# Social & Affordable Housing Pathways

It is recognised that the current Housing NSW social housing stock is not well-aligned, with many tenants having spare bedrooms or occupying properties that are aged and with significant maintenance back-log or due for renewal. This poses an unsustainable burden on the State.

Equally, it is recognised that there is a need to create a larger service delivery role for Community Housing Providers (CHPs) and expand the range of housing stock available to low-income households, including opportunities to secure an affordable place in the private rental market. We believe the current programs have had a mixed success:

- Property Transfer Programs have succeeded in retaining assets on balance sheet but are short term (3 years) and limit transfer lifecycle/refurbishment and management responsibility to CHPs.
- Community Housing Agreements have transferred title and property built under 'Nation Building'. Whilst this approach has had some success, it may have created challenges in the CHPs' given their:
  - capacity to raise finance on the security of transferred property on a significant scale is capped due to loan to value ratio borrowing limits being reached, and
  - potentially unfunded liabilities arising out of long term maintenance obligations from the transferred property.
- Housing PPP's such as Bonnyrigg have had mixed results:
  - The scale, payment mechanisms & performance standards involved created complexity; and
  - the long term delivery of community housing is dependent upon residential sales left the project subject to macroeconomic influences outside of the scheme.
- Consideration of special purpose financial instruments such as Housing Supply Bonds, as an alternative funding mechanism for affordable rental housing, has not attracted institutional investors into this area of need.

In our opinion these approaches are unlikely to provide sustainable funding solutions that address the shortage of social/community and key/essential worker affordable housing stock. The objective of any sustainable solution will need to consider the following:

- Establish a robust and repeatable funding and delivery model for social and affordable housing that is not reliant on additional State capital or recurrent subsidies.
- Recognise the investment criteria for residential development differs to that of long term investors who are seeking a stable yield from long term rental incomes.
- Position social housing as a pathway to affordable and private rental and home ownership, thus freeing up social housing stock for higher need tenants.
- Be cautious in the sale of land or underutilised property to fund community housing developments which remove the:

- State's future flexibility to utilise that land for affordable housing
- ability to distribute equitably, social and affordable housing across greater Sydney

The shortage of affordable housing stock in Sydney and in many other parts of Australia is due in part to some tenants that could afford to live in more expensive rental homes (that is, without experiencing 'rental stress' by paying more than 30% of household income on rent) choosing to rent homes that would otherwise satisfy the affordable housing criteria for lower income groups. Additionally, the increased housing demand from students, retirees and families has further tightened the private rental sector creating greater pressure for both social and affordable housing.

This demand on the rental market is expected to increase as the overall population of NSW increases to over 9 million by 2030 and its population ages. With Sydney making up 59 per cent of the state's total population with 4.3 million residents and this will rise to 63 per cent by 2031 with 5.8 million people[i].

Without a sustainable pathway from social to affordable and private rentals, we believe low income earners will continue to be forced into an environment of rental stress, homelessness or onto the social housing waiting list.

We believe that direct engagement with private finance sector and CHP's is likely to provide a sustainable funding mechanism that is not reliant on either State capital funding or recurrent State subsidies. This these mechanisms have the potential to address the current burden that social housing portfolio is placing on the State and increase the supply of rental accommodation, providing a pathway to tenants out of social housing.

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i Department of Planning and Infrastructure (2013) *New South Wales in the future: Preliminary 2013 population projections*

# Doubling Delivery

How national housing regulation can lever in extra finance to deliver greater public benefit at lower public cost

This report has been prepared by **Dr Tim Williams** as a commission from PowerHousing Australia and in response to the request from the Hon Mark Arbib, Minister for Housing and Homelessness to provide international observations on the National Regulation of the not-for-profit housing sector.

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# *Doubling delivery:*

## How national housing regulation can lever in extra finance to deliver greater public benefit at lower public cost

## Introduction

Effective regulation creates markets.

It also can cheapen the cost of finance. In perhaps the most impressive international example, effective regulation of social housing in England created a market environment in which housing associations ('Registered Social Landlords': RSL's) were able to access substantial finance from both banks and the capital markets at highly competitive rates.

Before the GFC, loans were regularly available to RSL's at only 25-30 base points above London Interbank Overnight Rate (LIBOR). Even now, bank and bond finance is available to English housing associations at 100 bps which compares very favourably indeed with the borrowing costs of big corporates. This is because, as the Council of Mortgage Lenders puts it *'there is a regulatory environment that ensures housing associations continue to command the confidence of lenders and continue to attract investment at competitive rates'*[1]. The issue for the Commonwealth is how to achieve a similar result in Australia.

This paper examines how regulation developed so effectively in England, a massive new momentum to the Not for Profit community housing providers there and adding significantly to the delivery of social and affordable housing – and how we might make progress towards the same ends here.

In particular the paper identifies what investors have welcomed about the regulatory framework and government policy in England with a view to guiding the next steps towards national regulation in Australia.

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[1] *CML response to review of social housing regulation, October 2010,* http://www.cml.org.uk/cml/media/press/2580

## Regulation, extra finance and new tools for investment

The paper also reviews an often under-estimated part of the successful private financing framework in the UK, which is the work of the Housing Finance Corporation, itself originally a joint-creation of the national social housing regulator and the peak organisation for housing associations, the National Housing Federation, though now independent of both.

The Housing Finance Corporation is a not for profit mutual society and is the foremost organization in the UK dedicated to raising private sector finance for the development of social housing. Since its inception in 1987 THFC has raised over £2 billion for lending to registered housing associations. As an independent financing vehicle THFC raises funds by a variety of means including public secured bond issues, private placements and bank loans. By aggregating the requirements of individual housing associations it aims to achieve economies of scale for associations whilst providing a broadly based security portfolio for investors. It is a creature of regulation and a source of finance absent from the Australian scene. Why not have one here?

The caveat that not all is rosy in the social housing garden of England is stressed though, for good or ill, there are lessons to be learned.

## 'The most successful mixing of public and private investment anywhere' [2]

In that short sentence is summed up what massive public benefit has been achieved in England through regulated private leverage undertaken by housing associations. Since this regulatory regime was created in the 1988 Housing Act, housing grant of £38 billion has been used by housing associations to lever in an additional £50 billion of private sector investment. This effectively means for every £1 paid in government grant the social housing sector produces over £2 in value. In terms of both productivity and meeting housing need, this means that the sector delivers double what the pre 1988 grant-only regime delivered.

Although between a third and 40% of that extra investment came into the sector to finance stock transfers from public housing, it's often forgotten that regulatory pressures – to achieve national Decent Homes standards in all social housing whoever the social landlord was– have themselves been a big driver behind the transfer of homes to the only landlords who could access the borrowing needed to fully upgrade these homes. That was the Not for Profit housing providers.

As a direct result of dynamic regulatory reform and national social housing standards, a now highly significant Not for Profit (NFP) housing sector was created. Now 50% of all social housing units in England and 100% of all new social homes currently being built are in the ownership of the NFP sector.

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[2] *David Orr, CEO of National Housing Federation,* *http://www.guardian.co.uk/society/2007/dec/05/guardiansocietysupplement.housing*

## A robust regulatory model

So robust has this regulatory model been that, in the wake of the Credit Crunch, as private housing providers ceased development and even as RSL's themselves came under severe pressure, the NFP sector in England became the dominant housing developers of new stock. Not bad for a single piece of legislation – and indicative of what can be achieved through regulated private leverage in the public interest. This is so big a transformation that, despite the differences in the markets and constitutional frameworks of the two countries, it is vital that the Commonwealth in seeking reform gets to the heart of the regulatory underpinnings of this transformation and what the conditions for similar success in the Australian context might be.

To do this, it's necessary to spend some time on the historical background of developments in England. This is little studied in England itself so it is not unexpected that this experience has not had much influence over thinking and developments in Australia. Also, although there has been recent Australian research on comparative regulatory frameworks much of it seems to over-emphasise the differences between cultures and housing markets and doubt the applicability of lessons learned elsewhere about 'what works'. [3]By contrast, I identify incentives and regulatory frameworks which might easily translate across cultures. After all, 'He who pays the piper calls the tune' seems to work quite well whichever country one is in.

For what should not be in doubt is that the scale of private finance for social housing and the highly competitive and effective market which has evolved in England, so quickly, marks this experience out as amongst the most successful in global terms in the area of public-private partnership. And highly relevant to anyone seeking to increase private investment in, and delivery of, social housing here through regulatory innovation and government policy.

## Lack of a national framework holds back development

The emphasis of this paper is that the absence in Australia of such a robust national regulatory framework as exists in England is a key factor holding back the development of the Not for Profit housing sector and inhibiting the attraction of significant, new, private investment. International experience shows that private investment is more likely to occur in not-for-profit housing if a national regulatory framework is in place. Research confirms that *England's regulatory regime can be directly credited with reducing the cost of funds lent to the social housing sector*. [4] So why not here?

I add: progress is being made and the recent Federal Government stimulus package and commitment to grow the sector have had a significant impact. I

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[3] *Travers et al, Stakeholder views of the regulation of affordable housing providers in Australia, AHURI, January 2011*

[4] *C. Barbato, R. Clough, A. Farrar, P Phibbs 2004, Could regulating community housing make a difference to affordable housing? AHURI Research and Policy Bulletin Issue 34, Sydney Research Centre*

hope this paper will add further momentum; as such momentum is needed if the stimulus is not to be a one off but lead to sustainable growth in the sector. I am optimistic that with a little resourcefulness, boldness and innovation around policy, great progress can be made here quickly to introduce what Australian lenders wish to see in an effective and attractive national social housing market and what they will back with their cash. It's no mystery what they want after all and what they like about the UK social housing market – grant, cash flow, security *and national regulation* – so let's give it to them.

## The background to regulation in England

Until the late 1980's the Public Housing sector in England was largely comprised of a municipal housing sector which owned 3million homes. These had been publicly funded and developed through large scale council-led building programmes, in the 1950's, 1960's and early 1970's.

The smaller charitably funded housing association sector owned around 1 million homes and was subject to national regulatory oversight - a regime largely geared around ensuring the sustainability of that sector through limited revenue deficit grant funding and full cost grant aiding of limited new development activity. Then came 1988 and key phases of development of the sector ensued.

***Phase 1*: A *Private Finance Programme* –**

The 1988 Housing Act opened the door for housing associations to access private finance from banks and other bodies. These also included a mutually owned national Housing Finance Corporation – created by the Housing Corporation(the national regulator) and the National Housing Federation (the peak body for RSL's) - which enables housing associations to access bond market finance, either individually or by the aggregation of often smaller housing associations.

A significant innovation in the '88 Act was in terms of the treatment of housing assets procured or enabled by government grant funding to the sector. Since the 1988 reform, the government gives a waiver over any prior claim on assets of the RSL should a mortgagee seek possession for default of payment of loans. So, the first charge on the RSL's assets goes to the private funders. This in itself created a leverage-able title and asset unencumbered by prior claims, debentures or caveats.

The combination of new finance and its low cost from the start enabled immediately, 20- 25% more homes to be built per public pound than under the previous grant models. The leverage ratio improved further through the next phases as banks got more knowledgeable about the sector, its new social rent backed asset class and its increasingly sophisticated landlords – and as the sector itself got more experienced at financial engineering and asset management.

***Phase 2*: *a Stock Transfer Programme*** –

Prompted both by the 1988 and the later Decent Homes Standard, saw the transfer from municipal ownership to the not-for-profit private ownership housing association regime of 1.1million homes. Each of these stock transfers was the subject of a ballot of all residents and each was secured through the promises made to (and delivered) to tenants around the improvements that could be made to their homes and neighbourhoods through the leverage of substantial amounts of private finance.

***Phase 3*: *Housing Corporation National Affordable Housing Programme –***
A programme of concentrating grant distribution through a relatively small number (80 of some 1,500 HA's) of providers.

Through the use of both competitive grant bidding processes and targeted regulatory activity (through such things as the regulator publishing research on how the most efficient housing associations were using grant to lever in investment and the publication of individual and comparative viability assessments) the overall proportion of public funding for new development as a proportion of total scheme costs reduced from circa 80% to between 33% and 50%. The very purpose of 1988 had been achieved beyond expectations.

***Phase 4*: *the opening up of the Register and Grant Programmes to Local Authority Landlords.***
This phase also saw the creation of a new regulator (The Tenant Services Authority) and the separation of the regulatory function from that of investment (now undertaken by the Homes and Communities Agency). Banks had to be reassured – and were - that the regulatory regime which had brought so much private investment into the sector would continue.

A current wave of reform under the new Conservative government is under way – and lenders are playing a formative role in influencing a regime which protects those elements which has secured so much private funding over the decades. The funders warn that just as governments can create incentives for markets so too can they destroy them by sudden unhelpful shifts in policy in regulation. Markets need consistency.

## Growth – and consolidation - in the NFP sector

The English affordable housing market is now divided roughly in half between Local Authority owned housing stock and stock owned by housing associations. The HA sector is diverse in both the size of providers that operate within it and the range of activities each undertakes. There are still around 1,500 housing associations of which the majority has fewer than 250 homes.

However, there has been considerable consolidation, mergers and concentration of ownership since 1988 with the regulator increasingly determining to grant fund only a minority of 'developing ' RSL's, with the right capacity, funding, skills and governance. At 31 March 2010, although 379 providers had over 1,000 homes, the 63 largest providers, who each own in excess of 10,000 homes, collectively own 48% of all social homes in England. This concentration has been fundamental to the organization and the risk base of the sector – and thus to the terms and conditions in which private finance is available. National regulation has created national scale social enterprises borrowing from national and international banks.

There are two sub-sectors of HAs: traditional and stock transfer providers. The latter providers are comparatively young, having transferred stock during the

1990's and 2000's from local authorities. Stock transfer providers managed 45% of the homes in the sector. One of the key drivers behind stock transfer has been the legal requirement on social landlords, whether NFP or Council, to meet the Decent Homes standard for their stock. Over the last 15 years or so over 2 million homes in England have been modernised using leveraged private finance and regulation as the driver for delivery largely under the Decent Homes programme.

The book value of the overall NFP sector's housing assets is now over £110 billion. They generate an annual surplus of £553 million. Development activity, particularly for the largest providers, is not restricted to homes for rent and much innovation around shared equity and rent to buy products has been the result. Indeed the largest developers for homes in London and the South East of England are registered providers who, unlike private developers, retain a long term management and ownership responsibility of significant proportions of their new build development.

## Key Components of the English Regulatory System

There are a number of key components of the English system which have been critical in establishing and maintaining the confidence of private financiers.

They include

1. The establishment of a national regulator at arms length from government and

2. A regulatory system which comprises :-
    - a public register,
    - clear and effective powers for the regulator to intervene if problems are identified,
    - a set of national standards that cover governance and viability,
    - the subordination of public debt to private finance, enabling sec.

Another, not strictly regulatory pillar, has been

3. The payment of housing benefit direct to landlords.

These are set out in more detail as follows:

### 1. *National, arms length, independent regulator*

Regulation is operated by a quasi autonomous public body with an independent board appointed by Ministers with the operational and statutory autonomy to make regulatory decisions free from political interference. The regulator is not a landlord or developer and its decision-making process is governed by statute and is independent from the national housing department.

## 2. *Regulatory system comprising*:

- *a Register of all Providers;*

- *a set of clear regulatory powers for intervention* including the right to appoint directors to the board, the right to direct the cessation of government housing grant, the right to require a transfer of management, the right to direct the ` change of ownership of homes (private providers only), rights to hold a legally enforceable moratorium on the calling in of debts in the case of insolvency `plus lower order rights in relation to requesting information, acceptance of voluntary undertakings and publication of assessments.

- *The setting of standards*

Under the Housing Corporation the prime emphasis was on the finances and governance of housing providers. Standards in these areas were set using a series of guidance and good practice notes. Under the modernised regulatory powers vested in the Tenant Services Authority standards were set in six key areas (tenant involvement and empowerment, the home, neighbourhood and community, rents (including tenure), governance and viability and value for money.

- *A nationally regulated rental regime*

(One of the six standards above) ensuring that homes continue to be let at below market value. During the late 90's and the first part of the last decade this regime was regulated through 'influencing powers' (i.e. not a statutory regime) from 2008 onwards the regime had the backing of the formal standards framework. The valuation of assets using this rental regime (known as Existing Use Valuation - Social Housing) helps to maintain a further buffer for private lenders. The extent of this buffer varies depending on the geography of local housing markets. In some parts of the capital rents are as low as 25% of market values and they are typically 50-70% of market values elsewhere

- *the subordination of public debt to private finance*. This effectively creates a significant buffer whereby private investors £50bn is protected by both the £38bn of grant and then another £19bn of book asset values.

## 3. *The final piece of the 'regulatory jigsaw' in England is,* in fact

a non-regulatory element. The ability of English Landlords to receive the payment of housing benefit (HB) directly from Local Authorities for their tenants that are eligible for benefit aids the certainty of cash flow and minimises bad debts. For many landlords HB accounts for 70% of rental income.

These components have remained largely the same since 1988 despite the separation of Investment and Regulation in the 2007 Housing and Regeneration Act. Whilst the scope of the Regulatory Regime expanded to cover public bodies in 2008, and the level of prescription contained in the Regulatory Standards reduced dramatically at the same time, the overall building blocks outlined above remained, and are proposed to remain, as is, despite the proposed re-joining of investment and regulation through the 2011 Localism Bill.

## The lenders: what they say they like about 'robust regulation'

The 150 lenders active in social housing in the UK until the GFC reduced the appetite for all asset classes of UK banks – some of which ended up with credit ratings lowers than many of their clients in social housing – saw the social housing finance system has having 4 main pillars. These were: the fact that loans were fully securitised, the grant subsidy which supported housing development, the secure cash flows and income enabled by housing benefit and robust regulation,

The UK's Council of Mortgage Lenders (CML), representing most funders of social housing, has been persistently eloquent on the importance of the latter to its members.

For example, when responding to the regulatory framework of the new Tenant Services' Authority in early 2010 the CML stated:

> 'The CML on behalf of lenders welcomed the new regulatory framework and increased range of powers now available to the TSA. A key focus of the new regulatory regime is on the core elements of governance and viability and there is recognition of the importance of robust independent regulation in sustaining the confidence of lenders and investors'.[5]

Similarly in 2007,after the Cave review of regulation recommended the retention of a stand alone regulator separate from government, the CML welcomed this and noted that its members were able to lend to RSL's on competitive terms because of the 'existence of robust regulation'[6]. The CML was therefore pleased that the government had ensured that,

> *'a regulatory regime will continue to be in place that will give lenders confidence and so safeguard a continuing flow of private funding to help build and improve more homes.'*[7]

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[5] *CML http://www.cml.org.uk/cml/media/press/2580*
[6] *CML http://www.cml.org.uk/cml/media/press/2580*
[7] *CML http://www.cml.org.uk/cml/media/press/2580*

Noting 'the importance of the continuation of robust social housing regulation to our members who lend to housing associations' the CML in their response the latest changes to regulatory architecture in England stressed that,

> *'It is essential that the localism bill safeguards the existing approach to economic regulation and the regulator's ability to intervene and/or enforce where there is a serious threat to the viability and governance of the housing association sector'*[8]*.*

The language used by the CML as the voice of UK lenders about national social housing regulation is very telling of the advantages they see for them as investors. They talk of the need:

> *'to have regulation that that creates the conditions needed to make sure housing associations can continue to access private finance – both through bank lending and the capital markets. Regulation does not eliminate risk for lenders but it does limit the risk associated with financial exposure and provides the legislative powers and mechanisms to supervise and intervene where a housing association is at risk of failure.'*[9]*.*

Not much concern here about the 'burdens of regulation' some studies in Australia have worried about. [10]

## National regulation: 'borrow more easily and at lower rates'

What does concern lenders is inconsistency and policy shifts – and political interference with regulation. They point out to the current UK Conservative government about the dangers from the market perspective of tinkering with structures which have levered in so much finance:-

> 'The strengthening of financial regulation through the Tenant Services Authority has meant that housing associations have been able to continue borrow more easily and at lower rates than other property sectors both before and during the credit crunch. The capital markets also look favourably on the housing sector and the strong investment grade ratings given to the sector are supported by the existing system of regulation and the stability associated with it.'[11]

If anyone thinks this is just the view of a peak organisation and not bankers, let the head of housing finance at the Bank of Scotland, reassure them. What we look

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[8] *CML http://www.cml.org.uk/cml/media/press/2580*
[9] *CML http://www.cml.org.uk/cml/media/press/2580*
[10] *Travers et al,op.cit*
[11] *CML, http://www.cml.org.uk/cml/media/press/2580*

for he said, is *'a strong, stand alone, regulatory regime. This is vital for lender confidence'.* [12]

And why not? £50 billion went into the sector from debt financing from a wide range of 'traditional' lenders from across the world – with lenders experiencing minimal losses and only one RSL insolvency in almost 25 years.

Clearly the GFC led to an increase cost of finance for RSL's and narrowing of access to funds, as with all enterprises active in property and housing. Their business models are also currently in flux because of central government proposals to increases social tenants' rents and reduce their security of tenure. However, RSL's in England still have access to finance at rates significantly lower then corporates – and the relative increase in the cost of debt has opened up the way for bond finance to re-emerge.

## Housing associations and the bond market

During 2010 alone the market saw the following big RSL bonds

- the London & Quadrant Housing Group's £300m bond with a margin of 115 bps over gilt in January;
- Notting Hill Housing Trust's £110m bond with a margin of 110 bps over gilt in July;
- Hyde Housing Association's £200m bond with a margin of 105 bps over gilt, also in July; and
- Sanctuary Housing Group's £120m bond with a margin of 100 bps over gilt in September.

Of course, for lenders the potential for increased social housing rents and reduced security of tenure under current government proposals is likely to have a positive impact on social housing valuations, which will further increase the capacity of housing associations to borrow by means of bond issues.

The evidence of an increased appetite from investors for housing association debt in bond markets is now clear. The sector's excellent track record in managing through the recent period of financial turmoil has led to renewed interest from these funding sources at a time when investors are seeking to gain more balance in their portfolios through acquiring more low risk, lower return investments.

At the same time the differential in pricing between bond and debt finance (bank loans) has significantly reduced, meaning that there is much less of a premium involved in bond finance. Associations can access bond markets either through stand-alone issuances or through 'aggregator' organisations such as The Housing Finance Corporation (THFC) which issue joint bonds on behalf of a number of organisations. Although bond finance can be less flexible than debt finance, this

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[12] *Ian Haston, http://www.insidehousing.co.uk/cml-audit-commission-too-inexperienced-to-regulate/1449400.article*

can be an advantage in the current volatile environment as it can reduce re-pricing and other lender behaviour risks that have challenged the sector recently.

Accessing bond finance also has the potential added benefit of achieving a more conventional capital structure with a more balanced mix between debt and bond finance and between shorter and longer term debt. Housing associations are long-term property businesses after all, ideally suited to the longer term investment appetite of bond investors.

In retrospect there is some evidence that the sector's capital structure had become too weighted towards shorter term or more flexible bank debt, creating re-pricing and other risks that were then exposed during the credit crunch. So bonds seems set to be a long term feature of regulated RSL finance and not just a short term response to the GFC.

## Bonds for smaller housing associations too

And lest one thinks that bond issues are only relevant to major RSL's in England with massive estates, it should be noted that in January 2011 Glen Oaks Housing Association, based in south Glasgow, raised £14m (circa $22m) in a bond issue from the Housing Finance Corporation, after the Scottish Government scrapped the '20-year rule' which prevented community-based housing associations from using their housing stock as security for long-dated bonds. Glen Oaks is a community-controlled organisation run by a management committee of volunteers.

Effective regulation creates markets. Everywhere. Including Australia

## National regulation in England and its relevance to Australia: what's not to like?

We have seen that UK lenders are passionate defenders of social housing regulation as it grew after the 1988 Act. It created transparent regulation with no political interference. It shaped a simple framework and structure with 4 basic pillars. It created stable partners for private investors who knew who and what they were funding. It created a national market with no regional or local variations in policy, regulation or funding: nation-wide banks like nation-wide markets after all. It created simple products and a formula which bankers could easily sell to their credit committees.

Credit committees don't like bespoke projects requiring lots of investigation into what they are and the credit-worthiness and business plans of who is producing them: and the days of relationship banking are long gone. They like simple, formulaic, knowable, repeatable products and services from clients with familiar models underpinned by a national regulatory system with an implied guarantee that their clients won't go under. Difference/uniqueness costs more and brings unknown risks and costs. Same, same is what credit committees look for, so as to have projects without high transaction costs but with low risks. Novel or original products and services are very worrying.

That's what lenders liked about the regulatory system in the UK. It turned what could have been tricky high art into low maintenance science where selecting products, services and RSL's to back was just a matter of saying 'this is just like the ten we bought before'. But then it's what credit committees everywhere look for – simplicity, familiarity, uniformity, repeatability, security certainty – and scale. These are needed in the Australian social housing system to emulate the UK RSL revolution.

## Australian national regulation and Not for Profits: ferment under way

Clearly although the UK now has three separate social housing regimes following devolution to Scotland and Wales, England, which makes up 85% of the UK population, is internally unified with no regional governments or markets. Australia has no such simplicity and this is a serious barrier to national regulation.

However, there is a consistent, strong trend in Australia in several other services towards national regulatory systems rather than requiring providers to be registered or accredited in individual jurisdictions. Aged care providers are regulated by the Aged Care Standards and Accreditation, an independent national regulator, subject to government guarantee and Health professionals recently moved to a national registration and accreditation scheme.

The Commonwealth has begun a serious debate about how to move Australian social housing regulation in this direction – with the explicit aim of growing the Not for Profit sector. I agree with Access Economics Deloittes in believing *'the outcomes of this national discussion will be critical to the future shape, capacity, cohesion and overall productivity of the not-for-profit sector'.* [13]

## Regulation in Australia: a plea or two…

This paper reviews that discussion and concludes by suggesting ways in which the best elements in the UK approach to national regulation and enhanced leverage via the Not for Profit sector can be supported here despite barriers of jurisdiction and institutional self interest. It also makes a plea or two that:

- in designing regulatory regimes explicitly meant to lever in finance from banks or institutional investors please ask those sectors what features they need to see in a system to attract them: their input is critical and in being involved they will get to know the sector better anyway. The

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[13] *Ian Haston, http://www.insidehousing.co.uk/cml-audit-commission-too-inexperienced-to-regulate/1449400.article*

national government needs to have a high level forum with and for actual and potential national investors in community housing providers

- in seeking regulatory elegance and uniformity please don't overcomplicate through a surfeit of options

- in framing a national system of regulation please keep eyes on the main prize – which is to secure new and more finance from the private sector to build and maintain the social housing which the nation needs :all other considerations are in reality secondary

- therefore a regulatory framework and investment strategy which encourages the emergence of bigger, cross-state and ultimately national NFPs who can leverage funds and new development at scale, is the objective

- therefore as well as the banks, ask the bigger NFPs what they need to grow and give it to them, in the public interest:

- the Commonwealth should not believe that 'the current systems of state regulation are fundamentally sound ' when some do not have regulators independent of government and are embedded in public housing departments;

- or believe that making regulatory regimes more consistent across the nation is the same as creating a unified national regulatory system or national market for private investors in social housing.

In her ground-breaking March 09 speech advocating the growth of the Not for Profit sector, the then Housing Minister Tanya Plibersek explicitly linked her ambition to grow the sector to 35% of total social housing to cross-jurisdiction harmonisation and national regulation which she also believed would support the emergence of 'bigger players' both in terms of community housing providers and private investors. [14] She was right on both counts.

## Progressing the national regulatory framework

The debate sponsored by the Commonwealth on national regulation resulted in the Commonwealth, State and Territory Housing Ministers agreeing to progress the national regulatory framework on 22 May 2009. At the time a report was prepared by consultants ARTD which established the benefits of a national regulatory system *for housing providers* as including:

- the reduction in barriers to operating across jurisdictional boundaries;

[14] *Minister Plibersek, March 19 2009 speech, Sydney Institute*

- reduction in the cost and administrative burden of regulation by having a consistent system;
- and securing the reputation of the not-for-profit housing sector as an industry with high regulatory standards. [15]

Given the UK experience what is striking about this is any significant appreciation of the role of national regulation in creating an asset class and a national market in which banks and institutional lenders would enthusiastically invest – though the latter point alludes to it.

## 'Regulation and Growth for the Not for Profit Housing Sector (2010) '

Progress on this thinking was to some degree then overtaken by the housing stimulus package which resulted in some significant but ad hoc impetus to the growth of the NFP sector. A re-scoping exercise in 2010 produced the key FAHCSIA discussion paper on 'Regulation and Growth of the Not for Profit Housing Sector'. This said that:

> *'For not-for-profit housing providers to play a bigger role we need a regulatory system that gives us all confidence. Tenants need secure and stable housing. Investors need confidence that they can partner with a viable and well-managed sector. Housing providers themselves need simple regulations which give them the opportunity to expand across State and Territory borders and to enter into solid commercial relationships'.*[16]

Significantly, in making the latter point the discussion misses the key thing which is that these differential regulatory barriers and differential burdens of compliance are not just demanding in terms of resource and time. They actually impede the achievement of economies of scale for community housing providers and thus inhibit their ability to leverage private finance at commercial rates.

The point is however well made that:-

> 'Institutional investors with the capacity to make substantial contributions to affordable housing finance do not want the inefficiencies of multiple regulatory systems. The lack of an efficient, government-assured national market will hold back this source of capital investment.
>
> A robust, well regulated not-for-profit sector will of itself be more attractive to greater investment. Regulation and prudential supervision will increase confidence in the sector and may also help lower loan-to-value ratios for the sector as a whole.

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[15] *ARTD consultants, National Regulatory System for Community Housing Providers, Re-scoping the Approach Final Report 3 August 2009*

[16] *FAHCSIA, Regulation and Growth of the Not-For-Profit Housing Sector: Discussion Paper*

A national system of regulation and prudential supervision is essential to protect government investment, increase investor confidence in the sector and protect the interests of tenants.

A national regulatory framework is necessary for the growth of a strong national not-for-profit housing sector. National regulation will support growth and enhance the sector's capacity to operate across multiple jurisdictions'.[17]

## Minister Arbib takes regulation forward

The in-principle acceptance of this needs now to take form in legislation and action. Minister Arbib is clearly apprised of the problem and some of the solutions.

In an interview with News 24 in March 2011, Minister Arbib talked about the issues with the national government's provision of funding for community housing. Pointing out the significant amount of new money which the government had brought into the system he yet felt there was 'a problem' because this record level of spending is 'not as effective as it could be'. He said:

- rather than the government providing the housing, the community sector and non-profit providers need to be empowered to deliver the projects;
- this has been successful in other countries, specifically in the UK, where large community housing organisations have the appropriate leverage needed to lend money from the banking industry;
- to achieve success, the non-profits need to have a significant asset base and an appropriate mix of affordable housing and social housing in their portfolio;
- The States and the National Government are working to create a national regulation on community housing to empower community organisations and give them the support they need to deliver successful housing projects;
- The next opportunity for change is the renegotiation of the National Affordable Housing Agreement (ref 17)(see Conclusion below);

In his Address to the National Affordable Housing Exchange Conference, 14, April 2011, he went further:

- The current public housing shortfall is around 90,000 homes and is expected to grow to 150,000 by 2020;
- The cost to meet this shortfall is around $24 billion and the government simply cannot guarantee the funds needed;
- There is also a lack of confidence in the money going into the public housing system; as the shortfall has only grown over 10 years since the investment of $10 billion (prior to the stimulus);

[17] *FAHCSIA, Regulation and Growth of the Not-For-Profit Housing Sector: Discussion Paper*

- An issue of the stimulus is that it has not created momentum, as it is a one-off investment;
- To continue momentum, the government needs to create a regulatory framework for ongoing support to the non-profit and private sector- the code would seek to:
    - Protect tenants;
    - Provide good governance and common registration requirements;
    - Limit the regulations to one set of reporting and monitoring obligations so that organisations can operate efficiently across state borders;
    - Ensure that registrars are independent and only need to register once;
    - Create a tiered system where the level of regulation is proportionate to the level of risk;
    - Have one jurisdiction enact national laws as a host with other jurisdictions referring to and/or adopting the law – this system has been successful in the legal and health sectors of government; [18]

This is the right track but I suggest the focus must not be lost on a key objective of effective national regulation: to attract the private funding to meet the public shortfall. In designing a new system we urge one big idea on the Minister. Follow the money.

## Follow the money: some recommendations around making quick progress on realising the benefits of national regulation by creating a single market for finance

In an important report for the community housing sector in Victoria Access Economics Deloittes point out that despite Victoria's progress on the registration of major developing housing associations and some significant asset transfers to growth providers achieving high leverage (in some case by more than 50% of assets), only limited access to bank finance has been secured *'and only after lengthy and difficult application processes'*.[19].

Banks may be willing to lend but typically are using higher risk premia. Information provided to Deloitte Access Economics by growth providers suggests current borrowing rates centred around 7.2%. This represents a premium of about 100 basis points over standard variable rates charged to large businesses. Remember in the UK, RSL's are accessing finance more cheaply than corporates.

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[18] *Arbib, Address to the National Affordable Housing Exchange Conference, 14, April 2011*

[19] Deloitte Access Economics (March 2011), "Increasing affordable housing through the Victorian community housing sector" *http://www.chfv.org.au/Deloitte-Access-Economics-Report-Launch/*

But if funding is expensive it's even more difficult to get hold of it in the first place due to a 'lack of understanding on the part of financial institutions, and the large banks in particular'. Application processes are detailed and arduous.

While I agree that as the Access Economic report says, *'There may be a role to be played by peak bodies in helping member organisations to obtain funds through pooling and through acting as a liaison point with financial institutions'* [20] what is also required to reduce risk *premia* on lending rates is – and here I agree with Travers et al -indeed 'a stable policy framework with adequate long-term funding initiatives'.[21]

## Australian lenders want robust national regulation

I shall something about pooling, funding initiatives and that policy framework – surely national registration of all providers seeking federal funding – in my conclusion.

Informing my judgement is the confirmation recent research into regulation in Australia offers about the strong support there is in the finance sector here for strong and clear regulation. In a comment echoing the support of the CML in England a Victorian banker interviewed stressed that:

> 'What regulation provides for us is a comfort level, especially when government is involved, and the government is already a stakeholder providing 75% of the funding in projects. Without the regulator there would be no certainty. The last thing we want to do is to foreclose on properties and have people in need of accommodation being tuned down. What regulation provides is that certainty: that stock would be transferred to the community housing sector. No one wants to be on Today Tonight'. [22]

Even more instructive is the finding that of all the 5 'National regulation proposals' put forward by the Commonwealth *'most finance sector respondents (including ABA and Westpac) favoured option 3, a single regulatory system run by the Commonwealth'.*[23]

Clearly opinions vary as between community housing providers on the right solution but the clarity sought by the private sector financiers obtaining whose cash is the very purpose of national regulation for many is summed up thus: *'The ABA noted that "the chance for divergences across jurisdictions creates unnecessary legal, and regulatory complexity, administrative burden and compliance cost"'.*[24]

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[20] *Deloitte Access Economics (March 2011), "Increasing affordable housing through the Victorian community housing sector"* *http://www.chfv.org.au/Deloitte-Access-Economics-Report-Launch/*

[21] *Travers,op.cit*
[22] *Travers,op.cit*
[23] *Travers,op.cit*
[24] *Travers,op.cit*

## Conclusion

Harmonisation in some form is coming.

In finalising its position the Commonwealth needs to focus on what national regulatory reform will lever in the most extra private funding to achieve public values in housing. That simple test will drive massive change and draw in significant and much needed investment. Ask the lenders. Involve them in the final design.

The word 'national' is important to the lenders. Although much improvement can be made by regulatory reform within states (by for example ensuring a split between the Regulator and State governments so that conflicts of interest over the funding of public housing are avoided) and between states by making regimes more similar to one another, the real prizes in terms of private investment come from creating a single national market for social housing finance. National Banks understand and appreciate national markets – and scale. Both will come when social housing providers across the nation, with development ambitions and capacity, register nationally to access federal funding.

Scale will also come from a transfer of stock from public housing providers driven by regulatory pressures and the need for new funding to bring properties up to modern standards. Needing to meet the Decent Homes Standard in England was a key driver over a dozen years in transferring almost 1 million homes to the Not for Profit sector. This was totally in the interests of tenants, because it was only the leverage which the Not for Profit housing providers could uniquely access which helped tenants get the social homes they deserved. I agree with Travers et all when they say that the optimum condition for an early impact for national regulation and the leverage it brings comes with the scale afforded by large scale transfers of public housing. Regulation can drive that shift and justify it too.

Finally a recommendation to not just regulate better to facilitate private leverage but actually to create an institution which can directly provide access to cheaper finance for the sector - and one that was itself in the UK originally an offspring of the national regulator. Australia needs its own Housing Finance Corporation as that model fits the scale of Australian NFPs and market well.

As we have seen, the UK's Housing Finance Corporation is itself an independent not for profit organisation that raises longer-term bond finance for medium-sized housing associations. It operates without government control, subsidies or a guarantee and the quality of its bonds are rated by credit rating agencies. By acting as an intermediary between borrowers and lenders it allows investors to spread their risk across several housing associations.

Bonds are typically purchased by institutional rather than private investors.

Although not underwritten by government, they benefit from strong cash flows and a closely regulated sector. Particularly important for smaller to medium sized housing associations is the HFC's syndicated bonds where the institutional investors' risks are spread across a number of recipient housing associations.

This 'bond wrapper' enables organisations with a few thousand homes to access the capital markets at a discounted cost. National regulation is the cornerstone of an institution which in itself has delivered £2b private finance to Australian-sized NFPs. In creating the former in Australia we create the possibility of the latter, and so much more.

This is why the NAHA renegotiation is not only, as Minister Arbib put it, the 'next opportunity for change'.

It is a potential game-changer: and that's what Australian social housing needs

# Recommendations for the Commonwealth –
## and for PowerHousing Australia to consider

1. The Commonwealth should legislate for a national system of regulation in 2012.

2. In determining the design options, the Commonwealth should consider,

   a. what regulatory system will lever in most private investment
   b. what regulatory system will lift most unnecessary cost-burdens for the community housing sector, and
   c. what regulatory system will help most to grow the commercial and delivery capacity of the sector across the nation.

3. The Commonwealth should use the NAHA working party with PowerHousing to identify the elements of (b) above and should establish a working party with the banking and finance sector to identify the elements in (a) above.

4. The Commonwealth should review the role of national social housing standards – a Decent Homes for Aussies standard? - in raising higher standards to tenants and in driving stock transfer to providers with the required leverage to upgrade homes and indeed housing estates

5. The Commonwealth should review the possibility of supporting the emergence of a Not for Profit social housing bond finance aggregator – an Australian Housing Finance Corporation.

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