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

SGCH Submission

6 January 2021

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Mr Chris Leptos AM
NHFIC Act Review Secretariat
NHFICsecretariat@treasury.gov.au

Dear Mr Leptos,

Thank you for the opportunity to provide a submission to the independent statutory review of the operation of the *National Housing Finance and Investment Corporation Act 2018.*

SGCH commends the Commonwealth government for establishing the National Housing Finance and Investment Corporation (NHFIC). Since its formation in 2018, NHFIC has been a game changer for the community housing sector. The continued support of the Commonwealth by, for example, extension of the guarantee cap in the October 2020 budget, has underpinned growing investor confidence that will allow the development of more social and affordable housing.

SGCH's submission is informed by our experiences raising finance for social and affordable housing projects, including our present $450 million of senior debt facilities comprising:

- $225 million from the Commonwealth Bank of Australia, and
- $225 million from NHFIC.

SGCH is using these existing facilities to deliver a pipeline of over $500 million of social and affordable housing projects in Sydney, including over $100 million of construction activity in FY20 and $83 million in FY21, supporting 1,665 jobs and $536 million in economic activity.

Our submission highlights the following core points:

- NHFIC has been an outstanding success and has met the objectives of the NHFIC Act
- NHFIC provides cheaper, longer term debt than is achievable from banks
- Continued strong support of the Commonwealth government for NHIFC is key to building an efficient and sustainable capital market for social and affordable housing
- Consideration should be given to the use of credit enhancements through credit wrapping, equity tranches and sub-debt tranches
- NHIF could be re-directed to enable greater housing supply through providing more accessible funds that act as equity-like catalytic investment in projects

NHFIC can continue to grow and evolve the way it participates in the community housing sector, including developing new products that leverage its unique position to help deliver more housing, more efficiently and in turn generate greater economic and social outcomes.

Yours sincerely,

Scott Langford
Group CEO

About SGCH

The SGCH Group (SGCH) has a 35-year history of delivering social and affordable housing and successfully partnering with government and other stakeholders to deliver long term economic and social outcomes.

We are a Tier 1 provider regulated under the National Regulatory System for Community Housing (NRSCH). We operate across Sydney, housing 11,500 people in around 6,600 homes.

Our independent, skills-based board sets and guides the strategic direction of SGCH, overseeing activities with an appropriate level of governance and risk management. Together, our board, executive team and staff manage a growing portfolio in a financially sustainable manner. The SGCH team has extensive expertise in social and affordable housing service delivery, asset management, governance, financial management, capital markets and treasury management, risk management, contract management, planning, development and construction, communications, and stakeholder and community relations.

As of 30 June 2020, SGCH had total assets of more than $1.0 billion and committed debt facilities of $450 million to finance our existing development pipeline. During FY20 we invested over $100 million in our development pipeline and will invest a further $83 million during FY21.

As a sector leader we have a strong track record negotiating debt finance to support our social and affordable housing developments including:

- $61 million with Westpac (2014)
- $170 million with Clean Energy Finance Corporation (CEFC) (2017)
- $225 million with Commonwealth Bank of Australia (CBA) (2018)
- $210 million with National Housing Finance and Investment Corporation (NHFIC) (2020), with an existing $15 million (2019) bringing total borrowings to $225 million.

Contact Details

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Review of the Operation of the NHFIC Act (2018)

SGCH commends the Commonwealth government for establishing the National Housing Finance and Investment Corporation (NHFIC).

The establishment of NHFIC has been a significant facilitator for the growing institutional appetite to invest into the sector. This in turn has provided Community Housing Providers (CHPs) with access to longer tenor and more efficiently priced senior debt than was otherwise available in the market and enabled an increase in supply of much needed social and affordable housing. This occurs without the Commonwealth, State and Territory Governments being required to directly fund, nor directly deliver that social and affordable housing .

This incremental growth of social and affordable housing supply than would otherwise occur has many benefits, including:

- Reducing homelessness, together with the associated costs and negative externalities;
- Improving affordability for low-income households that supports their increased capacity to invest in their own futures (including progressing towards home ownership);
- Increased development activity, including creation of construction opportunities and employment.

To date the establishment and operation of NHFIC has enabled the satisfaction of the objectives of the NHFIC Act "…*to improve the housing outcomes for Australians by:*

(a) strengthening efforts to increase the supply of housing; and
(b) encouraging investment in housing (particularly in the social or affordable housing sector); and
(c) providing finance, grants or investments that complement, leverage or support Commonwealth, State or Territory activities relating to housing; and
(d) *contributing to the development of the scale, efficiency and effectiveness of the community housing sector in Australia.*"

The continuation of NHFIC and Commonwealth government support is critical to the future of the CHP sector and ensuring continued progress in achieving sustainable funding of social and affordable housing from non-government sources. This support steps towards a larger scale CHP sector that can mobilise capability and capital to complement other government initiatives that sustain and increase the supply of social and affordable housing across the community.

Impact of NHFIC on the Community Housing Provider Sector

SGCH's borrowing experiences prior to the establishment of NHFIC

The provision of social and affordable housing is capital intensive with long investment horizons to ensure certainty of housing outcomes. Prior to the establishment of NHFIC, there was a significant mismatch in the tenor of available senior debt (typically 3-5 years) and the investment horizon for social and affordable housing (20 years+). This created significant inefficiency in the capital solution, with substantial refinancing costs and risks borne by CHPs.

Historically SGCH financed new property development primarily from its own balance sheet. In 2014 SGCH established the first wholesale debt funding facility for a CHP in Australia, which it used to fund new social and affordable housing developments. Westpac provided a $60 million facility over 40 months, secured by first mortgages over part of SGCH's owned residential property portfolio, leveraged to only 15%. It also contained strict limits on SGCH's practical ability to draw those funds. Hence, in 2015, 2016 and 2017 SGCH drew down approximately $10 million in each of those financial years. At that time, in comparison, banks were typically providing loan tenors of 5-7 years (compared to less than 4 years), at leverage of 40%-60%. This reflected the bank's very cautious approach to lending to CHPs, who were at that time something of an unknown entity.

Over the past 5 years the banks' interest in and familiarity with the CHP sector has grown. In 2017 the Westpac facility was refinanced and expanded by the Commonwealth Bank of Australia to $110 million. It was expanded again in late 2018 to a $225 million facility with a 4 year tenor. Though this demonstrates the growth in appetite of banks to lend to CHPs, the tenor of facilities are still typically 3-5 years which is not aligned to the long horizon over which social and affordable housing assets are held, this creates refinancing risks and costs for CHPs.

SGCH considers that an evolving debt market may see banks playing a role in the construction phase with NHFIC (and other mechanisms that may develop) providing long term senior debt.

Social and affordable housing can be seen as a new, hybrid asset class, comprising elements of existing property, social infrastructure and economic infrastructure asset classes. However, it does not fully satisfy the characteristics of any one of these accepted asset classes, making it more challenging for banks to fit into their existing lending frameworks.

An additional benefit from NHFIC's operations over the last 2 years has been significantly increased awareness from institutions and the broader community of the role and opportunities in the social and affordable housing space; this gives CHPs confidence in the continued interest in the sector.

NHFIC's Affordable Housing Bond Aggregator

The creation of the bond aggregator and the provision of the Commonwealth guarantee has readily enabled NHFIC to raise substantial new, non-government funding for CHPs to provide social and affordable housing, as evidenced by the over subscription of bond offerings and low interest rates achieved on those bonds. SGCH welcomes this innovation by the Commonwealth government for funding social and affordable housing. It has overcome a form of market failure to readily finance the provision of social and affordable housing by CHPs.

NHFIC's financing terms enable far greater provision of social and affordable housing than would otherwise occur. This is critical to the health, wellbeing and success in life of the people who live in the homes provided by CHPs. This increase in supply also assists governments at all levels meet their own obligations regarding the supply of adequate, safe housing for their citizens.

NHFIC's overall cost of lending to CHPs is excellent, which is assisted by NHFIC's low operating cost structure. Its credit margins are well sized given the credit risk of lending to CHPs and the underlying cost of funds to NHFIC. Similarly, the tenor of NHFIC loans is significantly longer than anything provided by banks. These lending terms provide a substantial and sustainable benefit to CHPs over and above any funding provided by banks. The bond markets that fund NHFIC lending are also better aligned to provide the longer tenor required, given the long term nature of social and affordable housing investments.

Separately, Australia has globally low rental yields, partly attributable to investor bias towards capital growth over yield. CHPs have limited focus on capital appreciation because as social and affordable housing properties age, they tend to be redeveloped and continue to be used for provision of housing rather than being sold to monetise a capital appreciation.

Additionally, social and affordable housing rental yields are 100–200 bps less than comparable private market housing. To accommodate the lower yield from tenants, concessions are required.

As the spread between the cost of NHFIC debt and CHP rental yields is relatively small, NHFIC's lending terms greatly assist social and affordable housing property developments to be financially viable. Because banks cannot provide similar financing terms, they cannot facilitate the same levels of social and affordable housing development.

SGCH was able to obtain $225 million of funding at historically low interest rates from NHFIC. The refinancing achieved was on more favourable terms than could be obtained from banks, particularly in relation to the tenor (12 years) and resulted in well over $40 million reduction in financing costs over the life of the loan that will enable SGCH to deliver approximately 100 fully equity funded homes that it would otherwise be unable to provide. Using that $40 million as SGCH's equity in a leveraged transaction with further efficiently-priced NHFIC senior debt will increase the number of social and affordable housing dwellings able to be provided multiple times over.

SGCH appreciates NHFIC financing is currently reliant on credit enhancement provided by the Commonwealth government guaranteeing the repayment of bondholders. The current continuation of that guarantee is important because:

- NHFIC is still a relatively young institution and its lending to CHPs has not occurred through a full economic cycle, nor has it occurred over the full tenors of loans to CHPs for social and affordable housing;
- Similarly, investing by bondholders to NHFIC has not occurred through a full economic cycle, nor has it occurred over the full tenor of the bonds; and
- Institutional interest in the provision of social and affordable housing by the CHP sector is still a relatively recent phenomenon.

This means a steady state of operation has not been achieved and the form of market failure that led to the creation of NHFIC still exists. To overcome that failure, bond markets require evidence of long term loan performance and stability by CHPs repaying NHFIC and NHFIC repaying bondholders, which will attract the same low-return bond investors as has occurred for NHFIC bond offerings that enjoy the Commonwealth guarantee.

Without the credit enhancement by the Commonwealth government, it is highly unlikely that bond offerings would occur on the same terms as has been achieved to date, meaning NHFIC would be unable to provide loans to CHPs on the same concessional basis. The Commonwealth government should continue to provide credit enhancements to ensure low cost and long tenor debt can be provided to CHPs.

The Role of NHFIC in Housing Supply

NHFIC's National Housing Infrastructure Facility

The National Housing Infrastructure Facility (NHIF) is strongly aligned for supporting broad-acre subdivision projects. SGCH largely delivers higher density, multi-family projects. To date NHIF has had very limited to no application to SGCH.

NHIF could be re-directed to enable greater housing supply through providing more accessible funds that act as equity-like catalytic investment in projects. These could be 'equity loans' that are repaid on refinance or when development uplift is realised on completion of a new social and affordable housing property developments.

Increasing Private Investment in Housing

NHFIC's lending has readily resulted in the provision of incremental social and affordable housing, principally through:

- Concessional financing to CHPs (including providing refinancing to CHPs) that has reduced financing costs. NHFIC estimates it has presently reduced financing costs to CHPs by $199 million. That reduced financing costs enables the provision of social and affordable housing that would not otherwise be provided and equates to approximately 500 additional dwellings. SGCH's first-hand experience of NHFIC refinancing is that over $40 million of investable capital was released for SGCH to invest in new developments. Indeed, the NHFIC refinancing undertaken by SGCH during 2020 is expected to be a significant catalyst for SGCH's growth plans for several years;
- De-risking social and affordable housing projects for CHPs, which occurs through CHPs having greater certainty of accessing suitable debt funding, debt funding more closely matching the risk profile of social and affordable housing and the tenor of debt funding more closely aligning with the economic life of those dwellings; and
- NHFIC lending has created market confidence in social and affordable housing as an investment class, together with the reassurance and stability that long term debt is available to CHPs. The support from the Commonwealth government has resulted in genuine interest in social and affordable housing and private sector equity capital (both institutional and private) co-investing with CHPs. This includes Cbus recently providing mezzanine financing for social and affordable housing projects.

Since NHFIC's creation, it has played a pivotal and essential role in establishing a capital market that supports the provision of social and affordable housing and the growth of the CHP sector. However, it has not been established long enough (i.e. through at least one full lending and refinancing cycle) for the capital markets to sustain their participation in this new asset class without the support of an institution like NHFIC, and its Commonwealth guarantee.

The CHP sector plans for the long term (as a developer and holder of new assets on a 50+ year time horizon) and takes a detailed design and material selections approach to ensure the built assets will perform efficiently and well over that time.

This requires confidence in the longevity of NHFIC and its Commonwealth guarantee. Any uncertainty about whether the Commonwealth government will provide support for future bond issuances does adversely affect CHPs in their provision of new social and affordable housing property developments and refinancing of their existing social and affordable housing projects. Clarity regarding the future of the NHFIC and the Commonwealth guarantee to underwrite longer tenors and mitigate costly refinancing events will be an important outcome from the current review.

The Government Guarantee of NHFIC's Liabilities

The difficulty market-priced funding has in financing sub-market rental housing could be considered a form of market failure, with that failure leading to the need for an institution such as NHFIC. There is no evidence this failure has been corrected, especially as the bond market requires evidence of long term loan performance and stability to attract and secure the same low cost bond investors as has occurred for NHFIC bonds with the Commonwealth guarantee.

The Commonwealth guarantee has been essential for obtaining favourable bond issuances that have provided funding to NHFIC to lend to CHPs on favourable terms, including low interest rates, longer (12 year) tenors and higher leverage, which is producing more social and affordable housing. Without the guarantee, it is very unlikely that NHFIC would obtain the same funding from bondholders and so would be unable to lend to CHPs on the same favourable terms as has occurred to date.

Importantly, as NHFIC matures and its business model evolves over time, other forms of credit enhancement should be examined to ensure future bond offerings are able to be placed to ensure the sustainability of the social and affordable housing sector. This could include consideration of credit enhancements through credit wrapping, equity tranches and sub-debt tranches. SGCH would welcome the opportunity to work with NHFIC and the Commonwealth Treasury to co-design products that extract the maximum benefits from the Commonwealth guarantee for the Commonwealth government, future investors and the CHP sector.

In the longer term NHFIC needs a sustainable financing model that is not reliant on the Commonwealth guarantee for successful bond issues. This will occur once full maturity of the AHBA loan product is achieved, once bondholders investments in NHFIC's bonds and NHFIC lending to CHPs has completed a full cycle - including, repayment (or refinancing) of loans by CHPs to NHFIC and NHFIC to its bondholders.

Other Issues

Base Rate Risk (interim)

CHPs as borrower assume interest base rate risk between the date of entering into an AHBA loan agreement and the relevant NHFIC bond being issued, noting the duration between these events is potentially many months. Typically, in capital markets this exposure can be hedged.

NHFIC's loans to CHPs are linked to the relevant NHFIC bond price and there is no market for hedging that risk. As a result, a borrower cannot effectively hedge this interim exposure to interest rate movements, which negatively affects it. It also adversely affects the viability of the NHFIC loan offering.

SGCH believes it would be beneficial to review the loan base rate for AHBA loans. If NHFIC loan products were able to be linked to BBSY or other well-traded financial instruments, this will enable a borrower to hedge their interim exposure to interest rate movements. It would also benefit CHPs by enabling enhanced attraction to NHFIC's lending, together with facilitating continued equity investment in social and affordable housing through further de-risking of financial risk.

SGCH notes that passing this interim risk to NHFIC may impact pricing of AHBA loans, but considers NHFIC and the Commonwealth government are the best placed entities to manage this risk rather than individual CHPs.

New Products

Given the long term nature of social and affordable housing investments and CHPs enduring mandate to provide that housing, NHFIC could provide longer tenor loans of 20+ years.

NHFIC has been extremely successful with its current senior debt products. As NHFIC matures and its product offering evolves over time it will remain important that NHFIC supports the continued growth of the CHP sector in ways that are relevant to CHPs. To this end, SGCH is keen to continue to work with NHFIC, Commonwealth Treasury and other relevant stakeholders to develop new and innovative ways to support the allocation of increased capital to the provision of social and affordable housing within the community.