Infrastructure Partnerships Australia leads the national infrastructure debate by bringing together both the public and private sectors to promote partnerships in infrastructure provision.

Infrastructure Partnerships Australia

Submission to Inquiry into Housing Affordability in Australia

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Introduction

Infrastructure Partnerships Australia (IPA) is the peak industry body and has within its membership infrastructure developers, constructors, investors and operators, as well as transport service providers and government departments and agencies.

IPA is dedicated to improving the provision of infrastructure in Australia, recognising the well documented positive relationship between infrastructure capability and economic productivity and performance.

We are acutely aware of the complexity associated with the formation and delivery of infrastructure, particularly in ensuring infrastructure services are 'fit for purpose' and can be managed effectively over the course of their very long economic life. To this end, IPA endeavours to create a community of learning among public and private infrastructure practitioners that will support realistic expectations and enduring outcomes as well as greater opportunities for private sector to contribute and work in close co-operation with government in developing infrastructure and services.

Housing is one of the most basic human needs and all governments have a commitment to ensuring that affordable access to housing is possible to all citizens. The satisfaction of housing needs for all sections of the society is not merely challenging but resource-intensive. For those at the lower end of the income distribution this can place almost intolerable pressure on their resources and it is for this reason that most countries including Australia are looking for innovative solutions for arresting dwindling housing stocks and making housing more affordable.

To this end, IPA acknowledges the efforts already undertaken by Federal Government in developing the National Rental Affordability Scheme (NRAS) whereby the private sector is encouraged to deliver affordable housing product for rent and purchase utilising Government policy, initiatives and incentives.

IPA welcomes the opportunity to submit to the Senate Select Committee on Housing Affordability in Australia. We acknowledge the inquiry as an opportunity to provide inputs which can contribute to ameliorating the acute supply-demand mismatch in affordable housing in Australia.

Affordable Housing

The term 'affordable housing' has come to mean different things to different people. In its broadest sense, affordable housing refers to any housing that meets some form of affordability criterion. One version of this definition uses the concept of housing stress as its criterion for affordability. The 1992 National Housing Strategy defined housing stress as a household in the bottom two income quintiles paying in excess of 30% of net income. In this broad definition, affordable housing means any housing costing less than 30% of income for the bottom 40% of income earners.

IPA is of the opinion that affordable housing cannot be looked at in isolation to social housing. Appropriate solutions to social housing also have an impact on affordable housing by freeing up high value prime land for better utilisation. The private market is now in a position to offer hybrid solutions to both affordable and social housing projects thereby increasing the overall housing stock. One recent example in this direction has been the announcement by the City of Sydney Council that prime city land will be transformed into hundreds of new affordable apartments under a $260 million project to bring key workers, priced out of the property market, closer to their work. The development on the 3.6-hectare site in Glebe-Ultimo will be for 700 new affordable, social and private housing units.

The terms of reference for this inquiry is quite exhaustive. IPA notes that some of the issues lie beyond the domains of our policy advocacy framework. As such our endeavour would be restricted to issues that explore effective public private participation in the housing sector which look at finding solutions to promoting both affordable housing and social housing.

The Social Housing Sector in Australia

Social or public housing, managed by State Housing Authorities (SHAs), is the major social housing response to low-income people in Australia. Throughout the post-war period of the twentieth century, public housing stock in Australia, despite minor fluctuations and state variations, generally has continued to grow.

However, on the turn of the new millennium, total public housing stock has begun to decrease. The main reason for this is quite plain. Funding from the Commonwealth government, and matching funds from State and Territory governments for the Commonwealth State Housing Agreement (CSHA) have been declining in real terms for a decade and State Housing Authorities are struggling to deal with this resource crunch. In this environment, SHAs have tightened allocation and tenancy arrangements, which have contributed, to less revenue received and higher service costs.

The funding decline has come at a time in Australia's history when housing affordability and access for low-income people in the general housing market is extremely difficult. House prices have sky-rocketed, especially in capital cities, investment in the private rental market has generally been directed towards higher cost housing and general private rents have continued to increase as part of this property boom. A significant number of people in Australia have been recorded as being homeless and the lack of affordable housing is a key contributor to this.

There is increasing realisation that government alone cannot shoulder the entire burden of renewing existing housing stock and investing in new ones. Alternative long term solutions have to be found which can effectively address problems in this sector.

Why Public Private Partnerships?

Future growth in social housing is likely to be increasingly reliant on new kinds of delivery models, new partnerships and the ability of the sector to attract private finance.

Social housing is looking at developing different ways of doing business to contribute to solving the more complex and varied problems in the housing system. It is now being accepted that, where appropriate risk sharing mechanisms are implemented, the public private partnerships can be an alternative route of funding and delivering cost-effective social housing projects.

A recent study undertaken by Infrastructure Partnerships Australia has revealed the benefits of PPPs over traditional procurement methods in infrastructure. Key findings of the report are presented below.

<u>IPA Report</u>

In December 2007, Infrastructure Partnerships Australia launched a landmark report titled 'Performance of PPPs and Traditional Procurement in Australia'. This major independent study was commissioned by IPA and undertaken by The Allen Consulting Group and Melbourne University. The study undertook a comprehensive analysis of 21 PPP projects and 33 traditional projects around the nation, allowing for the first rigorous and comprehensive comparison of traditional government-delivered and privately financed and delivered projects. The salient findings of the report were:

- PPPs demonstrate superior cost efficiency over traditional projects ranging from 30.8% (from project inception) to 11.4% (from contractual commitment to final outcome).
- In absolute terms, the PPP cost advantage was economically and statistically significant: On a contracted $4.9 billion of PPP projects, the net cost over-run was $58 million (not statistically significant). For $4.5 billion of traditional procurement projects, the net cost over-run was $673 million (statistically significant)
- With respect to time over-runs on a value-weighted basis, traditionally procured projects performed poorly. On a value weighted average traditional projects were completed 23.5% behind time. In contrast, PPPs were completed 3.4% ahead of time on average (This is measured from contractual commitment to project completion).
- PPPs are a proven vehicle to deliver government value for money in infrastructure procurement. Approximately $400 billion is expected to be spent on Australia's infrastructure over the next decade. With 10-15% market share, PPPs would create approximately $6 billion in potential cost savings (vis a vis traditional procurement) over the decade.
- Project size matters greatly in choice of procurement model. Project size and complexity has a marked (statistically significant) negative impact on time over-runs of traditional projects. In contrast timeliness of completion of PPP projects were not negatively impacted by size and complexity of the project.
- The study has uncovered the myth of sovereign 'risk free' borrowing rate. The report highlights the fact that the risk free borrowing rate is not actually equal to the cost of capital. An infrastructure project always has project risk associated with it, irrespective of the fact whether the public or the private sector undertakes it. Thus the cost of capital is equal to the risk free borrowing rate plus the project risk.
- In contrast to commonly held perceptions, PPP projects were far more transparent than traditional projects, as measured by the availability of public data for the study.

- The benefits identified in the study are conservative. Because the study was design and construction centric, it has not captured the long term value delivered from:
  - ✓ Whole of life asset management
  - ✓ Long term risk transfer
  - ✓ Young assets, full risks not adequately captured
  - ✓ Asset quality at end of concession period

A Case for PPPs in Social Housing

As an asset class public housing provides many positive attributes as a potential investment. It is considered that this has been an under-utilised asset class for PPPs.

With a co-ordinated approach and the right policy guidelines, there are compelling reasons (see below) to consider the PPP model for augmenting social housing stocks in Australia.

- There is a significant shortage of pubic housing and/or affordable private rental accommodation as evidenced by large and continuously growing public housing waiting lists.
- Housing is a natural economic asset in that it generates a rental income stream, albeit differing in detail, in both the public and private sector.
- Over the longer term a (potentially significant) increase in capital value should arise on the housing stock.
- Real estate as a class of investment is very well understood by trustees, funds managers etc so transactions costs can be expected to be low relative to some other more complex types of assets.
- Providing new public housing should not lead to any competition related problems of exclusivity or non-competition arrangements that can arise with transport related investments.
- Most state governments in Australia especially Victoria, NSW, South Australia and Queensland have made impressive starts in providing key social infrastructure through PPP procurement models (e.g. schools, prisons and hospitals). NSW has also initiated the first ever PPP in social housing in Australia. A co-ordinated and homogenous approach to these PPP's across State borders will also create the opportunity for further efficiency gains such as those enjoyed in mature PPP markets (detailed below)..

THE UK EXPERIENCE IN SOCIAL HOUSING

Most local municipal housing authorities in the UK are faced with the problem of deteriorating housing stock as a consequence of a lack of investment going back many years. The Government has resisted giving funds to authorities to enable them to bring the housing back into good repair and instead has encouraged investment from the private sector.

There were two principal ways in which such investment was introduced. The first and most common was introduced in 1988. It involved the authority transferring the housing stock to a not-for-profit entity like Registered Social Landlords (RSLs) which then raised private funds secured against the property. The price at which the property transfers was determined was by looking at the value of the rents generated from the property less the costs of carrying out the necessary repairs and improvements and the costs of managing the stock. This investment option has been very successful. Since 1988 over 900,000 dwellings have been transferred from local municipal housing authorities to RSLs.

In the last few years the Government has looked at PFI as an alternative to the transfer option. In a PFI transaction the housing stock remains owned by the local municipal housing authority. A private provider undertakes, in a 25 or 30 year Agreement, to refurbish and then manage and maintain the stock. The necessary investment is raised by the private provider. The authority pays a performance based fee to the private provider out of which the provider services debt, meets its contractual obligations in terms of the stock and repays its investors.

Source: PPPs – UK Case Studies – International Financial Services London, 2003-04 (www.ifsl.org.uk)

Case Study from Scotland

THE GLASGOW HOUSING ASSOCIATION

The transfer of the ownership and management of the City of Glasgow's entire housing stock to a newly created not for profit vehicle Glasgow Housing Association ("GHA"), was the biggest and most ambitious such venture to have been undertaken in the UK. Its aim was to tackle significant structural and social problems in one of Europe's most deprived areas engendered by a prolonged lack of public investment in the housing stock in the City.

Structure and Funding

The contractual structure was similar to that of a business transfer agreement but underpinned by a large number of ancillary agreements enduring, in some cases, for up to forty years after the original transfer date. A one-off purchase price was paid for the stock. The ancillary agreements were wide-ranging and encompassed all stakeholders.

Sources of funding for GHA included syndicated loan from UK and European banks and a suite of grants provided by the Scottish Executive. The funding structure was designed to facilitate second stage transfers to the community. The project was also designed to achieve a substantial VAT saving which was critical to the financing of the project and robustness of the business plan.

Risk Transfer

Unlike a conventional PFI transaction in which the majority of risk lies with the private sector, a broader concept of risk sharing between the sectors was adopted. This was largely driven by the fact that for political reasons, there could be no departure from a prescribed purchase price. This factor, combined with the scale of the

Project and the sensitivities of GHA's Business Plan, meant that a more collective approach to risk share was taken. In addition, the Project was one of great political sensitivity both in national and local terms. The perceived "privatisation" of Glasgow City Council (GCC's) housing was highly emotive and there was a concerted politically driven effort from some quarters to halt the progress of the Project by whatever means. Given the scale of the contractual liabilities being entered into by GHA, the risk of post-completion reduction (the transaction being set aside on any successful judicial review action), was not one which could be shouldered by GHA alone and steps were taken to ensure that this risk was shared.

Risk share was therefore broadly allocated as follows:

Income stream risk - GHA
Construction Risk - GHA
Due diligence risk - GCC
VAT risk - Scottish Executive/GHA
Legal Challenge risk - Scottish Executive

Unlike conventional PFI projects, which on the whole take place against a wholly commercially backdrop, the critical social and political focus and demands of the Project meant that a formulaic approach to risk allocation was unworkable.

Lessons learnt

Whilst exercises of this type (although not of this scale nor ambition) have been widely undertaken in England since 1988, the Project was a comparatively new departure in Scotland and the level of doctrinal opposition to the exercise and the resulting procedural challenges were a hindrance to progress. In addition, the complexity of the Project as it developed on the ground inevitably meant that all stakeholders had to be prepared to exercise flexibility in terms of delivering the Project in a manner as consistent as possible with the original political vision for the Project set out in the 1999 Framework Agreement.

Source: PPPs – UK Case Studies – International Financial Services London, 2003-04

Case Study from NSW

BONNYRIGG LIVING COMMUNITIES PUBLIC-PRIVATE PARTNERSHIP

The Project

The Bonnyrigg Living Communities Project is Australia's first social housing Public Private Partnership, also involving the development and sale of private housing.

The Bonnyrigg Estate, in Western Sydney comprises 933 dwellings, with 833 being social housing and the remaining private dwellings. Most of the social housing dwellings are at the end of its economic life or require major refurbishments.

In order to address this predicament the NSW Department of Housing sought to enter into a Public Private Partnership (PPP) to undertake the building of new social and private housing.

Among the requirements of Housing NSW:

- There should be no reductions in the number of public housing dwellings;
- The ratio of public to private housing should be no greater than 30:70.
- Private housing must be indistinguishable from the public housing, and must be well integrated with the public housing; and
- Public and private housing needed to be delivered contemporaneously.

The successful Bonnyrigg Partnerships consortium (Westpac, Becton, Spotless, St George Community Housing) were required to fund the design and construction of public and privately owned homes, improve the design and amenity of the precinct and community areas and provide support services for social housing tenants over the term of the agreement.

In order to maintain the required ratio, the consortium is to construct 2,384 new social and private dwellings in 18 stages over a 13 year period. The private development, therefore, provides an opportunity to cross subsidise the cost of the social housing whilst addressing the shortage of affordable housing.

Source: http://www.bonnyriggpartnerships.com.au/

The Bonnyrigg Project demonstrates the successes of combined action in the delivery of public dwellings – it is estimated that the cost of the project to the Government over the next 30 years is $386 million, representing an approximate 10% saving in comparison to traditional public sector delivery.

Furthermore, the added 1451 private dwellings represent much needed stock to be introduced to the Sydney housing market, at affordable prices.

Conclusion

IPA understands that the Department of Housing, NSW is considering options to structure Public Private Partnerships (PPPs) to ensure the quality of public housing stock and service delivery to tenants. Under these projects the private sector will be encouraged to invest in social housing infrastructure. IPA feels that there are strong lessons to be learnt from the UK experience in the social housing sector especially their successes in transferring the housing stock to RSLs which then could raise private funds secured against the property. IPA believes that effective partnerships will deliver value for money for the community, provide better and additional affordable housing, reduce high concentrations of public housing and deliver greater diversity in community outcomes, reduce maintenance liabilities (for the government) and implement best practice in urban design. It is essential that the government creates the right risk transfer, partnering approach, policy guidelines and certainty to engender greater private sector interest and involvement.

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