Committee Secretary
Senate Economics Legislation Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600
AUSTRALIA

13 April 2018

INTRODUCTION:

Compass welcomes the opportunity to provide input to the Committee's examination of the National Housing Finance and Investment Corporation Bill 2018 and the National Housing Finance and Investment Corporation (Consequential Amendments and Transitional Provisions) Bill 2018.

Compass Housing Services is an international NGO that provides social and affordable housing for low to moderate income households. Our vision is for a world in which all people have appropriate and affordable shelter and are engaged in sustainable communities. Compass currently manages over 4500 properties and community development projects in Australia, New Zealand and Vanuatu.

The creation of the NHFIC, and in particular the Bond Aggregator, will represent a significant milestone in the evolution of the social and affordable housing sector and is something Compass has been advocating for a long time. Compass remains concerned however, that the potential impact of the NHFIC and the aggregator on the supply of social and affordable housing will be negligible unless attention is given to addressing the funding gap.

THE ECONOMIC RISK OF NOT PROVIDING SOCIAL AND AFFORDABLE HOUSING:

Adequate and affordable housing is pivotal to the social and economic wellbeing of our community. Yet over the past 30 years many Australians have fallen into the habit of viewing housing primarily in terms of its market price, instead of in terms of its utility as a place to live. It is doubtless the case that housing's status as a tax advantaged vehicle for speculative investment and wealth creation has worked out well for existing home owners and those with significant borrowing capacity, but it has had a deleterious effect on the security and stability of low to moderate income earners, for many of whom, housing stress is now simply a fact of life. Moreover, the distortion of the housing market, and the erosion of housing affordability, has produced a series of side effects that are already undermining living standards, and could, if left unchecked, represent a serious threat to the economy more broadly.

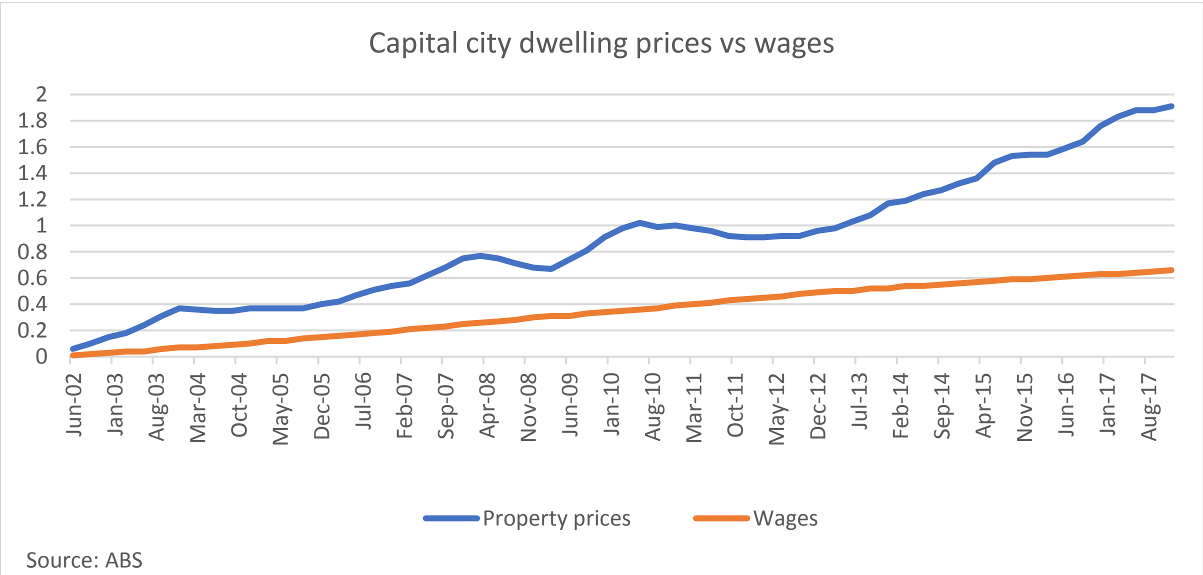
It is important to be clear about what we mean by "affordable" housing. One useful measure, as it relates to the purchase price of housing, is the median multiple or "price-to-income ratio". The median multiple is derived by dividing the median dwelling price by the median income. The resulting figure is the number of years worth of income required to buy a median priced dwelling. A median multiple of more than 5 is generally considered to be "severely" unaffordable. Australia's overall median multiple is currently 6.6 and our capital cities are now amongst the least affordable housing markets anywhere in the world.

LEAST AFFORDABLE HOUSING MARKETS 2018

Rank:	City	Median multiple
1	Hong Kong	19.4
2	**Sydney**	**12.9**
3	Vancouver	12.6
4	San Jose	10.3
5	**Melbourne**	**9.9**
6	Los Angeles	9.5
7	Honolulu	9.2
8	San Francisco	9.1
9	Auckland	8.8
10	London	8.5
16	**Adelaide**	**6.6**
18	**Brisbane**	**6.3**
21	**Perth**	**5.9**

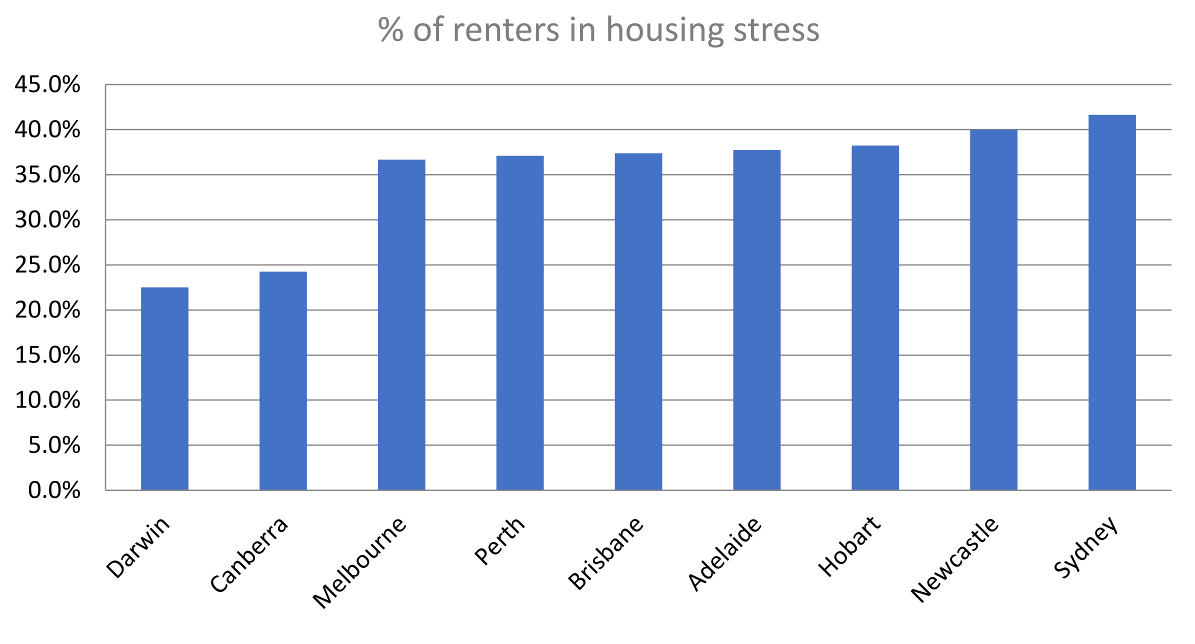
Source: Demographia 2018

Over the past 15 years, capital city dwelling prices in Australia have increased by more than 190%. Over the same period, wages have increased by just 66%. For most of the 20th Century, Australia's median multiple was less than four and if price-to-income ratios had remained at 1980s levels, the current median house price in Sydney would be just $364,000. From this point, a return to historic norms would involve prices falling by 60% or incomes increasing by 200%.



The current situation is neither normal, nor sustainable, and carries substantial economic and social risk.

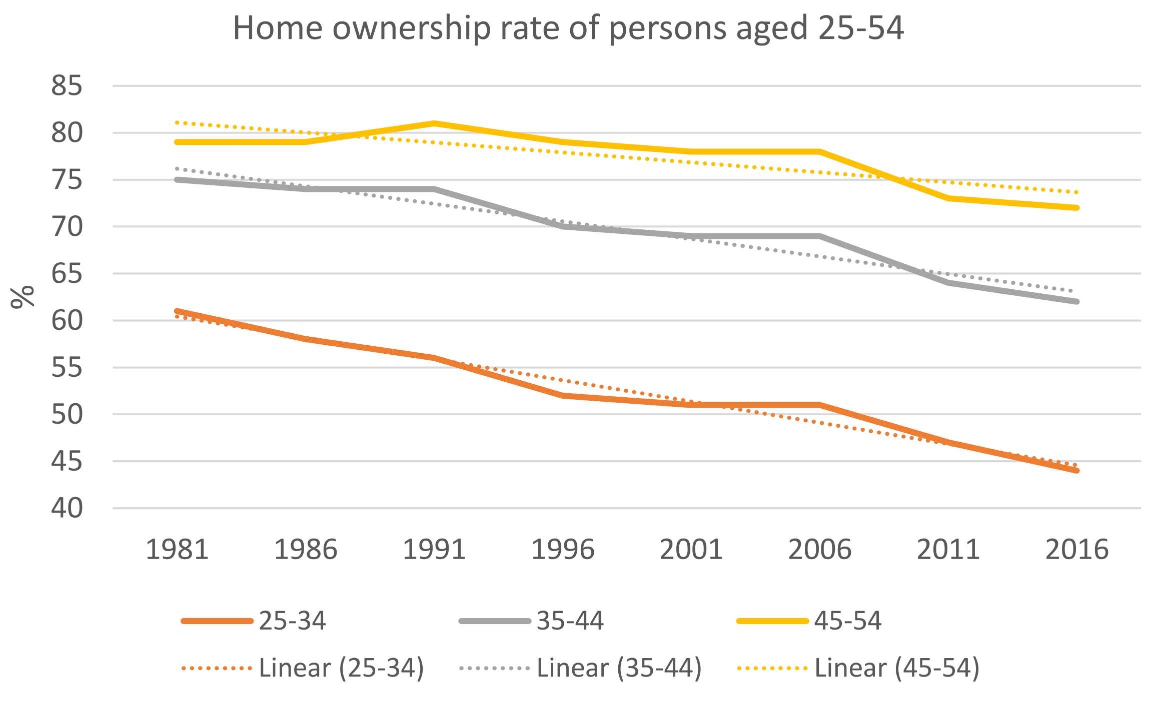
The two most obvious consequences of housing unaffordability are increased levels of housing stress, and elevated levels of household debt. Housing stress is another useful measure of housing affordability and is experienced by households with incomes up to 120% of median who pay more than 30% of their gross income on housing costs. Currently approximately 35% of renting households in Australia are experiencing housing stress. It stands to reason that households experiencing housing stress have less disposable income which has consequences for the economy more broadly.



Source: ABS Census 2016

Likewise, Australia's record levels of household debt, (which currently accounts for 188% of disposable household income and 123% of GDP, and consists primarily of housing debt), represents a potentially significant drag on economic activity as highly leveraged households are exceptionally sensitive to interest rates and increases in the cost of living.

Another inevitable consequence of unaffordable housing is a pronounced decline in the rate of home ownership which in turn has serious implications for the retirement saving system, the viability of which is based on the (largely unspoken) assumption that by the time people reach retirement age, they will have few, if any, housing costs. The ongoing decline in home ownership however, will threaten that assumption as more people will become lifelong renters and will therefore continue to have significant housing costs in their old age.



Source: Yates (2015), ABS, Grattan Institute

This risk to the retirement saving system is compounded by the fact that today's historically large mortgages mean greater numbers of home owners are likely to reach retirement age without having paid off their mortgage and will therefore use up a substantial portion of their superannuation in doing so, leaving less to cover ongoing living expenses. The result in both cases is likely to be increased demand for the age pension, and for housing benefits like Commonwealth Rent Assistance (CRA).

The next outcome of a lack of affordable housing, and the one that most directly impacts Compass, and is most directly related to the objectives of the NHFIC, is increased pressure on the already overstretched social housing system.

Research conducted by Economist Judith Yates from the University of Sydney as part of the Everybody's Home campaign reveals Australia requires approximately 130,000 additional social housing dwellings to achieve a 6% share of all occupied dwellings. Maintenance of this target over the next ten years would require just over 100,000 dwellings, or 10,000 per year. Achieving a 6% share over the next 10 years therefore would require a net addition of 23,000 social housing dwellings per year for the next 10 years. If the government were to take a longer-term approach and attempt to reach a 6% target over 20 years rather than 10, the required annual target would fall to 16,500.

These numbers do not take account of the fact that many existing social housing dwellings are near the end of their useful life and will need to be either replaced or substantially upgraded over the period in question if they are to remain habitable.

As well is impacting on household budgets and government resources, a lack of affordable housing can negatively affect social cohesion and productivity. The reason cities create value in the first place is due to the economics of agglomeration. However, the ongoing decline of affordability, particularly in capital cities, has slowly forced low to moderate income workers to the outskirts or to relocate altogether. As well as impacting human capital, and productivity by forcing workers to commute long distances to the job hubs of the inner cities, this process risks establishing a form of social and economic apartheid in which low and moderate income working households are prevented from living in the communities in which they work.

WHAT WILL BE THE IMPACT OF THE NHFIC?

The stated goal of the NHFIC is to improve housing outcomes for Australians, by boosting the supply of affordable rental housing, specifically by financing critical infrastructure to increase overall supply, and providing CHPs with a more efficient source of funds via a bond aggregator.

The bond aggregator is welcome development and one that has long been sought by the CHP sector. As many contributors noted during the first round of consultation however, concerns remain about the absence of recurrent government funding to make new construction projects viable.

The Ernst & Young report to Treasury in September 2017 suggested CHPs could expect to obtain finance through the NHFIC up to 1.4% cheaper than conventional bank finance. While this would be welcome, and attractive to CHPs seeking to refinance existing debts, it is nevertheless unlikely to be sufficient to encourage new supply. As noted by the Council on Federal Financial Relations Affordable Housing Working Group, establishing and maintaining a portfolio of below market rental housing inevitably requires ongoing subsidies to bridge the gap between the below market rental revenue and the operating costs (including debt servicing).

Without recurrent funding, CHPs are unlikely to be able to create the pipeline of work necessary to support the function of the aggregator. The success of the bond aggregator and of the NHFIC to fulfil a crucial part of its mandate therefore, will ultimately depend on the successful resolution of this issue.

METHODS OF ADDRESSING THE FUNDING GAP

Stock transfers

One proven method for enabling CHPs to service larger debts is to transfer the title of a proportion of existing public housing assets to a CHP, under a covenant requiring their ongoing use as social housing. The combination of a greater asset base, increased access to Commonwealth Rent Assistance and cheaper finance through the bond aggregator would significantly increase the capacity of CHPs to deliver additional dwellings. The following hypothetical is indicative of the potential benefits of this approach.

Based on an average household CRA entitlement of $60.60 per week ($3139 p.a.), the transfer of 10,000 dwellings to a CHP would attract more than $31 million dollars of revenue over and above the rents normally paid by social housing tenants. This additional revenue could theoretically service a debt of $627.8 million at 5% interest. Based on a conservative estimate of $250,000 per dwelling, a debt of $627.8 million would be sufficient to deliver around 2511 additional dwellings – representing an increase of 25% on the original 10,000 dwellings transferred.

Inclusionary zoning / planning incentives

State and territory governments have the capacity to catalyse increased social and affordable housing through better use of planning tools. This may include inclusionary zoning instruments that require a proportion of the development to be dedicated to social or affordable housing, or incentives that offer developers greater yield, or relaxation of normal restrictions in exchange for a portion of the development being retained as affordable housing (e.g. the NSW Government's State Environmental

Planning Policy (Affordable Rental Housing) 2009). Different jurisdictions have applied different standards of inclusionary zoning. Currently the City of Sydney has mandated an affordable housing component in specified zones such as Ultimo/Pyrmont. In these areas, developers either include affordable housing within developments or pay an affordable housing levy. Meanwhile the Newcastle City Council has announced its intention to push ahead with a 15% inclusionary zoning target for developments on privately owned land and a 25% target for state owned land. Inclusionary zoning may have the ancillary benefit of making land banking less attractive as developers will be forced to negotiate harder for sites if an affordable housing requirement exists.

Build-to-rent

The build to rent model involves developers and their financial backers building apartments with the specific intention of retaining them as rental housing (as opposed to selling them to individual homeowners or investors). The practice is common and well supported by institutional investors in the USA and the UK but still relatively unknown in Australia where the rental market is dominated by small "mum and dad" landlords.

It should be noted however that build-to-rent is not in itself an "affordable housing" scheme. Investors may elect to rent dwellings out at market rates with any "affordability" dividend simply coming from the increased supply in the market. However opportunities do exist for build-to-rent apartments to be offered at below market rates with investors receiving a tax benefit through a Managed Investment Trust for example to ensure the investment remains attractive. This approach would be similar to the US Low-Income Housing Tax Credit program.

COLLECTION AND ANALYSIS OF STATISTICS

Compass notes the Explanatory Material to the NHFIC Bill credits the failure of supply to keep up with demand as among the main causes of the significant appreciation in house prices witnessed over the past 15 years. Compass further notes that in addition to lending and investment activity aimed at improving housing outcomes, the draft legislation permits the NHFIC to do "anything incidental or conducive to the performance of the above functions". As such Compass believes consideration should be given to resourcing the NHFIC to carry out some of the functions of the former National Housing Supply Council, specifically the provision of estimates, projections and analysis in relation to housing supply and demand. Doing so would provide the board and management of the NHFIC with solid evidence on which to base strategic decisions in relation to the Corporation's activities.

Compass once again thanks Committee for the opportunity to provide feedback on the draft legislation and looks forward to reading the Committee's final report.

Yours sincerely,

Greg Budworth
Group Managing Director
Compass Housing Services