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Enhancing affordable rental housing investment via an intermediary and guarantee

LOWERING THE COST OF FINANCE TO COMMUNITY HOUSING ORGANISATIONS TO BUILD AFFORDABLE HOUSING IS FEASIBLE IF THE GOVERNMENT CREATES AN INTERMEDIARY TO AGGREGATE AND ASSESS BORROWING DEMANDS OF THE SECTOR AND ISSUE BONDS BACKED BY GOVERNMENT GUARANTEE TO INVESTORS.

KEY POINTS

- Government guarantee schemes to address the supply of affordable housing have been established in a number of countries including the UK, Ireland, Switzerland, the Netherlands and the United States.
- Two models are proposed for Australia. One, the Affordable Housing Finance Corporation (AHFC), involves the issuing of bonds backed by government guarantee, whilst the other relies on issuing debt using conventional securitisation methods.
- The research team preferred the AHFC option. It overcomes many of the barriers to investment in affordable housing by offering investment opportunities at an appropriate scale, simplicity and risk weighted return. It is also attractive to housing providers because of its lower cost. The government guarantee would help establish a robust and competitive investment market.
- To implement this strategy, the government would: establish an agency to act as intermediary between investors and housing providers; offer a default guarantee

This bulletin is based on research conducted by ***Associate Professor Julie Lawson*** *and* ***Professor Mike Berry*** *at the AHURI Research Centre—RMIT University,* ***Professor Hal Pawson*** *at the AHURI Research Centre—the University of New South Wales and* ***Ms Carrie Hamilton*** *at Housing Action Network.* *This project examined international experience in using intermediaries and guarantees to fund affordable housing in Australia.*

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on bonds issued by the agency; and give a clear commitment to policies and programs which ensure a stable operating environment, such as adequate supply incentives and revenue side subsidies.

CONTEXT

Insufficient finance—private and public—for affordable housing investment, relative to the growth in demand, is an ongoing policy concern. Previous AHURI research (project 30652) shows institutional investment is a desirable source of finance to achieve long-term growth in the supply of rental housing.

This research considered the international experience using intermediaries and guarantees in order to establish an entity for securing finance for Australian community housing organisations (CHOs). It also considered what policy and practice changes were necessary to make this work.

The project researchers interviewed key stakeholders in Europe (where such models have been successfully implemented) and stakeholders in New South Wales, Victoria, and the Australian Capital Territory.

A Think Tank meeting was held in Melbourne in October 2013, hosted by Australian Super, involving 24 Australian and international experts and all members of the research team.

KEY FINDINGS

Government guarantees lower the perceived risk of affordable housing investments to those loaning money. As a result, borrowers can offer lower interest rates and still attract investors. In turn, lower interest rates mean affordable housing developers can provide more stock to targeted lower and moderate income households. Government guarantees are justified as a way to correct market failure in providing sufficient housing for these households.

Where government guarantees have been implemented

Guarantee schemes involving a specialist *financial intermediary* that targets investment towards specific segments of the housing market have been established in a number of countries, as summarised in Table 1 below.

TABLE 1: INTERNATIONAL GUARANTEE SCHEMES

Guarantee scheme and year established	Social housing as % of housing market
Dutch Guarantee Fund Social Housing (WSW) backed by the sector, a fund and central and local governments (1983)	32
Swiss Bond Issuing Co-operative for Limited Profit Housing (EGW) backed by the Swiss Confederation (1991)	11
French Mutual Fund for Guarantees of Social Housing (CGLLS), backed by the French Government (2001)	17
Irish Housing Finance Agency (HFA) backed by the Irish Government (1982/2012)	8
UK Affordable and Private Rented Housing Guarantee Schemes, backed by UK Government since 2013 (THFC)	17
Scottish Government's National Housing Trust, backed by the Scottish Government (2010)	24
US Risk Sharing Scheme between Housing Finance Authorities and Department of Housing and Urban Development (HUD), backed by Federal Housing Administration insurance (1992 pilot/2001 permanent)	5

How existing specialist financial intermediaries operate

A specialist financial intermediary, backed by government guarantee, pools and vets the borrowing needs of housing providers and then issues well rated bonds (e.g. AAA rating is the highest) to investors. The cost effectiveness of the financial intermediary enables savings to be passed on to the borrowers.

Financial intermediaries range from not-for-profit membership cooperatives and stakeholder managed organisations (EGW, THFC, refer to Table 1) to publicly-owned companies reporting to governments (HFA, CGLLS, refer to Table 1). They vary in size, depending on the size of the sector and the level of monitoring undertaken in the organisation. Some intermediaries deliver a dividend to their governments, others build and hold reserves as risk mitigating funds.

Most schemes only provide guarantees to approved and registered social housing providers to build and renovate a range of rental, shared equity and ownership housing services.

Most schemes have a strong role in monitoring and strengthening the financial capacity of their borrowing landlords, ensuring they are worthy of a low risk rating. Risk analysis is often done by or on behalf of the intermediary.

Purchasers of social housing bonds include major pension funds and insurance companies, public sector banks, international financial institutions and governments.

Costs and benefits for stakeholders

The financial intermediaries and government guarantees have greatly expanded credit options for the social housing sector, creating entirely new investor markets and reducing loan interest costs as well as lengthening loan terms. For example, the Dutch WSW has reduced interest rates by 1–1.5 per cent below the going equivalent mortgage rate.

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

Models applicable to social housing finance in Australia

Two mechanisms are put forward and compared.

1. *The Affordable Housing Finance Corporation* (AHFC) adapts the established Swiss and UK approaches. It involves the formation of an expert non-profit financial intermediary ('Australian Housing Finance Corporation') to assess and aggregate the borrowing demands of registered CHOs and issue bonds with a carefully structured and targeted guarantee.
2. *Securitisation* draws on the leadership of the financial sector in securing a large flow of private investment into highly-rated housing bonds, using the established tool of securitisation (e.g. where mortgages are bundled together and sold to other investors, creating a tradeable market that encourages investment). A guarantee by government is not required in this instance but is replaced by direct equity contributions to the scheme.

The Affordable Housing Finance Corporation

The research team concluded that the AHFC offers the best way to establish a housing bond market in Australia targeted at expanding the supply of affordable housing through the not-for-profit housing sector.

Government would have a guarantee agreement with the AHFC designed to minimise any potential call that could require a government transfer. Government would administer guarantee eligibility rules and impose a cap on volumes of finance guaranteed. Lead banks would take responsibility for issuing bonds to the market, while ratings agencies would independently rate those issues.

Through its management team, the AHFC would:

- Assess the risks and benefits of applications for borrowing money from individual CHOs.
- Combine the approved borrowing applications from many different CHOs.
- Raise large volumes of money ($50–200 million and upwards) from long-term low-yield bonds issued by lead banks to institutional investors.
- Distribute the money to the applying CHOs.
- Monitor the CHOs proper and effectlve use of the money.
- Collect the repayments (of both interest and principal) from the CHOs.
- Repay the banks who would return money to investors.

The AHFC's advantages include: its relative simplicity and transparency; capacity to be harmonised easily with the Australian National Regulatory System and state-based regulatory systems for not-for-profit CHOs; capacity to fit well with existing government subsidy policies (e.g. Commonwealth Rent Assistance); minimal impact on government budgets; negligible probability of the government guarantee being called; and lower cost of finance to providers and lower equity contribution by project sponsors (compared to the Securitisation model).

POLICY IMPLICATIONS

The report outlines key steps for the implementation of the AHFC. These include: the creation of a financial intermediary; establishment of an overarching guarantee agreement; appointment of an expert board; hiring of specialist credit assessment team; market scan and aggregation of borrowing demands; and establishment of reserve funds and issuing of bonds.

The proposal would fulfil the Australian Government's commitment to increase private investment in affordable housing, bridging the gap between Australia's affordable housing investment needs and the risk/return strategies of the large superannuation funds as they enter the pension phase of operation. It also aligns with the government's aim to develop deeper, longer term bond markets in general and can directly inform efforts to grow long-term lower cost investment in social and economic infrastructure for Australian cities.

FURTHER INFORMATION

This bulletin is based on AHURI project 53019 *Enhancing affordable rental housing investment via an intermediary and guarantee*.

Reports from this project can be found on the AHURI website: www.ahuri.edu.au or by contacting AHURI Limited on +61 3 9660 2300.

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