



EXECUTIVE SUMMARY

Paying for affordable housing in different market contexts

Inquiry into increasing affordable housing supply: evidence-based principles and strategies for Australian policy and practice

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The Inquiry Panel are to provide guidance on ways to maximize the policy relevance of the research and draw together the research findings to address the key policy implications of the research. Panel members for this Inquiry:

Paul McBride	Department of Social Services, Australian Government
Caryn Kakas	Family and Community Services, NSW Government
Scott Langford	SGCH Group
Mike Scott	Development Consultant
Marion Thompson/James Yuen	Department of Planning, WA Government
David Tow/Janet Chappell	Urban Growth NSW
Julian Wright	Housing Authority WA

Executive summary

In this study six recently completed affordable housing developments across Australia are analysed to ascertain how affordable housing project costs, revenues and subsidies interact to produce affordable housing.

Using the project data, an interactive modelling tool is developed. The 'Affordable Housing Assessment Tool' (AHAT) is designed to calculate the impact of different cost and subsidy parameters on housing affordability for the various types of lower income households in need of affordable housing.

The research reveals the diverse and bespoke funding arrangements adopted by providers in the study. This has resulted in affordable housing project outcomes being driven by funding opportunities rather than by defined housing needs. The AHAT uses housing needs to refocus decision-making on what housing outcomes are required and on what subsidy levers can achieve those outcomes.

The tool produced by the research is user-oriented and has substantial input flexibility. It aims to assist:

- policy-makers needing to assess the efficacy of different subsidy arrangements for affordable housing
- affordable housing practitioners wanting to know the impacts of prospective affordable housing projects under given subsidy schemes and market conditions.

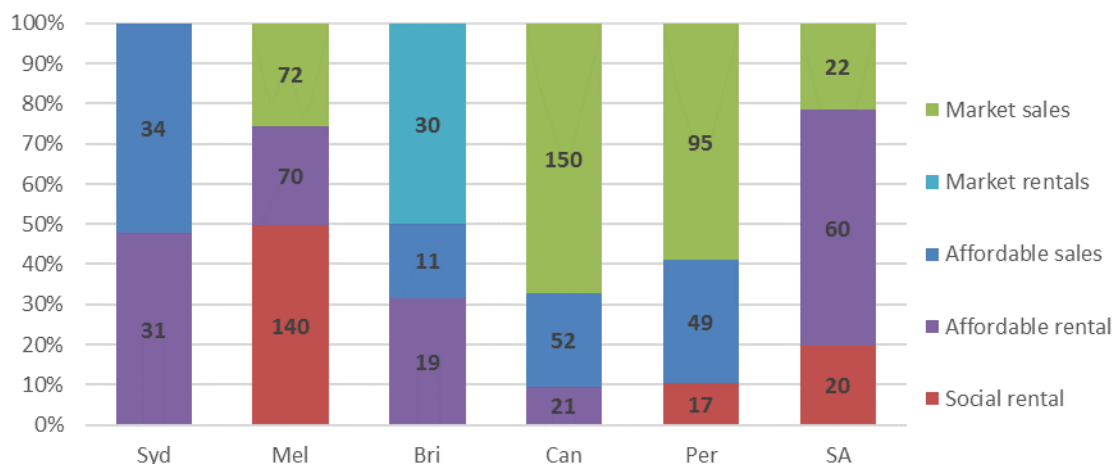
Six key lessons about financing affordable housing are drawn from the research.

1. Government facilitated access to land is central to generating development opportunities and a key means of improving long-term project viability.
 2. Government equity investment offers considerable potential for delivering feasible projects and net benefit to government.
 3. Reducing upfront debt loads and lowering finance costs are critical to long-term project viability.
 4. Delivery across the housing needs continuum helps to meet overall social and tenure mix objectives as well as providing opportunities to improve project viability through cross subsidy.
 5. Planning policies can deliver additional sources of cash or land, however, the financial benefit of planning bonuses is limited.
 6. Increasing the scale of not-for-profit housing provision will offer financial benefits for the long-term delivery of affordable housing.
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Key findings

The affordable housing projects studied comprised developments located in six different Australian jurisdictions that were completed between 2013 and 2016. Inner, middle and outer metropolitan areas plus a regional area were represented. Five of the projects were delivered by community housing providers (CHPs) and one by a state government in partnership with a private developer. Figure 1 below summarises the outcomes along the housing continuum for each of the projects.

Figure 1: Continuum of housing outcomes across six projects (dwellings)



Note: In addition to the outputs shown here, the Melbourne project supported approximately 228 further social and affordable rental homes off-site, through surpluses gained from the market sales and debt raised on the title and rental revenues of the retained assets. 'Affordable sales' includes below-market housing outcomes not retained by the proponent: namely sales to other NFP housing providers and investors receiving NRAS incentives, and sales to owner-occupants as part of a shared-equity scheme.

Source: Case study research.

The main funding mechanisms used in combination were:

- access to and/or discounted purchase of public land (six cases)
- public and/or NFP development capital (five cases)
- market sales (four cases)
- operating subsidies (five cases).

One project also supported affordable home ownership using government loan products.

Analysis of the cases highlighted a variety of approaches to delivering financially feasible affordable housing projects. In many respects, this variety suggests there is no universally optimal financial arrangement. However, through the development, calibration and testing of the 'Affordable Housing Assessment Tool' (AHAT), it is possible to draw some more general conclusions regarding the impact of different policy, market, organisation and tenant contextual factors on financial feasibility, and to highlight transferable lessons for policy development and project planning.

The key findings concerned with financing affordable housing projects are listed below.

The importance of government support for access to land

Market land costs and not having direct access to land pose major barriers to developers of well-located social and affordable housing. In the absence of any widespread capital subsidy

program that can assist providers to compete in the land market, the provision of public land at below-market cost offers an alternative for governments to effectively support affordable housing development. Having privileged access to public land, even when purchased at a 'market' equivalent price, is also beneficial.

Value of government-retained equity

When government retains ownership of its land and treats this as an equity stake in a development, it can both support the achievement of affordable housing and enhance the value of its investment through the improved land value that the development creates.

Need for a fit-for-purpose subsidy ('gap funding') to cover operational losses under private financing

Producing social or affordable housing with a component of private finance invariably generates a gap between the revenues recouped from sub-market rents and the recurrent costs of provision, including debt servicing. There is, therefore, a longstanding case for a 'revenue gap' subsidy to support the provision of affordable housing. The AHAT produced in this study would enable policy-makers to test different design options for such a subsidy.

Benefit of mixed tenure and development at scale

Cross-subsidy opportunities that arise from mixed tenure and mixed use developments were shown to enhance project feasibility and improve the financial position of community housing providers (CHPs) towards their mission of providing additional affordable housing. This mechanism also provides much needed flexibility to enable CHPs to better manage development risk across different market contexts and cycles.

Retaining affordable housing and social benefit

One advantage of the not-for-profit model of affordable housing provision lies in the potential for NFPs to retain the social benefit created by public investment over the long term. Providing time-limited subsidies to the private sector to produce affordable housing that is predicated on sale and realisation of future capital appreciation is less efficient over the longer term than directing such subsidies to NFP providers.

The importance of a needs-based modelling approach to investment decisions

Too often the composition of affordable housing projects has been driven more by disparate funding rules and opportunities than to meet priority housing needs. As a result, the rents of many 'affordable dwellings' may not be affordable to those on the lowest incomes or those in need of larger (higher rent) housing, or tenure pathways for households may not be operational. By using the AHAT, the financial model for a project (or program) can be explicitly designed to generate the range of housing that meets a set of defined housing needs.

Policy development options

The study findings lead to a set of policy implications for consideration by all government agencies with an interest in promoting affordable housing development at scale.

- 1** How governments treat valuation of their land that has the potential to be developed as affordable housing should be reviewed. Rather than seeking 'highest and best use' land value for sales of government land for affordable housing, a preferable approach would be to treat public land as a transparent subsidy input with the sale price reflecting the housing needs that the development seeks to address—that is, its residual value as an affordable housing development for a specific needs cohort.

- 2 Governments should assess the costs and benefits of supporting affordable housing developments over the long-term. Given that affordable housing is a 30-year plus investment, it is appropriate that its benefits are assessed over a comparable time period. The AHAT provides a tool for this.
- 3 Obtaining lower cost finance than is presently on offer will have a significant impact on affordability outcomes and the cost to government of funding the gap between revenues and required investor yield. The analysis, therefore, reinforces the rationale for the 'Bond Aggregator' facility—to provide CHPs with access to lower cost long-term finance—that is being developed by the Australian Government.
- 4 The analysis supports the case for targeting public subsidy for affordable housing to not-for-profit (NFP) developers to ensure that a long-term social benefit is retained.
- 5 The analysis points to the importance of CHPs developing sufficient scale to support the delivery of a diversity of housing outcomes without sacrificing their ability to serve house high needs groups. Large-scale development can generate valuable cross-subsidy opportunities, both within individual projects as well as across portfolios.
- 6 Fragmentation of affordable housing subsidy mechanisms adds cost and complexity to the development process and, by implication, leads to a less than optimal outcome for public investment. Australian and state/territory governments therefore need to develop a coherent and long-term policy framework and mix of strategies to support housing provision across the continuum of housing need. Subsidy levels and the quantum of public funding should be matched to needs along that continuum.
- 7 The results of both the case study analyses and the modelling exercise highlight that any comprehensive funding and subsidy arrangements to support social and affordable housing delivery will need to respond to the spatial variation in costs that affordable housing providers face.
- 8 The findings on housing outcomes highlight a gap in public policy support for a shared home ownership product. A well-designed and funded national shared ownership program would help to make the housing needs continuum work more effectively with concomitant social and financial benefits over the long term.

For practitioners, the AHAT is considered to have value as:

- a pre-feasibility modelling tool to allow providers to judge the best mix of funding and available subsidies to support the delivery of a designated set of needs for any given project
- an educational tool for the range of stakeholders involved in affordable housing delivery about the way scheme costs, revenues and gap funding can be best managed to bring projects to viability while keeping a focus on providing homes to target needs groups
- informing a discussion about trade-offs to be made in a project set up and thereby helping affordable housing developers to determine which of the available funding and subsidy mixes will optimise their social goals
- to exemplify the way policy can impact on the viability of affordable housing delivery and thereby contribute to wider advocacy for policy development and improved practice in the delivery of affordable housing projects.

The study

The study had several components.

First, it examined how recently completed affordable housing development projects located in different urban and regional markets across Australia had worked. Six carefully selected projects that met pre-set criteria were used as case studies to ascertain how affordable housing project costs, revenues and subsidies interacted to produce affordable housing.

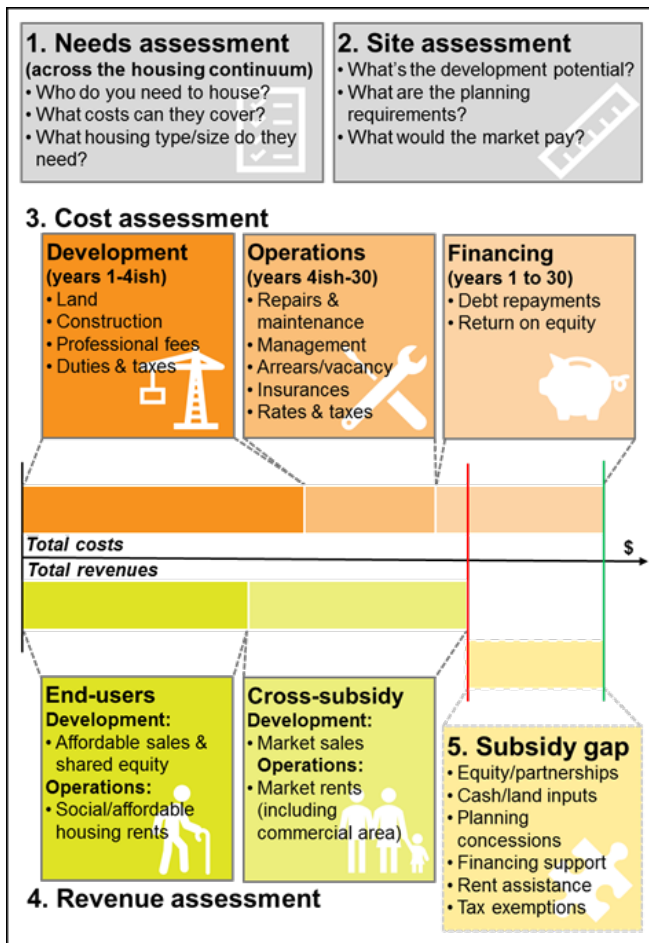
The case study research used extensive documentary evidence, interviews and site visits to determine the market and policy context shaping each project and to unpack how the project financing mechanisms interacted to deliver affordable housing outcomes along the housing continuum. This also provided real data to assist building and calibrating the AHAT, which formed the second study component.

The AHAT was conceived and designed to calculate the impact of different cost and subsidy parameters on housing affordability for the various types of lower income households in need of affordable housing. The starting point for the model is the definition of the housing need that a project seeks to address in terms of the mix (size, type, incomes, etc.) of potential residents and the dwelling mix (tenure, price or rent, size, number) that matches this need. Together, this information determines the potential revenue outcome that will underpin project feasibility. From this starting point, the model then applies a traditional project level feasibility assessment methodology—based on a range of physical and planning constraints and housing market contexts. The policy levers (or subsidy options) incorporated into the model are based on the various mechanisms used across the case studies. The aim is to use different policy levers to generate an outcome that, over a 30-year period, would generate sufficient return on levels of upfront equity investment. The workings of the model are shown in Figure 2 below.

Third, in order to generalise the findings about financing affordable housing in different market contexts, three hypothetical project scenarios representing three housing markets (high, medium and low-cost) with a corresponding development type (high, medium and low density) were tested. This produced the key lessons discussed above and shown in detail in the report.

Finally, in consultation with independent experts, policy-makers and practitioners, the tool was road tested and the research findings for policy and practice were developed.

Figure 2: The Affordable Housing Assessment Tool—summary of key components



Source: authors.

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