International financing models for affordable housing

VIVIENNE MILLIGAN
CITY FUTURES RESEARCH CENTRE UNSW
&
JULIE LAWSON
OTB TU DELFT & RMIT

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Purpose

- To chart the changing focus of housing policy and the roles of public & private finance
- To illustrate different levers used internationally to attract private finance to affordable housing
- To draw lessons from their application, success and failure
- To catalyse further development of financing arrangements suitable for Australian conditions
Broad trends in national housing policies late 20\textsuperscript{th}c

- Reduction of public investment in ‘bricks & mortar’ (supply side)
- Shift to assistance for individuals (demand side)
- Promotion of home ownership
- Leveraging and mobilising private finance for housing – focus of this presentation
- Market and third sector providers of housing preferred
- Retraction and devolution in traditional central government roles
Contemporary housing market challenges

- Record levels of mortgage indebtedness and consequential risk to national economic & political stability
- Pressure on wages & social security systems arising from housing stress levels
- Burgeoning costs of demand side programs in government budgets & tax expenditures
- Social, tenure and spatial polarisation
- Labour market shortages in certain industries & regions linked to housing affordability problems
- Finance driven housing market (e.g. sub-prime lending practices)
- Consequences of GFC and any regulatory fall out for housing finance
21stc policy ideas are shifting

- Weakening of Washington consensus on the respective roles of governments & markets
- Moves towards evidence-based policy making
- Changing views on the hegemony of home ownership for all, need for greater choice
- Greater recognition of total costs to government & wider civic impacts of social problems, such as poor housing in failing communities
- Renewed expectations on governments to reduce risks for individuals
- Higher environmental standards affecting the need to regulate urban growth patterns and individual housing designs & services
What should ‘good housing policy’ be today?

- Housing recognised as core area of government, industry & civic interest
- Central government drives and guides regional / local action & promotes pathways for investment to respond to local needs
- Focus of housing policy is broad & integrated with wider economic, social & environmental goals
- Subsidies are proportionate & balanced (e.g. by tenure, by supply & demand; by income level)
- Supply side incentives are appropriate and responsive
- A reasonable level of certainty in policy settings prevails
- Large tranches of private finance available for supply & upgrading tasks
- Effective public & private partnerships (e.g. to tackle social exclusion / community building)
- Well developed housing market expertise / information in or close to government
Publicly Driven Financing Mechanisms for Affordable Housing

Mix and layering of:

- Public grants
- Public loans (subordinated)
- Discounted public land
- Developer contributions (mandated / negotiated)
- Interest rate subsidies
- Protected circuits of savings for affordable housing (and other investment)
- Tax privileged private investment
- Government secured private investment
- Tax privileges for providers of affordable housing
- Regulates generation of profits, use of equity
- Rent subsidies to support revenue
- Tenant equity
Variety of ways of financing / delivering

Capital markets

Financial intermediary

Commercial, off-market or low interest loans and grants

Land market: Freehold or constrained property rights

Social, cost, market based, with or without rental assistance

Universal Access or Eligible tenants only

Welfare & labour market policy/resources

Housing providers: public, limited profit, private, etc

Cost capped, size limited housing or all forms

Defined schedule of repayments, dynamic, fixed, variable

Supply circuit

Demand circuit

Supply circuit may be influenced by guaranteed loan repayments, tax exempt investment, sound asset management, etc

Demand circuit may be influenced by guaranteed rents, demand assistance, security of tenure, etc

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Directions in financing

- Traditionally public grants & loans
- Public borrowing constraints + greater availability of finance from capital markets increased reliance private finance, mobilised via incentives and subsidies
- Intermediation varies: off/on market, stand alone institutions or embedded in finance market
- Volume, rent levels and cost bounded by conditions in finance, land and housing markets, impacts on public expenditure
- Differences in cost effectiveness, impact on volume and nature of housing services, robustness, manageability
- Clarity of mission & right balance of regulatory and financing models to ensure continuity, appropriate growth & strong social outcomes

Comparing international models and their outcomes

ENGLAND
UNITED STATES
FRANCE
AUSTRIA
SWITZERLAND
<table>
<thead>
<tr>
<th>Country</th>
<th>Soc Hsg %</th>
<th>Income mix/demand levers</th>
<th>Rent regime</th>
<th>Main private finance mechanisms (supply)*</th>
<th>Public policy supply levers*</th>
<th>Delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td>England</td>
<td>21</td>
<td>Broad access increasingly targeted with full subsidies</td>
<td>Amenity &amp; cost related</td>
<td>Bank debt secured by secure revenue and grant (40-50%)</td>
<td>Public grants Developer contrib. (under planning provisions) (≈50%)</td>
<td>NFPs Local Authorities Private (few)</td>
</tr>
<tr>
<td>US</td>
<td>5</td>
<td>Low &amp; moderate Limited no vouchers for low incomes</td>
<td>Affordable rents related to area median income</td>
<td>Equity investment via tax credits (42%) Bank debt (36%)</td>
<td>State &amp; local govt loans</td>
<td>Public housing authorities For Profits NFPs</td>
</tr>
<tr>
<td>France</td>
<td>17</td>
<td>Segmented, varies with program subsidy conditions</td>
<td>Govt set maximum rents (by location &amp; program)</td>
<td>Low interest loans raised via tax privileged public savings scheme (70%)</td>
<td>State &amp; local subsidies (10%) Local authority land &amp; developer contrib. (under planning provisions)</td>
<td>Public bodies NFPs PPPs</td>
</tr>
<tr>
<td>Austria</td>
<td>21</td>
<td>Broad, targeting varies with local subsidy conditions</td>
<td>Cost based, costs are capped</td>
<td>Low interest loans raised via tax privileged Housing Bonds (40-60%)</td>
<td>Graduated public grants/ loans (30-40%) Municipal land set asides &amp; land banking</td>
<td>Regulated limited profit assoc. &amp; co-ops. Municipal companies</td>
</tr>
<tr>
<td>Switzerland</td>
<td>8</td>
<td>Broad, limited subsidies for low incomes</td>
<td>Cost based</td>
<td>Bank loans (60%) Bond issuing cooperative (25%)</td>
<td>Low interest public revolving loan (6%) State guarantee for bond</td>
<td>Regulated limited profit assoc. &amp; co-ops. Municipal companies</td>
</tr>
</tbody>
</table>

*Typical projects*. Provider and tenant equity and/or minor loans make up additional finance. Source: Lawson et al, forthcoming
Which models have served policy goals best?

- During house price boom?
- During labour market and socio-economic restructuring?
- During the current global financial crises?
- Over the long term?
- Have they mitigated social inequality?

Time for reflection & reassessment of core strategy in terms of outcomes and risks
<table>
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<tr>
<th>Country</th>
<th>Cost effectiveness</th>
<th>Access and affordability low incomes</th>
<th>Finance costs &amp; supply</th>
<th>Robustness</th>
<th>Delivery issues</th>
<th>Public subsidy impacts</th>
</tr>
</thead>
<tbody>
<tr>
<td>England</td>
<td>Private debt public equity model</td>
<td>Heavily subject to housing and finance market conditions</td>
<td>Reliance on housing benefit</td>
<td>Low cost debt finance from well developed, competitive market</td>
<td>Dramatic change in cost/ supply of finance and land market post GFC</td>
<td>Mature provider oriented delivery system; few suppliers</td>
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<tr>
<td>US</td>
<td>Tax credit private equity model</td>
<td>Has improved significantly as market developed Leakage of funds</td>
<td>Access heavily rationed, poor affordability for low incomes</td>
<td>Equity finance higher cost than debt Supply limited by nos. tax credits</td>
<td>Investor equity subject to market conditions</td>
<td>Complex layering of project finances; fragmented</td>
</tr>
<tr>
<td>France</td>
<td>Public savings scheme model</td>
<td>Very cost effective, long term and robust</td>
<td>Lowest cost loans to approved lowest income projects</td>
<td>Significantly longer terms &amp; lower interest than commercial loans</td>
<td>Savings scheme robust across cycles (operated counter cyclically in GFC)</td>
<td>Well developed but complex</td>
</tr>
<tr>
<td>Austria</td>
<td>Structured bond finance model</td>
<td>Substantial investment from individuals $1 govt $20 private</td>
<td>Increasing tenant equity reduces affordability</td>
<td>Tax privileged bond channels low cost finance to meet demand</td>
<td>Bond mechanism is flexible, responsive and sustained</td>
<td>Prescribed business model drives efficiency</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Co-operative finance model</td>
<td>Low scale public financing limits outcomes</td>
<td>Insufficient subsidies to ensure affordability</td>
<td>Pooling of smaller demands via bond issuing co-operative reduces costs</td>
<td>Supports continuity for NFPs when market conditions less favourable</td>
<td>Limited capacity Umbrella orgs. provide technical support</td>
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<td>Limited impact, reliant on revolving fund</td>
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Lessons for Australia
Current supply model

- Large unmet demand from low and moderate incomes
- Small asset base
- Very limited long term public loans & grants
- NRAS tax credit national instrument
- Commonwealth rent assistance modest (Henry reforms?)
- Untargeted and regressive tax incentives
- Fragmented & small scale opportunities in planning system; land commissions not fully mobilised
- Regulation developing
- Delivery models developing
Financing challenges in Australia

**Supply circuit**

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**Demand circuit**

- Welfare & labour market policy/resources

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Characteristics to attract private finance in Australia

- Institutional & subsidy arrangements to attract private investment on a scale to make a difference (Housing Supply Council projections)
- National planning framework to promote affordable housing
- Rents that cover the costs of operating & financing decent housing
- Meeting the gap between rents & tenant incomes with adequate rent subsidies
- Management of assets by social housing providers to enhance their value and enable further leverage over time
- Robust and responsive regulatory framework justified by sufficient scale / growth path
The concept of Housing Supply Bonds

- Australia is yet to establish a vehicle to channel institutional investment into affordable housing
- Various proposals involving bonds have been made but not implemented
- There are well established bond financed schemes operating overseas we can learn from
Characteristics of successful bonds models

1. The establishment of financial intermediaries (e.g. Housing Banks, Austria; Bond Issuing Cooperative, Switzerland)
2. The development of a specific and standardised financial instrument (such as a bond) to raise funds
3. Bonds receive tax concessions and have additional credit enhancements (provided by preferential underwriting or guarantees) to increase their attractiveness to investors
4. Bond holders are additionally protected by regulations requiring registration of housing providers. These delivery agents must comply with legislated requirements and regulatory codes
5. Finally, packaging (or pooling) of other forms of assistance (such as direct public grants and land access) is also facilitated
Housing Supply Bonds – a model for discussion...

Private bond placement holders
(superannuation funds, individual investors, deposits in FHSA)

Bonds/ Bond retailers

Pooled Social Housing Fund

Registered Social Housing Provider
(of affordable housing and refurbished social housing)

Annual recurrent grants
(eg. NRAS)

Upfront grants
Land/ development contributions

Subordinated public loans

Rent revenue

CRA

CRA +

Provider Regulations
CRA guaranteed

Effective guarantee

Prudential Regulations

Tax privileged status

Private bond placement holders

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Insights from international experience …

- Co-financing can work, creative tensions must be carefully monitored & balance achieved
- Professional norms & regulatory framework to ensure decent standards & reduce costs & importantly, benefit tenants
- Debt / private equity financing models must not dictate social policy
- Government responsibility to support incomes that are inadequate to afford decent housing
- Income mix positive for social acceptance, integration of weaker households & stronger revenue stream
- Appropriate balance of supply & demand side subsidies – always need both + long term commitment & responsiveness to need & market conditions
- Mechanisms to raise and channel private investment can be cost effective and strategic but need careful design & market co-operation & competition
Thank you

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**Sources**

- Lawson, J., Gilmour, T. and Milligan, V. (unpublished) International measures to channel investment towards affordable rental housing, Research Paper, AHURI, Melbourne

**Further contact**

- Vivienne Milligan: v.milligan@unsw.edu.au
- Julie Lawson: j.m.lawson@tudelft.nl