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CHIA Submission

Review of the Operation of the National Housing Finance and Investment Corporation Act 2018

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Executive Summary

CHIA is the peak body representing not for profit community housing organisations (CHOs) across Australia. Our 170+ members manage a $40 billion-plus portfolio of more than 100,000 homes, housing people on very low, low, and moderate incomes who find it hard to access affordable and appropriate tenancies in the private market.

The Community Housing Industry Association (CHIA) welcomes the opportunity to submit a response to the Review of the Operation of the National Housing Finance and Investment Corporation (NHFIC) Act 2018. Our submission has been informed largely by direct experience of working with and using services provided by NHFIC. In addition, the review has prompted us to reflect on that experience with members, as well as with other interested parties in academia, and in the investment community -both domestically and internationally. Our submission is focused on those parts of NHFIC's operations that are most relevant to CHOs' operations - specifically the Affordable Housing Bond Aggregator (AHBA; although we have also touched on issues connected with the National Housing Infrastructure Fund (NHIF) and the research function; acknowledging that the latter has only been in place for less than 12 months.

CHIA and its members are longstanding advocates for the establishment of an Australian financial intermediary for affordable housing and, at the outset, we wish to emphasise our view that NHFIC and specifically the AHBA has been a success. This is amply demonstrated by the issue of three social bonds in less than two years of operation, at highly advantageous – and decreasing – rates of interest. From a standing start, NHFIC was able to complete the processes and documentation to issue bonds, negotiate with State governments, assess the creditworthiness of CHOs, and secure investor interest. The demand from both CHOs and investors has been considerable and sustained. The outcomes in terms of both savings to CHOs and also for tenants, are well documented in NHFIC's social bond report[1] and individual CHOs' case studies. Not only have NHFIC's bonds been used to refinance existing loans, releasing equity for reinvesting in additional homes and services, but they have also supported new construction too.

The AHBA's success should come as no surprise. It is a prime example of evidence-based policy. Not only is its design influenced and underpinned by extensive research but its implementation was supported by broad sector engagement and expert advice and analysis. NHFIC has also received strong bipartisan support, adding assurance to potential investors of its likely longevity. The contribution of the NHFIC board and officers to successful implementation should also be commended.

[1] nhfic-social-bond-report-2019-20-website-version.pdf

Community Housing
INDUSTRY ASSOCIATION

The whole enterprise is founded on extensive research conducted through AHURI[2], drawing on the experience of successful overseas examples such as The Housing Finance Corporation (THFC) in the UK. This body of evidence was supported by sector contributions such as the CHIA NSW (then the NSW Federation of Housing Associations) project to 'operationalise' the AHURI research, producing a blueprint for a financial intermediary.

The Affordable Housing Work Group (AHWG) established by the Council of Financial Federal Relations provided opportunities for consultation with CHOs, financial institutions and investors about 'ways to boost the supply of affordable rental housing through innovative financing models'. This was an excellent process. CHIA strongly supported the AHWG's recommendation to establish a bond aggregator and subsequent recommendations in its second report '*Supporting the Implementation of an Affordable Housing Bond Aggregator*'. This report identified three key policy and regulatory reforms to 'assist with achieving the policy outcomes desired through the implementation of a bond aggregator', the first two of which were to occur by 1 July 2018 to support the BA's commencement. The recommendations were as follows:

1. Progress initiatives aimed at closing the funding gap that exists for delivery of social and affordable housing
2. 'Work together to develop and implement a uniform and nationally applied regulatory framework' …..'that specifically brought in Western Australia and Victoria'.
3. That the *National Industry Development Framework for Community Housing* be revised and updated to reflect findings and recommendations from the Review of the National Regulatory System for Community Housing.

Following the Federal Government's decision to progress the AHWG bond aggregator recommendation CHIA (through its previous CEO, Peta Winzar) was then part of the expert panel that advised the government about the design, establishment and implementation of what became NHFIC. This process was underpinned by further practical research, notably the 2017 EY report: *Advice, modelling, evidence and an implementation plan for the establishment of an affordable housing bond aggregator*.

EY concluded that 'Government should commence work to establish the (bond aggregator) BA as part of the NHFIC, noting that CHPs (CHOs) are likely to be the primary agents to maintain and expand the stock of affordable housing'. It noted that unlike international counterparts, CHOs were unable to access long term finance via capital markets and were thus 'relying on shorter term bank debt (typically 3-5 years). The report authors argued that longer term capital markets finance would 'lower interest costs and better match the sector's asset life – a core principle of good corporate finance practice – and can therefore make a meaningful contribution to the Australian sector's growth in scale and sophistication.' This contribution would, they found, be enhanced by the Federal Government guaranteeing the BA's issuances, the guarantee being 'most suited to meet identified market gap and the BA objectives' plus the 'additional pricing benefit associated with an explicit guarantee should drive further benefits for CHPs'.

This review aims to assess NHFIC's impact on the CHO sector and (social and affordable) housing supply. NHFIC, and specifically its AHBA, is an essential component of the policy architecture. In the absence of complementary action, however, NHFIC will be constrained in what it can achieve to tackle one of the most pressing policy challenges facing the Federal and State and Territory governments: the increasing shortfall

[2] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014) *Enhancing affordable rental housing investment via an intermediary and guarantee*, AHURI Final Report No. 220, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/final-reports/220.

of rental housing affordable to households in the bottom two income quintiles. Later in the submission we touch on the factors identified in the previously cited research and reports that would enable NHFIC and the AHBA to build on their successful start.

In the meantime, recognising NHFIC's successful start, CHIA is not recommending significant changes to the way in which it operates. It has attracted institutional investors to a new asset class by providing assurance of its long term, stable and very low risk nature. However, it is early days and premature to conclude the market failure NHFIC was set up to address has been resolved.

If confidence is to be maintained and further extended then changes to the model must be to enhance these features of the investment. Significant changes to the model must be avoided in the short term and if necessary in the longer term, planned in such a way as to mitigate any adverse consequences. This is particularly the case in respect of the government guarantee. It is not only institutional investors that require assurance that the guarantee will remain in place, and the cap lifted in response to demand. CHOs need to be confident that NHFIC will be in a position to meet their demand for loan - uncertainty in this respect will hobble strategic planning and the ability to commit to new transactions that increasing supply.

Below we have summarised our recommendations, made in the body of the report. In the report we also make comment on the potential budgetary implications of these recommendations.

Recommendations

1. NHFIC should build on its success and work with the community housing industry to:
    a. refine and streamline processes, potentially tailoring products to match the size and complexity of loan
    b. consider modifications to its loan conditions, and settings to, for example, to its security package requirements that would allow CHOs more flexibility in negotiating loans from the commercial sector.
    c. consider longer-dated tenor loans - up to 20 years.
2. The investment mandate should be amended to enable the use of the NHIF for direct equity investments and grant into social and affordable housing, delivered by not for profit registered CHOs
3. Indigenous Community Housing Organisations (ICHOs) that are registered in 'local schemes' that mirror the NRSCH requirements in all other respects should be allowed to apply for NHFIC finance
4. The Commonwealth Government should commit to further increases in the cap and extension of the guarantee beyond 2023, until alternative measures that secure similar pricing are put in place.
5. The Commonwealth Government and state and territory governments should re-engage with the NRSCH review and commit to resolving the issues that appear to be preventing progress to the establishment of a higher powered and genuinely national system
6. NHFIC should establish a reference group / advisory committee with expertise in affordable housing development and operation.
7. The potential future direction of NHFIC should be the subject of further (and substantial) engagement with all stakeholders. Current issues to explore include:
    a. Planning for end of the bonds' terms -designing the options for refinancing
    b. Building on the current outcomes framework for assessing bonds, to support the development of a standard sustainability reporting framework for social housing that would allow not just NHFIC to provide robust evidence of achievement but also CHOs to demonstrate their 'worth'

to a wide range of investors. One example is the framework developed by the Good Economy and supported by 39 UK housing associations and 31 investors including THFC and NAB

c. a potential role in facilitating equity investments.

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Review of the Operation of the National Housing Finance and Investment Corporation Act 2018

Introduction

The Community Housing Industry Association (CHIA) welcomes the opportunity to submit a response to the Review of the Operation of the National Housing Finance and Investment Corporation (NHFIC) Act 2018.

CHIA is the peak body representing not for profit community housing organisations (CHOs) across Australia. The industry provides one in five of Australia's social rental properties, complementing public housing. CHOs manage a $40 billion-plus portfolio of more than 100,000 homes, housing people on very low, low and moderate incomes who find it hard to access affordable and appropriate tenancies in the private market. Our 170 plus members include the largest (managing over 10,000 dwellings) to those with less than 100 homes. Our members provide a diverse range of housing for Aboriginal people, people with disabilities and the formerly homeless.

About our submission

This submission is informed by our (and our members') knowledge of social and affordable housing and experience in the community housing industry as well as working with NHFIC and using its services. In preparing the submission we also consulted with members, with other stakeholders and with independent experts. We also appreciated the willingness of the review team to meet on several occasions with CHIA and its members. The written submission aims to reinforce and build on the points made in those sessions.

Rather than tackle all the areas identified in the review's issue paper we have focused on those most relevant to our industry as outlined below. We have also focused on the social and affordable housing part of the housing spectrum. The submission therefore covers the two areas listed below and the detailed issues bullet-pointed under each of these main headings:

1. **The impact of the National Housing Finance and Investment Corporation (NHFIC) on the Community Housing Provider (CHP) Sector**
   - **a.** The CHP sector's access to finance – including whether NHFIC has represented a more efficient source of funds, reduced refinancing risks, and reduced borrowing costs;
   - **b.** The scale and prominence of CHO sector delivery of sub-market rental housing – including through partnerships with the private sector and institutional investors;
   - **c.** Improving the attractiveness of affordable housing as an asset class for private investment; and
   - **d.** The financial capacity of the CHO sector through the provision of professional advisory services (via the Capacity Building Program) – including in relation to NHFIC applications, business planning, property development, risk management and financing.

2. **The Role of NHFIC in Housing Supply**
   - **a.** The appropriateness of NHFIC's financing, including NHFIC's ability to complement, leverage or support Commonwealth, state or territory activities relating to housing that otherwise would not

have occurred; NHFIC's role in facilitating additional investment in housing, including social and affordable housing;

b. Whether the scope of the definition of 'eligible project proponents' and 'eligible projects for NHFIC financing' outlined under the Investment Mandate is effective; and

c. The suitability of the government guarantee for NHFIC's liabilities, including its bond issuances.

In Appendix 1 we have also summarised the housing challenges in which NHFIC has an important role to play. It explains the importance of NHFIC but also why it needs to be supported by other policy measures. While we acknowledge NHFIC's role in broader housing affordability issues CHIA believes that its prime focus should be on those parts of the housing system where government intervention is necessary to address market failure. In Appendix 2 we have briefly explained the community housing sector and the advantages for government in investing in the sector.

1. The Impact of NHFIC on the Community Housing Sector

1a. CHOs' access to finance – including whether NHFIC has generated a more efficient source of funds, reduced refinancing risks, and reduced borrowing costs

AHURI research indicated that the single greatest issue for CHOs in obtaining private finance to complement necessary government support was their inability to access long term funds at reasonable rates: '*Clearly the short loan terms experienced by CHOs in the current market do not match the asset life of the rental dwellings, and add significant refinancing risk as well as recurring time burden of negotiating new loans time after time. It is the single most untenable borrowing condition facing CHOs in Australia today, underscoring the relevance of this project's exhaustive search for more workable financial mechanisms*'[3]

The AHBA has had an immediate impact and 22 CHOs have already accessed NHFIC bond finance, a number on more than one occasion, both to refinance existing loans and secure funding for new social and affordable housing developments. We understand that NHFIC is also negotiating further bond issuance. As anticipated, loans have been concentrated in jurisdictions where the state or territory governments have supported CHOs as a social housing delivery vehicle, both through state/territory programs and, historically, to complement Federal Government initiatives such as the National Rental Affordability Scheme (NRAS) and the Social Housing Initiative. Successful applications have been received primarily but not exclusively from larger CHOs - i.e., those registered as Tier 1 in the National Regulatory System for Community Housing (NRSCH) and the WA scheme, or Housing Associations in Victoria. This was to be anticipated given that it is these CHOs that generally have the financial capacity and development experience necessary to exploit the opportunity.

Feedback from CHOs who have accessed funding has been overwhelmingly positive. NHFIC's own social bond report[4] includes testimony from individual CHOs about how the combination of lower rates and longer tenor compared to those previously available have provided the confidence to proceed with longer term business strategies. All have commented favourably on the application process, recognising that NHFIC necessarily adopted a prudential approach in its first issuances. This could have hardly been

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[3] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014) *Enhancing affordable rental housing investment via an intermediary and guarantee*, AHURI Final Report No. 220, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/final-reports/220 p34.

[4] nhfic-social-bond-report-2019-20-website-version.pdf

otherwise given it was building confidence with risk averse investors unfamiliar with the community housing industry while, at the same time, protecting against the guarantee being called upon. One CHO with previous experience of negotiating long-term finance noted that they had experienced a similar application process and concluded that this might be typical practice for financiers dealing with long-term low risk investments. Clearly, going forwards there may be a role for NHFIC to have tailored products and policies for different CHOs to suit their size, the purposes for which finance is sought and the risk associated with the proposal. These would have varied levels of credit policy and credit assessment processes.

The community housing industry, however, acknowledges that during its short existence to date NHFIC has already demonstrated a willingness to modify processes and has, for example, introduced cashflow lending in response to community housing industry feedback.

Given its success, NHFIC is now in a position to work with the community housing industry to:

a. refine and streamline processes, potentially tailoring products to match the size and complexity of loan
b. consider modifications to its loan conditions, and settings to, for example, its general security package requirements that would allow CHOs more flexibility in negotiating loans from the commercial sector
c. consider longer-dated tenor loans that move from 10 years to 20 years. (**Recommendation 1**)

We do not anticipate these changes will have a budgetary impact.

CHIA has been made aware of two concerns about NHFIC's role in the market. Firstly, that its costs and terms and conditions may be needlessly excluding smaller CHOs. And, secondly, that it is 'crowding out' commercial lenders.

On the first point, CHIA believes that NHFIC facilities should be available to any registered CHO regardless of size, providing that the organisation meets the standard loan conditions and can demonstrate the required financial capacity. For the more complex and bespoke transactions (such as cash flow lending) we appreciate that to be cost effective a minimum size loan is likely to be necessary. As NHFIC broadens its CHO client base and transactions become more diverse it should consider differentiated margin pricing as the one size fits all may not be fit for purpose for future.

At the outset, there were a few questions raised about the cost of arranging the finance and also the perceived minimum loan amount. To an extent these concerns have been addressed with NHFIC confirming that it will consider loans of any amount. Indeed, while media attention has been focused on issuance to larger CHOs, two smaller loans of $4.9M and $7M were made from its first two bonds. As acknowledged earlier in this submission the application process is more intensive and costly than that some CHOs have experienced for a short term commercial loan, a procedure explained by the longer tenor and the guarantee requirements. NHFIC has responded to requests to seek ways to minimise the loan transaction costs and is, we understand, shortly to introduce the option for CHOs to use standard legal documentation. The capacity grants also provide eligible CHOs with the option to access professional advisory services to assist with loan applications.

Clearly NHFIC long-term debt may not best suit all CHOs' requirements. Some CHOs who have benchmarked costs and conditions have decided that alternative commercial lenders best meet their needs. This is the case not just for smaller CHOs but also larger providers seeking construction loans.

In our short governance section, we have proposed a mechanism - the advisory committee - that could (amongst other things) provide confidence NHFIC is provides fair access to all registered CHOs.

On the second question of concern brought to our attention by the Review team, we are unaware of any evidence that NHFIC is 'crowding out' the commercial sector. As just demonstrated commercial lenders are still active in the part of the market where they can offer a competitive product, including construction loans. The AHBA was set up to address a market failure, i.e., to enable CHOs to access long term finance not on offer from commercial institutions. In the words of Associate Professor Julie Lawson in correspondence with CHIA, NHFIC is in fact ***'crowding in"*** *- it is not "crowding out" investors but rather leading the market, playing a role attracting investment in affordable housing bonds to finance regulated affordable housing. Retail banks and credit unions can play a catch-up role as (and if) the market expands'*. This would be consistent with the UK scene where THFC which offers a government guarantee with some of its investment options, is but one of many financiers to the not-for-profit housing sector.

Often unremarked is the fact that commercial institutions have 'benefited' from NHFIC in other ways. ANZ UBS and Westpac for example were joint lead managers of the latest $562M social bond.

It is in the interests of the community housing industry (and ultimately the people we need to house) that NHFIC and the commercial sector work well together to provide the lowest cost finance made available on the best possible terms.

Going forwards there is scope for NHFIC to work in partnership with the sector by contributing resources from its research budget to develop a standard sustainability reporting framework for social housing. A widely accepted reporting standard that allows CHOs to report their performance in a transparent, consistent and comparable way will raise their profile with the investor community and stimulate further interest in social and affordable housing.

1b. The scale and prominence of CHP sector delivery of sub-market rental housing – including through partnerships with the private sector and institutional investors

For NHFIC's social bond report, independent modelling assessed $202M in savings over 10-12 years to participating CHOs, generated by longer tenor, fixed interest loans. This saving could theoretically deliver up to 820 new community housing homes. NHFIC has also provided the lion's share of the financing requirement for all recently completed and new social and affordable housing developments – estimates of the homes it has 'supported' include the refinancing of 5,435 existing, and financing of 1,291 new, homes.

While some of NHFIC's finance has been for refinance this is clearly an efficient use of NHFIC funds. The refinance has been used to create equity that the sector can use to for new projects.

CHOs have also reported that the availability of long-term finance has enabled some otherwise marginal projects to cross the feasibility threshold. Others have noted they have been able to include a small number of additional units.

CHIA has heard that some commentators believe that more debt could be taken on by the sector; presumably an assertion that some CHPs retain assets as yet unencumbered as loan security. This may be so in some instances but apparent 'spare capacity' needs to be assessed against constraints on borrowing:

- As emphatically concluded by the Affordable Housing Working Group, the capacity to take on debt (in terms of being able to provide security) is insufficient to make *social or affordable* housing projects viable. The key limiting factor is an organisation's ability to source matching government financial or equivalent support for projects, not its capacity to designate owned assets as loan security.
- Some CHOs face financial hurdles imposed by State and Territory Governments that limit borrowing capacity.
- Some states and territories have been slower or have yet to complete 'tripartite agreements' with NHFIC that will facilitate lending to the community housing industry. Our observation is that NHFIC has been determined to secure these agreements and progress has been made.
- CHOs need to balance development risk against the requirement to ensure tenancy and asset management outcomes. Governing bodies are rightly concerned to protect these parts of their businesses.

There are however, as noted earlier in the submission, potential ways in which NHFIC's security requirements could be modified to enable some CHOs to prudently extend their borrowing.

However, the AHBA is not the prime driver of whether CHOs are able to construct new social and affordable housing. As predicted in the EY report cited earlier '*solve the sector's primary concern – the funding gap and level of Government intervention required to make projects commercially viable – as the BA is not intended to loan to ventures or entities that cannot meet its credit requirements. The drivers of the funding gap and other sector challenges ……. may be summarised as a function of a low margin, regulated business model largely dependent on Government intervention. The BA will however, enhance the sectors commercial viability by providing more efficient debt finance, and other qualitative benefits*.'

The same report reinforced the point that the funding gap needed to be addressed by noting that at the time (2017) '*Options to address the funding gap are being further considered by the Affordable Housing Working Group (AHWG*)'. Up until now Federal, State and Territory Government social and affordable housing investment has been limited and / or not directed at the community housing industry. The Victorian Big Housing Build announced in November 2020 is the first substantial government program and we anticipate that NHFIC will play an important part in providing finance to the sector to deliver this.

In summary, NHFIC has played its role well in contributing finance to enable housing to be developed but under its current investment mandate is constrained in its ability to assist CHOs further. Clearly the major role in supporting the CHO sector to deliver more homes lies with the Federal, State and Territory Governments. Not only do they control the levers to plug the funding gaps via expenditure programs or land policy, but state and territory governments can as noted earlier control what debt CHOs can take on by setting financial standards that constrain activity.

CHIA has also made proposals in its last two Pre-Budget Submissions here and here to the Federal Government on how it might support more social and affordable housing, in partnership with States and Territories. We have made other recommendations later in the submission.

1c. Improving the attractiveness of affordable housing as an asset class for private investment;

The demand for bonds issued by NHFIC demonstrates its success. All three bonds were oversubscribed by domestic and overseas investors, attracted new investors for each issue and were rated Triple A. Regular repeated issuance has provided investor confidence. NHFIC is great evidence-based policy, well implemented.

In the project commissioned by CHIA NSW, as cited earlier in this submission, the authors noted several characteristics of a financial intermediary that would attract institutional investors. These are summarised below:

- It will aggregate the individual finance requirements for CHOs in order to package them to an institutional market scale.
- It will act as a credible, financially sophisticated, single representative face for the sector to engage with the institutional markets and advocate on its behalf.
- It will represent the sector to investors providing reciprocal education and communication. CHOs are mostly small not-for-profit organisations operating successfully in their local communities, but individually lacking the scale and financial credibility to operate at an institutional level. Balance sheets are strong, but relatively small, and apart from the benefits of property transfers, capital creation is slow due to thin operating margins. However, CHOs manage stable operating businesses with high quality cashflows predominantly derived from tenant rental that is sourced from government benefits. There is excess demand for the properties being managed and this is unlikely to change given long waiting lists. The largest credit risk with these businesses is managing maintenance, vacancy and tenant turnover to minimise disruption to rental flow.
- The Intermediary will establish standardised credit terms and conditions and ensure these are harmonised with the investors' requirements. As the interface between the CHPs and the investors, the Intermediary will free individual CHPs of the cost and inefficiency of negotiating finance separately. The result will be to ensure all CHPs who participate will receive consistent terms in their financial dealing.

One investor described NHFIC bonds to CHIA 'as attractive because they stack up on a risk-adjusted return basis because they echo the traditional characteristics of a government bond, due to the government guarantee provided'.

Critical to the attractiveness of the investment has also been that NHFIC lending has gone to not for profit registered CHOs. For this submission we consulted a number of superannuation funds. We asked them whether they would be concerned if NHFIC included 'for profit' build to rent proponents. Their view is summed up by one response, 'Both our perception of risk and purpose would change. NHFIC was established as a bond aggregator to provide loans for not for profit registered housing providers. We don't understand why NHFIC's purpose would be changed in such a way, especially when there is still demand for funding for new construction in the CHO sector to meet demand for social and affordable housing. Build to rent should be considered as any standard commercial enterprise.'

Clearly it is still relatively early days and the importance of maintaining investor confidence by making no major changes in policy settings is clear. NHFIC has performed well but capital markets need to witness long-term loan performance over an economic cycle. The market failure that led to the creation of NHFIC still exists and has not been corrected. To correct the market failure, bond markets need enough time and evidence loan performance and to see the stable, secure borrowing that the sector can deliver.

One further observation we would make is that it is important the Commonwealth Government maintains its role in social and affordable housing. Institutional investors require scale - provided by a national market - and diversification (i.e. across markets). None of the smaller states, at least, could achieve development of this asset class acting alone and some of the larger ones have not invested in community housing at any scale. One of the original arguments for aggregation was that it allowed for the matching of demand from a small and diverse sector to large investors seeking scale and consistency to invest. It is the aggregation of demand and the guarantee that have operated in tandem to draw the institutional investors in.

1d. The financial capacity of the CHO sector through the provision of professional advisory services (via the Capacity Building Program) – including in relation to NHFIC applications, business planning, property development, risk management and financing

CHIA administers the capacity-building fund for NHFIC. The program was designed by NHFIC to conform to their investment mandate and available for services to assist CHOs with loan applications. Grants are available for up to $20,000. Initially restricted to smaller CHOs, there were understandably few applications. Since being extended to larger CHOs in November 2019, the scheme has generated a steady flow of applications. It is too early to provide evidence that the program has led to successful loan applications as most contracts have not been completed. That said, the feedback from CHOs who have completed projects has been positive.

NHFIC has been willing to consider adapting the program to meet sector needs but is constrained by the narrowness of its investment mandate. However, the recent introduction of sector-wide grants for 2021 provides an opportunity to respond to some common capacity issues and align with state and territory industry capacity funding.

Later in the submission we have recommended how the program might develop in future.

2. The Role of NHFIC in Housing Supply

2a. The appropriateness of NHFIC's financing, including NHFIC's ability to complement, leverage or support Commonwealth, state or territory activities relating to housing that otherwise would not have occurred and NHFIC's role in facilitating additional investment in housing, including social and affordable housing

In the previous section the submission we explained how the AHBA has assisted CHOs to deliver social and affordable housing. A further observation we make here is that within the parameters of the investment mandate, NHFIC has been pro-active in working with states and territories to bring forward new schemes.

While primarily focused on social housing renewal rather than additional supply the recent partnership with the NSW Government involving CBUS providing subordinate debt is one example.

CHIA was not party to the thinking that underpinned the establishment of National Housing Infrastructure Fund (NHIF) but notes a recent agreement with the NSW Government to utilise this facility. There is scope to consider modification of the investment mandate to enable direct equity investments (or loans) and grant into social and affordable housing. (**Recommendation 2).** The model with the NSW Government and CBUS, for example, would be enhanced by a grant contribution from the NHIF to reduce the cross subsidy requirement and enable additional affordable housing.

The budgetary impact of this recommendation should be neutral as grants (currently capped at a total of $173.5M) are available. Allocating a greater proportion of the NHIF funds to grants could stimulate further interest from superannuation funds in the provision of subordinate debt / equity.

(We have noted the potential for NHFIC to take a more prominent role in stimulating this type of investment under recommendation 7.)

2b. Whether the scope of the definition of eligible project proponents and eligible projects for NHFIC financing outlined under the Investment Mandate is effective

Currently NHFIC requires providers using the AHBA to be registered in the NRSCH or the Victorian and Western Australian regulatory schemes. CHIA supports this restriction as it contributes to investor's mitigation of risk. Not only are CHOs subject to regular compliance assessments that complement NHFIC's own processes but registered entities also need to include 'wind up' provisions in their constitutions that provide investors with confidence that their assets will be taken over by another registered entity.

In the previous section we noted that at least some current investors would be concerned if the AHBA service was extended beyond registered not for profit CHOs. The NRSCH does however, allow 'for profit' entities to seek registration and, we assume, potentially use the AHBA. CHIA believes that lending to such entities should be carefully considered and, if granted, be for the purpose of delivering social and affordable housing.

Some registered Indigenous Community Housing Organisations (ICHOs) are currently excluded from using the AHBA as their constitutions do not allow them to meet the 'wind up' requirements in the NRSCH. Where these ICHOs are registered in 'local schemes' that mirror the NRSCH requirements in all other respects we recommend the Investment Mandate is modified to allow them to use the AHBA. (**Recommendation 3**). This recommendation does not have a budgetary impact.

In Appendix 2 we have summarised the other benefits of using not for profit CHOs - in terms of making best use of public funds. In addition, CHOs are also subject to regulation by the ACNC to ensure they remain mission orientated and also have state and territory contractual obligations to meet. Investor perception of risk will inevitably change if the AHBA includes entities that are not subject to this oversight, which will then feed negatively into bond pricing.

Further, unregulated entities pose additional risk that the government guarantee will be drawn upon. The Federal Government's experience from administering NRAS provides evidence of the risks, with only non-registered entities having committed serious breaches of the scheme's compliance standards.

2c. The suitability of the government guarantee for NHFIC's liabilities, including its bond issuances

The government guarantee has been critically important in attracting investor interest in NHFIC's bond issuances. While it is difficult to estimate the impact on pricing, officials at the THFC told CHIA that as a rule of thumb such a measure typically achieves a 1% reduction in interest rate. The beneficial potential of an intermediary underpinned by a guarantee was clear from the research that underpins the AHBA.

Fixed income investors need to be convinced of the low risk of any new investment. The government guarantee is a cost effective (cheap) way for the Commonwealth Government to signal social and affordable housing is a safe haven. As one superannuation fund told us 'the Government guarantee provides NHFIC with pricing close to Government issued bonds, access to 10+ year funding (note there are very few non-Government bonds over 10 years) and volume'. They went on to say that if the bonds did not have such a guarantee 'they would not fit into our Fixed Interest portfolio which only has Government issued or Government guaranteed bonds in it. 'Our credit portfolio has a target of 2% p.a. over bank bills so to invest in the bonds and hold them in the credit portfolio we would need a much higher credit spread.'

CHIA notes that the guarantee is in place until at least 2023. We strongly support the Commonwealth Government's recent decision to increase the cap and the positive signal this sends to investors. The sector needs confidence that NHFIC will be able to lend when it presents compliant proposals and will not be constrained by the level Commonwealth guarantee provided. This uncertainty is concerning from a new project basis and a refinance basis. The Commonwealth should provide this certainty.

CHIA thus recommends that the Commonwealth commits to further increases in the cap and extension of the guarantee beyond 2023, until alternative measures that secure similar pricing are put in place. **(Recommendation 4)** There is a very small cash impact attached to this recommendation. Increasing the cap by $1 Billion in the recent Federal budget had a small balance sheet impact - Budget Paper No. 2: Budget Measures p161.

The EY report cited earlier notes that the absence of consistent national regulation of the sector is one reason that the guarantee is necessary. As they write:

> '*There are different regulators and sector regulatory complexities in regards to the perfection of security interests that are ambiguous and need resolution to successfully deliver a BA that meets the stated objectives. A nationally consistent framework - in application and intent - that enables an appropriate framework for the management of lenders' security interests is required. National CHP governance and financial deregulation also needs to be applied consistently across State and Territory jurisdictions to provide Investor confidence that the regulatory safety-value is functional. Government support therefore has to bridge the gap between capital markets requirements, the standalone creditworthiness and debt needs of CHPs and the unique Australian regulatory and policy environment'.*

EY echoed the AHWG which recommended that:

> '*the Commonwealth and State and Territory governments and the community housing sector work together to develop and implement a uniform and nationally applied regulatory framework that supports the implementation of a bond aggregator'. Specifically, they identified the need to facilitate the entry of Western Australia and Victoria into a suitably strengthened National Regulatory System for Community Housing to the extent required to enable the bond aggregator to lend into those jurisdictions in a way that maximises investor confidence*'.

In the UK, THFC officials have confirmed to CHIA the importance of effective and highly professional regulation in boosting investor confidence, highlighting the associated scope for providing 'early warning' of potential problems via the regular and in-depth reporting function of the English regulator.

The NRSCH review seems to have stalled with the outcomes unclear. CHIA recommends that the Commonwealth Government and state and territory governments re-engage with the review and commit to resolving the issues that appear to be preventing progress to the establishment of a higher powered and genuinely national system. **(Recommendation 5)**. Resources were allocated to carry out the review. There will be resource implications attached to creating a genuinely national scheme but the running costs may not be dissimilar to the amount currently spent on the three separate regimes.

NHFIC Governance

In CHIA's submission[5] to the 2018 NHFIC Bill we supported the proposed governance arrangements but, in relation to the skills of board members, suggested there would be merit in ensuring the board has access to expertise and knowledge of the affordable housing sector specifically (clause 18(2)(c)). This recommendation was approved.

We also welcomed the provision for the board to establish advisory committees and suggested establishing a reference group / advisory committee with expertise in affordable housing development and operations. NHFIC has considerable board and executive experience in finance and property but little specifically in this area. CHIA believes such a committee would usefully formalise the arrangements that NHFIC has in place to interact with the industry and provide a forum to resolve issues and take forward modifications and enhancements to its processes. We believe its administration will be minimal.

It would also and allow a sector perspective into forward planning and development of the NHFIC model.

This could include:

- Planning for end of the bonds' terms -designing the options for refinancing
- Building on the current outcomes framework for assessing bonds, support the development of a standard sustainability reporting framework for social housing that would allow not just NHFIC to provide robust evidence of achievement but also CHOs to demonstrate their 'worth' to a wide range of investors. One example is the framework developed by the Good Economy and supported by 39 UK housing associations and 31 investors including THFC and NAB
- a potential role in facilitating equity investments

[5] 2018-1-22-submission-on-NHFIC-Bill.pdf (communityhousing.com.au)

- contributing to its research agenda. **(Recommendation 6)**

The Future of NHFIC

We do not believe this review is an appropriate vehicle for significant changes to the way NHFIC operates. Our reasons are as follows:

- The review was programmed over a short (and holiday) period and has not enabled in-depth consultation
- NHFIC has delivered excellent initial outcomes and its core function – the AHBA - requires policy certainty if it is to successfully create a secure long standing market for social housing bonds
- Many of the actions that would enable more social and affordable housing to be constructed do not lie with NHFIC but with the Commonwealth Government as well as with, state and territory governments

The benefits NHFIC has brought to the community housing sector has led us to begin identifying how it could evolve.

There are undoubtedly ways in which it could facilitate equity / capital injections into community housing and CHIA along with other organisations are working up proposals along these lines.

NHFIC could also strengthen its industry development role and allow the sector more influence in how this is driven. The model adopted by the Canadian Housing and Mortgage Corporation (CMHC) - The Community Housing Transformation Centre is worth exploring.

The CMHC also provides examples of the roles NHFIC might take on. There would be merits in NHFIC building on its current functions to becoming Australia's National Housing Agency.

At this stage CHIA recommends that the potential future direction of NHFIC is the subject of further (and substantial) engagement with all stakeholders. At this stage it would be premature to predict the additional costs involved. **(Recommendation 7)**

Appendix 1: Meeting Australia's housing needs

The AHWG recognised that Australia is facing a massive housing challenge. The proportion of Australia's dwellings that are social housing has declined significantly over the last 25 years at a time when market housing has become much less affordable. There is mounting evidence of Australia's shortfall of housing affordable to households in the bottom two income quintiles. Research commissioned by CHIA NSW and Homelessness NSW in 2016, which built on prior AHURI research, identified a shortfall of over 650,000 homes across Australia affordable to households in the bottom two income quintiles. Accounting for projected household growth to 2036, more than one million additional social/affordable rental homes will be needed to meet the needs of these lower income households over the next 20 years[6]. The failure to supply sufficient homes compounds housing stress, again amply demonstrated by other robust research and analysis. We draw on a few examples below:

- More than half of the of low-income households in rental housing – some 1.3 million people – face housing costs exceeding 30% of their income, leaving them without enough remaining funds for essentials like food and clothing[7].

- The private rental market has not supplied enough dwellings at rents (i.e. $202 or less per week) affordable to households in the bottom income quintile. By 2016 the national deficit of such dwellings had risen to 212,000. While the situation for private renters in the second lowest quintile is less extreme, the availability of homes affordable to this group (i.e., rented at below $355 per week) is substantially compromised by such homes being occupied by higher income earners.[8]

- Using the projected number of households in Australia (ABS 2015) the number of social housing dwellings per 100 households has declined from 5.1 per 100 households in 2007–08 to 4.6 in 2017–18[9]. No reliable figures exist on the additional new social and affordable homes currently planned for the next five years but even on optimistic assumptions it is highly unlikely to exceed 10% of what is required. Factoring in the loss of affordable homes through the expiry of incentives awarded under the National Rental Affordability Scheme (NRAS) and other time limited schemes, as well as continued public housing sales and demolitions, the prospective net increase in social and affordable homes over the next five years is likely to be barely above zero. Unless there is a change of course by Australian governments, social and affordable housing provision per capita will continue to contract, just as it has for the past 25 years. The recently announced Victorian Government Big Housing Build is one recent positive sign of activity.

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[6] Troy L, van den Nouwelant R, Randolph W (2018) Filling the Gap - Estimating need and costs of social and affordable housing delivery http://communityhousing.org.au/wp-content/uploads/2019/03/Modelling_costs_of_housing_provision_FINAL.pdf

[7] Productivity Commission (2019) Vulnerable Private Renters: Evidence and Options

[8] Hulse, K., Reynolds, M., Nygaard, C., Parkinson, S. and Yates, J. (2019) *The supply of affordable private rental housing in Australian cities: short-term and longer-term changes*, AHURI Final Report No. 323, Australian Housing and Urban Research Institute Limited, Melbourne, https://www.ahuri.edu.au/research/final-reports/323, doi:10.18408/ahuri-5120101.

[9] https://www.aihw.gov.au/reports/housing-assistance/housing-assistance-in-australia-2019/contents/social-housing-dwellings#sh1

- A more meaningful measure of the decline in social housing supply is the reduction in the annual number of such properties being let to new tenants. This results from the decline of gross provision (see above), from the reduced number of newly built homes coming onstream, and from the contracting availability of affordable 'move on' accommodation (meaning fewer existing tenants have the capacity to transition into the private market). Therefore, '*Considering both public housing and community housing, the gross number of social rental lettings dropped from 52,000 in 1997 to 35,000 in 2017 – an absolute decline of a third*[10]*. Pro rata to population, this represents an effective reduction in social housing supply of some 50%' (UNSW City Futures Research Centre submission to Parliamentary Inquiry on Homelessness 2020).*

- In Social housing as infrastructure: an investment pathway (ahuri.edu.au) the authors estimated that, 'to simply prevent further deterioration in the current level of social housing shortfall, of over 430,000 dwellings (manifest need plus evident need) there is a need for a national program producing just over 290,000 homes over the projection period, or nearly 15,000 per year'. At best we are building roughly 3,000 social and affordable housing homes annually but many of these are simply replacing existing dwellings.

At the Federal level the government's infrastructure agency Infrastructure Australia in its 2019 Audit[11] has recognised that '*access to safe, adequate and affordable housing is a crucial foundation for enabling a person's physical and mental health and wellbeing. Without access to appropriate housing, people are unable to focus on other aspects of their lives (such as health, education and employment) and are unable to contribute productively to society*' and that many Australians currently do not have their housing needs met by the market. The audit clearly outlines the problem - i.e., that '*the social housing system suffers from a lack of funding, an ageing housing stock with high maintenance needs, increased demand due to housing affordability issues, insufficient funding to increase the supply of dwellings in the system, and tenants with increasingly diverse needs'.*

[10] Pawson, H., Milligan, V. & Yates, J. (2020) Housing Policy in Australia: A case for system reform; Singapore: Palgrave Macmillan
[11] https://www.infrastructureaustralia.gov.au/publications/australian-infrastructure-audit-2019

Community Housing
INDUSTRY ASSOCIATION

Appendix 2: The Community Housing Industry and its role in the housing system

Not-for-profit CHOs are a critically important part of Australia's housing system. The number of homes managed by the community housing sector has more than tripled in recent years (from 32,300 in 2006, to 100,200 dwellings in 2019: a 210% increase or 67,900 dwellings[12]). The increase in dwellings has largely come from transfers of ownership or management of public housing dwellings to community housing organisations, though larger CHOs have used government subsidy programs to construct new homes. In 2020 the community housing sector owns and / or manages almost 25% of total social housing and while their development pipeline is small, CHOs are adding the lion's share of all housing affordable to households in the lower two income quintiles.

There are circa 552 CHOs across Australia, and they differ substantially in size and scale. The largest 38 providers manage 82.5% of homes and while the average size of these larger community housing portfolios is 2,357 there are many far smaller organisations. However, despite this diversity, the mission and ethos of those that are charitable are similar. In addition, they operate within a regulatory and policy system that sets overall objectives, places constraints on their operations and directs a substantial amount of what they can do.

The Report on Government Services (ROGS) provides evidence that CHOs overwhelmingly allocate homes to the most disadvantaged groups on the social housing waiting list. Table 18A.17 shows that almost 82% of allocations in 2017/18 went to priority need groups. This means people who were not only eligible in terms of having very low incomes, but also assessed as affected by other serious disadvantage(s) impeding their ability to secure suitable housing in the private market. The ROGS also provide evidence (Table 18A.42) that CHO tenants are consistently pleased with their homes and services, with around 80% reporting they were satisfied or very satisfied in each of the last three National Social Housing Surveys.

The development of new social and affordable housing requires government subsidy to make it stack up. Put simply, revenue from rents set at levels affordable to low income Australians is insufficient to cover both the ongoing operating costs – management and maintenance – and development loan repayment associated with land acquisition and construction costs. This is commonly described as the development projects 'funding gap'. The Affordable Housing Working Group set up by the Prime Minister when he held the position of Treasurer, explains the position well in its last report[13].

The subsidy required to fill the funding gap will vary depending on the location and type of housing concerned.[14] In general, variations in the unit cost of development are mainly attributable to the varying cost of land; construction costs vary less across the country. In an environment where subsidy is in short supply, CHOs need to build high quality dwellings but also ensure costs are kept to a minimum and that we maximise the numbers of dwellings constructed.

[12] https://www.aihw.gov.au/reports/housing-assistance/housing-assistance-in-australia-2020/contents/social-housing-dwellings
[13] https://treasury.gov.au/sites/default/files/2019-03/170921-AHWG-final-for-publication.pdf
[14] Troy L, van den Nouwelant R, Randolph W (2018) Filling the Gap - Estimating need and costs of social and affordable housing delivery http://communityhousing.org.au/wp-content/uploads/2019/03/Modelling_costs_of_housing_provision_FINAL.pdf

In New South Wales, CHOs are on track to deliver 2,700 new homes over the eight years to 2020 [15]. In Victoria, the industry delivered 1,033 additional social and affordable homes across 95 projects between 2010 and 2019[16] .

Not for profit Community housing is a sustainable social housing model that lowers the direct cost to government of providing affordable housing to low income households. These CHOs are eligible for a range of tax concessions (on for example land tax and GST) that apply to both their procurement and operating costs and thus reduce cost of housing development. The not for profit business model and tenant outcomes - also retains any surplus in the business - there are no developer margins - for use on additional services or further development. A recent study revealed that holding 1,000 properties in state government management and ownership would result in a $30 million deficit after 30 years, whereas transferring the same number of properties to community housing would deliver a $40 million surplus over the same period, which could be reinvested to produce additional social housing.[17]

A report commissioned by the NSW agency, Landcom[18] and published earlier in 2019 assessed the financial feasibility of build to rent projects incorporating affordable rental housing, comparing the results from for profit and not for profit developers. They concluded 'there will be a significant advantage to governments layering in additional subsidy support to leverage existing CHP concessions (rather than for-profit developers)'.

With the right policy settings and support to build on what it has already achieved the community housing will double again — or more — in the next decade.

[15] http://nswfha.wpengine.com/wp-content/uploads/2018/06/Deliveringnewhousingsupply.pdf

[16] https://chiavic.com.au/wp-content/uploads/2019/09/Development-Snapshot-2019-FINAL-1.pdf

[17] Pawson, H., Martin, C., Flanagan, K. and Phillips, R. Recent housing transfer experience in Australia: Implications for affordable housing industry development. Inquiry into affordable housing industry capacity. Melbourne. AHURI. 2016. p 50-55

[18] https://cityfutures.be.unsw.edu.au/research/projects/how-can-australian-build-rent-product-contribute-urban-renewal-and-affordable-housing-supply/