Engaging Institutional Finance with Affordable Housing: What, Why and How?

Hal Pawson, Assoc Director, City Futures Research Centre, UNSW
In Aus, as well as US, UK and elsewhere, 20 years since govt ceased routinely fully funding affordable housing

Although some form of public subsidy always needed, AH development substantially funded with private finance

Post-GFC interest rates low, **BUT** new constraints on traditional debt finance with attractive terms

Capital markets present large and growing alternative funding opportunities

Affordable rental housing output falling further below needs
What is ‘institutional investment’?

- Govt aspirations for ‘institutional investment’ in rental housing long established in Aus and elsewhere
- 2008-2014 NRAS program the most recent Aus effort to achieve this
- ‘Institutional financing of rental housing’ = capital provided at scale by corporate entities (e.g. super funds) charged with generating investor returns
- Collectively, Australian ‘managed funds’ control over $1.4 trillion in assets
- Some now directly funding public infrastructure – e.g. tunnels, roads – so why not affordable housing (runs the argument)
- Financing can be structured either as:
  - Equity – fund owns the asset and bears associated risks (e.g. US), or
  - Debt – fund lends to investing entity (e.g. CHP) which bears the risk
Why institutional investment in rental housing?

- One part of the argument about diversifying ownership structure of *market rental* housing
- Moving away from overwhelming reliance on ‘mum and dad investors’ – small scale ‘amateur landlords’
- Institutional funds could enable large scale development of rental blocks in single ownership
- Scope for more **efficient**, more **professional** management
- Seeking long term stable returns, institutions less concerned with maximising capital gains
- Hence more comfortable with longer tenancies appropriate given growing % of family renters
Institutionally financed market rental housing – under HA management

- Some larger UK HAs partnering with institutional financiers to provide market rental
- *Fizzy Living* subsidiary of Thames Valley HA financed by Abu Dhabi sovereign wealth fund £1bn investment
- Initial development target – 1,000 dwellings within 3 years
- Another model: HA leases back institutionally financed (and owned) market rental housing
- Expanding supply of well-managed, good quality market rental property
Why institutional investment in affordable rental housing?

- Another part of the argument relates to *affordable rental* housing
- Even if assisted by govt funding & cross subsidy, CHP development needs private finance (see graphic)
- Bank finance hard to secure on good terms
  - Short loan terms worsen CHP re-financing risk
  - High interest rate cover ratios (ICRs) limit CHP borrowing
  - Fund raising fragmented and inefficient
- UK HAs have largely replaced bank loans with institutional financing via 30-yr bonds
- Effectively a new form of debt financing

Financing profile of AH projects in England 2012-2014

Source: Peter Redman
How institutional investment?

- **Housing Supply Bonds** – key proposed mechanism to channel finance at scale into affordable housing supply
- Privately issued market rated suite of bonds (tradeable debt) for different classes of investors
- Govt guarantee for institutional investors to lower risk & thus required return
- Will compensate for modest ‘yield’ from housing occupied by low income tenants
- But other govt support also necessary – e.g. free/discounted land, ‘son of NRAS’
- Generating Aus. market will require a steady flow of projects
  - national scope
  - mix of market & affordable rentals
How institutional investment?

- Linked with HSB model is proposal for institutional structures
  - Government guarantees
  - Specialist housing finance intermediary organisation
- Guarantees lower financier-perceived risk of affordable housing investments
- Facilitate cheaper and more plentiful private finance
- AH guarantee schemes established in the UK, Ireland, Switzerland, the Netherlands and the US
- CHPs enabled to access finance at rates similar to govt itself
- Acting on behalf of CHP consortia, intermediary can
  - Promote efficient fund raising
  - Enable smaller landlords to access long-term, low margin finance
Financing rental housing – latest industry views

- Growing super fund interest in lower risk, lower yielding investments to generate predictable returns
  
  "It's a nice asset class, it's domestic property, has a social good, which is very important for many funds…potential for a steady return as well as a capital gain…"
  
  Pauline Vamos, CEO, Assoc of Super Funds of Australia)

- Institutional investor engagement almost achieved via NRAS
  
  The government change regarding NRAS has severely impaired some of the strategies we were looking at

  Superfund investment manager
Institutional investment: making it happen

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<tr>
<th>Barriers</th>
<th>Strategies</th>
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<td>Lower yields than for competing investment options</td>
<td>Govt. interventions to adjust risk return equation</td>
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<td>A lack of industry knowledge of rental housing products and performance</td>
<td>Urgently collect &amp; publish information on CHP financial deal terms, asset portfolios &amp; tenancy performance</td>
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<td>Small scale and fragmented nature of deals on offer, coupled with insufficient liquidity</td>
<td>Scale up investment program &amp; pool CHP opportunities</td>
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<td>Changeable and uncertain or unsuitable government policy settings</td>
<td>Long term govt. pledge / strategy / targets</td>
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<td>National (c/w) leadership to achieve scale &amp; required diversity of investment options</td>
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Key references


Milligan, V. et al (2015) *Next Moves: Expanding Affordable Rental Housing in Australia Through Institutional Investment*; City Futures Research Centre

