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Re: Housing Legislative Package – Housing Australia Future Fund Bill, National Housing Supply and Affordability Council Bill, and Treasury Laws Amendment Bill

Industry Super Australia (ISA) undertakes collective projects on behalf of 11 IndustrySuper Funds including joint marketing activities and policy research and advocacy. ISA has been working closely these funds, collective investment vehicles, and also other large profit to member industry super funds to identify policy settings that would enhance their capacity to invest in social and affordable housing, including the operation of the Housing Australia Future Fund (HAFF).

The legislative package contained in the consultation is an important step toward realising improved housing outcomes for Australians with the potential to partner with superannuation funds and other institutional investors to provide longer term capital to finance projects on appropriate terms.

Given the constraints around the timing and duration of the consultation this initial submission is not intended to be comprehensive. It necessarily focuses on the proposed structure, adequacy, and governance arrangements around the establishment and operation of the HAFF and policy settings relevant to institutional investors who have agreed as part of the Housing Accord to work constructively to identify financing solutions that may increase the supply of social and affordable housing.

ISA is available to continue to engage with Government on the details of the proposed legislative package in advance of and during its consideration by Parliament.

Background and Overview

The consultation seeks feedback on the legislative basis to give effect to the establishment of a Housing Australia Future Fund originally announced by the federal Labor party on 13 May 2021[1] and subsequent announcement of a Housing Accord in the October 2022 Budget[2].

At the center of these announcements was a commitment to build 30,000[3] social and affordable homes within five years supported by the establishment of the $10bn HAFF which would operate in perpetuity.

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[1] https://anthonyalbanese.com.au/housing-australia-future-fund
[2] https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/national-housing-accord-working-together-help-tackle
[3] An additional 10,000 affordable homes (total 40,000) were added in the October 2022 Budget supported by a separate $70m p.a budget appropriation

The explanatory materials state the establishment of the Housing Australia Future Fund in intended to "create a secure funding stream to support an increase in social and affordable housing".

The establishment of the fund recognises the fundamental project financing gap associated with social and affordable dwellings where below market rent revenues are insufficient to service the capital needed for construction and ongoing availability of the dwellings for their intended purpose.

The consultation comprises three bills which establish the Housing Australia Future Fund, a new National Housing Supply and Affordability Council, and consequential amendments including renaming the National Housing Finance and Investment Corporation (NHFIC) to become Housing Australia.

Apart from the requisite provisions to establish the HAFF much of the legislation focuses on the proposed structure of accounts through which investment income from the HAFF can flow and their purposes.

There is considerable emphasis on the establishment of accounts and mechanisms to facilitate the payment of grants[4] and relatively less detail on the accounting of income streams that could support institutional investment to close the estimated project financing gap. This detail may be forthcoming[5] or contained in the investment mandates provided to Housing Australia. However, on face value there is a greater emphasis on the use of investment income ultimately available to the HAFF Special Account for grants than envisaged in the original policy announcements and Budget announcement of the Housing Accord. Coupled with latitude of proposed ministerial discretion of the apportioning HAFF special account disbursements there is a risk that investment income from the HAFF available to support capital raising from institutional investors may be insufficient or too unpredictable. The key recommendations and supporting details addressing this are outlined in the remainder of the submission.

Key Recommendations:

ISA makes five key recommendations to ensure there is adequate certainty for the issuing of financial instruments to institutional investors who provide capital for financing projects:

- The annual limit for amounts debited from the Housing Australia Future Fund Special Account as proposed in S36 Part 5 of the Housing Australia Future Fund Bill should be indexed annually by the consumer price index (ideally the housing group[6]) for each year subsequent to the financial year beginning 1 July 2023.
- The approval process of payments by the Minister from the Housing Australia Future Fund Special Account to the Housing Australia Special Account in S36 Part 4 of the Housing Australia Future fund Bill occur on the explicit advice of Housing Australia after it assesses its requirements and commitments under its legislated functions and investment mandates for current and future years.

[4] The Bills outline at least three separate mechanisms for the Minister to authorise or direct the payment of grants.
[5] Paragraph 4.3 of the explanatory materials state certain aspects of the exposure draft legislation are yet to be finalised, in particular the draft legislation for Housing Australia's investment function. In the absence of these details ISA is unable to offer a definitive view on the overall workability of the proposals in attracting institutional investors.
[6] See https://www.abs.gov.au/ausstats/abs@.nsf/lookup/28A24C64FA71CAA5CA2570CA00787F8D

- The Minister should prioritise payments to the Housing Australia Special Account from the Housing Australia Future Fund Special Account when considering any new grants to be provided from the Housing Australia Future Fund Special Payment Account under the proposed S 26 and new grants via the COAG reform fund under the proposed S 29 in Part 3 of the Housing Australia Future Fund Bill.
- The Commonwealth should explicitly underwrite the returns from the Housing Australia Future Fund to meet payment commitments to the Housing Australia Special Account.
- The Extension of the Commonwealth Guarantee for Housing Australia by amendment to S 51(2) of the Housing Australia Act by the Treasury Laws Amendment (Housing Measures No. 1) Bill 2023 should be extended to at least 1 July 2030 and ideally longer to mitigate refinance risk for institutional investors.

ISA considers these are the minimum necessary amendments to realise the Government's stated policy objective of the Housing Australia Future Fund to "provide a secure funding stream to support an increase in social and affordable housing" as outlined in the Explanatory Memorandum (p55).

Adequacy of HAFF investment earnings to support the capital financing requirements

ISA has been working closely with funds, collective investment vehicles, community housing providers, and NHFIC to assess the capital finance requirements likely to be needed to deliver on the policy commitment of 30,000 (40,000 including the separate budget appropriation) social and affordable dwellings.

Using estimated construction costs of around $550,000 per dwelling and underlying net rental cashflows available to support servicing commitments there is an identifiable project financing gap. Under conservative assumptions it is likely in excess of $10bn in additional capital will need to be found to construct 40,000 social and affordable dwelling units .

If the initial capital is amortized and repaid via the investment earnings over 25 years in equal installments, over $400m per year will be required simply to repay the principal excluding any investment returns to compensate investors.

Even assuming a small premium on the projected long-term Government Bond rate it will require approximately $570m per annum in HAFF supported cashflows / availability payments to be preserved in real terms (i.e escalating nominal cashflows at 2.5% per annum) to meet principal and interest repayments. Not indexing the cap will reduce capital available for investment by one third.

Clearly these estimates leave little room for capital grants beyond those already announced as part of the policy for acute housing needs. It is possible the freeing up of funds from the National Housing Infrastructure Facility (NHIF) might provide some limited flexibility.

It is important to recognise the financing task has been complicated by significant increases in interest rates (affecting the risk-free rate for investment) and also building construction costs which are up almost 13% in the year to September 2022[7]. Although the investment mandate for the HAFF is not available yet, ISA strongly recommends it is set at CPI + 4.0% (or a nominal 6.5% assuming inflation returns to the middle of the target range). This would facilitate the maintenance in real terms of the annual funding cap of $500 m per annum and also maintenance of the capital in the HAFF in real terms.

Recommendation:

- The annual limit for amounts debited from the Housing Australia Future Fund Special Account as proposed S 36 in Part 5 of the Housing Australia Future Fund Bill should be indexed annually by the consumer price index for each year subsequent to the financial year beginning 1 July 2023.

Certainty of cashflows to support institutional investment

It is difficult to reconcile the exposure draft legislation and proposals for an annual determination of payments from the HAFF special Account to the Housing Australia Special Account (S36) with providing adequate certainty to Housing Australia (or an outsourced investment fund tasked with aggregating capital for projects) to issue financial instruments to institutional investors supplying capital.

Although the precise structure of the financial instrument(s) will need to be determined based on the final legislation, investment, mandates and competing investments, it is likely they will need to be sufficiently differentiated from ordinary commonwealth government securities (CGS)and NIFIC's bond aggregator to be attractive to institutional investors at volume.

Preliminary soundings suggest a floating rather than fixed rate would be necessary along with a range of tenors including those that are shorter due to the lack of liquidity relative to CGS. Revolving debt (without amortisation) may be necessary to ensure yields are attractive enough for some investors. Accommodating the possibility of supporting equity investment by institutional investors will also be important.

Nevertheless, the pricing of a debt like instrument are bid on an entitlement to future (discounted) cash flows. Plainly this is incompatible with a model where the future cash flows of the HAFF available to Housing Australia to raise capital are unknown and only determined on an annual basis.

Recommendation:

- The approval process of payments by the Minister from the Housing Australia Future Fund Special Account to the Housing Australia Special Account in S36 Part 4 of the Housing Australia Future fund Bill occur on the explicit advice of Housing Australia after it assesses its requirements and commitments under its legislated functions and investment mandates for current and future years.

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[7] ABS Producer Price Indices September 2022 – output prices of construction https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/producer-price-indexes-australia/sep-2022#construction

QLD Government Case Study

In June 2021 the Queensland Government announced the establishment of a similar vehicle to the proposed HAFF called the Housing Investment Fund (HIF).

Challenges with the adequacy of the HIF resulted in an announcement in October 2022 to double the capital in the HIF to $2bn and increase the investment mandate to target returns of $130m per annum (6.5%) up from a 4.0% return target previously.[8] In making the announcement the Treasurer specifically referenced the need to provide a long-term, sustainable source of funding for the Government's housing initiatives and the impact of rising costs of building materials and labour on projects.

Following the revisions, the Government confirmed the income from the fund would support the construction of 5600 social and affordable homes.

If the capital requirements and financial model / solutions were broadly replicated in the Commonwealth scheme the HAFF would have to deliver annual income of $650m per annum for 30,000 dwellings. This is 30% higher than the proposed $500m annual cap.

It is also worth noting that while forms of financial assistance under the program include capital grants and other concessions, the primary form of support agreed under the HIF will take the form of subsidies profiled over the duration of the program. [9]

The approach adopted here recognises the capitalization of cashflows to provide upfront capital is more impactful than the use of cashflows to provide one off capital grants. Under the Commonwealth program up to 25 years of cashflows can be capitalized into upfront capital.

ISA acknowledges there may be circumstances where grants might be desirable and the best use of HAFF revenues however the primary legislation should prioritise Housing Australia's financing activities when considering new grant proposals so it has greater certainty to contract with institutional investors to raise capital for social and affordable housing under the program.

Recommendation:

- The Minister should prioritise payments to the Housing Australia Special Account from the Housing Australia Future Fund Special Account when considering any new grants to be provided from the Housing Australia Future Fund Special Payment Account under the proposed S 26 and new grants via the COAG reform fund under the proposed S 29 in Part 3 of the Housing Australia Future Fund Bill.

Reducing risk for investors

[8] Joint Ministerial press release 22 October 2022 see: https://statements.qld.gov.au/statements/96394

[9] EOI Documents Housing Investment Fund October 2021 (paragraph 3.1.2 p 5) https://yoursay.chde.qld.gov.au/qhigi-resources

A key determinant of efficient pricing of capital provided by institutional investors is reducing the inherent risk. By increasing transparency around potential risks and mitigating them the Commonwealth will lower the cost of capital allowing a higher amount of capital to be raised from the cashflows than would otherwise be the case. The flip side is that higher risk will have to be priced in resulting in higher returns for investors and lower capital that can be realised from the cashflows.

Accordingly, it is important the Commonwealth is prepared to stand behind the income stream from the HAFF and explicitly underwrite it should it fall short in any given year of being sufficient to meet the finance commitments to investors. We understand this is likely the Government's policy intent but it would be useful for this to be explicitly outlined in the legislation.

Similarly, we note the Treasury Amendment Bill extends the Commonwealth guarantee available to Housing Australia in its financial dealings to 1 July 2028. Since this date falls during the roll-out of the five year social and affordable program we recommend it be extended to 1 July 2030.

Recommendations:

- The Commonwealth should explicitly underwrite the returns from the Housing Australia Future Fund to meet payment commitments to the Housing Australia Special Account.
- The Extension of the Commonwealth Guarantee for Housing Australia by amendment to S 51(2) of the Housing Australia Act by the Treasury Laws Amendment (Housing Measures No. 1) Bill 2023 should be extended to at least 1 July 2030 and ideally longer to mitigate refinance risk for institutional investors.

Conclusion

ISA is strongly supportive of the HAFF and associated programs outlined in the Housing Accord. The key for institutional investors is ensuring the framework for the HAFF offers sufficient certainty and mitigates risks that would otherwise result in pricing of capital that is too high to meet the objectives of the program.

Ad-hoc decision making must be avoided and a realistic assessment of the capital needs should be understood. ISA's strong view is that the proposed changes as set out in the recommendations are necessary to ensure the HAFF is workable from an investment perspective.

We recognise the Government wishes to have flexibility around the use of grants (beyond those already outlined and accounted for in the announcements to date), but it would appear there is limited capacity in the available revenues from the HAFF given the estimated capital shortfall. Proceeding without addressing these issues is likely to significantly reduce the number of dwellings that can be constructed. This of course is a matter for the Government.

ISA continues to be willing to work constructively to implement this important initiative and provide further detail and advice as requested.

Yours faithfully

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