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EXECUTIVE SUMMARY

Supporting vulnerable households to achieve their housing goals: the role of impact investment

Inquiry into social impact investment for housing and homelessness outcomes

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Inquiry into social impact investment for housing and homelessness outcomes

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

Executive summary

This report is part of an AHURI Inquiry into social impact investment for housing and homelessness outcomes and addresses the question: What are the actual, potential and perceived opportunities and risks of social impact investment (SII) for housing and homelessness policy in Australia? It examines different SII finance options and uses financial modelling and case studies to address this question with a focus on access to housing and support for vulnerable households.

- The most vulnerable groups requiring housing include: People primarily citing financial stress and/or housing crisis; those experiencing homelessness; people experiencing domestic and family violence (DV); those leaving home due to family and domestic violence and housing crises; people with complex needs such as mental health and/or alcohol and drug issues; people with a disability; the aged who have low incomes and have insecure housing.
- The key SII options considered in the study are: the bond aggregator model for funding for affordable housing; Social Impact Bonds (SIBs), private capital impact investment firms; Impact Investment Mutual funds; and Social Impact Loans.
- In terms of the role of impact investing to finance low-cost affordable housing, our empirical findings suggest that social impact financial models that rely solely on rental streams could provide a steady annuity stream to investors in the current low interest rate environment. Capital gains returns add to the financial benefit of an impact investing option. To supplement a bricks-and-mortar SII approach and support vulnerable populations to enter and maintain housing, the SIB instrument appears the most viable SII option.
- There is much promise with various SII financial instruments and models, but numerous barriers need to be overcome. A viable SII market would require assistance by government to help close or minimise return gaps, especially because of a) the low incomes of very vulnerable tenants; b) the finance gaps faced by Community Housing Providers (CHPs); and c) the limited number of impact first investors.
- The study finds a limited existing use of SII in the case of social enterprises. Low levels of SII do not simply reflect a case of building understanding and capability among social enterprises and not-for-profits. Nevertheless, the study presents social enterprise case studies which demonstrate that SII can work when there is alignment of purpose and an understanding of the social impact of the investment, and there is an acceptance of a lower than market financial return and some level of risk presented by the enterprise.

This report is the second of three projects to be released as part of the Australian Housing and Urban Research Institute (AHURI) Evidence-Based Policy Inquiry, *Inquiry into social impact investment for housing and homelessness outcomes* (see Muir, Moran et al. 2017 for the first report of this Inquiry). The Inquiry sets out to answer:

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

This report primarily answers the second research question for the Inquiry. It takes a specific look at finance models and options regarding how this might work in practice. What different finance instruments and models could be used to enact SII in Australia to address housing affordability and homelessness issues? Who might be helped? Will there be winners and might certain groups be left behind? This project has examined different finance options and used financial modelling and case studies to better understand the potential, opportunities and risks of SII in Australia to address these issues.

Key findings

SII is being considered as a (relatively) new solution to a previously intractable social problem—affordable housing and housing for vulnerable people in the housing market. Internationally, affordable housing is a target for approximately half of impact investors, but it is the largest investment area (accounting for 22% of total assets under management). SII presents an important opportunity in Australia, but we need to better understand the finance instruments and models that might be feasible and which groups can most benefit from SII in the housing space.

This research has found that the most vulnerable groups requiring housing who are experiencing homelessness or at direct risk of homelessness include:

- **People primarily citing financial stress and/or housing crisis:** This group generally presents without other contributing issues, and are less likely to have a history of homelessness (AIHW 2014).
- **Indigenous people** are experiencing a growing over representation in the homelessness population. In 2015–16 Indigenous people were 9.1 times more likely to use Specialist Homelessness Services (SHSs) than non-Indigenous people (AIHW 2017).
- **People experiencing domestic and family violence (DV):** There were 38 per cent of people seeking SHS assistance who cited DV as a reason. Most of this group are women (63%) and children (29%) (AIHW 2017). Over half (61%) were at risk of homelessness (AIHW 2017).
- **Young people:** Including those leaving home due to family and domestic violence (15%) and housing crises (24%), one in four young people presenting were Indigenous in 2015–16 (AIHW 2017).
- **People with complex needs such as mental health and/or alcohol and drug issues.** Clients with a current mental health issue are the fastest growing client group within the SHS population, growing at an average rate of 13 per cent per year since 2011–12 (AIHW 2017). They are more likely than other homelessness populations to require support to successfully access and/or maintain a tenancy.

- **People with a disability.** People with a disability on low incomes are constrained both in public housing and the private rental market (Productivity Commission 2011) and have more complex needs than the average homelessness client (AIHW 2017). In 2015–16 there was a 12 per cent increase in the number of clients; with an estimated 10,000, people with disability who sought assistance from SHSs. Twice as many people with a disability seeking assistance were over 55, when compared with the general SHS population (AIHW 2017).
- **The aged who have low incomes and have insecure housing or are homeless.** Often these people have been renting and rental in their area has become unaffordable. People aged 55 and over comprised 8 per cent of all people accessing SHSs in 2015–16. SHS use by this group is growing at over twice the rate of the general SHS population, with an average annual growth rate of 9.5 per cent each year since 2011–12. The growth for Indigenous older clients has been even higher at 16.8 per cent each year. Older clients are also requiring longer support periods and are having greater difficulty in finding suitable housing. (AIHW 2017).

It is important to understand these different vulnerable groups to determine the type of housing and tenancy support services that will assist them to achieve safe, stable and affordable tenancies and then to consider appropriate funding sources.

SII has become an increasing federal and state/territory government focus as a financing solution to complex social problems, like housing security and affordability for low income earners and addressing homelessness. Interestingly, while the Council on Federal Financial Relations Affordable Housing Working Group[3] concluded that SII was not a preferred model for affordable housing (because of its inability to attract institutional investors at scale), this research found a range of finance instruments that could be further explored because of the benefit of an asset base in housing. These include financial instruments that are already being considered and implemented:

- The bond aggregator model for funding for affordable housing. This includes social impact loans for housing at subsidised rates. Government payments to individuals could be passed on to the lender to meet interest and principal costs.
- Social Impact Bonds (SIBs), which are based on a return payment for savings (typically by government) if specified social outcomes (such as housing access or tenancy sustainability targets, or provision of accommodation at specified cost) are achieved. Typically, SIBs work with smaller funding amounts than other types of impact investment models and will need to be scaled up to fund larger scale tenancy support initiatives.

However, this project found three additional options that should also be considered:

- Private capital impact investment firms which invest in affordable housing projects and work closely with project managers. The holding period would be approximately ten years, with assets then on-sold to other market participants. Projects could be relatively small ($20 million to $30 million). Given price movements over the past decade and assumptions set out in later sections, private equity partners investing in residential houses (units) could have earned a return of 5.9 (7.2%) per cent per annum, with positive risk adjusted return (Sharpe ratio).
- Impact Investment Mutual funds (listed or unlisted) have the ability to mobilise a large amount of capital, the flexibility to be tailored for SII and provide liquidity to enable capital

[3] For background on the Australian governments' Council on Federal Financial Relations Affordable Housing Working Group see https://treasury.gov.au/consultation/council-on-federal-financial-relations-affordable-housing-working-group-innovative-financing-models/.

gains to be realised without the need to sell the underlying affordable housing assets. A trustee could oversee the fund and a Community Housing Provider (CHP) provide tenancy management. This could be supplemented by government-funded tenancy and/or social supports. The mutual fund could be listed on a stock exchange or set up as an unlisted retail or wholesale fund. Fund units could be sold to individual investors or institutions, including superannuation funds. Financial modelling of an SII mutual fund given price movements over the past decade and assumptions set out in later sections, superannuation products would have, on average, generated a positive return for beneficiaries on residential houses (units) of 6.4 (7.7%) per cent per annum, with positive risk adjusted return (Sharpe ratio).

- Social Impact Loans form the third alternative. In this case government payments are made to individuals (or the lender) to cover part of the interest and/or principal payments due on a loan covering the purchase of property. These loans may also accept delayed repayment.

While there is much promise with various SII financial instruments and models, there are numerous barriers that need to be overcome. A viable SII market would require assistance by government to help close or minimise return gaps, especially because of i) the low incomes of very vulnerable tenants; ii) the finance gaps faced by CHPs; and iii) the limited number of impact first investors.

- Our empirical findings suggest that social impact financial models that rely solely on rental streams may be possible and could provide a steady annuity stream to investors in the current low interest rate environment. However, we do not pursue this possibility further in this study as social impact investors would generally focus on both capital gains and rental returns in considering the performance of their investment.
- CHPs face high operational and asset management costs as well as often facing costs to support the tenancies of vulnerable people. It is challenging for CHPs to generate a financial return because they are unlikely to readily sell dwellings for this reason because they aim to provide tenants with security of tenure. Further, CHPs face reduced rental income and capital gains (and thus returns). This is particularly true if a property is to be made available at a social rent rate (30%) of income, and the only income source is a social security payment, which is the case for many vulnerable households. Finally, CHPs are limited in their ability to scale while they are ‘leasing’ rather than owning government properties because they cannot leverage these properties against borrowed funds to increase stock at a reasonable interest rate. We do not explore this possibility in this study though this is an important area for future research.

Applicability of SII in the context of housing vulnerable populations

The research findings suggest that the finance options explored, with the exception of SIBs, are most suited to large investments in housing assets, which make them more suitable for scalable affordable housing initiatives, rather than as scalable options to support people vulnerable to homelessness to enter housing. Questions need to be raised as to the extent that homelessness interventions and affordable housing for vulnerable households with welfare as their only income source, might achieve viable financial returns, and the investment environment required to support these investments.

The SIB structure appears to be most suitable to support vulnerable populations to enter and maintain housing. While there is a growing body of evidence that homelessness support is associated with a reduction in the use of non-homelessness services; including health (e.g. days in hospital and mental health care) and justice services. Thus far, there has been little evidence in any change in employment or in the cost of welfare payments (Conroy, Bower et al. 2014; Johnson, Kuehnle et al. 2014; Zaretzky, Flatau et al. 2013). Studies typically conclude that cost-savings from reduced use of non-homelessness services at least in part offset the cost of providing homelessness support. However, in only limited cases has the conclusion been drawn that the cost offsets clearly completely offset the cost of support (Wood, Flatau et al. 2016). As SIB payments are typically triggered only if the value of the economic impact of the program is greater than the cost of delivering the program, this suggests that only a limited number of homelessness support programs would be suitable for financing using a SIB. It remains to be demonstrated whether the Aspire SIB achieves its financial returns.

The few Australian examples where SII has played a role in affordable accommodation and support for vulnerable households relate to financing of social enterprises which operate in this space, either providing employment opportunities for vulnerable populations or affordable accommodation. The Big Issue, STREAT and Launch Housing's HomeGround Real Estate are three of the most well-known and established.

The limited use of SII is not simply a case of building understanding and capability among social enterprises and not-for-profits. The findings from the Aspire, HomeGround Real Estate and STREAT case studies provide insight into particular challenges in using SII as a funding source when both housing and support services are required.

Needs and market expectations do not align because:

- *Social enterprises and Not-For-Profits (NFPs) usually exist as a response to market failure*, which means that they exist when the market is not able to provide people with what they need and, critically important in the SII space, it also means that significant profit generation is highly unlikely because market failure responses can result in low margin solutions.
- The majority of impact investors expect a market return, rather than a lower than market return (Impact Investing Australia's 2016 survey of current and potential social impact investors found 58% expected competitive market rates of returns). This is challenging in Australia where we have a smaller pool of investors than in other countries where SII is more developed.

The two social enterprise case studies, STREAT and HomeGround Real Estate, demonstrate that SII can work when:

- There is alignment of purpose and an understanding of the social impact of the investment.
- There is an acceptance of a lower than market financial return.
- There is an acceptance of some level of risk presented by the enterprise.
- There is confidence that the returns generated from the SII would only be used for purposes that aligned with the values and purpose of the organisation.
- Transaction costs are accounted for and covered.
- There is an appetite for low liquidity—that is, there is limited ability to exit.
- Organisations are using a mix of funding types (SII plus grants, philanthropy and donations): the right capital needs to be available in the right format at the right time.
- Taxation (or other direct government subsidies) is assisting to support the financial viability of the enterprises.
- There are income sources that generate profit (STREAT has the Social Roasting Company; 78% of HomeGround Real Estate's 267 properties do not have subsidised rent).

In the case of the Aspire SIB, some key findings can be gleaned despite the early stage of this SII:

- It relies on measurable outcomes that have fixed dollar values against the change in service utilisation: improvement in health (hospital bed days), justice (convictions) and short-term or emergency accommodation homelessness service utilisation relative to a fixed historical basis.

- The returns rely on the availability of high quality linked data across different government portfolios to measure outcomes and define the counterfactual.
- Government is underwriting the risk to some extent (2% pa fixed coupon over 4.5 years).
- While the Aspire SIB was oversubscribed within a four-week period, with approximately 65 investors taking part, showing an appetite in the market for Impact Investing opportunities, it is important to recognise that this was in part attributed to being South Australia's first SIB and a gap of three or four years since the last Australian SIB capital raising exercise.
- It is too early to determine if this SIB will generate the returns expected.
- Lack of rigorous and publically available government service use and cost data required to define the economic model which informs outcome payments under the SIB arrangement is seen as major challenge to SIB development.
- The intensity of the procurement process and high fixed transaction costs limits applicability to larger scale programs (these types of costs are likely to fall over time).

Policy development options

The findings of this research have a number of policy implications:

- Australia lacks pooled investments in the property market as an asset class. There are currently few listed or unlisted investment options that provide investors with exposure to the residential property market on a pooled basis, which raises challenges for the development of social impact property funds to provide affordable housing or housing for the most vulnerable. The four vehicles outlined in this report should be explored as options by government.
- While there is much promise with various SII financial instruments and models, there are numerous barriers that need to be overcome. A viable SII market would require government assistance to help close or minimise return gaps for investors and CHPs.
- Our research found that most of the returns on residential property investment during the study period arose from capital gains. This suggests that social impact investors will seek portfolios that create exposure to both capital gains and rental returns.
- The findings of this report reinforce the need for government to revisit the National Rental Affordability Scheme (NRAS). Research suggests that one of the limitations of institutional investors in NRAS was a lack of trust in the government's ongoing commitment. This has implications for not just a future form of NRAS, but also implies the need for stable longer term government commitment in other areas that will help boost trust and, in turn, investment in SII and housing projects.
- NRAS also demonstrated that private-sector investors seek investments with exposure to both the potential for capital growth and rental returns (Rowley, James et al. 2016). This suggests that at least for private investors, there is some need for market structures which provide for liquidity, allowing exposure to capital gains as well as rental income.
- Government policy and regulatory changes could assist to increase opportunity for superannuation funds to invest in SII initiatives in affordable housing.
- Given SII relies on understanding the social return on investment, it is critical that high quality outcome data collection, reporting and evaluation forms a core part of developing the SII landscape in Australia.

- 2017 Commonwealth Government budget proposals for a bond aggregator and managed investment trusts to support investment in affordable housing are important initial steps in development of market infrastructure to support pooled investments and liquidity.

It is important to acknowledge that this study was undertaken at a time of more than two decades worth of Gross Domestic Product (GDP) growth and sustained growth in property prices in Australia and rising rents. However, it was also a time of limited wage growth (no real growth for people on social security payments) and increases in social inequality. This has created ideal market conditions for investors and increased the housing stress of many and the demand for more affordable housing. This environment also increases future risk in investing in the housing market because the residential property market may not generate the same levels of capital growth in the next decade. It is clear that housing portfolios could be evaluated over a longer time horizon, but data is not available at present. The residential property returns analysed in this study provide valuable insight into the residential property market in Australia over the last decade. Postcode level data used in this study have not been available for analysis until quite recently and the use of this data marks a key contribution of this study.

There are two further general observations about the return data used in the present research study. First, capital gains are an important component of residential property total return, consistent with a wide range of financial and real assets. Second, in contrast to capital gains, rental yields are relatively stable over the study period. Similar levels of stability are also observed for coupons attached to bonds, dividends paid on shares, and rental yields earned on commercial property.

The finance vehicles are only useful if they can be matched to the needs of either housing or housing service providers and/or people in need of housing support. Findings from the three case studies illustrate a number of issues that require policy attention if the potential of SII is to be realised. Key policy implications include:

- The need for capital requirements to match legal form—STREAT was able to leverage the benefits of their charitable status and issue equity in the Social Roasting Company assets that were important to doubling their scale early in their history. NFPs are unable to take on equity capital because of their company structure. Like STREAT, if they wished to do this, it would require a subsidiary for-profit company.
- The importance of blended and appropriate capital with a focus on financial viability and optimal social impact.
- The needs of the social enterprise must be married with the needs of impact investors, and this union is time consuming and expensive to orchestrate. There are high transaction costs that organisations will need assistance with either via a pro bono arrangement or direct funding.
- There is a need to support increased access to a breadth of financial/funding categories—grant, sub-market ‘soft loans’ and SII—if social enterprises addressing entrenched social problems such as homelessness are to thrive.
- Housing-based social enterprise models struggle to support people with higher needs. They usually cannot afford even the discounted rents of affordable housing properties; and the costs of tenancy support is high. Separate block grant funding may be required to sustain this support for the tenant and to decrease the risk for landlords.
- Establishment, infrastructure and operational costs require seed or core funding separate to SII.
- Ongoing capacity building is critical across the SII market.
- Growth of market size is required to assist it to meet its potential.

- The reduction of fixed transaction costs (or the provision of funding or pro bono support for transactions, such as through NFP intermediaries) is critically important to SII's market development. If not addressed, smaller to medium-sized NFPs will not be able to compete in the market for SII funding.
- Government has an important role to play in ensuring required outcome data are collected, data management methods are robust and efficient, data linkage protocols are established (and the process becomes less costly), and infrastructure is provided to support interrogation and analysis of data. Investing in analysis of linked government administrative data is particularly important to develop evidence around the longevity of positive outcomes for program participants, and thus the period over which economic savings are expected to be generated.
- Commonwealth Government involvement in the SIB market is important with the potential to increase the size of the SIB market through Commonwealth Government issue of SIBs, further development of market infrastructure and through improved data availability.
- There is a need to further grow the investor base for SIBs and social impact investing generally, and grow the amount of capital willing to accept a mixture of financial and social return.

In regard to specific groups of vulnerable people, further consideration and future research is needed about whether SII is appropriate and whether sufficient return on investments would flow. For example, in aged care, while a SIB may be appropriate, aged care is currently funded by the Commonwealth Government while most cost savings are likely to come from state and territory government health portfolios. Further monitoring is also required for people with disabilities as the National Disability Insurance Scheme (NDIS) is implemented.

The study

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

- Determine the most vulnerable population groups requiring affordable housing and/or who are homeless.
- Examine different finance instruments and models for SII in residential property and the return and risk generated.
- Provide case study evidence of SII in housing and employment options that aim to support key vulnerable population groups (including seniors, those with disabilities, the homeless and social enterprises providing opportunities for the homeless).
- Inform housing and SII finance policies.

Key data collection methods:

- A targeted literature review was undertaken examining government policy and financial mechanisms through which affordable housing and support for vulnerable households is provided in Australia and the potential forms of impact investment vehicles; characteristics of vulnerable household populations; and four vehicles for gathering funds into a pool to facilitate impact: private equity, mutual funds, SIBs and social impact loans.
- Three case studies were conducted, including on the Aspire SIB (SA); HomeGround Real Estate (Victoria); and STREAT.

- Issues around SII to fund housing and support for the elderly and people with disabilities were explored via stakeholder interviews with representatives of Foundation Housing, Capital Asset Developments, Grace Mutual, the Centre for Public Impact, BlueChip CHP, Impact Investing Australia, ShelterSA and Homeground.
- Financial analysis of capital gains and rental return data to provide information on the level and distribution of returns generated by residential property portfolios. Data was based on 65,724 properties (36,935 houses and 28,789 units) per year from the Suburb ScoreCard, Core Logic RP data supplied to the University of Western Australia (UWA) by SIRCA; Australian Taxation Office taxable income data; and location data from the Australian Bureau of Statistics.

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AHURI undertakes evidence-based policy development on a range of priority policy topics that are of interest to our audience groups, including housing and labour markets, urban growth and renewal, planning and infrastructure development, housing supply and affordability, homelessness, economic productivity, and social cohesion and wellbeing.

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