.

- Revolving funds to provide equity to development projects. The equity would be returned once mortgage loans are issued.

The market price of housing for purchase is affected by many factors. However, there has been little scrutiny of the development process and particularly of multi-unit residential development. Profit margins in this sector are high, suggesting competition is less effective than it could be. There is a need for policy-makers to gain a detailed understanding of residential property development and possible industry reforms to improve efficiency.

SII would be assisted by:

- Government reviewing the fiduciary duties of superannuation fund managers, as these appear to be open to interpretation. This would provide legal clarity for concessionary SII.

8.2 Key questions answered through this research

To date SII in social and affordable housing in Australia has been undertaken largely by banks, which lend to registered CHPs. A small quantum of SII originates from non-bank sources and is invested in non-community housing provision.

Quantum of SII in social and affordable housing Australia

The largest investors are the banks that lend to market ready CHPs and who compete with non-SII in doing so. The exact quantum of these funds is not available to us although it is in the order of \$1.5 billion. The quantum of non-bank SII is small, perhaps around \$20 million, and is invested in non-community housing provision. This contrast says a great deal about the demand side for funds. Firstly, it suggests market ready CHPs are currently the predominate source of demand for SII. For SI investors, however, this means SII must be very competitive in order to serve that demand. Secondly, it demonstrates the reliance of SII in social and affordable housing on these CHPs and if they cannot grow, nor can SII in social and affordable housing.

The \$20 million however punches above its weight in terms of impact and innovation—this is investment that steps out of the old investment comfort zone and in doing so, backs innovation but also system change. Key questions raised by this investment are: what is the risk we are taking and can we mitigate risk differently? It is a question worth asking as risk moulds the availability of housing credit. The reform of land titles that enabled the introduction of strata title in the 1960s was a quest to remove the risk to mortgage lenders represented by company ownership of apartments, and thus provide a basis for securing development financing. The current crisis of housing affordability is giving birth to a critical examination of housing development and finance by small NFP housing developers and impact-first SII. Early indications are that there are options worth pursuing.

Who are SI investors in social and affordable housing Australia?

Banks, lending to CHPs, are the largest investors in dollar terms. These are partial finance-first investors. A small quantum of SII originates from non-bank sources such as small superannuation funds, NFP organisations and individuals. These are a mixture of partial finance-first and full impact-first investors. Full finance-first investors are notably absent although there are potential full finance-first investors engaged in public debate aimed at creating the conditions that would permit them to invest.

Investment occurs in intermediaries and directly into projects or programs. Intermediary SEFA, for example, was established with equity provided by a mixture of social banks, individuals and NFP organisations. Subsequently commercial banks have contributed equity. In possibly the earliest example of SII in housing investment, STEPS put together a group of NFP and individual (SMSF) equity investors. Across the other case studies, the individual equity investors are a mixture of sophisticated investors very knowledgeable about property investment and

well-meaning amateur investors. Some are HNWI while others are 'Mum and Dad' investors. Equity investors have proved important for obtaining debt funding (sometimes also SII and sometimes not) which has allowed projects to proceed.

But who are they? The research did not attempt to systematically survey the individuals about their motivations or beliefs. Westpac is a textbook corporate impact investor. The other investors however are a combination of socially minded business people and business-minded people associated with social service organisations.

Why are SI investors investing in social and affordable housing?

SII in housing provision is motivated by concerns of declining housing affordability and the lack of social housing available to an increasing number of households who require housing assistance. To paraphrase Westpac, this is neither socially or economically sustainable (Westpac 2016). Social banks, in the tradition of social finance, view their role as supporting the providers of social and affordable housing. How they do this varies, with some moving beyond simply lending to CHPs to creating new products and changing systems. The non-bank SII identify the current systems of delivery as being problematic, so much of that investment is aimed at shifting old models or creating new models.

What type of SII is occurring?

Bank SII funds the CHP sector. These SI investors are acutely aware of the problems faced by CHP providers of social rental housing, particularly the limitations imposed on lending by the lack of free cash flow of these organisations, the risks posed by potential changes to income security, and the impact changes in allocation policy can have. As SI investors, they are keenly aware of the needs of their demand side. Being banks, their size and role provides the opportunity to pursue changes not open to other kinds of SI investor. The non-bank SI investors are small (by dollar value) investors, and are innovators and pioneers. They invest in models outside the community housing sector, often because they view the CHP model as problematic.

What does the literature tell us?

The literature is very clear that SII in social and affordable housing supply is a function of government investment in social and affordable housing provision. Moreover, government investment needs to be in a system that delivers revenue to support housing providers so that they have the surpluses required to service debt or equity investment. As the investment is in long-lived assets, policy and funding commitment and stability is required to ensure investor confidence.

8.3 Final Remarks

The research revealed that there is far more SII in social and affordable housing than previously understood. There is also a sizeable latent pool of SII held by superannuation funds, funds that invest in affordable housing in the US and are likely to invest in UK housing associations (Places for People Group Limited has appointed NAB to arrange a series of fixed income investor meetings in Australia regarding its issue of medium term notes). Such investment does not involve credit enhancement, as the US and UK governments fund the gap between a tenant's capacity to pay and the cost of housing provision, providing confidence to investors. Government in Australia does not currently fund this gap, and this lack of funding comprises the most significant barrier to expanded SII in social and affordable housing in Australia.

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Appendix 1: Research methods

The field of SII is nascent and academic literature on the topic, especially in relation to housing, is scant. As a result, this report is highly reliant on grey literature. This investigation into SII in social and affordable housing in Australia is supported by a review of analogous investment in the US and UK.

To conduct the primary data collection in this study, we performed a series of semi-structured interviews with key institutional informants. Framed by a qualitative research design, the semi-structured interviews were used to explore salient issues raised following the literature review. Thus, the key informant interviews gathered first-hand accounts of the issues raised in this Project.

The sample of key informants was gathered using a variant of the snowball sampling technique (November 2008). The purpose of this technique is to focus on the power of institutional networks when identifying the most relevant actors in a particular field (Suri 2011). Rather than providing an exhaustive list of participants, the goal is to reach a level of network 'saturation', whereby the most relevant actors in a given network are identified. The snowball approach identified a number of actors with knowledge of SII models beyond our own professional networks. As the interviews progressed, further key actors were identified based on institutional and sector-relevant expertise with SII models. Follow up contact was then made with these actors to establish their willingness to participate.

This approach had the advantage of acknowledging and leveraging the research team's own professional networks. Each member of the research team has a high degree of embeddedness in the affordable housing and/or the SII fields. This yields a significant advantage when operationalising snowball sampling techniques, since relational and experiential factors can greatly enhance sample quality.

Initially using a list of 47 names drawn from the research team's knowledge of key actors in the sector, the team then discussed the appropriateness of potential interviewees, relative balance according to their role and field position, and identifying any gaps (i.e. missing actors). This process yielded a nuanced list of 26 names with informants drawn from government, SI investors and intermediaries, and not-for-profit housing providers. The data drawn on are for the supply of housing only and exclude projects or programs that combine funding for housing with tenancy or personal support. Throughout the data collection period Internet searches on SII in social and affordable housing in Australia continued (recognising market developments occurring as the project progressed), with new potential interviewees incorporated into the list.

The interviews were conducted during 2016–17, and each interview lasted for approximately one hour. In total, 26 interviews were successfully completed, and Table A1 summarises key informant characteristics. The interview data were transcribed verbatim, set against the semi-structured questions, and imported into the NVivo 11 qualitative analysis software.

Table A 1: Completed interviews

Participant category	No.
Intermediary	6
Investor	11
Affordable housing provider	11
Government	6
Total interviews	26*

*Note: *total interviews are smaller than number of participants as some participants held multiple roles.*

The data was processed and analysed using a three-step process. This process was developed to increase the reliability of analysis between coders, and accentuate the accuracy of our analysis. As is common in qualitative research methods, highly structured procedures are used to ensure rigour in application of method and in the analysis of data (Morse, Barrett et al. 2002).

First, exploratory thematic coding was conducted independently by two research team members. This allowed for a comparison against the key thematic issues raised during the literature review. This step involved a first-pass reading of the transcripts, with contemporaneous notes made about the themes emerging from this coding process.

In step two, the two coders met and discussed their list of codes, compared against the themes arising from the literature review. Changes were then made to the list of codes, refining the thematic codes in NVivo. This step prompted the coders to reflect on both the accuracy of the first, thematic codes and to determine any emergent themes based on the first step. Any new codes were then added into the full code list, and another round of coding was applied to the data.

Step three involved a second and final reading of the fully coded transcripts, and key summaries of the core themes were written up into the analysis shown in sections 4–6. This allowed the team to check the coding patterns across the data to find any dominant themes arising, discrepancies between actor types, as well as any coding errors applied during the process.

There are some limitations in the approach outlined above. First, the variant of snowball sampling used relies heavily on the professional networks of the research team. Typically, snowball (and respondent-driven) sampling rely on initial informants outlining the other most relevant actors based on their own professional networks. In adopting a variant of this sampling approach, we are thus mindful of the potentially inexhaustible list of participants reached. That said, beginning with a list of names from the research team's own networks facilitated an efficient way of identifying the key players in the sample and likely gaps that needed to be filled. Thus, our sampling methods aimed for saturation (i.e. no further names and potential gaps could be yielded from the process).

Appendix 2: Interview guide

Understanding opportunities for SII in the development of affordable housing

Thank you for taking time to speak with us as part of this AHURI funded research project. As part of this research, we are seeking your professional views about current SII in affordable housing, barriers to investment, future opportunities and how these might be achieved.

As many of the projects and proposal we are seeking to understand involve sensitive financial matters we wish to reiterate that the detail you provide will be de-identified and/or aggregated so as to avoid inappropriate disclosure.

Investors & intermediaries

Part 1: About your organisation / your investment

1 Could you please briefly describe your organisation [or for individual describe yourself as an investor]

- Could you tell me how you define social impact investing?
- What kind of problems/issues do you see as being amenable to social impact investing?
- [For intermediaries or funds] Can you tell me how your funds have been assembled?
- Regarding your investment mandate/guidelines, what is the quantum of funds available for investment and what percentage is available for affordable housing?
 - For debt, does this affect the interest rate you can offer – are you competitive with mainstream financiers?
- Does your organisation limit exposure on specific sectors? How does this affect your capacity to meet demand for funds for affordable housing?
 - prompt for specifics on limitation and examples where this meant could not finance
 - ‘club’ financing arrangements
- What level of financial returns are you looking for in an affordable housing project? What other types of returns do you seek? How does this compare to non-housing investment?
- What type of financial instruments or arrangements has your organisation used or investigated? (e.g. bonds, loans, discounts, equity, grants, guarantees...)
- Do you seek to measure the social impacts of the investments you make in affordable housing? – how go about making the measurements?

Part 2: Affordable housing

2 Can you tell me about what you think the purpose of SII is in affordable housing provision? (e.g. social/financial and?)

- I would like to hear about affordable housing projects you have been involved in, including projects that have not proceeded.
- First of all how many projects have you funded and what were they?
- Secondly are there projects that did not proceed, and what were they and why did they not go ahead?
 - At what point in the project proposal was the decision taken to not fund?

- Is assessing housing project more or less difficult than other types of investment?

For each of the projects I'd like considerable detail—if that is possible—this is to enable us to understand how SII is different from mainstream finance or more typical residential development project metrics.

To start: (for each project separately)

- 1 Can you briefly describe the project(s):
 - Who is the proponent? Are they a not for profit entity?
 - Can you tell me what type of housing it is, for example social rental (25–30% of income, affordable rental (charity 74.9% market or NRAS 80% market), or purchase (shared equity, other (nightingale, MCM)
 - How many social and/or affordable housing dwellings were/will be built?
 - Does it involve cross-subsidies from the sales of market housing (how many market dwellings)?
 - Were there government grants – if so what proportion of costs did this cover?
 - Other sources of funding besides yours– grants/donations?
 - Is there NRAS funding involved?
- 2 Did you provide debt or equity?
- 3 If not debt or equity what was the support / instrument used?
- 4 What was the quantum of the loan (debt/equity), and loan period – long or short term? –
- 5 What return did you seek (interest rate/ fees/patient capital/social – how did these compare to the market?)
- 6 Did you require the proponent to provide equity? Was it their own capital or was it provided by third party? (grant, or if equity what was the return required?)
- 7 Did you take security over assets, require guarantees? How do you approach the issue of potential foreclosure?
- 8 How did you determine the credibility of borrower (capability, experience, etc.)
- 9 Which costs did you fund? (e.g. soft costs, professional & application fees versus hard costs such as land and construction costs)
- 10 Was the loan to value ratio a relevant consideration? Are there issues valuing affordable housing?
- 11 Were there any other conditions on your financing?
- 12 At what point do you release the funds?
- 13 For projects involving state owned housing did the Director's Interest have an impact on whether you would invest or the conditions you impose?
- 14 Did the location of the project that an impact on your investment decision, for example suburb/region/zoning/planning?
- 15 [If relevant] Land & property ownership - freehold titles vs leasehold – partnership arrangements – to what extent was the partnership arrangements/ leaseholds an issue for the SII?
- 16 Were there other risks and mitigation measures?

17 Turning to projects that are underway or completed:

- How are the investments are going—are repayments being made, and/or made to schedule?
- Have there been follow-on investments?

18 Considering all of the above what would you consider as the constraints on SII in affordable housing and what are the opportunities or potentials?

19 Finally I would like to hear your views on the role of intermediaries and investors—the similarities/differences, how important are each of them?

Housing developers

1 Could you please briefly describe your organisation & it's role in social and affordable housing?

- Can you tell me what you understand by the term SII?

I would like to hear about affordable housing projects you have been involved in that have involved SII, including projects that have not proceeded.

For each of the projects I'd like considerable detail—if that is possible—this is to enable us to understand how SII is different from mainstream finance or more typical residential development project metrics.

To start: (for each project separately)

2 Could you tell us which SII have invested or indicated interest in your projects

3 How many projects have you had funded through SII?

- Were these direct investors or through intermediary?

Can you briefly describe the project(s):

4 Who is the proponent if not solely your organisation? Are you/they a not-for-profit entity?

5 Can you tell me what type of housing is involved, for example social rental (25–30% of income) affordable rental (charity 74.9% market or NRAS 80% market), or purchase (shared equity) other (nightingale, MCM)

6 How many social and/or affordable housing dwellings were/will built?

7 Does it involve cross-subsidies from the sales of market housing (how many market dwellings), or market rental?

8 Were there government grants—if so what proportion of costs did this cover?

9 Other grants/donations?

10 Is there NRAS funding involved?

Turning to social impact investors you have dealt with and further detail of projects and proposals:

11 What type of financing arrangement did you seek? (e.g. debt, equity...)

Turn to the deal you negotiated:

- How many SII were involved?

- What was the quantum of the debt or equity?
 - What is the loan/investment period—long or short-term?
 - Were you required to provide equity? Was it your own capital or was it provided by third party? (grant, or if equity what was the rate of return required?)
 - Which costs did the SII fund? (e.g. soft costs, professional & application fees versus hard costs such as land and construction costs)
 - Did the SII take security over assets, require guarantees? Was the potential foreclosure an issue for the SII?
 - Was the loan to value ratio a relevant consideration? Are there issues valuing affordable housing?
 - If long-term loan—when are payments required? Is there any patient capital?
 - What revenues were considered in terms of your organisation being capable for servicing the loan? Did tenants/purchaser profile affect this?
 - What interest rate will you pay? How did this compare to the market?
 - What fees will you pay? How did this compare to the market?
 - Did the SII assess your credibility as a borrower (capability, experience, etc?)
 - Were there any other conditions on the financing?
 - For projects involving state owned housing did the Director's Interest have an impact on whether the SII would invest or on the conditions they imposed?
 - Did the location of the project that an impact on the SII's investment decision, for example suburb/region/zoning/planning?
 - [If relevant] Land & property ownership—freehold titles vs leasehold—partnership arrangements—to what extent was the partnership arrangements/ leaseholds an issue for the SII?
 - Were there other risks and mitigation measures considered by the SII?
 - How the experience was different from a mainstream bank, how much the financial model changed as a result of their involvement.
- 12** Turning to projects that did not proceed, and what were they and why did they not go ahead?
- Considering all of the above what you summarise as the constraints on SII?
 - What would you consider are the opportunities or innovations that SII could foster?
- 13** Considering your experience, can you tell me about what you think the role of SII is, if any, in affordable housing provision?
- 14** Finally I would like to hear your views on the role of intermediaries and investors—the similarities/differences, how important are each of them?

Government representatives

- 1** Could we start with how you define social impact investing?
- 2** What kind of problems/issues do you see as being amenable to social impact investing?
- 3** Can you tell me about what you think the role of SII is, if any, in social/affordable housing provision?

Measurement of the social impacts of the investments you make in affordable housing? How do you go about making the measurements?

- Could you tell me about actual or proposed SII funded affordable housing projects that you are familiar with?
- Are you able to tell us any more about investors/intermediaries/demand-side?
- Are you able to tell us about the type of tools/instruments used for social impact investing in social/affordable housing projects? (e.g. bonds, loans, discounts, equity, grants, guarantees)
- Turning now to government - Is there a role of government for govt is facilitating or supporting SII affordable housing?
- Long term debt facility? (but revenue stream issue)
- What aspects or elements of the projects you mentioned just before are/would be attractive for government/unattractive for governments?
- What type of measures could government take to support SII affordable housing?
- How do you see SII being different from other types of actual/potential investment (or investors) in social/affordable housing?

For example, NRAS vs LIHTC?

- Is scale, in your view, likely to be an issue in creating a mainstream SII housing sector?
- Are there SII social/affordable housing proposals that you are aware of that failed to get off the ground?

Do you know why did they not go ahead?

- 4** What would you consider are the opportunities or innovations that SII could foster?
- 5** What would you consider you as the constraints on SII?
 - For example, Directors Interest? Lack of capital grants, profitability?

Wrap up & Thank you.

Appendix 3: Participant consent form

Participant Consent Form

Principal Investigators: Dr Andrea Sharam, Dr Michael Moran, Chris Mason, Suzanne Findlay, Assoc. Prof. Wendy Stone

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

1 I consent to participate in the project named above. I have been provided a copy of the project consent information statement to which this consent form relates and any questions I have asked have been answered to my satisfaction.

2 In relation to this project, please circle your response to the following:

- I agree to be interviewed by the researcher

Yes No

- I agree to allow the interview to be recorded by electronic device

Yes No

- I agree to make myself available for further information if required (We may seek to clarify comments once analysis commences or seek additional material)

Yes No

3 I acknowledge that:

(a) my participation is voluntary and that I am free to withdraw from the project at any time without explanation

(b) the project is for the purpose of research and not for profit

(c) any identifiable information about me which is gathered in the course of and as the result of my participating in this project will be (i) collected and retained for the purpose of this project and (ii) accessed and analysed only by the researcher(s) for the purpose of conducting this project

(d) my anonymity is preserved and I will not be identified in publications or otherwise without my express written consent

(e) while the project is in progress information will be securely stored by each of the researchers on their password protected desktop computer/in a locked cabinet in their secure office. Once the project is completed the Swinburne researchers will destroy the transcriptions they hold. Sharam will archive project material at Swinburne University until destruction is required in line with privacy laws.

By signing this document I agree to participate in this project.

Name of Participant:

Signature:.....

Date:

Appendix 4: Participant information statement

Participant Information Statement

Title: Understanding opportunities for social impact investment in the development of affordable housing

Chief Investigators

Introduction

Sharam, Moran and Findlay are conducting interviews with key stakeholders in the Australian social impact investment and affordable housing sectors so as to provide policy-makers and industry with a comprehensive view of the current and potential role of social impact investment in the supply of affordable housing. The data obtained from the interviews will fill an important gap in current knowledge.

We have identified you as a representative of one of the stakeholders involved in the social impact investment or philanthropy and/or affordable housing development in Australia. We are aiming to interview 30 people.

This Participant Information Sheet/Consent Form tells you about the research project. It explains the processes involved with taking part. Knowing what is involved will help you decide if you want to take part in the research.

Please read this information carefully. Ask questions about anything that you don't understand or want to know more about. Before deciding whether or not to take part, you might want to talk about it with a relative or friend.

Participation in this research is voluntary. If you don't wish to take part, you don't have to.

If you decide you want to take part in the research project, you will be asked to sign the consent section. By signing it you are telling us that you:

- understand what you have read
- consent to take part in the research project.

You will be given a copy of this Participant Information and Consent Form to keep.

What this project is about and why it is being undertaken

To date there has been no review of social impact investment in the development of affordable housing in Australia. Social impact investment in affordable housing supply has been limited. Importantly, philanthropists and social impact investment actors hold that their role should be complementary to, rather than replace, government capital grants for social housing (LMCF 2014) provision. While investment has been limited in Australia, the quantum of social impact investment funds potentially available for affordable housing projects suggests a deep concern about the lack of affordable housing stock. Frustration at a lack of opportunities for investment, characteristic of SII more broadly, is driving a search for innovation.

Existing evidence suggests that what SI investors want to provide and what affordable housing project proponents need do not necessarily align. Further, SI investors compete with mainstream financiers who have access to highly competitively priced funds and can mitigate their risk to a greater extent. This raises the question: what can social impact investment offer

that is different from mainstream development finance, and what outputs or social impacts are achieved that are not already achievable? In short, what is the *raison d'être* of social impact investment in financing social and affordable housing?

Project and researcher interests

Sharam's housing policy experience is extensive and includes non-academic research, governance and project roles in the community housing, homelessness and philanthropic sectors.

Moran's research focus is the public policy dimensions of the philanthropic, not-for-profit, and social enterprise sectors in domestic and comparative perspective.

Mason's foundational work on the development of a social enterprise policy corpus in the UK remains the most comprehensive empirical and scholarly account of these policies. He has developed the first comparative assessment of two social enterprise policy corpora (Australia and the UK), designing a systematic and robust analytical procedure to compare large policy data sets.

Findlay is a Masters of Social Investment and Philanthropy student and research assistant.

What participation will involve—time, effort, resources, costs, compensatory payments, etc.

Your participation will involve being interviewed at a place of your convenience (e.g. your office), or by telephone. This may take up to one hour.

Participant rights and interests—Free Consent/Withdrawal from Participation

If you do consent to participate, and consent to participate is indicated by you when you sign the participant consent form. You may withdraw from the research at any time. If you decide to withdraw from the project, please notify a member of the research team. You have the right to have any unprocessed data withdrawn and destroyed, providing it can be reliably identified.

Participant rights and interests—Privacy & Confidentiality

Your privacy is assured. Neither university will keep, or make available, any personal information or individual responses to a third party (i.e. any individual, organisation, agency or researcher not directly involved in this project). The information gathered will only be used for research purposes. The researchers will de-identify the transcriptions used. No publicly available results (i.e. reports or journal articles) from the project will contain information that could identify either you or your organisation.

While the project is in progress information will be securely stored by each of the researchers on their password protected desktop computer/in a locked cabinet in their secure office. Once the project is completed the Swinburne researchers will destroy the transcriptions they hold. Sharam will archive project material at Swinburne until destruction is required in line with privacy laws.

With your consent we will electronically record the interview so that our records of what you say are accurate. The recordings will be transcribed. However, **any information you provide will be completely confidential**, we will **use labels such as 'Institutional investor 1' or 'Tenants advocate 3' to describe you and will not use your name** when writing reports from the results of the research and **we will take out any other information that could identify you**. This means that **no one will have knowledge of what you have personally told us**. All the information collected will be held by Sharam in a locked cabinet and secure room until it is destroyed.

As a condition of our funding for the project we are also required to submit the de-identified data to the Australian Data Archive (www.ada.edu.au), a national service for the collection and

preservation of digital research data and to make these data available for secondary analysis by academic researchers and other users. Your identity is not provided to the ADA.

If you agree to take part in this research under the conditions outlined here, we need you to sign a consent form to say that you agree to participate in the interview.

The anonymous information we find out from the research will be used in a variety of ways. These will include:

- conference papers and presentations
- progress and a final report for AHURI to be published in written form and electronically
- published academic journal articles
- published practitioner journal articles
- newspaper articles

The data will not be supplied in any form (other than published or publicly presented papers) to any other researcher, individual, organisation or agency.

All research in Australia involving humans is reviewed by an independent group of people called a Human Research Ethics Committee (HREC). This research project has been approved by the Swinburne University HREC. This project will be carried out according to the National Statement on Ethical Conduct in Human Research (2007). This statement has been developed to protect the interests of people who agree to participate in human research studies.

Further information about the project – who to contact

Dr Andrea Sharam

Chief investigator

RMIT School of Property, Construction and Property Management

Tel: 0413 465 413

Andrea.sharam@rmit.edu.au

Should you have any concerns or questions about this research project, which you do not wish to discuss with the researchers listed in this document, then you may contact:

Reviewing HREC name	RMIT University
HREC Secretary	Peter Burke
Telephone	03 9925 2251
Email	human.ethics@rmit.edu.au
Mailing address	Research Ethics Co-ordinator Research Integrity Governance and Systems RMIT University GPO Box 2476 MELBOURNE VIC 3001

Appendix 5: Credit assessment in relation to property development

Table A 2 provides a description of each the considerations of lenders (the '5 Cs') and their main elements. The purpose of the exhaustive credit assessment process is to determine whether debt or equity will be provided and to mitigate the risk of default (return of capital) and returns being lower than anticipated (return on investment).

Table A 2: The 'Five Cs' of Credit Assessment

Five 'Cs'	Description	Includes
Character	Appraisal of the borrower's integrity	Character Competence Identification Social and financial stability Honest and reliable
Capital	Appraisal of the borrower's financial strength	Assets & Liability statement Title searches Gearing
Capacity	Analysis of the borrower's capacity to repay	Cash flow Confirmation of income (project revenue)
Conditions	Analysis of key external and internal factors	Loan conditions and covenants Market and economic conditions
Collateral	Appraisal of security available to support the borrowing	Mortgage Guarantee Lien Fixed/floating charges Multipartite agreements

Source: Bryant (2012).

Development models that deviate from the norm (in that they cannot comply with the five Cs) face financing challenges. This includes NFP housing providers intending to build and retain property for sub-market rental, and deliberative developers (groups of intending owner-occupiers undertaking multi-unit development who are able to internalise the developer margin and thus procure more affordable housing (Sharam, Bryant et al. 2015a), who do not wish to sell any of the assets to fund debt retirement. In Table A 3 we take the five Cs of credit assessment as described by Bryant (2012) and compare how the credit criteria used to assess for-profit housing developer proposals, becomes problematic when applied to NFP deliberative developers. Key differences include whether the proponents are considered competent to undertake the project, the adequacy of income to retire debt, security and type and location of dwelling.

Table A 3: Credit assessment: for profit /not-for-profit /deliberative developers

Developer	For profit developer (build to sell)	Not for Profit developer (build to retain for rental)	Deliberative developers (apartments)
Character	Profit maximisation objective of proponent aligns with project goal Senior management, consultants and builder chosen for skills and expertise for specific project Track record	Mission orientation confusing Concern that senior management and board may lack requisite skills/experience Regulation or government policy shifts may be viewed as risk or constraint	Required to deliver profit (albeit internalised) which affects design and location Lack expertise Decision making seen as risk No track record
Capital	Equity contribution Loan-to-cost ratio and loan-to-value ratio requirements focus proponent on reducing costs and ensuring profit margin (often to the detriment of design and quality*)	Limited equity available (cash reserves/grants) Liabilities ongoing (maintenance, personnel) Gearing constrained by limited cash flow Assets cannot be realised on market in the event of debt default Cost of projects may be less than market value Cost minimisation desired but balanced against lifecycle costs (maintenance) and cost to tenants	Equity contribution requirement excludes less wealthy households Equity rather than deposit provides security Minimum LTV favours high value localities negating affordability value in low cost land Savings significant thus capacity to pay increased
Capacity	Presales confirm revenue will be available when building competed	Revenue generated from social rents low thus amortisation of debt over extended period required.	In effect 100% pre-sales confirming product/location, waiting list
Collateral	Security taken over project itself as no other assets Personal guarantees provided by proponent and senior executives	Assets have limited applicability as security Senior executives and/or board members unlikely to provide personal guarantees	Security over project only Non-home owners have limited assets to offer as security Reputational risk to financier if required to step in
Conditions	Requirements for pre- sales Limits on sales per buyer Limits on foreign sales	High demand for tenancies evidence for future cash flow	Constraints on locality and design that could deliver cost savings

Developer	For profit developer (build to sell)	Not for Profit developer (build to retain for rental)	Deliberative developers (apartments)
	Restriction on locality Restriction on design	Changes to government policy could adversely affect cash flow Interest cover ratio Tripartite agreements (including government)	

*Note: *Most buyers of apartments in Australia are investors (Sharam, Bryant et al. 2015b).*

Source: Authors, after Bryant (2012).

Dwelling type, design and location is important, as financiers require the LVR to guarantee their funds can be recouped if the developer fails to complete the project or make repayment. Accordingly, the proposed product must have broad market appeal to ensure there is demand. Disability housing often struggles to obtain finance because market demand for non-standard housing is limited and hence the market value is often deemed as less than the value of the loan required to build it (Callanan, Leshinsky et al. 2017). LVR requirements restrict apartment development in new greenfield estates on the urban fringe because there is a limited market for this type of housing product (given the competition from relatively cheap detached housing). But apartments in inner urban areas will be financed reflecting high demand from investors and tenants. Financiers typically seek a minimum proportion of presale contracts as evidence of strong demand for the product. For deliberative developers, the product still needs to have broad appeal to the market although such developments are effectively 100 per cent pre-sold, which can limit cost savings (through design or building on land in cheaper locations) (Sharam, Bryant et al. 2015a).

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Australian Housing and Urban Research Institute

Level 1

114 Flinders Street

Melbourne Victoria 3000

T +61 3 9660 2300

E information@ahuri.edu.au

ahuri.edu.au

ACN 090 448 918



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