The Frontier Line

Thought leadership and insights from Frontier

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Australia lags on affordable and social housing

About us

Frontier has been at the forefront of institutional investment advice in Australia for over twenty five years and provides advice over more than $450 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Frontier's purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.

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Consultant

Bianca Ray joined Frontier as a Consultant in 2016 and provides consulting support to a number of clients and undertakes investment and manager research with a real assets focus. Bianca has experience in direct unlisted investment, management and valuation of commercial real estate spanning across Australia, UK and Europe. Spending over 10 years in the United Kingdom working at Prime Commercial Properties, Henderson Global Investors and Lunson Mitchenall in London, and with Coles Group and Herron Todd White in Australia. Bianca holds a Bachelor of Business (Property) with Distinction from RMIT University and is a Member of the Royal Institution of Chartered Surveyors and an Associate of the Australian Property Institute.

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Jennifer Johnstone-Kaiser joined Frontier in 2018. Jennifer leads Frontier's property research program providing consulting and research for clients, both domestically and globally. Jennifer has held many senior positions, most recently as Country Head and Director of Business Development with Savills Investment Management. Before this Jennifer was Mercer's Head of Real Estate - Asia Pacific and worked with consultancy firm Pinnacle Property Group. Jennifer is a Senior Fellow of Finsia and sits on the Property Council's Market Trends Roundtable and Global Investment Group. She holds a Master of Finance and Bachelor of Business, Property (Distinction).

Australia lags on affordable and social housing

Housing distress is detrimental to people's ability to earn, learn and contribute positively within their families, local communities and beyond.

"For every $1 invested in affordable housing, the community benefits by $3 due to worker retention, educational benefits, enhanced human capital, health cost savings, reduced family violence and reduced crime. It is an investment in both essential infrastructure and people that compounds over the long term."[1]

This paper looks at the social and affordable housing market in Australia, challenges in policy, and delivery approaches across state and federal governments. We also look at the US and UK markets where private capital is playing a meaningful role in delivering social housing and whether there are lessons to be learned for Australia.

Frontier supports investments into needs-based real estate, such as housing, for the differentiated characteristics to traditional macro sensitive real estate. Growing demand in the sector due to the rise in housing unaffordability and undersupply of affordable housing stock suggests Australian institutional capital could be taking a proportionately greater role in what historically has been a public sector responsibility. As we review the investable universe for social and affordable housing in Australia and its limited opportunity for institutional investment to date, we identify the key challenges the sector faces:

- Insufficient and inconsistent tax policy. We identify four key policies including capital gains tax, negative gearing, land tax and stamp duty, and GST where federal, state and territory governments could optimise incentives, often already awarded to smaller private investors or build to sell developers.
- Lack of build to rent (BTR) housing sector that would support an institutional housing platform. Frontier actively reviews and assesses global residential markets including US multi-family and UK private rented sector. These established markets provide private capital a management platform to access social and affordable housing subsectors.
- Low return outlook for social and affordable housing in Australia. Below market rents and weak government incentives limit the appeal for financially motivated investors.

[1] Source: Affordable Housing Strategy, 2020 City of Melbourne

Introduction

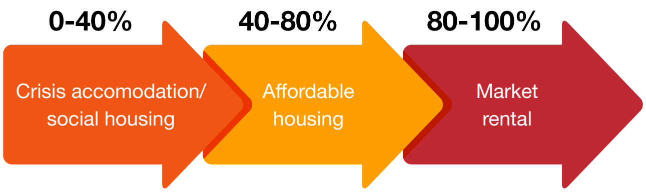
Providing access to housing for those who need it the most is an essential form of social infrastructure. Not having safe and stable accommodation is often a barrier to educational attainment, stable employment, good health, family and community contribution and relationships.

There are several types of subsidised housing at various levels of market rent including social, affordable, key worker and crisis accommodation, to meet the specific needs of individuals and families. This paper focuses on the social and affordable housing sector.

Social housing is defined as long-term rental accommodation which is subsidised by government, for people on a very low to low income[2], based on a required eligibility criteria and waitlist.

Affordable housing is defined as subsidised housing which caters for the needs of low to moderate income households and priced so these households are also able to meet other basic living costs[3]. According to NSW Affordable Housing Ministerial Guidelines 2018-19, housing is usually considered affordable if it costs less than 30% of gross household income or less than 75% of market rent. However, it is important to note that definitions of social and affordable housing vary slightly in each state and territory and there is no unified definition across Australia.

Chart 1: Indicative subsidised housing costs relative to market rentals



Social and affordable housing are often defined by different key measures, methods of assessment, and the institutions via which tenants access housing.

	Social housing	Affordable housing
Rent	% of income	% of market rent
Individual admission	Government priority lists	Eligibility based
Operators	Government and community housing providers (CHP)s/ non-government organisations (NGO)s	CHPs/NGOs

Across Australia, the supply of social and affordable housing is not keeping pace with need. With an estimated one million social housing dwellings needed over the next decade[4], there are significant shortages across all states and territories in Australia, that continue to widen. As at January 2020, there were over 210,000 people on housing waitlists across the country[5].

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[2] Definitions of very low, low and moderate income varies in each state. For example, in NSW: i) very low-income household earns less than 50% of the median household income in the relevant state; ii) low income household earns 50%- 80%; iii) moderate income household earns between 80%- 120%. In Victoria, Governor in Council Order sets out the income ranges for very low, low, and moderate-income households (per the Victorian Planning and Environment Act 1987). These are periodically updated (planning.vic.gov.au/policy-and-strategy/affordable-housing/resources)

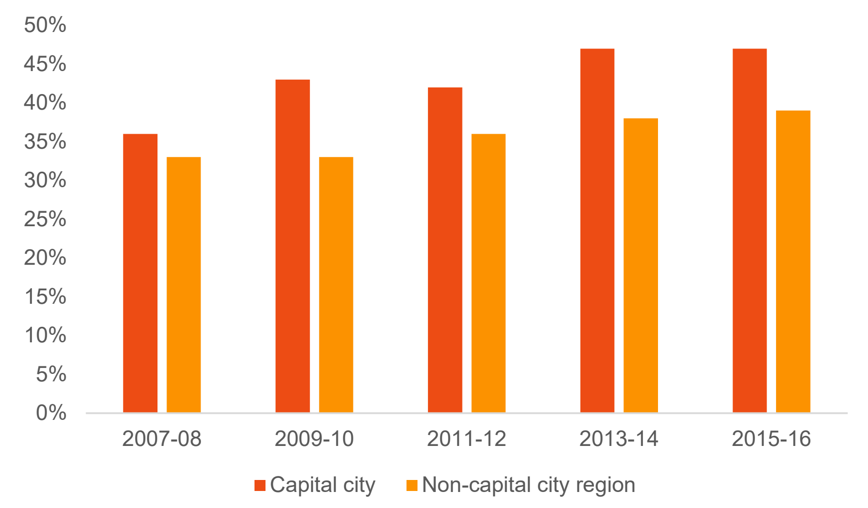
[3] Per footnote 2 above

[4] Source: Troy & Randolph 'Estimating need and costs of a social and affordable housing delivery', City Futures Research Centre, UNSW Sydney,2019

[5] Source: Productivity Commission, Report on Government Services 2020

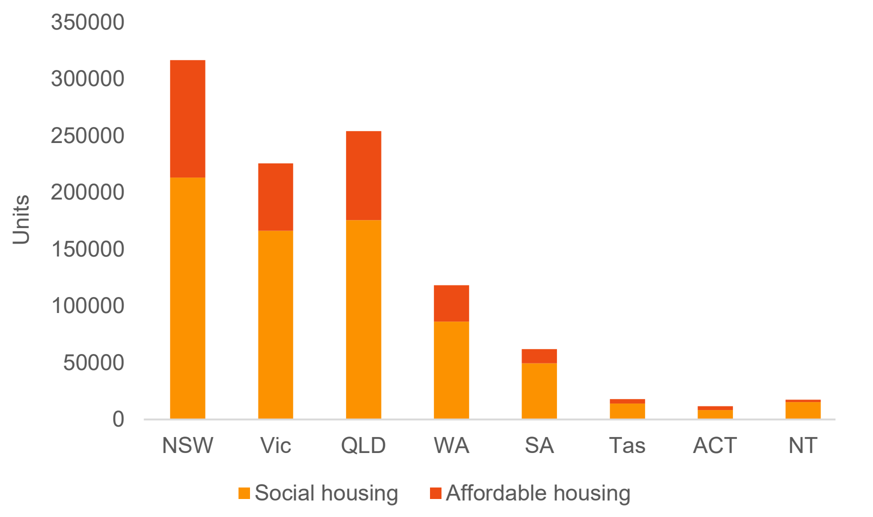
Equally the pressure on low-income households grew notably over the four years to 2015-16, where 47% of low-income renters in capital cities were paying more than 30% of their income in rent[6].

Chart 2: Proportion of low income households in rental stress



Source: CHIA 2018 national plan for affordable housing.

Chart 3: Social and affordable housing required by state (2019-2036)



Source: Troy et al. (2019).[7]

The need for adequate social and affordable housing is further exacerbated by the fact ageing stock does not match current needs. Public housing stock built in the 1950s and 1960s was mainly designed to accommodate working families in three bedroom houses. Today's tenants are more likely to be single person households (57% of public housing households), leading to under-utilisation of public housing dwellings. In 2016, 16% of public housing dwellings were under-utilised.[8]

[6] Productivity Commission. Report on Government Services, 2018. Table GA.2

[7] According to the study, housing need is split into two categories. The first category is households in the bottom income quintile ($400, $800 and $1,000 per week for singles, couples and families respectively) for Australia and requiring social housing, requiring a higher level of housing subsidy. The second category is households belonging to the second income quintile ($500, $1,250 and $1,750 per week for singles couples and families) and are experiencing housing stress, requiring a lower level of subsidy.

[8] Source: https://www.ahuri.edu.au/housing/policy-analysis/public-housing-renewal-and-social-mix

Key players in Australia

Governments at all levels, developers, community housing providers (CHPs) and charities are key to the successful delivery of social and affordable housing in Australia.

Governments are responsible for policy setting, regulation, and provision of subsidies. It is unlikely we will see a delivery model in the near term in Australia that can be sustained without direct or indirect government subsidies (e.g. direct contributions to tax and planning incentives, and bond guarantees).

Developers and builders are vital players in the market, bringing new stock into the sector, either through new developments, refurbishments or a combination.

CHPs and charities are the providers who ultimately make housing developments successful by introducing and managing residents and maintaining the community. They are mission-driven, not-for-profit organisations that own, develop and maintain rental housing in the social and affordable sectors.

Regulatory and policy framework

"There has been no overarching planning process for settlement in Australia since the 1990s"[9]

Currently, there are federal, state and local council level schemes running in conjunction to support the provision of social and affordable housing. The regulatory framework is extremely complex and there is no clear and coherent policy across Australia.

At the Federal level, programs include the National Housing and Homelessness Agreement (NHHA) and the National Housing Finance and Investment Corporation (NHFIC).

The NHHA is a joint initiative by the Commonwealth and state governments to improve the provision of housing across the housing spectrum, and requires the states to allocate funding from the Commonwealth to housing and homelessness services.

The NHFIC was established by the Commonwealth as an agency that offers loans, grants and investments to encourage the construction of affordable housing and related infrastructures.

At the state level, there are policy and organisational duplications and inefficiencies.

In NSW, the funding and management of social and affordable housing programs have been led by the Department of Communities and Justice (DCJ) (along with the Aboriginal Housing Office (AHO) and Land and Housing Corporation (LAHC)). The DCJ is responsible for negotiating funding from the Commonwealth under the NHHA, and commissioning and managing the delivery of social housing; affordable housing is delivered by other providers on behalf of the DCJ. There are numerous schemes that are currently running, some with overlapping objectives.

In Victoria, there are three key players involved in the provision, regulation and management of social and affordable housing:

- Director of Housing for the Department of Health and Human Services Victoria (DHHS) provides policy development; funds and leases housing to registered agencies; funds housing support and homelessness services; and owns and manages a portfolio of social and affordable houses.
- Registrar of Housing Agencies is supported by the housing registrar unit of DHHS and registers community-based organisations that provide affordable housing.
- Registered housing agencies (not-for-profit, NGOs) develop or manage social housing, comprising registered housing associations and registered housing providers.[10]

In Queensland, the Department of Housing and Public Works (QDHPW) has a key policy role for social housing. On-the-ground delivery is through the Department of State Development, Manufacturing Infrastructure and Planning (DSDMIP) and local governments. For affordable housing, key drivers are DSDMIP frameworks and national policy settings such as the NHFIC and tax incentives. QDHPW also has a catalyst role here, providing policy and some financial input.[11]

[9] Source: ISA, 'Fixing Affordable Housing in NSW and Beyond', 2020

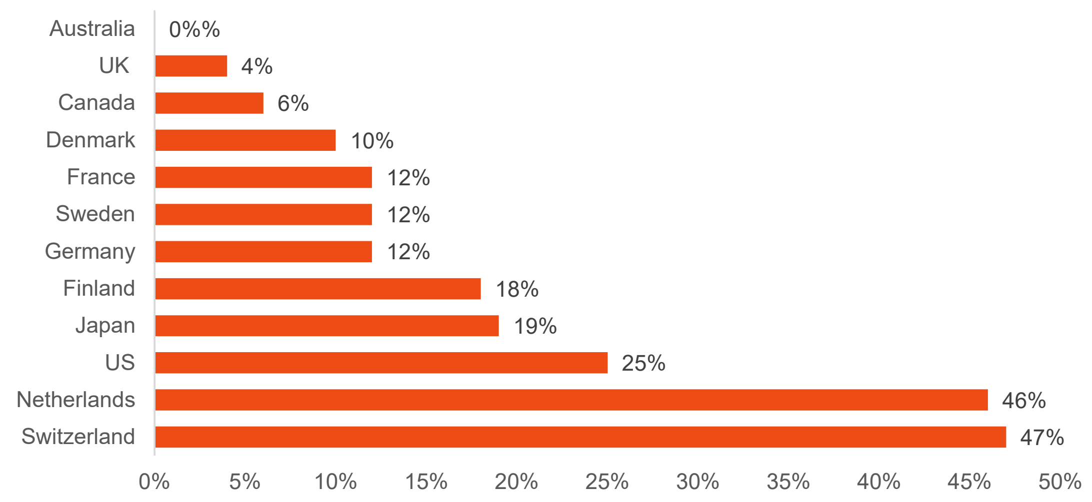
[10] An independent 'Review of Social Housing Regulation' was announced in November 2020. This is part of the Victorian Government's $5.3 billion 'Big Housing Build'.

[11] Sustainable Built Environment National Research Centre, 'Queensland Social and Affordable Housing Network Maps', 2020

Challenges to developing an Australian portfolio

The BTR sector in Australia is in its nascency compared to other developed international markets, and housing is not a meaningful allocation in institutional real estate portfolios.

Chart 4: Residential as a % of global institutional portfolios



Source: IPD, NCREIF, LaSalle Investment Management.

In recent years, some sector growth in Australia has evolved but this is not meaningful in terms of completed and operational stock. In terms of pipeline, it is estimated that 16,000 housing units are proposed by developers such as Assemble, HOME, Mirvac, Greystar, Investa, Sentinel and Blackstone. Of this pipeline, approximately 9% is currently under construction.[12]

We do not have transparency to individual/retail investor returns for the private rental market in Australia, however development projects across BTR target a stabilised ungeared IRR of approximately 6%[13], which provides an indication for expected returns. Given operational stock is limited, sector return transparency is not available. Tax treatment for institutions is unfavourable relative to individuals and holding back the Australian BTR sector evolution.

There are a series of challenges to developing an Australian portfolio.

- Firstly, the capital gains tax discount of 50% available to individuals is not available for institutional investors.
- Secondly, institutional investors cannot claim mortgage costs against residential assets as can individual investors, known as negative gearing.
- Thirdly, land tax and stamp duty frameworks are state and territory controlled and overall disincentivise large scale institutional investors when compared to individuals or smaller landlord investors. Large scale BTR properties are assessed for land tax on the whole estate and this cost cannot be passed onto the residential tenants. The land tax exposure of single rental residential property, commonly held by smaller investors, is assessed differently often resulting in lower land tax exposure.
- Fourthly, the treatment of GST. Investors in BTR cannot claim credits on construction and other ongoing costs associated to managing residential property as GST does not apply to rental payments received by landlords.

In 2020, the NSW government, followed by Victoria, announced land tax discounts for build to rent developments that would approximately halve land tax exposure. This has been welcomed by developers and asset owners already investing into build to rent. While reports suggest this initiative could provide a development premium of at least 100 bps it will be interesting to see if this measure is enough to adequately draw material institutional investment into the sector.

[12] EY Build-to-Rent – Sector Update April 2021

[13] ibid

It is also worth highlighting that in contrast to the unfavourable tax environment and lower returns available to institutional investors in residential real estate, other segments (retail, office and industrial) have historically provided attractive returns. This has been a contributing factor to the lack of institutional capital participation in the residential housing sector.

Given the absence of a BTR market in Australia, it is unsurprising that an investable social and affordable housing market has not developed. These segments, by definition, will have lower than market rentals, and for the returns to be attractive for institutional investors, government incentives and support will be required.

Chart 5: MSCI Australian property total returns as at 31 December 2020

Source: MSCI

Implementation examples in Australia

Institutional private capital has played a relatively minor role in the social and affordable housing sector in Australia to date. Main participation channels have been through:

Social bonds issued by NHFIC

NHFIC is responsible for the Affordable Housing Bond Aggregator (AHBA) that provides low cost, long-term loans to registered CHPs to support the provision of social and affordable housing.

NHFIC funds AHBA loans by issuing its own bonds into the wholesale capital market. These low-cost loans offer interest rate and term advantages for CHPs compared with typical bank loans. $1.2 billion has been issued to date and attracted both local and offshore investors. Major investors included Cbus, UniSuper, CareSuper, Blackrock, AIA, QIC and QBE Insurance.

Real estate equity investments

Institutional investors, supported by internal capabilities, have mobilised in some cases to invest directly into assets to address housing affordability. For example, investors such as HESTA and AwareSuper have targeted developments supporting key worker housing (e.g. teachers, nurses, emergency services and social workers). The economics in this instance is reportedly supported through acquiring discounted residential stock from developers at an average discount of 20%, providing the ability to pass on a rental discount to a market value of 20% to qualifying key workers.[14] Other examples include AustralianSuper's 25% investment into affordable housing developer Assemble Communities and HESTA's partnership with the CHP, Nightingale Housing and not-for-profit group Social Ventures Australia.

Infrastructure equity investments

The Redfern BTR project in inner-Sydney, led by the government's LAHC, provides an example of a PPP investment structure, where the development will revert back to government ownership at the end of the term. While delays remain, LAHC has identified three shortlisted groups including Compass Housing Services, Frasers Property and Hume Community Housing Association, Capella Capital, Lendlease Building and Evolve Housing. The project is intended to generate a mix of social, affordable and market rate private rental housing.

While the above case studies are encouraging, they are relatively small for a sector that needs in the region of $20 billion of investment per annum over the next decade.The majority of the case studies we observed dominated the NSW and Victoria regions, which lead in terms of housing unaffordability and shortage of stock.

[14] Investment Magazine, 'Funds look to affordable housing as commercial property faces headwinds', October 2020

Global industry insights

Government incentives will be key to unlocking more broad-based investment in the sector. Equity investment in particular, is difficult for the sector because the rental return on social and affordable housing is necessarily less than in standard residential accommodation and other segments of commercial property.

This table provides examples of areas which governments can directly influence through financial, regulatory/planning and tax incentives.

Financial	Regulatory	Tax
• **Subsidise development costs** • **Grants** • **Financing costs** — Government guarantees — Lower interest rates	• **Planning regulations e.g. inclusionary and opportunity zoning** • **Land leased or acquired on attractive terms** • **Application and approval processes**	• **Tax credits** • **Tax exemptions**

The UK and the US have established and attractive housing sectors, including an institutional social and affordable housing segment. These regions share common issues of growing housing unaffordability and provide examples for the Australian market to understand and implement government incentives to drive private institutional capital into the sector.

United States of America

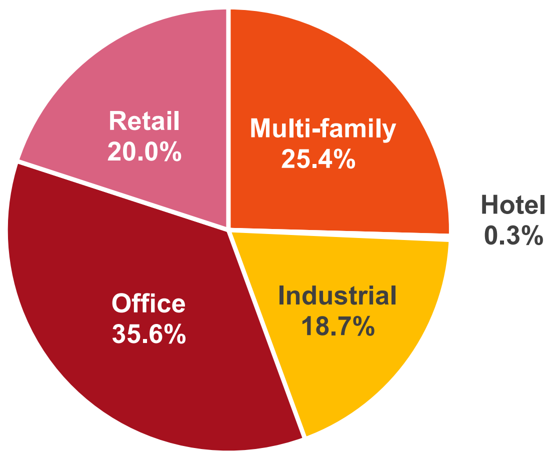
Multi-family sector

Institutional BTR housing, referred to as multi-family (or apartment), in the US has evolved over the last 20 years and today features as a considerable portion (>25%) of the core institutional property index (NCREIF).

While we do not have transparency on what proportion of the NCREIF Property Index may be affordable, approximately half of all the US's multi-family housing units can be classified as affordable.[15] Approximately half of these units, referred to as 'naturally occurring', are market led affordable housing (generally lower quality property and unsubsidised) and the other half is subsidised through government programs. Commonly, whether subsidised or not, these properties are generally affordable to households at or below 60 per cent of the median income in the local catchment.

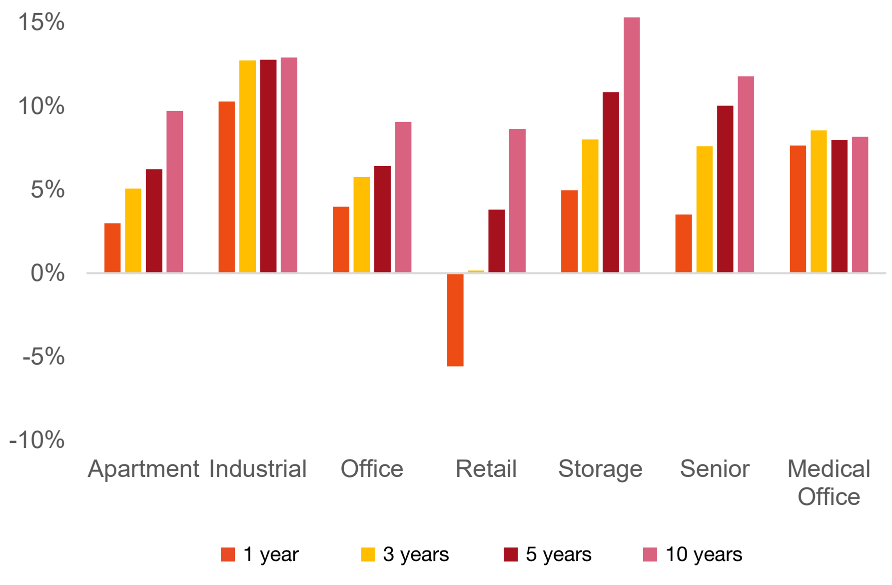
The US apartment sector has delivered attractive returns of circa 10% p.a. in the last decade. However, as with most other real estate sectors, returns have compressed in a low growth economic environment.

Chart 6: NCREIF Property Index (US$969b)



Source: NCREIF (June 2020).

Chart 7: US property market total returns to June 2020 (% p.a.)



Source: MSCI.

[15] The Affordable Housing Asset Class, US Urban Land Institute, 2019.

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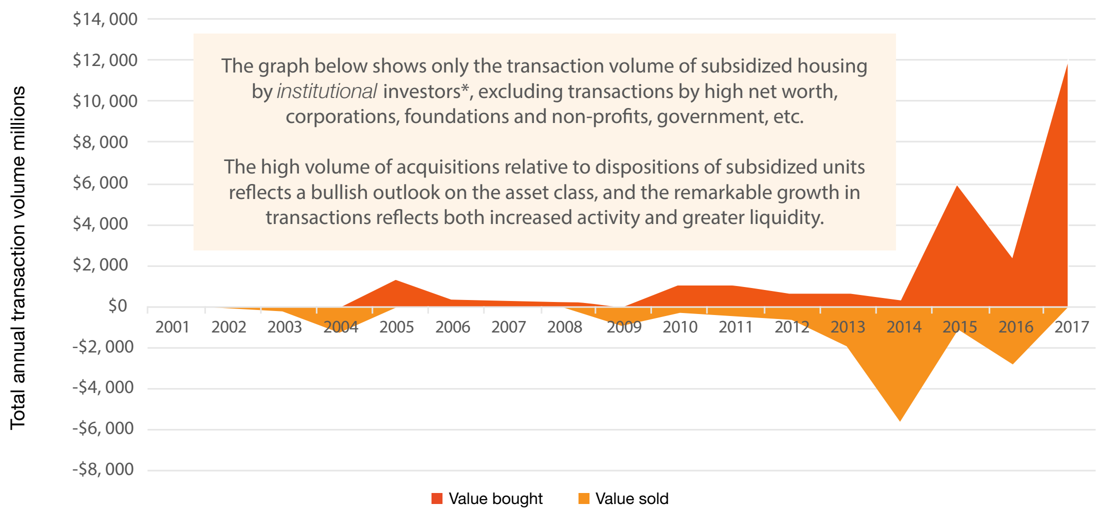
Affordable housing

Institutional capital into the social and affordable housing sectors has increased significantly in recent years.

Chart 8: Institutional investor subsidised housing transaction volume



Source: Real Capital Analytics, RCLCO. [16]

Government assistance programs such as the federal low-income housing tax credit (LIHTC) (discussed below) have supported the economics for investments into sector and promoted institutional interest.

There are a range of products available for investors to access the sector, both through specialist housing managers as well as diversified managers. Products are typically commingled closed ended and provide value add characteristics. Well known institutional managers such as Bridge Investment Group, Avanath and Turner Impact Capital offer products addressing housing affordability.

US government incentives for the social and affordable housing sector

1. Federal low-income housing tax credit

LIHTC was created by the Tax-Reform Act of 1986 and is designed to encourage private sector investments in the construction and rehabilitation of housing for low and moderate income families. The federal government issues tax credits to state and territorial governments. State Housing Associations award the credits to private developers of affordable rental housing projects through a competitive process. Developers of housing projects generally sell the credits to private investors to obtain funding and enhance project returns. Once the housing project is available for lease to tenants, investors can claim the LIHTC over a ten-year period.

2. Inclusionary zoning

Over the last several decades, local governments have passed reforms that mandate or incentivise new construction of affordable units, and many local jurisdictions now have inclusionary zoning (IZ). This government-based approach to affordable housing policy is additive to existing state and federally-funded programs, and IZ aims to transfer some of the taxpayer burden for developing and managing affordable housing from the public to the private sector by providing development incentives. These incentives may include density bonus (higher residential unit ratios that are particularly useful in central city locations), reduced parking requirements, accelerated approval and permitting processes, and fee waivers in exchange for a 10 to 30% allocation to affordable housing in mixed housing development. The depth of affordability varies by local government as each target income levels that are appropriate based on local master plan goals, state mandates, and needs based assessments.

3. Opportunity zoning

Opportunity zones (OZ) are an economic development tool that allows investment into distressed areas in the US in exchange for tax benefit to investors. The government incentive program was enacted in late 2019 with a purpose to promote economic growth and job creation in low-income communities. Across the US multiple low-income communities are designated as qualified opportunity zones. Investors can only invest in these zones through qualified opportunity funds (QOFs). The tax benefits are driven from re-purposing investors' capital gains into QOFs, ultimately delaying and reducing tax. For investments held for at least ten years, investors pay no taxes on capital gains generated through the investment in QOFs. A broad variety of activities and projects can be financed through QOFs including commercial and industrial real estate, housing, infrastructure, and existing or start-up businesses. Fund managers such as Bridge Investment Group have real estate fund products that are QOF structured.

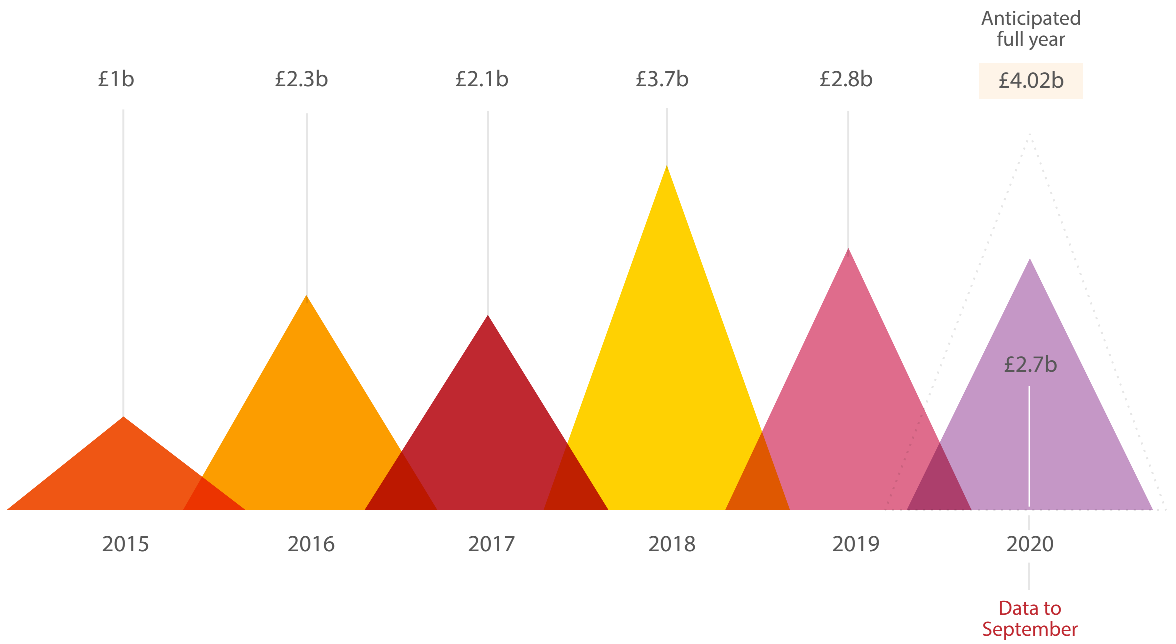
[16] Real Capital Analytics defines "Institutional Investors" to include equity funds, pension funds, insurance companies, banks, investment managers, sovereign wealth funds, open-ended funds, and other financial services firms.

United Kingdom

Private rented sector

The UK private rented sector (PRS) for institutional BTR residential real estate does not date back as far as the US multi-family market, but certainly has been accelerating in recent years and has a positive growth outlook.

Chart 9: Total investment in UK institutional PRS



Source: Knight Frank Research / RCA.

The affordable housing sector in the UK targets unlevered returns between 5 to 6% over a ten-year period, in line with the overall residential market and comparable to the returns expected by other real estate segment such as office and some niche sectors.

There are a wide range of products available to access PRS investments through wholesale commingled diversified or sector specialist products. Affordable housing products are fewer across the universe but growing. For example, there are products coming to market which focus on 'affordable housing impact'. These are typically value-add opportunities with a development angle and offer some additional return premium. Man Investments suggest the unmet supply of affordable housing in the UK is estimated to require incremental capital investment in the region of £17 billion per annum over the next 15 years. This capital demand for affordable housing already materially outweighs current institutional capital allocated to PRS overall, presenting opportunity for new private investment. Compared to the US, product depth is nascent for affordable housing across the UK, however Man Investments offer a wholesale closed end product with this strategy in mind.

UK government incentives for the social and affordable housing sector

UK government tax policy and its ‘affordable homes program’ are two key measures incentivising affordable and social housing development projects across the UK.

1. Affordable homes program

The affordable homes program (AHP) provides government grant funding to support the capital costs of developing affordable housing for rent or sale in the UK. This is a joint-funding exercise between the government and private investors. To be eligible, for-profit companies must comply with the government housing accelerator objectives, including rental income targets of 80% (maximum) of market rental value. The government has committed £4.7 billion of capital between 2016 and 2021 to help build at least 135,000 homes across the UK.

2. Value added tax (VAT) on development costs

Affordable housing BTR development projects can recover most of the VAT (GST equivalent) incurred on site acquisition and possibly some elements of construction costs which range between 0 and 20%. VAT may only be recovered through a ‘zero-rating’ regime where the developer grants a long lease in excess of 21 years. For example, this gives rise to developers working closely with local councils and housing associations to secure long lease terms in the region of 40 years. In turn, these operators can lease short duration leases to community members in need.

The final word

Frontier has globally supported needs-based niche real estate sectors for some time as a diversifier to investors' portfolios, underpinned by stable income driven long-term returns. These alternate real estate sectors have been evolving in recent years to support institutional investment that differentiates from traditional macro driven real estate. We expect affordable and social housing within the wider housing sector to grow in significance over the long term but initially unlikely to meaningfully contribute to returns.

We are seeing some innovative approaches in Australia across social bonds, real estate and infrastructure equity investments. While the investor examples we covered offer promise, the overall opportunity set remains limited with business models still evolving and largely untested. Through this paper we have highlighted the challenges for the Australian social and affordable housing sector relative to more mature housing markets of the US and UK. While Australia's state governments of NSW and Victoria have recently taken steps in tax policy to assist in the construction of BTR developments, much more is needed to improve the outlook and economics for the affordable and social housing sector to attract institutional capital. It requires a cohesive approach from federal, state and territory governments to provide tax, regulatory policy or financial measures to incentivise scalable development projects for institutional capital.

Frontier has a preference today for investment into US and UK affordable and social housing markets. These markets offer attractive risk-return dynamics supported by appropriate government levers. We continue to maintain a close watch of opportunities across Australia and understand investor interest in the sector, given the social benefits it displays and the supply gap for affordable housing to Australian households.

Want to learn more?

We hope this paper has generated lots of ideas for your own portfolios. If this is the case, please reach out to Frontier to discuss how we can work with you to use in this space.

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