
New Financial Models

6 July 2016

HIGH-QUALITY SERVICES



CONNECTING



LOOKING AHEAD



Anger Based on Powerlessness

- 2007-16 GFC, the aftermath and the consequences
- Economic change
- Workforce restructuring
- Globalisation and the decline of the State
- Immigration and cultural fear

Income Inequality

Ratio of the Average Income of the Richest 10% to the Poorest 10% (2013 or latest)



Political Instability

- The '*Washington Consensus*' – Elites and collapse of party policy leadership
- Brexit – The collapse of two Unions
- Trump – Introspection and economic protectionism
- Australia – No one to be trusted
- The rise of economic geography:
 - Tasmania, South Australia, mining areas of Queensland and Western Australia
- The rise of minor parties – One Nation, Greens, Recreational Fishers Party, NXT
- 5 Leaders in 5 Years – The land of the throwaway Prime Minister



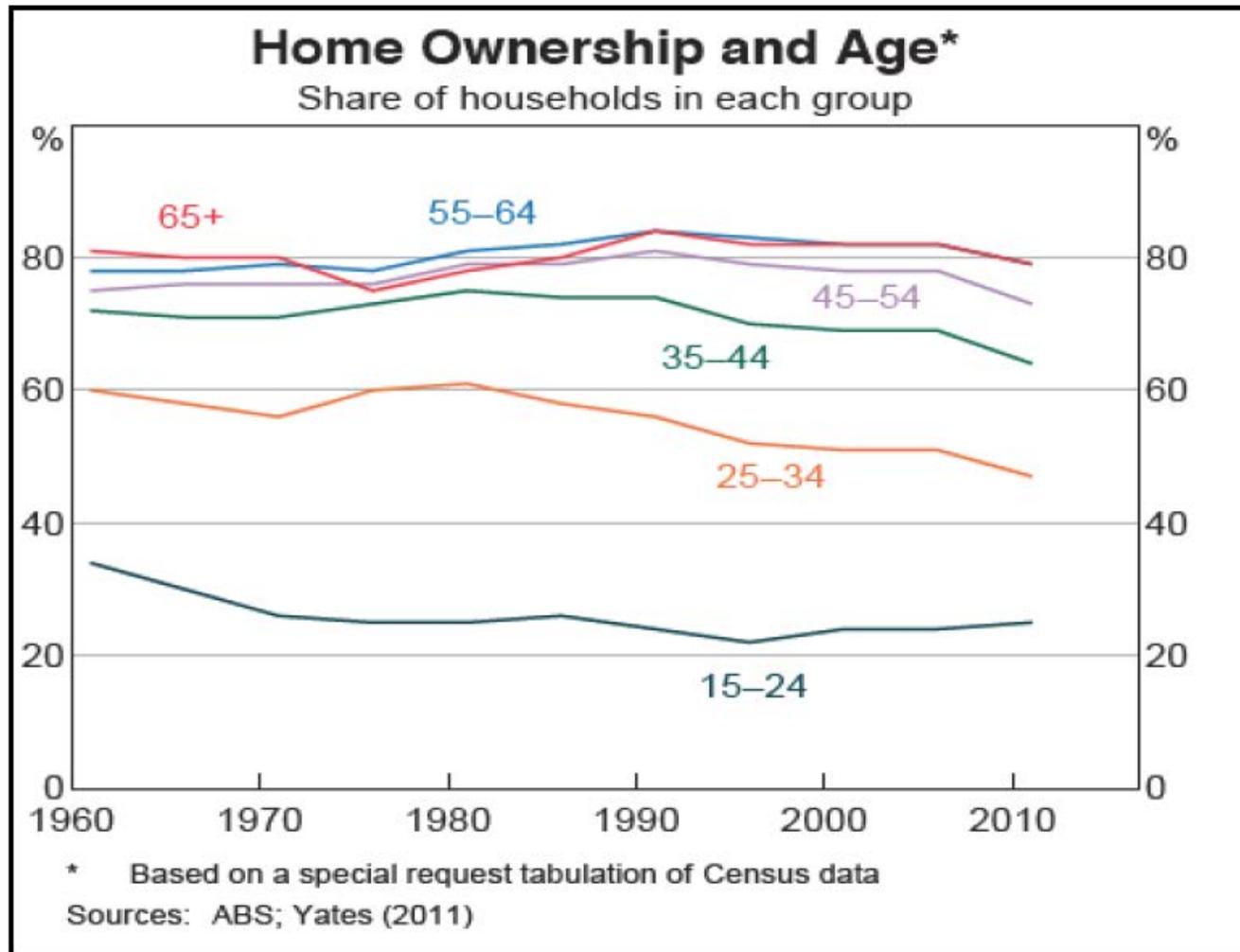
As Trump landed at Prestwick he was greeted by a Mexican mariachi band with a wheelbarrow full of bricks.

I love being Scottish 😂😂

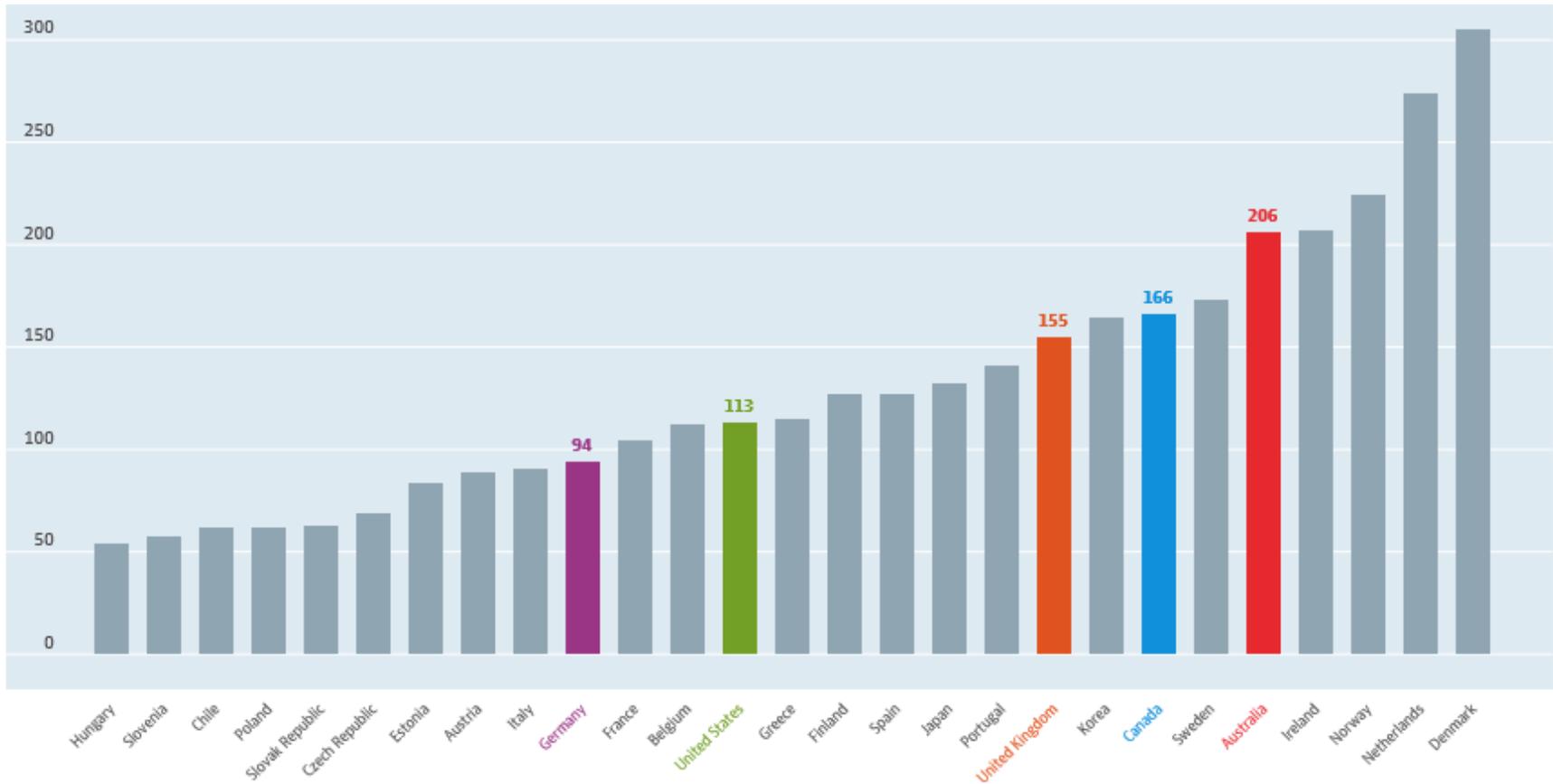
Why Housing might be relevant to this?

- The decline in home ownership and its consequences
- The rise in insecure tenures
- The spiral of decline in public housing

Home Ownership in Australia 1960-2010



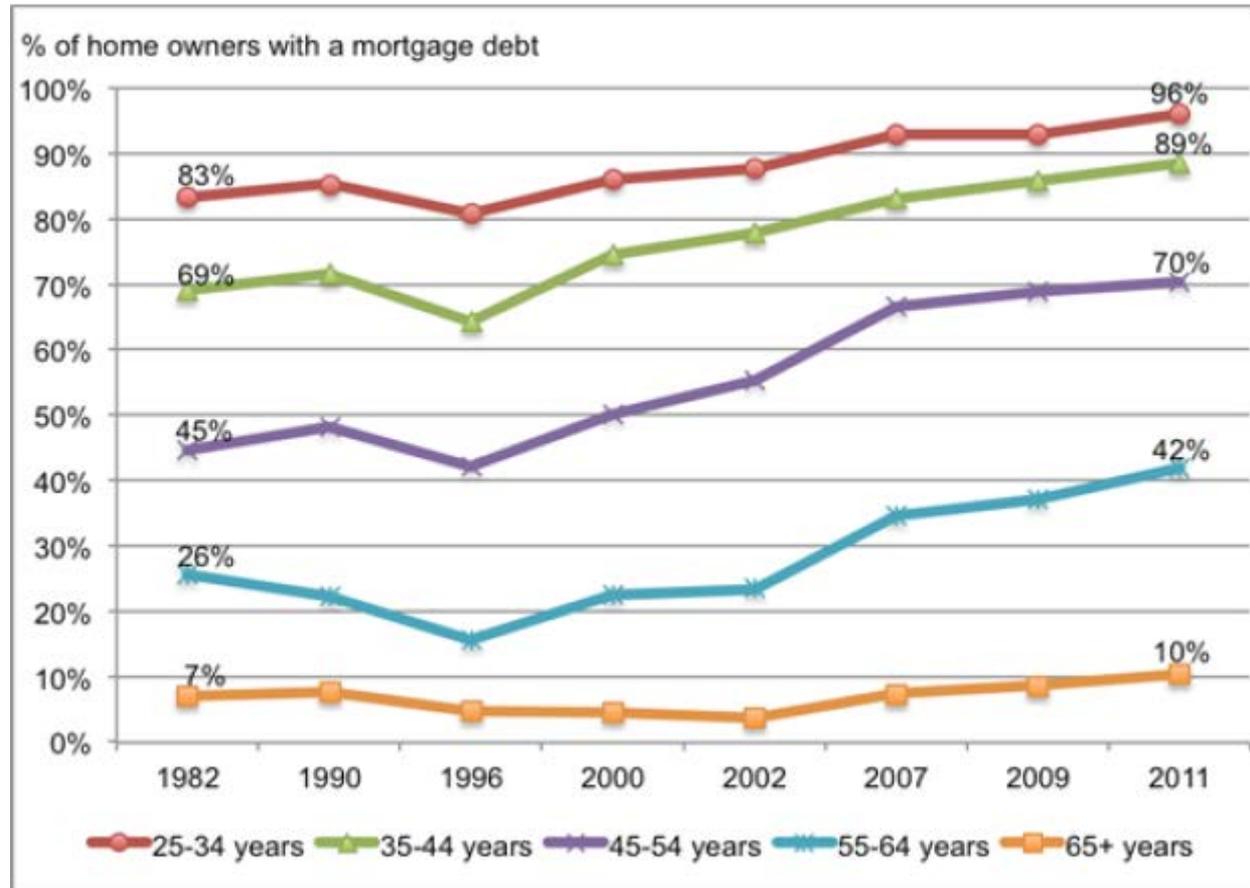
Household Debt – An International Comparison



Source: OECD, *National Accounts at a Glance*, 2015

Mortgage Indebtedness

Percentage of Home Owners with a Mortgage Debt, 1982-2011



Increasing number of households on the edge of home ownership

What is the financial gap?

Let's consider affordable home ownership

- **Someone on a very low income** - defined as those households earning less than 50% of gross median household income – for Melbourne this equates \$33,878 p.a.

*Median Price \$476,000 for a unit in Melbourne**

Dec qtr.2015 Valuer General



Very low income tenant is considered to be paying an affordable (30% of income) purchase price of \$164,216 for a house

- There is still a substantial gap between what people can realistically afford, and where the market is at



Shared Equity

- Two schemes currently running in Australia:
 - **Western Australia**
 - SharedStart – Government entity, KeyStart provides finance to purchase a property
 - Government retains up to 30% share
 - Options to increase share over time
 - **South Australia**
 - HomeStart Finance – Government entity providing a variety of loan options
 - Shared Equity loan option – No interest or loan repayment on equity portion until the house is sold
 - Geared towards purchase of the ‘right property first time’, savings made through not having to move to a bigger or better property later in life.
 - **Victoria**
 - If the Victorian Government is unwilling to set up it’s own lending authority – could it contract an interstate provider to introduce it’s retail products?

Rent/Right to Buy

- Rent to Buy
 - Suitable for Home Owners in financial difficulties
 - Buyers with low incomes
 - Operator provides majority of purchase funds and retains ownership on the title
 - ‘Contract’ and ‘Lease’ two separate documents
 - Regular payments consisting of rent and funds towards purchase price

- Right to Buy
 - Well established model in UK for Council houses
 - Purchase made at discount price
 - ‘Right to Acquire’ Housing Association option
 - Must have been a tenant for a minimum qualifying period

Affordable Home Ownership – Government Land Contribution

Let's consider the following scenario:

- The Government wants to build 1,000 affordable dwellings (2 bedroom, 1 bathroom) – what could this look like?
- To take advantage of potential savings the Government can contract out to Housing Associations (and Super funds) (20-30% savings on construction), and use surplus land (Places Victoria) or Public Housing Estate Renewal
- **Therefore land is free**
- Assume **\$323,000** average construction cost (not including land)
- Total construction costs of \$323 million

Home Purchaser
– 75%

Housing
Association or
Super Fund – 25%



- Dwellings sold @ **\$242,250** (75% of construction cost)
- Purchaser may need to borrow at least 80% - **\$193,800**
- Purchaser income of around **\$50,000** to sustain mortgage repayments on \$193,800
- Costs recouped: **\$242.2 million**
- Super Fund/Housing Association: Retains approx. \$80 million on balance sheet – actually higher as market value would be in the range of \$480,000 per dwelling
- **25% repaid** when either the household earns above **\$100,000** per annum, or dwelling is sold

Affordable Home Ownership – with land cost

Let's consider the following scenario:

- The Government wants to build 1,000 affordable dwellings (2 bedroom, 1 bathroom)
- To take advantage of potential savings the Government can contract Housing Associations (and Super funds) (20-30% savings on construction)
- Land has to be purchased
- Assume **\$378,000** average construction cost (including land)

Home Purchaser
– 75%

Housing
Association or
Super Fund – 25%



- Dwellings sold @ **\$283,500** (75% of construction cost)
- Purchaser to borrow at least 80% - **\$226,800**
- Purchaser income of around **\$60,000** to sustain mortgage repayments on \$226,800
- Costs recouped: **\$283.5m**
- Super Fund/Housing Association: Retains approx. **\$94.5m** on balance sheet – (actually higher as market value in range of \$480,000 per dwelling)
- Purchaser eligible to FHBG and Stamp Duty exemption
- **25% repaid** when either the household earns above **\$100,000** per annum, or dwelling is sold

Aged Housing

- Deferred Management Fees (DMF)
 - Well known model, generally includes:
 - entry fee,
 - service and maintenance fee
 - exit fee
 - Increasingly unaffordable for many
 - Recent negative press coverage due to hidden costs

- Life Long Leases
 - Responding to growing demographic of older renters
 - Limited savings and desire for housing security
 - Ability to capture pension and CRA
 - Long term tenure
 - No exit fees
 - Financial model dependant on turnovers

Insecure Home Ownership

- Between 2001-10 - **1.7m** Australians left home ownership every year
- Over one-third did not return by 2010; **34%** journeyed onto housing assistance programmes
- Dropping out estimated to add **\$393m** to government spending in 2009
- Between 2001-2010 - Around **60%** of Australian home owners cashed in some of their housing equity to borrow more (typically \$100k)

Housing Products?

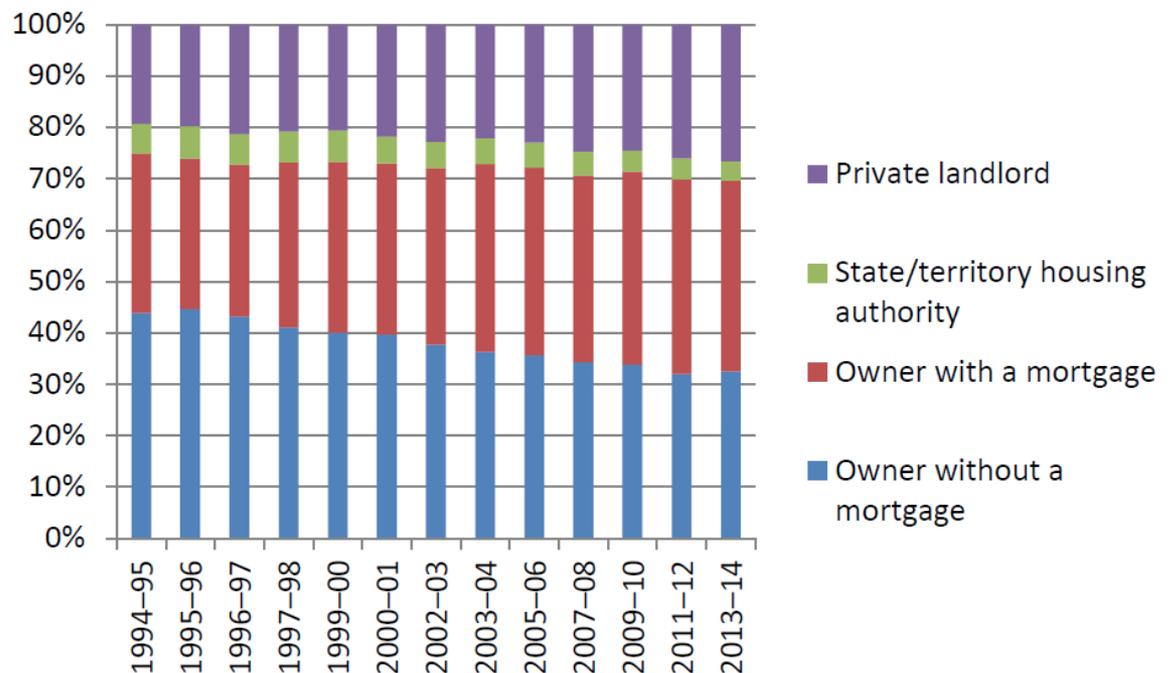
- Mortgage insurance for unexpected events
- Reverse mortgages for ageing households

Insecure Tenancies (Cont'd)

- Increasing numbers of people in private rental
- Long time private renters now outnumber public housing renters
- Opportunity for reform to the sector?
- Rights are not evenly spread between owner and renter
- Private Rental Brokerage Programs assisting vulnerable households access and sustain tenancies

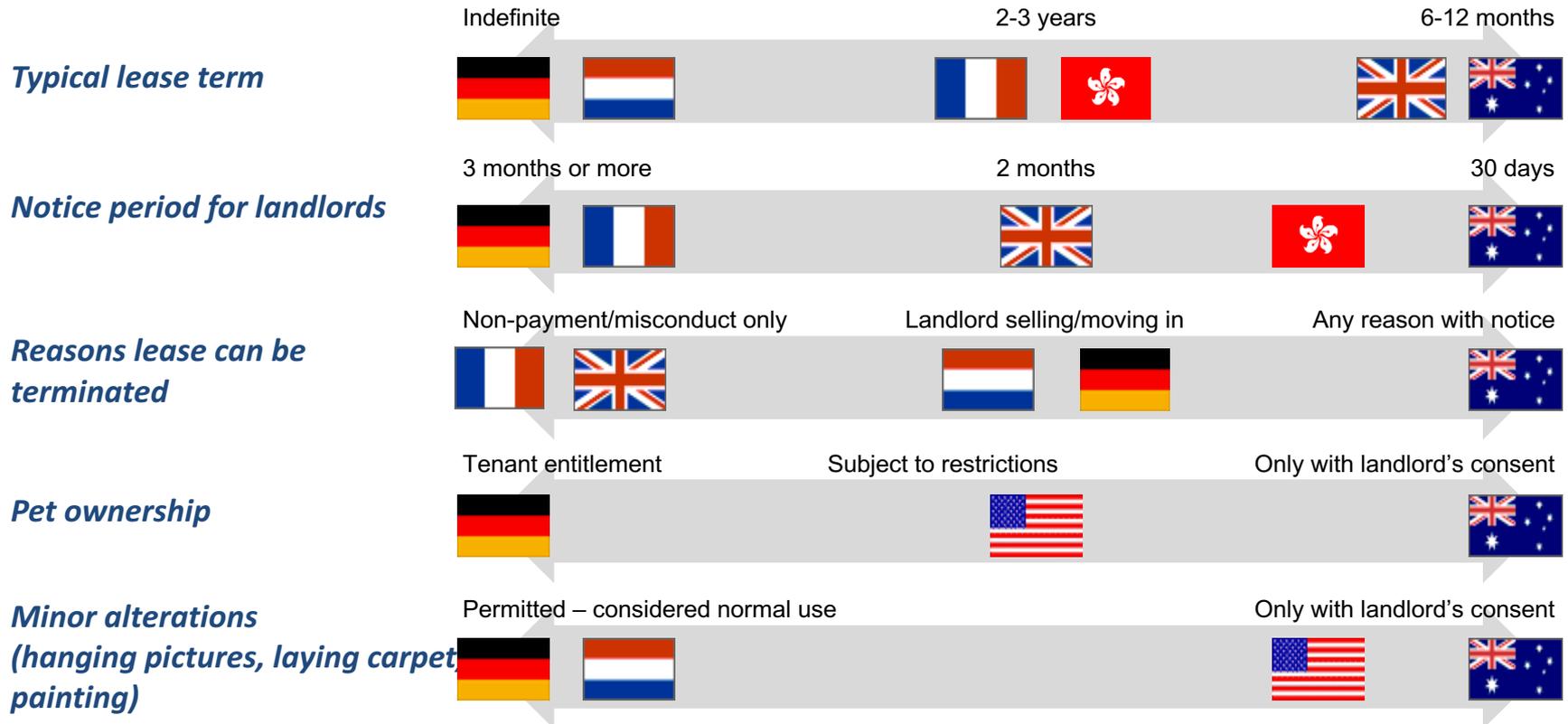
Housing Tenures 1994-2014

Source: ABS



Australia compared to other nations

International comparison of rental conditions



Source: Grattan Institute Presentation: analysis in *Renovating housing policy*

What is the financial gap?

Let's consider affordable rental

- **Someone on a very low income** - defined as those households earning less than 50% of gross median household income – for Melbourne this equates \$33,878 p.a.

*Median Rent \$400 per week for 2 bedroom house – Melbourne**

Dec qtr. 2015



Very low income tenant is considered to be paying affordable rent when the rent is \$195 per week

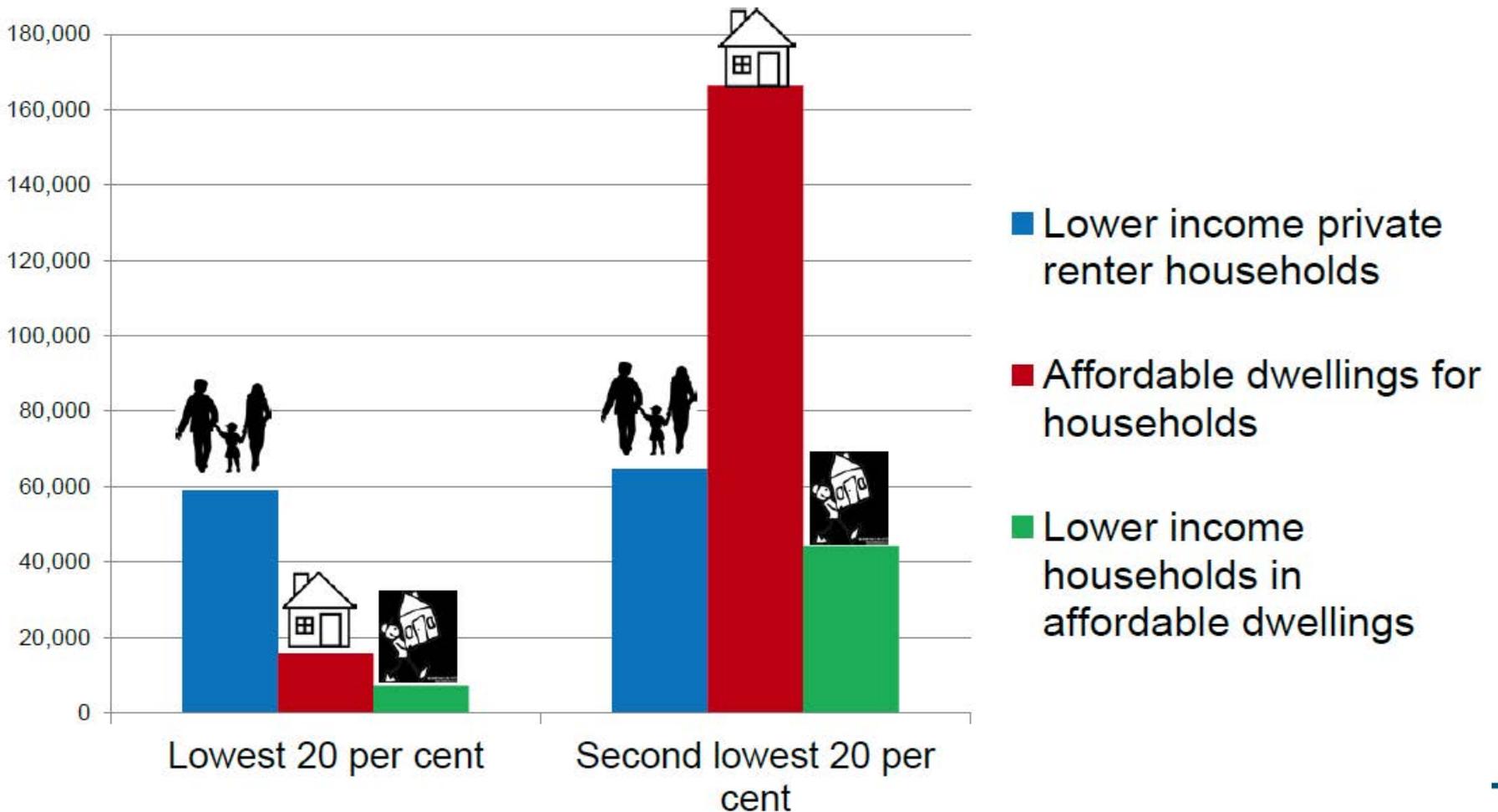
- There is still a substantial gap between what people can realistically afford, and where the market is at



Shortages of Affordable & Rental Stock

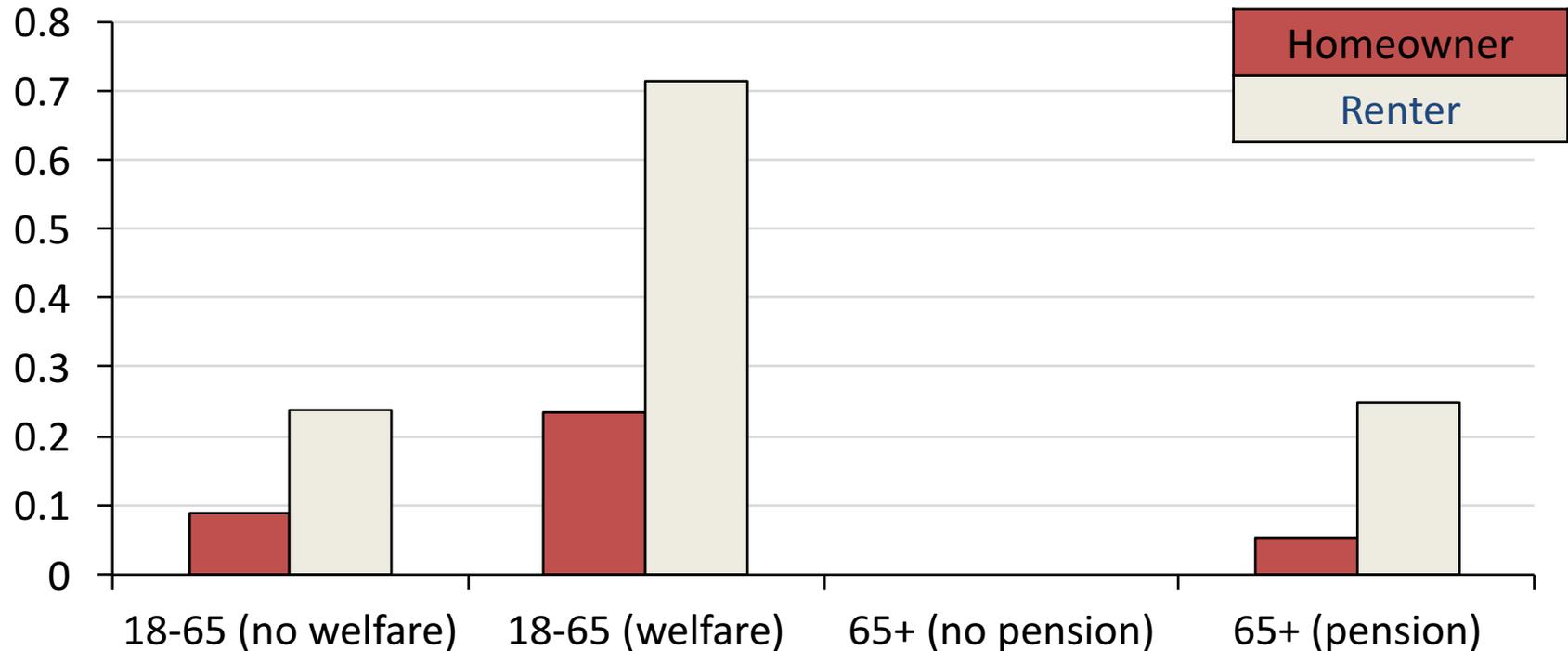
Shortages for low income households in Victoria

Source: AHURI, 2015



Low incomes face higher financial stress

Average number of financial stresses, 2009-10



Source: HES (2009-10). Grattan Institute Presentation, 2016

Notes: This measure of financial stress is built from four questions on the HES survey relating to whether, due to money shortage a given household: 1) skipped meals; 2) did not heat their home; 3) failed to pay gas, electricity or telephone bills on time; or 4) failed to pay registration insurance on time. The y-axis value is the average number of affirmative responses for the category.



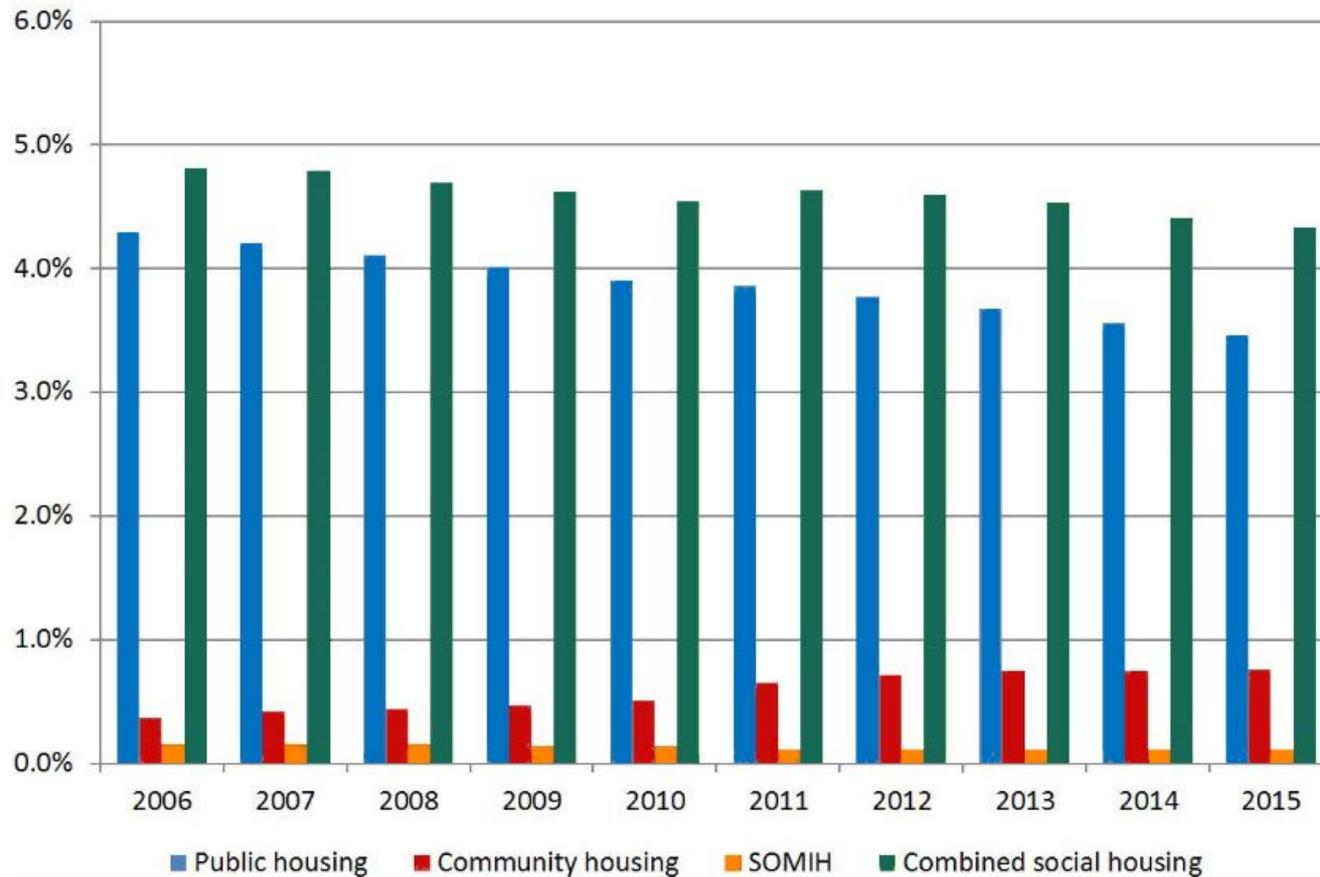
Public housing dwelling stock (number), Victoria and Australia



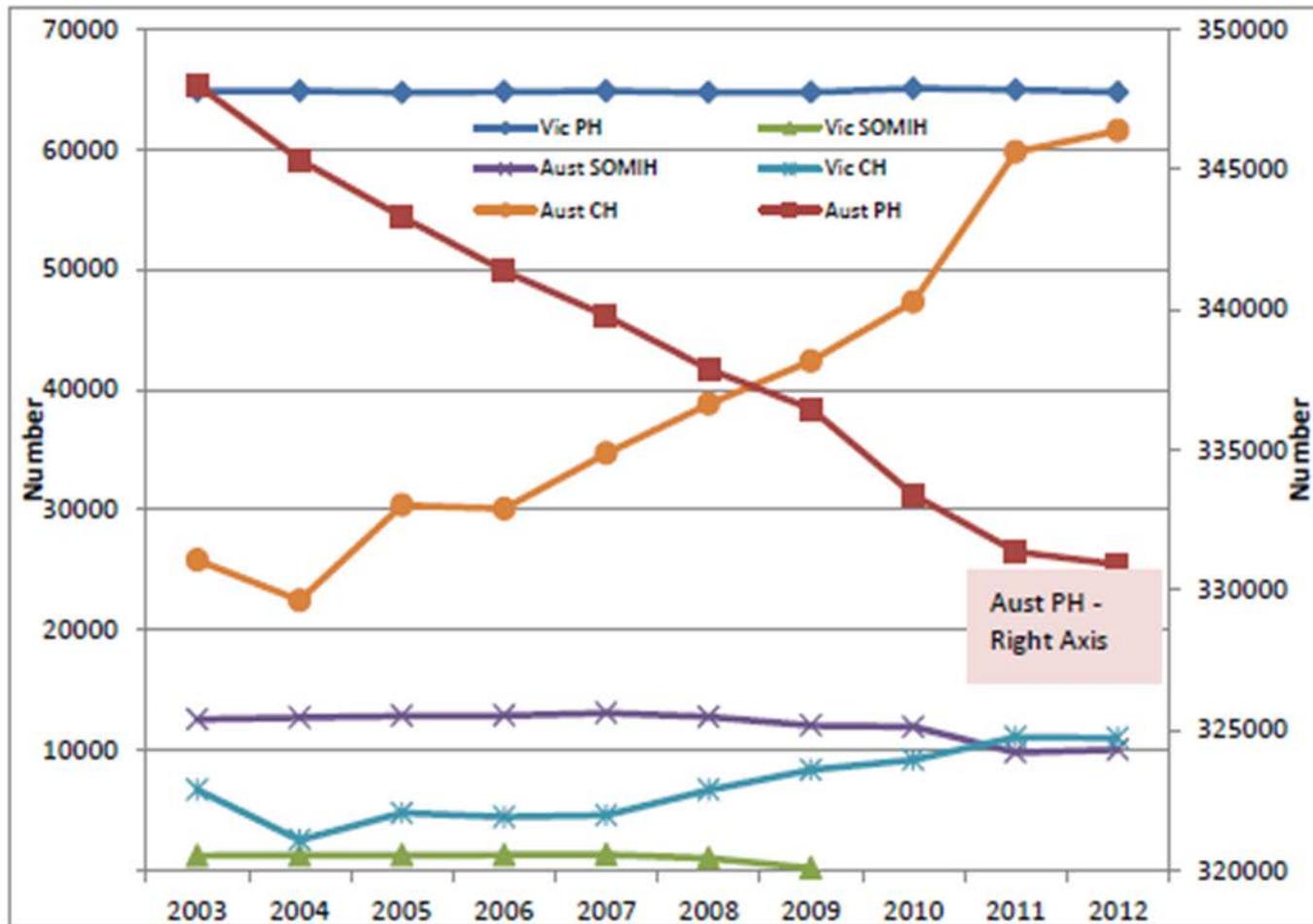
Data source: SCRGSP 2013.



Spiral of Decline in Social Housing



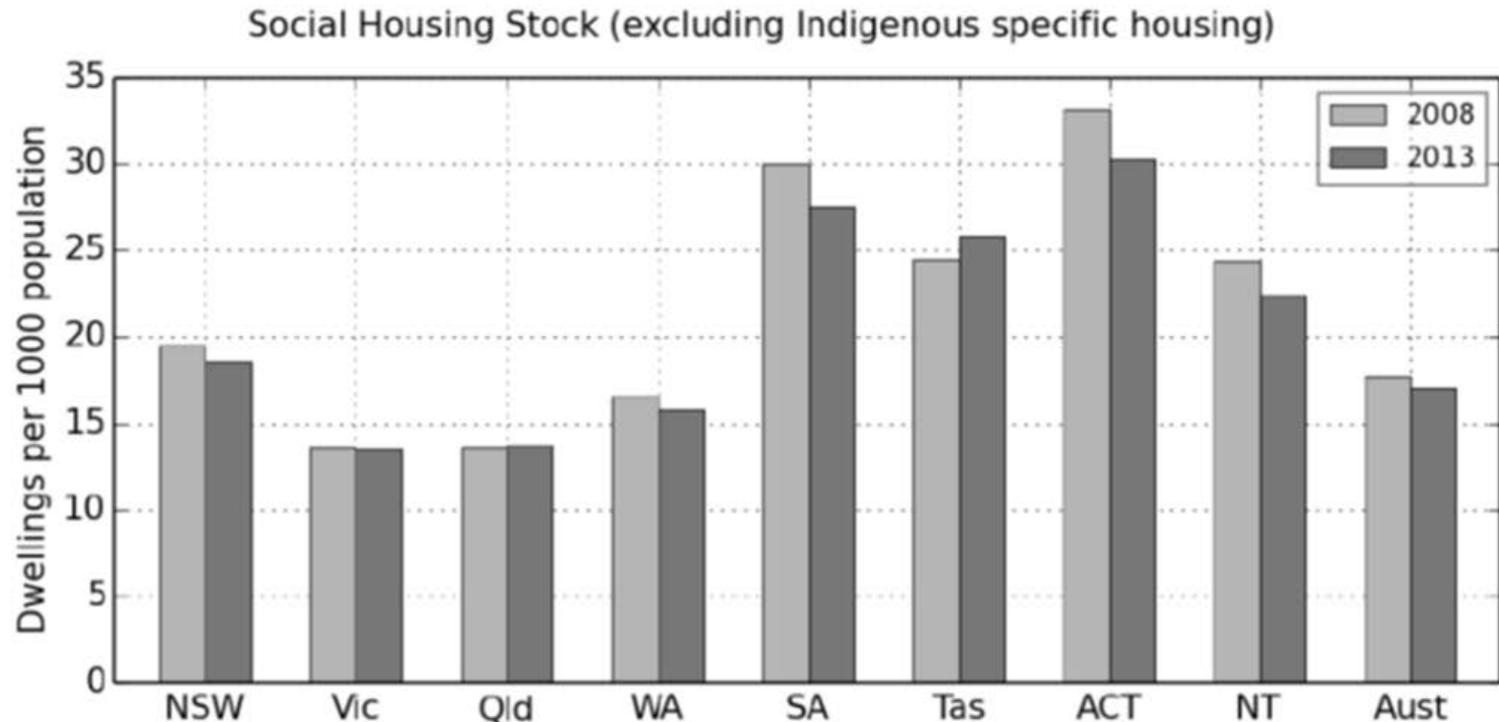
Social Housing, Victoria and Australia



Data source: SCRGSP 2013.



Social Housing Stock Numbers Declining



Source: ROGS 2014, Table 17A.3; ABS 3101

*To recover 2005 % of public housing dwellings to 1.25% of population – immediate capital of \$4.2B required (additional 11,000 dwellings)

Key Victorian Issues

- Halt the decline in stock numbers
- Capital investment / renewal of public housing estates
- Adopt either publically funded new supply

OR

- Make private finance possible



System Reforms

- Harness Private Capital
- Transform Commonwealth Social Housing Funding
- Encourage Innovation and Reform



National Responses?

1 Harness Private Capital to Reform Housing Delivery

- Commonwealth Government should establish a financial intermediary to facilitate efficient access to long term finance, via bond market
 - Establish the organisation, modest operational seed funding
 - Underwrite limited element of risk to ensure market acceptance

- Institutional investment in affordable, accessible & social housing delivery by:
 - Stabilising rent payments through automatic debit from Commonwealth benefits
 - Establishing uniform light touch – but robust – Commonwealth led National Regulatory System for social, affordable and accessible providers within 3 years
 - Registration a condition of accessing non-market finance and public land benefits
 - Providing investor certainty on the structure of social and affordable housing subsidies over forward estimates, including the role of CRA

2 Transform Commonwealth Social Housing Funding

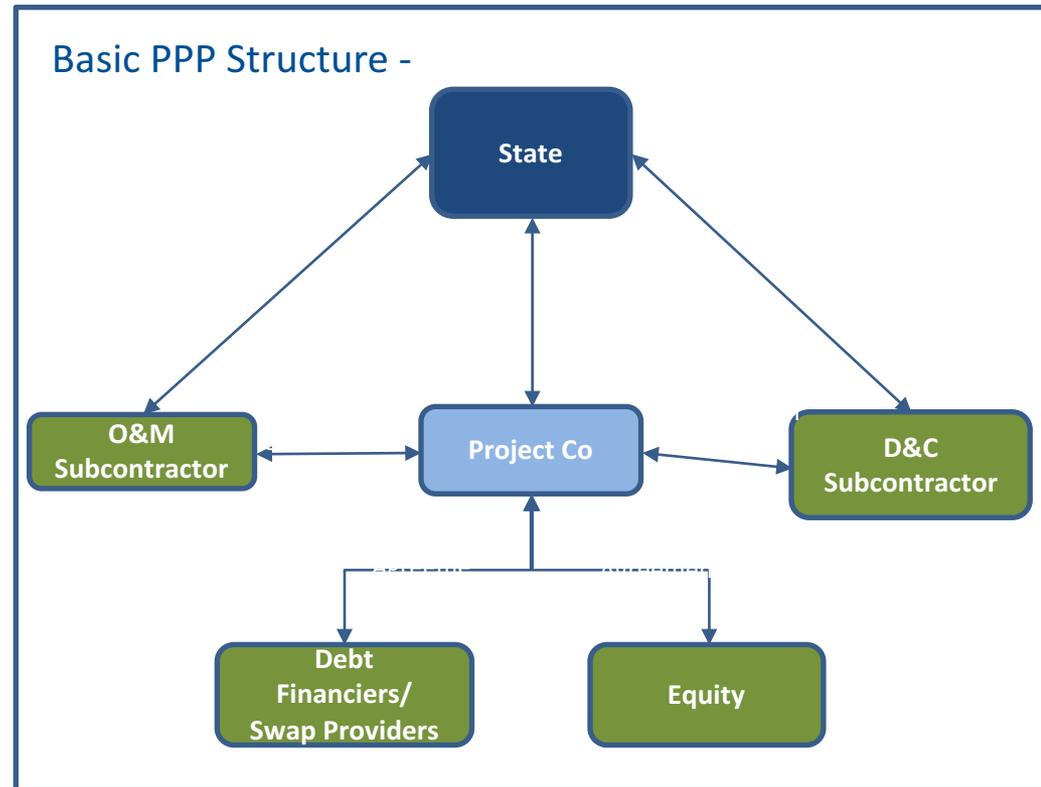
- Commonwealth Government provides substantial support for social housing through direct payments to States and CRA
 - Outcomes are unclear
 - Innovation and Contestability not supported
- Reform of NAHA
 - Reinstate matching State and Territory contributions
 - On-going investment in agreed core areas of social and affordable housing renewal and supply
 - Fund outcomes should be measurable and relevant
- CRA Reform
 - Unclear how effectively payments support low income renters in the private market
- Tenancy management and asset transfer to the NFP sector supported for efficiency and contestability
 - Public housing tenants eligible for CRA
 - Matching reduction in direct support for State Housing Authorities

3 Encouraging Innovation and Reform

- Commonwealth led Independent Affordable Housing Taskforce
 - Promoting better supply and dissemination of information
 - Innovation in sustainable and accessible construction practices
 - Affordable housing financial structures promoting the transition on the housing continuum
 - Sponsoring pilot projects
 - Support leveraging of underused land of all levels of Government
 - Targeted incentives
 - Planning options – Inclusionary zoning and value capture

New financial models – NSW/NZ style PPP

- **State** – Generally a State Government (AA/AAA Rated)
- **Project Co** – Special Purpose Vehicle Owned by private sector investors
- **Project Deed** – Sets out the rights and obligations of each party for project delivery
- **O&M Subcontract** – Passes on O&M services obligations (fixed-price, fixed time)
- **D&C Subcontract** – Passes on design, construction and commissioning obligations to D&C Subcontractor (fixed-price, fixed time)
- **Debt Financiers/Swap Providers** – Generally consists of non recourse senior bank debt plus interest rate swaps
- **Equity** – Owners of Project Co, enter into a project agreement with the State and pass relevant obligations through to sub-contractors



Conclusion

What should Treasurer Pallas cover in his forthcoming statement on affordable housing?

1. Ways to address the decline in low cost entry to home ownership
2. Reforms to the private rental market in favour of the tenant
3. Mobilise investment to stabilise public housing
4. Make transparent the use of housing resources through NAHA and the State
5. Enter into a dialogue with the Commonwealth and national reforms to affordable housing
6. Agree financial models to deliver new supply of affordable and social housing stock.