



EXECUTIVE SUMMARY

The opportunities, risks and possibilities of social impact investment for housing and homelessness

Inquiry into social impact investment for housing and homelessness outcomes

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AUTHORED BY

Kristy Muir

The University of New South Wales

Michael Moran

Swinburne University of Technology

Fabienne Michaux

The University of New South Wales

Suzanne Findlay

Swinburne University of Technology

Ariella Meltzer

The University of New South Wales

Chris Mason

Swinburne University of Technology

Ioana Ramia

The University of New South Wales

Richard Heaney

The University of Western Australia

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Authors	Kristy Muir	The University of New South Wales			
	Michael Moran	Swinburne University of Technology			
	Fabienne Michaux	The University of New South Wales			
	Suzanne Findlay	Swinburne University of Technology			
	Ariella Meltzer	The University of New South Wales			
	Chris Mason	Swinburne University of Technology			
	Ioana Ramia	The University of New South Wales			
	Richard Heaney	The University of Western Australia			
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Related reports and documents

Inquiry into social impact investment for housing and homelessness outcomes

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

Inquiry panel members

Each AHURI Inquiry is supported by a panel of experts drawn from the research, policy and practice communities. Panel members for this Inquiry:

Philip Fagan-Schmidt	Housing SA
Christine Fitzgerald	Department of Housing and Community Development, NT Government
Trina Geasley	City of Sydney
Adrian Harrington	Folkestone
Paul McBride	Department of Social Services, Australian Government
Sally McCutchan	Impact Investing Australia
Caralee McLiesh	NSW Treasury
Jo Toohey	Benevolent Society
James Waddell	NAB

Executive summary

Key points

- Australia faces numerous and complex housing policy challenges. The waiting lists for social and affordable housing are long (and a significant proportion of the social housing stock is no longer fit-for-purpose), large proportions of the population are in housing stress and too many people are experiencing homelessness. At a time of diminishing resources, new and scalable solutions are required to address these challenges.
 - Social impact investment (SII) is one innovative and growing mechanism for funding solutions to complex social problems. SIIs are investments intending to generate social and financial returns, while actively measuring both (SIIT 2014a; GIIN 2016). SIIs aim to bring together government, philanthropic and mainstream capital, and cross-sector capability to help address social problems.
 - SII has gained renewed interest from individuals (philanthropists, social investors), institutions (foundations), policy-makers, and increasingly, mainstream financial markets (asset managers) in the United States (US), the United Kingdom, Canada, Australia and other developed economies seeking to address a broad range of social issues, including housing and homelessness.
 - Government has a key enabling role in developing the SII market for housing and homelessness in Australia, controlling many of the levers that could remove barriers for other actors in the system, as well as many of the levers in the broader housing market that influence both the size and shape of the housing affordability challenge.
 - For both social and affordable housing there exists a significant financing gap (exacerbated by current housing market conditions in Australia), and government has a critical role in filling it if it wishes to engage the investment community in collaborating and contributing to solutions.
 - SII presents significant opportunities to contribute to housing and homelessness outcomes in Australia, but it is not a panacea. It will not be the most appropriate nor the most effective solution in all cases. Further, where SII does have a role to play, in many cases it will need to be implemented alongside other funding solutions and policy interventions.
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This report is the first of three project reports to be released as part of the Australian Housing and Urban Research Institute (AHURI) Inquiry, *Inquiry into social impact investment for housing and homelessness outcomes*. This report primarily answers the first research question for the Inquiry:

- 1 What is social impact investing and how can it be applied to housing and homelessness policy in Australia?

It also begins to answer the second and third research questions for the Inquiry (which will be dealt with in more detail in the following two project reports and in the overall Inquiry report):

- 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?

In answering these questions, this report unpacks the definition of SII and outlines key instruments and models of SII. It also presents evidence from a workshop, interviews and an online survey with diverse stakeholders on how SII can be utilised in Australia to create change and the actual, potential and perceived barriers, risks and opportunities involved. The report uses systems thinking to show how SII might be applied or operationalised to housing policy in Australia, including in addressing issues related to affordable rental housing, social housing and homelessness.

Key findings

The market for SII is still in its infancy and consequently the evidence base is, as yet, limited. That being said, research has outlined and demonstrated numerous case studies and examples in Australia and internationally where SII is successfully bringing together cross-sector actors to collaborate on exploring, implementing and financing programs and initiatives that are making a positive impact on the outcomes for and the lived experience of some of society's most disadvantaged citizens. This includes examples that have successfully increased the supply of fit-for-purpose social and affordable housing and delivery of innovative homelessness services.

SII potentially provides government with additional policy tools that can be used strategically to drive better social outcomes and achieve higher returns on investment of public money. SII may also provide a useful framework to help support innovation through cross-sector collaborations and partnerships. It might help drive cultural and behavioural change by:

- Focusing on paying for outcomes rather than funding activities and outputs.
- Increasing accountability for outcomes through measurement and increased transparency.
- Focusing on prevention and early intervention before problems become chronic or entrenched.
- Incentivising greater coordination and integration of services delivery and housing solutions by designing SII to include elements of both property provision and support services.

The ability of SII to contribute to these outcomes in practice will need to be tested as the evidence base evolves.

Government has a key enabling role in developing the SII market for housing and homelessness in Australia, controlling many of the levers that could remove barriers for other actors in the system, as well as controlling many of the levers in the broader housing market that influence both the size and shape of the housing affordability challenge—including the size of the financing gap (i.e. the difference between actual rates of return and competitive market-based rates of return demanded by mainstream investors).

Government will continue to provide and fund affordable housing and homelessness services. SII cannot supplant government funding and investment—'*No innovative financing model will close this gap and a sustained increase in the investment by governments is required to stimulate affordable housing production and attract private and institutional investment*' (Council on Federal Financial Relations 2016b: 2). What SII may be able to do is enhance the return on government's (increased) investment in housing and homelessness by attracting other sources

of capital (including mainstream capital) with different capabilities and risk return objectives to co-invest alongside it.

Combining financial models may increase the viability and success of SII transactions and offer stakeholders different benefits—but could also increase complexity. Due care needs to be given to ensure SII products are simple, clear and easy to understand. This is important so as not to deter potential investors, service providers or other key actors, and so that the benefits of combining financial models are more likely to be achieved.

SII is not a panacea and it will not be the most appropriate or effective solution in all cases. In some cases the cumulative savings to government may be modest, or the needs of beneficiaries so complex that there is insufficient certainty of achieving improved outcomes to attract SII investors or the costs of support outweighs the economic (but not the social) return. In these instances, SII will likely not be appropriate. It will be important to ensure that sound mechanisms are in place to make these determinations, and where SII is not an appropriate option that people continue to be adequately supported to have and maintain safe, stable, secure affordable housing and the opportunity to be part of and participate in society.

Further, where SII does have a role to play, if we are to make significant progress in improving housing affordability and homelessness, in many cases it will need to be implemented alongside other funding solutions and policy interventions.

Opportunities

There are many ways in which SII could be applied within the housing and homelessness context. Three areas, however, stand out in terms of their potential impact and likelihood of success (assuming the necessary levers are activated and risks appropriately mitigated). These are:

To significantly increase the supply of affordable housing with attractive attributes

- A total number of 393,000 Australian households in the lowest two income quintiles are currently renting unaffordable housing (paying more than 30% of their gross household income on rent), with 90,000 of those households living in severely unaffordable housing (paying more than 50% of their gross household income on rent) (Hulse, Reynolds et al. 2015).
- As it is likely Australia may have a more significant proportion of long-term renting households in the future, incorporating longer and more secure tenure and more rights/ability for tenants to make a home in any SII affordable housing solution design would have positive benefits.

To significantly increase the supply of fit-for-purpose social housing and support other positive outcomes

- A total number of 206,000 households are currently waiting for access to social housing units, of which more than a third are classified as 'in greatest need' (AIHW 2015). Further, a significant proportion of the current social housing stock is no longer fit-for-purpose, being at the end of its economic life, poorly maintained, lacking in location and amenity, or underutilised as households have become smaller.
- The SII solution design should promote the construction of additional fit-for-purpose housing units to absorb current and future demand and ideally allow flexibility in managing the underlying housing stock portfolio so that it can be renewed and remain fit-for-purpose over time.
- The SII solution design should aim to ensure effective support services (including coordination and integration with housing solutions) so as to assist tenants to maintain their

tenancy, improve their outcomes, and over time actively support a higher proportion of tenants being able to migrate from social housing to affordable housing, where this is appropriate and realistic.

- Increasing the supply of social housing should also ease the stress on transitional and crisis accommodation—so that those at risk of homelessness are placed in appropriate accommodation early and both the duration and instances of homelessness can be limited to help arrest progression to chronic long-term homelessness.

To act as an incubator for government to trial new ways of providing services that deliver desired outcomes most effectively, and importing what works back into the government's day-to-day commissioning for social services to maximise its initial investment in SII

- Current models of government's social service provision and delivery mechanisms are not achieving the desired outcomes. Many of the shortcomings that have been identified in the existing system are key elements that SII is specifically designed to counteract—including: a focus on paying for outcomes rather than paying for activities and outputs; a focus on prevention and early intervention—breaking the cycle before the problems become chronic and entrenched; increased accountability for achieving outcomes through transparent measurement; increasing cross-sector collaboration to find new and better ways to solve old problems; redirecting investment towards evidence-based services, programs and initiatives that achieve the best outcomes most efficiently; and leveraging government's return on investment by attracting other forms and providers of capital.
- Social impact bonds (SIBs) are beginning to play an incubation function as part of a wider trend in public policy to shift public funding of service provision from funding activities and outputs to outcome-based financing (Tyler and Stephens 2016). Designing appropriate mechanisms to transition successful solutions back into government's broader commissioning of services will be important to fully optimise the investment in SII. Seen in this light, government bearing more of the transaction costs of pilot SIB programs would seem reasonable given that the quantum of benefits will ultimately flow back to government through improved commissioning processes.

Risks

SII poses particular risks to government, service providers, investors, intermediaries and most importantly to beneficiaries if it is ill conceived, poorly executed or used in inappropriate settings. These risks need careful consideration in determining whether SII is the most appropriate model in a given context, and in the design of SII solutions. The most significant risks include:

- Beneficiaries are harmed if poor design of SII solutions has unintended consequences (e.g., results in housing stock that is not fit-for-purpose, located in sub-optimal locations lacking amenity and access to services etc.), services are disrupted or cease when SIIs mature or are otherwise terminated, and/or the most vulnerable people with the most complex needs are left out or left behind.
- Community housing providers (CHPs) are not provided with sufficient capacity to continue to scale-up; an increase in business risk profile (as a result of increased leverage and operational/financial complexity managing SII and undertaking more complex and risky housing development projects) undermines or threatens the sustainability/viability of CHP's business models; and/or the viability of smaller CHPs is threatened as they do not have the scale and capacity to participate in the new market paradigm.

- Moral hazard risks are inadvertently created by government de-risking investments to the point where the nexus between positive social outcomes and financial returns is severed, and investors alignment of interests with achieving positive social outcomes is weakened.
- Investors' performance expectations are not met, reducing confidence and stalling development of SII in housing and homelessness.

Policy development options

Government has an important enabling role in developing the SII market for housing and homelessness. It controls many of the levers that can remove barriers that enable other actors to participate, as well as levers in the broader housing market that influence both the size and shape of the housing affordability challenge. The most significant implications of these for policy development and practice change to support realisation of the SII opportunities identified while mitigating associated risks are:

- Addressing related public policies that are putting upward pressure on prices and adversely affecting housing affordability—increasing the size of the problem and the financing gap that needs to be filled. The consequences of not addressing this means that the problem that needs solving is larger than it should be, the financing gap that needs to be filled (most likely be government) is higher, and systemic risks of a property price correction heightens risks to investors who may attempt to address the issues.
- The role of government, as recognised in the *Social Impact Investing Discussion Paper* (The Treasury 2017) and the Council on Federal Financial Relations Housing Working Group (2016b), remains pivotal. SII can support government initiatives, but stable, long-term government policy and funding are essential to attract SII and support the growth of CHPs. All levels of government need to work in concert to bring what they can to reducing risks and costs of delivery. The consequences of failing to provide a stable, long-term policy context are that key actors will not be confident to take risks and will stay on the sidelines, resulting in the challenges not being addressed, and leaving government as the primary actor to resolve.
- The bond aggregator model (Council on Federal Financial Relations 2016b) has industry and investor support and international precedent (e.g. UK), and provides the opportunity for institutional investment at scale and provides an efficient mechanism to finance both social and affordable housing. Without such a mechanism, many of the valid concerns of institutional investors cannot be adequately addressed, making it difficult to attract institutional capital to participate—one of the critical success factors identified in this research given the scale of the problem.
- An improved National Rental Affordability Scheme (NRAS), applying learnings from the original NRAS and combined with the bond aggregator model, provides the opportunity for CHP investment at scale, in targeted fit-for-purpose social and affordable housing stock. Government could also look to other 'in-kind' support mechanisms and broader planning/zoning levers to support the construction of additional affordable housing units. The consequences of failing to provide mechanisms to fill the financing gap are that supply will not increase sufficiently to meet need, or CHP business models become too risky and viability of the sector is threatened (e.g. if CHPs take on additional debt and/or additional development risks and become over-leveraged relative to the development risks and/or relative to the future sustainable cash flows available to support additional debt).
- CHPs have the potential to play a growing role through government support and industry bodies (e.g. Frost and Hamilton 2016) and with international precedent (e.g. UK, Netherlands). If CHPs are not supported to achieve increased scale and capacity, they will

not develop to be seen as viable and attractive counterparties; a lack of scale also undermines viability/efficiencies in the sector.

- Homelessness is a complex issue and SIBs and social enterprises can be part of the solution, with government providing an enabling environment, including frameworks for better measurement of outcomes. These instruments are expensive and bespoke, and the greatest benefit may be as an incubator to test new solutions that can be imported back into broader commissioning and procurement practices. The consequences of not investing in innovation are that we may not be delivering the most effective outcomes or outcomes at sufficient scale. Also, if we fail to invest enough in prevention and early intervention, it usually results in much larger long-term costs to the system and poorer outcomes for people and society.

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. It aims to:

- Describe what social impact investing is and its application to housing and homelessness policy in Australia.
- Examine different finance models and structures, SII markets and case studies, both in general and as applied to policies and programs that aim to address housing and homelessness.
- Map SII and its actors in the supported housing system.
- Inform housing and SII finance policies.

A complex systems thinking approach underpins the methodology used in the research. The project used multiple methods to model and hypothesise how to influence change in the current and potential future system enabling SII to address housing and homelessness outcomes in Australia.

Key data collection methods included:

- A critical analysis of literature and policy on SII, housing and homelessness to establish a definition of SII based on existing evidence and to provide a summary of the main instruments and potential models of SII internationally.
- A workshop of diverse stakeholders (financial, housing and SII sector representatives and government) to discuss and come to systems thinking scenarios of the opportunities, risks and possibilities of using SII to address housing and homelessness outcomes in Australia. Thirty-two people participated in the workshop.
- Semi-structured in-depth interviews with diverse stakeholders (financial, housing and SII sector representatives, government and two formerly homeless advocates), asking participants to talk to and map the system of actors and influences involved in SII, including the roles of different groups and players, the levers for change and the barriers, risks and opportunities involved. Twenty people participated in the interviews.
- An online survey to test findings from the workshop, interviews and literature and policy review with diverse stakeholders (financial, housing and SII sector representatives and government). Seventy-two people participated in the survey.

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Using high quality, independent evidence and through active, managed engagement, AHURI works to inform the policies and practices of governments and the housing and urban development industries, and stimulate debate in the broader Australian community.

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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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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