THE CONSTELLATION PROJECT
TOWARDS ENDING HOMELESSNESS IN A GENERATION

Housing Boost Aggregator

A solution to unlock private investment in social and affordable rental housing supply

Australia has a well documented shortage of social and affordable rental housing for low and moderate income households.

While the National Housing Finance and Investment Corporation (NHFIC) supports the efficient debt financing of affordable housing using income from affordable rents, there remains a funding gap (averaging between 35-40% of build cost) that prevents CHOs from building new affordable dwellings in the first place.

Even with the exceptionally low interest rate environment of the past few years, this funding gap has remained a barrier to scaling up the industry to produce affordable rental housing.

The Housing Boost Aggregator (HBA) provides a solution to closing the funding gap through the creation of a new Commonwealth tax-subsidy and pooling portfolios of affordable housing projects to attract ongoing institutional investment.

In the US, tax incentives have been underpinning affordable rental housing construction for over 30 years

Layers of funding needed to develop affordable housing

Affordable Housing Boost

Competitively allocated to CHOs by the Commonwealth on a value-for-money basis

NHFIC Senior Debt

Serviced by rental incomes and project cashflow

Crowded-in Equity/Funding

State and LGA contributions, CHO equity, philanthropy & planning contributions

The HBA is a proposal to overcome the funding gap by separating what CHOs can safely borrow from the costs they cannot.

It fills the gap through an annual tax-based subsidy — an annual refundable tax offset, **the Boost**, from the Commonwealth government.

One major difference compared to earlier Australian programs is that the HBA targets each project's upfront funding gap rather than apply a one-size-fits-all methodology. The Boost is paired with a government agency — **the Aggregator** — that lets institutional investors like super funds invest at scale by providing gap funding up front in return for the annual Boost offsets.

Similar proven solutions work internationally by jointly engaging competition, the tax system and institutional investment to help scale up the supply of social and affordable rental housing and deliver value for money.

Tax incentives are already used by the Australian government to encourage businesses to engage in particular ways. For instance, the Research and Development Tax Incentive is in place to encourage investment in technological innovation. In the United States, tax incentives have been underpinning affordable rental housing construction for over 30 years with significant investor acceptance.

The HBA similarly uses the tax system to encourage institutional investment in affordable rental housing for:

- key workers
- low income earners in rental stress
- homeless households
- women escaping domestic and family violence

How it works

The HBA focuses on closing the capital gap to build the property, after all other available funding, incentives, programs, and cross-subsidies are included.

Funding the gap will be based on a competitive process – much like a reverse auction

The gap will be funded through a competitive process – much like a reverse auction – where affordable housing developers tender for the Boost required to fill their project-specific funding gap.

The Boost (equal to the upfront capital gap) is then provided in installments over time, creating 10 annual payments of tax subsidies (Refundable Tax Offsets - RTOs) that can be sold to investors in exchange for the total upfront gap. The Aggregator combines the annual payments from multiple affordable housing projects into time-limited pooled funds. This allows for the pooling of large and small affordable housing projects, and for institutional investors to purchase large or small shares of the combined flows of tax subsidies. In this way, the Boost separates the funding gap subsidy cashflow from the affordable housing operating cash flow (which is already earmarked to repay NHFIC's senior debt). This separation allows efficient fine-tuning of investment offerings for the private sector.

Government then awards Boost offsets based on value-for-money: projects that offer the most units for the least subsidy, based on how many additional layers of funding that the project can crowd-in to reduce the overall funding gap. Competition for Boost offsets is thus in place to reduce the subsidy ask, but also to avoid the Boost offsets simply substituting for existing sources of funding. HBA is designed to unlock additional supply, not shuffle the funding deck.

Boost offsets will be allocated contestably by states and territories, who can target their own housing and urban development priorities. It is important to communicate that this is a Commonwealth program that is funded recurrently over time using foregone tax revenue. This lends certainty and credible scale to institutional investors.

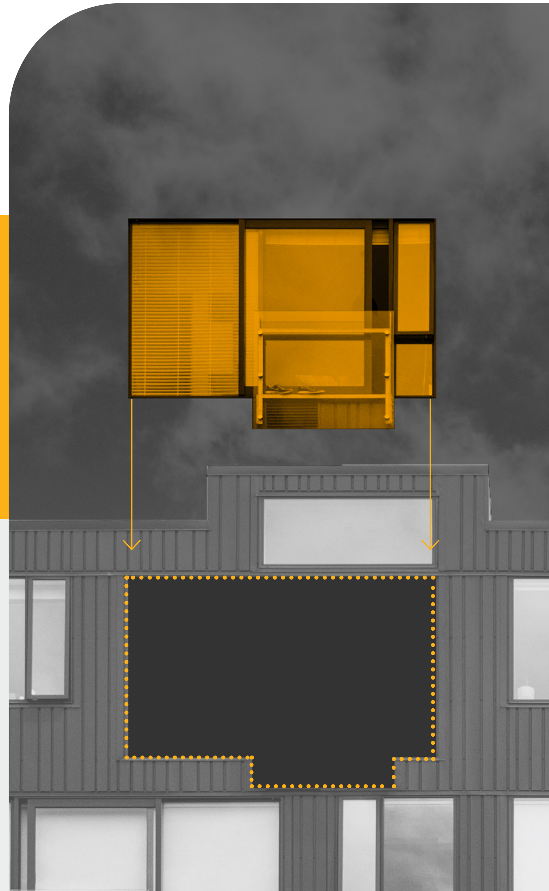
The HBA will close the funding gap by separating:

What CHOs can't borrow:

the funding gap — to be financed by the proposed Boost tax subsidy

What CHOs can safely borrow from NHFIC based on rental income:

cashflow borrowing



The annual Boost aggregation and allocation process

The Boost — a tax incentive program provided by the government

The Aggregator — a government agency that acts as the intermediary

1

CHOs calculate the funding gap for specific projects within their affordable rental housing build

CHOs experience a funding gap averaging between 35-40% of build cost after all available funding, incentives, programs and cross-subsidies.

2

CHOs tender for the Boost subsidy to fill their calculated project-specific funding gap

This tendering process will be based on a competitive model similar to that of a reverse auction.

3

The Commonwealth awards the Boost subsidy to tendering CHO projects

The Commonwealth will award the Boost subsidy to tendering CHOs based on a value-for-money assessment (i.e. the most units for the least subsidy).

4

The Aggregator converts the tax credits into upfront capital for CHOs

It combines the annual payments from multiple successful CHOs' affordable housing projects into time-limited pooled funds in which shares are sold to.

5

The HBA launches the fund and institutional investors purchase shares

Institutional investors provide the Aggregator with up-front funding for the Boost subsidy Intermediary.

6

CHOs begin project construction

Successful CHO's recieve capital from the Boost aggregator which allows them to start construction.

7

Once CHOs have allocated homes and receive rent, the CHOs can claim tax credits from the ATO.

Institutional investors receive an associated Boost offset from operational CHO projects through the HBA.

Our three lenses

Because the Boost clearly benefits all involved parties it makes the prospect of sustainable affordable housing growth a genuine possibility

How the Boost subsidy is used by housing providers

Housing providers, specifically the Government-regulated CHOs, tender for the Boost offsets to fill the project gap that remains after designing an affordable rental project and negotiating maximum land or planning concessions, philanthropic support, state government programs, cross-subsidy with market-rate dwellings, and any other funding available in their community. If successful, the developer claims the Boost offsets over time, creating a 10-year 'cashflow' they sell to investors through the Boost Aggregator in return for the upfront equity injection required to plug the project's funding gap. Once the project is built and tenanted, the affordable housing developer passes through the tax offsets from the ATO to the Boost Aggregator as a conduit to the investors.

The Boost offset is more flexible than previous Australian flat-amount affordable housing schemes where only certain bands of location and affordability levels were financially feasible. The Boost is flexible — allowing housing need and urban development priorities to determine where new affordable rental housing is provided, while accommodating variation in land/construction costs within and across regions.

How the Boost offsets are used by investors

The Housing Boost Aggregator is for institutional, not retail investors. Institutional investors like super funds will invest in regular fund offerings of Boost offsets pooled by the Boost Aggregator. For instance, if the investor pays $500 million for a share of an affordable housing Boost fund, they will receive $50 million plus an agreed return per annum for 10 years, once the housing projects are operational. These investors take no risk on project rental collections or operating costs, because that cash flow supports the project's senior NHFIC debt. These investors take no risk on project rental collections or operating costs because of the separation between the tax subsidy flow of funds (RTOs) and the operational cashflow of funds (rental income). Investments in the Boost offsets are characterised as subordinate debt.

Refundable Tax Offsets are dollar-for-dollar credits on tax liability. They are not 'deductions:' they are applied after calculating actual annual tax owed. If an investor's tax liability is lower than the offset, the investor would receive a refund from the ATO equivalent to the negative amount. The investor's counterparty is, essentially, the Australian Commonwealth Government.

How the Boost program is used by governments

Refundable Tax Offsets are part of the federal taxation system. The Commonwealth Government would determine the annual Boost program amount – in the form of total available RTOs - allocated for affordable rental housing. The competitive tendering process then maximises housing outcomes unlocked by this subsidy by ranking projects on value-for-money, within the wider housing and urban development objectives set by states and territories. Subsequent streams of Boost offsets must be allocated every year to achieve scale to attract institutional investment and stimulate this niche construction industry, again like the R&D tax credits.

The Aggregator agency may be a Commonwealth entity. It acts as an intermediary between the individual non-profit CHO developers and the sophisticated, large-scale institutional investors. Targeting institutional not retail investment is key to streamline program administration, and achieve most efficient risk/return pricing from investors: NHFIC's five successful bond issues is evidence of this. Note that there is no guarantee required for the HBA program.

Periodic scaling up of annual Boost availability can easily be achieved as part of counter-cyclical or stimulus policies.

Acknowledgements

This work has been supported by the following organisations:

With special thanks to the following people for their ongoing contributions towards this work

Wendy Hayhurst
Community Housing Industry Association

Adrian Pisarski
National Shelter

Gemma Pinnell
Industry Super Australia

Mark Degotardi
Community Housing Industry Association NSW

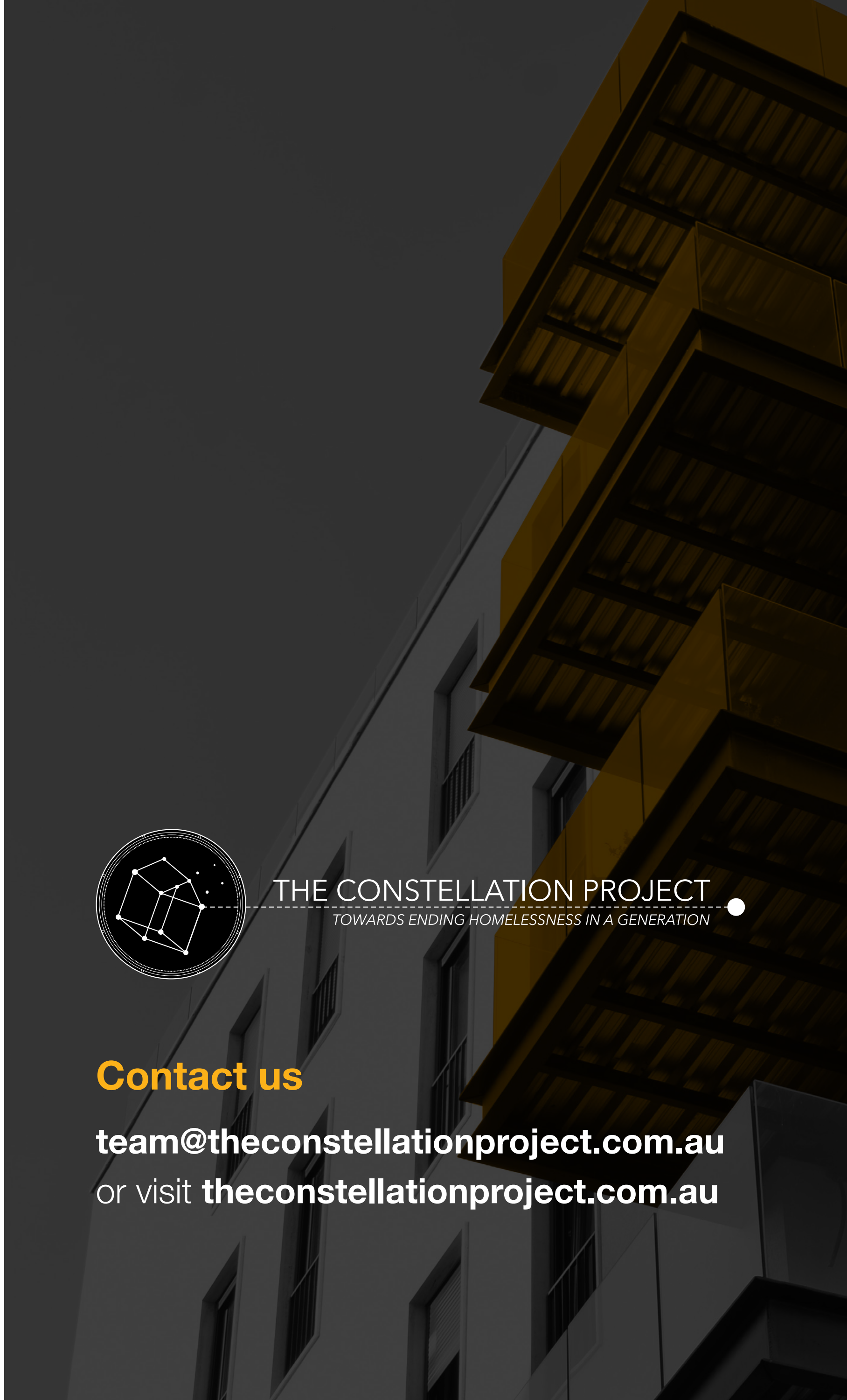
Charles Northcote
BlueCHP Limited

Erin Sales
Australian Institute of Superannuation Trustees

Geordan Murray
Housing Industry Association

Carrie Hamilton
Housing Action Network

Andi Nygaard
Swinburne University



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