AHURI Australian Housing and Urban Research Institute

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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:

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

- 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.

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AHURI's mission is to deliver high quality research that influences policy development and practice change to improve the housing and urban environments of all Australians.

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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