nsw Federation of Housing Associations inc

Leveraging change

How community housing providers can deliver best value from the Social and Affordable Investment Fund

NSW's prosperity and future growth is limited by the housing affordability crisis. Over half of low income renters and purchasers are in housing stress, and 60,000 households languish on the social housing waiting list. Home ownership rates are plummeting, especially for traditional first home buyers aged 25-35.

The $1 billion Investment Fund is a tremendous initiative. But with average Sydney house prices nearing a million dollars, the fund is only a drop in the ocean - building a thousand new homes. However, the community housing sector can help leverage precious tax-payer funds, delivering more homes per dollar.

What is the size of the problem?

Since Government housebuilding investment was sharply cut in 1996, only around 10,000 additional dwellings have been added to the NSW affordable housing stock over and above public housing sales and demolitions. Taking into account the number of extra homes needed to simply keep pace with post-1996 population growth, our conservative estimate is that this leaves a deficit of 32,000 affordable rental homes. And this makes no allowance for the way that demographic change (e.g. more single parent families) and declining private rental affordability will have increased the incidence of housing need over the past 10-20 years.

Assuming build costs averaging $350,000 per home, the bill to make good this deficit is over $11 billion. And that's just what it would cost to restore the scale of social housing provision that existed in 1996. Bringing the remaining homes up to a decent standard would come with another hefty price tag.

The Premier's Fund is a great start but we now need to ensure the dollars are leveraged to the maximum, and structural changes such as the bond mechanism we are proposing is introduced.

NSW community housing providers …

- Manage 32,500 tenancies
- Employ over 910 dedicated staff
- Run 64 local housing offices
- Income of nearly $600 million p.a.
- Capital base of $2.5 billion
- Have $175M bank debt invested in affordable housing

Figures based on June 2014 financial statements of the 27 NSW based Tier 1 and 2 registered providers. Analysis by Dr Tony Gilmour, Housing Action Network

What is community housing?

Not-for-profit community housing organisations have been providing high quality rental housing for people on low to moderate incomes for over three decades.

Our NSW sector has the largest, accomplished, dynamic and professionally led organisations in Australia. With well over 30,000 tenancies, our 27 leading organisations manage more homes than Victoria and Queensland providers combined.

The sector has low rent arrears, minimal vacancy rates, and high tenant satisfaction. In the latest AIHW survey, nearly twice as many community housing tenants (39%) were very satisfied with their landlord compared to public housing (22%).

How can community housing providers help?

The NSW community housing sector is ready to work with the Baird Government. Community housing providers always had the commitment and it now has the capacity and the proven track record. In less than a decade community housing providers have invested in and strengthened their organisations, enhanced their business systems, recruited and trained their workforce, taken on their first private finance loans and doubled their role in delivering new housing and tenant support services across NSW.

Through their responses to the Premier's Innovation Initiative, NSW community housing providers have demonstrated creative thinking. We deliver pathways to greater independence for social housing tenants, as well as making the housing system more sustainable.

Community housing providers offer a continuum of housing options including crisis, social and key worker (affordable) rentals. In future, we can work with rent-to-buy schemes and shared ownership. These innovations will provide a pathway towards home ownership for some tenants.

We are also committed to delivering housing throughout NSW for people with disabilities, those facing challenges and disadvantage, and Aboriginal community members.

SGCH a hit with bankers

Westpac Institutional Bank's Head of Government and Education Jon Ross said 'the landscape is now being reshaped by the growing role of community housing providers. We are beginning to see signs that the sector is evolving along similar lines to the UK; a mature market with total borrowings in excess of GBP40 billion'.

SGCH

Leveraging the Investment Fund

The Fund should kick-start affordable housing delivery throughout NSW by providing essential ingredients to encourage more investment. This investment will achieve far greater outcomes by leveraging other forms of finance and assets, and through delivery in part by tax-efficient community housing providers. We have four recommendations:

- Government should establish the infrastructure and legal framework for **NSW Housing Bonds**, as described later in this paper. This cutting-edge innovation will pave the way for greater private investment in affordable housing.
- A partial **government bond guarantee** would reduce investment risk and further reduce the costs of finance. This results in more efficient use of bond debt as cash flows will stretch further. The guarantee will only need to be partly cash-backed from the Fund, and just a slice of the bond will need backing.
- Bond finance will part-fund new social and affordable housing, but we will also need seed equity in the form of assets or land. Some limited **grant funding** targeted specifically at community housing providers to enable this equity transfer could be sourced from the Investment Fund and act as a further catalyst for leveraging.
- Some of the Fund could be set aside to fund a **revolving construction debt facility** that gets repaid at completion, for example with mixed tenure development involving some market-rate sales. This would be revolving and recycled to new projects.

Capacity and Capability

BlueCHP Limited, founded 7 years ago is a CHP focused on development. It has demonstrated the capability of the sector delivering over 1,600 homes. Currently, BlueCHP in partnership with NSW FACS and Lend Lease, is delivering 90 affordable homes at the St Mary's ADI site, bringing innovation in design and liveability.

Recently BlueCHP won the Logan Renewal Initiative, QLD (with Compass Housing) requiring an investment of $800 million delivering more than 2,600 homes over 20 years.

Charles Northcote CEO stated, 'To tackle the magnitude of the supply issue, long dated bond financing coupled with land is vital – CHPs will do the rest'.

BlueCHP Limited
AFFORDABLE HOUSING – FOUNDATION FOR LIFE

Community housing and Government can work in partnership to deliver excellent outcomes. Together, we can help the Innovation Fund make a significant difference to housing supply and economic prosperity.

Housing Bonds

Put simply, Housing Bonds are a means of **accessing the capital markets** that will be an important component in funding new supply of affordable rental dwellings. Community housing providers can pool debts to issue sizable repeatable transactions. They are privately issued bonds with government backing, but are not government-issued bonds.

Essentially, housing bonds are straightforward debt agreements, issued over a long term that match the profile of its underlying assets - bricks and mortar - and stable –secure cash flows which in social housing are primarily 'triple A rated' Federal welfare payments.

Why housing bonds?

Housing bonds are designed to expand and **improve upon the current bank loans** that have emerged to support private social and affordable housing expansion as government funding has receded. Although these early commercial lenders have nobly supported the emergence of community housing's private funding capacity, these loans are individually-negotiated, often of a short 3 - 5 year term, and require expensive interest rate hedges to mitigate future risk. This commercial lending has filled the limited opportunities for community housing expansion of the past decade, but larger-scale supply catch-up in the coming decade will be more efficiently served by pooled bonds. Critically, housing bonds would eliminate risks inherent with repeated refinancing.

Not only would housing bonds signal a maturing in community housing finance, but they would **expand the current means of funding Australian private rental housing** in general. Rental housing is currently funded by individual retail mortgages taken out by mum-and-dad investors who typically own fewer than five dwellings, with almost no securitisation of this massive asset class outside Defence Housing Australia.

What if there were better-diversified, sophisticated instruments like bonds in which mum-and-dads and institutional investors alike could invest that supported stable rental housing supply?

Housing bonds represent a policy direction towards rental housing as an investment asset class as is already the case in the UK. The bonds themselves, as a starting point, must be **large-scale**, **replicable** issues of debt supporting **high-quality** housing projects that would be contestably chosen based on feasibility and operational stability. The large scale of these regular bond issues will qualify for investment analysis by institutional investors like super funds, and their annual replicability will provide some liquidity in an otherwise illiquid asset class.

How would they work?

The fundamental principle behind housing bonds is this: investment in rental housing is investment in a stable ***cash flow,*** **not in *property*** per se. When well-managed, rental housing has a secure annuity-style income profile rather than a speculative, higher-risk property gamble. This distinction is central because security of rental tenure is just as important to a government's driver of workforce mobility/economic competitiveness as it is to the community housing industry's mission of achieving housing stability.

A major part of the solution

Housing bonds alone **cannot fund 100% of new rental housing**. They are not a 'silver bullet' that will work alone to address the state's rental housing backlog. They will provide debt that is sized to be supported by the given portfolio's cash flow profile, which may reflect varying targets for affordability relative to market.

The difference between this supportable debt and the total cost of the project is **the gap that must be funded by other sources**. In an affordable housing project, this would be a combination of government or non-profit equity that is invested in return for social outcomes; in a market-rate rental development this would be funded by a sponsor's commercial equity investment with conventional return expectations.

Government's role

The two main features that would jump-start a housing bond concept are the creation of a sophisticated financial intermediary and Government credit support in the form of a limited guarantee.

Substantial research has been done in Australia to arrive at our model, based both on overseas precedents for housing bonds as well as Australian settings.

The financial intermediary supports the fundamental concept of *pooling* upon which housing bonds are based: it would manage the portfolio composition and financial profile of eligible rental housing developments in order to achieve the diversification and transactional efficiency that are features of housing bonds.

The government **guarantee** or credit support is necessary to overcome initial new-market hesitance towards an asset class that has no track record of institutional investment. Because super fund asset advisors have no performance history of pooled rental housing assets to review and little familiarity with the in-built risk reduction of community housing's national regulation system, a government guarantee or similar credit support would be necessary to bridge this gap until a new asset class of housing bonds were established. Such a guarantee may only be needed for two to three years until the market takes off.

A government guarantee would reduce the risk of investing in the bonds and would therefore bring down their interest rate. A lower interest rate would mean a given rental cash flow could then support more bond debt, thus reducing the gap. Research has indicated that a well-structured, limited guarantee would not need to be reflected on government balance sheets, and consultation with ratings agency government risk analysts reveal that the magnitude of housing bond credit support proposed would not impact state or Commonwealth credit ratings.

The crucial link to be made is that **rental housing is key state infrastructure**, and should be planned and financed as such. The use of government guarantees for key economic infrastructure is well-documented and confirmed by the Commonwealth government as recently as the 2014 budget. The NSW government's understanding of available and affordable rental housing as key state infrastructure was confirmed earlier in 2015. Long-term debt instruments like bonds are therefore an appropriate step, together with other funding sources, in providing this much-needed infrastructure.

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