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Senate Inquiry: Affordable Housing
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Dear Sirs

Grace Mutual Limited is a not-for-profit entity designing investment mechanisms to attract wholesale funding into the social sector, in particular in relation to the National Rental Affordability Scheme.

To date, we have assisted in the financing of more than 1,000 houses under NRAS.

Observations on the effectiveness of NRAS

We wish to make the following observations on the impact of NRAS on affordable housing.

- NRAS has brought affordable housing to the awareness of the general public.

  Prior to NRAS, most people were unaware of the housing sector beyond a general suspicion of social housing. With the majority of built NRAS dwellings being sold to private investors, this has created widespread awareness of the need, the difference from social housing and the NRAS solution.

- NRAS has resulted in significant numbers of affordable dwellings being constructed.

  Regardless of criticisms of NRAS, it has resulted in the construction of at least [20,000] new affordable rental dwellings, directly positively impacting [30,000] tenants, building capacity and assets within the Community housing Sector, and creating or preserving thousands of jobs in home construction.

- Unclear, complex and poorly drafted regulations and law hurt the program.

  In addition to the complexity of the tax law, the NRAS Regulations are also unduly complex, in particular the interpretation on capping of rental increases at original rental rate plus NRAS indexation – for the full 10 years. This significantly disadvantages landlords who put in social tenants first, as they will not be able to increase rent, even if an essential worker becomes the tenant later. Many CHPs bowed to State pressure and put social tenants into NRAS dwellings in the early days.

  Another example is the rejection of thousands of investor tax returns by the ATO, due to the complexity around the State's NANE income and associated deductions.

Having two complex tax-related incentives (State & Commonwealth) increased the complexity and cost of documentation and legal services, and raised the barriers to institutional involvement, as did linking the incentives to the NRAS Rent.

- Too many NRAS incentives wasted on university student housing.

  Large numbers of NRAS incentives (at least 4,000) were awarded for the construction of student housing. There appears little evidence that this has any positive impact on the middle to low-income families that were the target of the original policy.

- Poor coordination between Government Departments undermined investor confidence.

  This occurred from the very beginning where the ATO took a hard line stance on introducing investors to benefit from NRAS, despite this being one of the foundational objectives of the program.

  Other examples include the wide variation in State government treatment of numerous aspects of the scheme.

- Under-resourcing of bureaucracy delays application reviews and undermines commercial arrangements.

  The significant time taken to assess applicants for Round 3 and the current round, results in the loss of many projects, either because options over land expire, or because bank and investor finance cannot wait for months before being confirmed.

<u>Alternative structure for the next evolution of NRAS</u>

In the event Government considers extending the NRAS scheme, we put forward the following alternate mechanism, which we believe may be both more valuable to housing providers, and cost the Government less.

In summary, the current position is:

- NRAS offers income support incentives to build new affordable rental properties, but the greatest need for developers and housing providers is capital - both debt and equity.
- The NRAS income support is generous and flexible, but it is difficult to turn into capital (tax offset & non-standard indexation).
- The biggest risk to the NRAS program is this lack of capital, and it may be the biggest challenge for Australia's housing sector.

Proposal: The Government's affordable housing scheme should be based on providing capital in the form of a 10-year, interest-free loan, rather than NRAS-like income support.

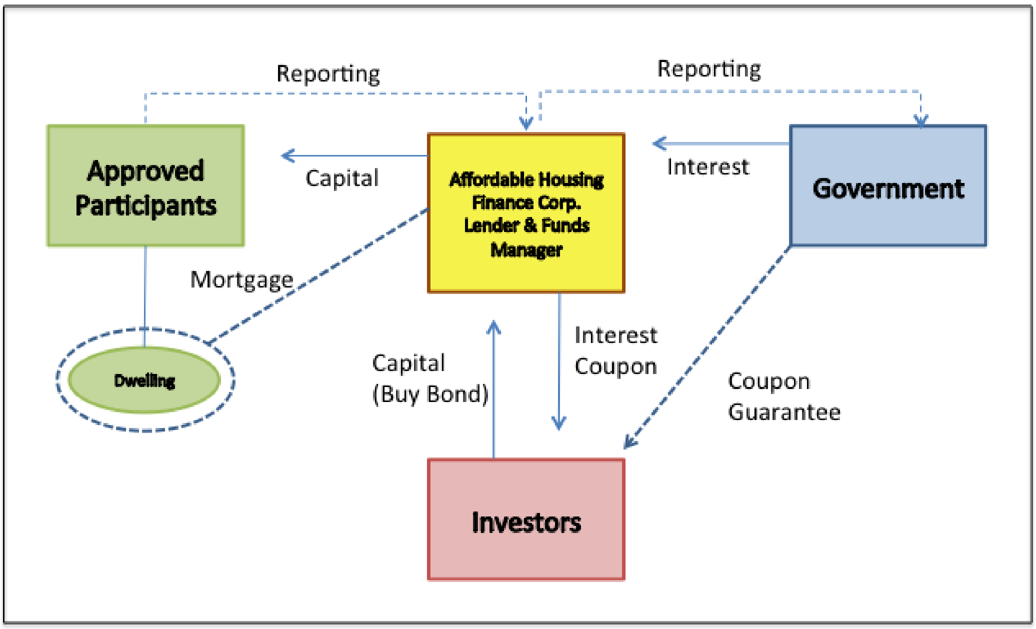
1. Capital meets the real needs of the housing industry.
    - It adds certainty for forward planning and certainty on cost, reducing the likelihood of allocated incentives remaining unbuilt.
    - The loan would be available as "take-out" finance, so the funding is only available on completion, as currently.
    - Participating NRAS providers throughout Australian have indicated that this approach would be preferable to the income support approach.

2. It is significantly (>26%) cheaper for Government:
    - Government's borrowing costs are lower than the industry's, so there is much less "leakage" and more overall efficiency.
    - Government can fix its forward costs by supporting a 10 year bond instead of carrying an unknown and uncapped 10 year exposure to indexation.
    - This approach can also reduce Government's cost of compliance management, shifting responsibility to third parties under a user-pay approach.

3. We believe the loan principal can be kept off the Commonwealth's balance sheet.

    Under the proposed structure, Government would be liable only for the payment of the coupon (interest) on the bond. Investor capital would be protected by mortgages over completed NRAS Dwellings.

    These services would be provided by a new Affordable Housing Finance Corporation, over which Government could exercise control (but not consolidate).



We believe highly credible parties would be pleased to participate in the proposed Affordable Housing Finance Corporation:

- Detailed structuring of the whole proposal
- Arranging and distributing the bond issue to investors
- Providing the lending/loan origination (including documentation, security trustee) and ongoing loan management
- Coordinating the scheme's compliance processes

We believe the scheme can be structured to:

1. Attract large amounts of institutional capital;
2. Provide long term, low cost debt to approved participants in NRAS;
3. Reduce the costs to Government of both the incentive and scheme management; and
4. Keep the debt off Government's balance sheet.

We look forward to the opportunity to discuss this in greater detail.

Kind regards

Andrew Tyndale
Director
Grace Mutual