International Housing Partnership

Forum on Capital for Housing & Community Development

Tuesday 7 October 2013
London

Capital Sources Working Group Background papers

Introduction

A significant issue for housing markets around the world is an adequate supply of housing to accommodate the current and projected demand for housing. In most markets the issue of affordable housing invariably turns to the question of what are the financing mechanisms to deliver and maintain affordable housing.

Following the economic downturn and credit crisis in the late 2000s there has been substantial changes in the policy and funding environments in which not-for-profit housing providers work. Direct public sector investment has reduced in many markets and providers have therefore had to innovate and turn to alternative mechanisms that blend capital solutions to enable ongoing delivery of affordable housing. Providers must consider how to combine their social purpose with a commercial approach geared to filling gaps in (often) dysfunctional housing markets by adopting project and core financing mechanisms that attract and service capital whilst also appropriately allocating and managing risk.

In 2013 the International Housing Partnership Capital Sources Work Group developed a paper titled Innovative Capital Sources that explored the emerging financing mechanisms across the four IHP countries. During 2014 the Capital Sources Work Group has noted with interest the success of UK Housing Associations with private placements in the United States. One of this year's Work Group contributors has also noted the potential of investor markets in Asia as a future source of capital. Recognising the global nature of capital markets there are longer term considerations for the IHP about collaborative financing mechanisms that will build on this peer to peer exchange of jurisdictional innovation.

Whatever the potential of direct collaboration on financing mechanisms there is keen interest from IHP members to explore new ways to raise capital for housing and community development enterprises, both in the capital markets and from impact investors. Some groups are also looking at the potential of utilizing capital reserves, or using revenues from other enterprises, to fund new projects. All are looking to better understand social impact bonds, public offerings, how to get rated, the impact of regulatory framework(s) and how this impacts the ability to raise or use capital.

The background papers that follow have been prepared by country representatives who are contributing to the IHP Capital Sources Work Group and will be presenting at a session on Tuesday 7 October during the Alternative Capital & Community Development Investment forum.

We trust these papers are useful background and look forward to your participation in this session during the forum.

Scott Langford
Chair, IHP Capital Sources Work Group
Chairman, PowerHousing Australia & General Manager, Junction & Women's Housing Ltd

Canadian Case Study: The Housing Finance Corporation
Shayne Ramsay – CEO, BC Housing

Outline: The Canadian Case Study provides an overview of The Housing Finance Corporation UK Model as background to Canadian efforts to establish a similar model in their jurisdiction. Shayne will talk to this initiative at the London Meeting.

Definition

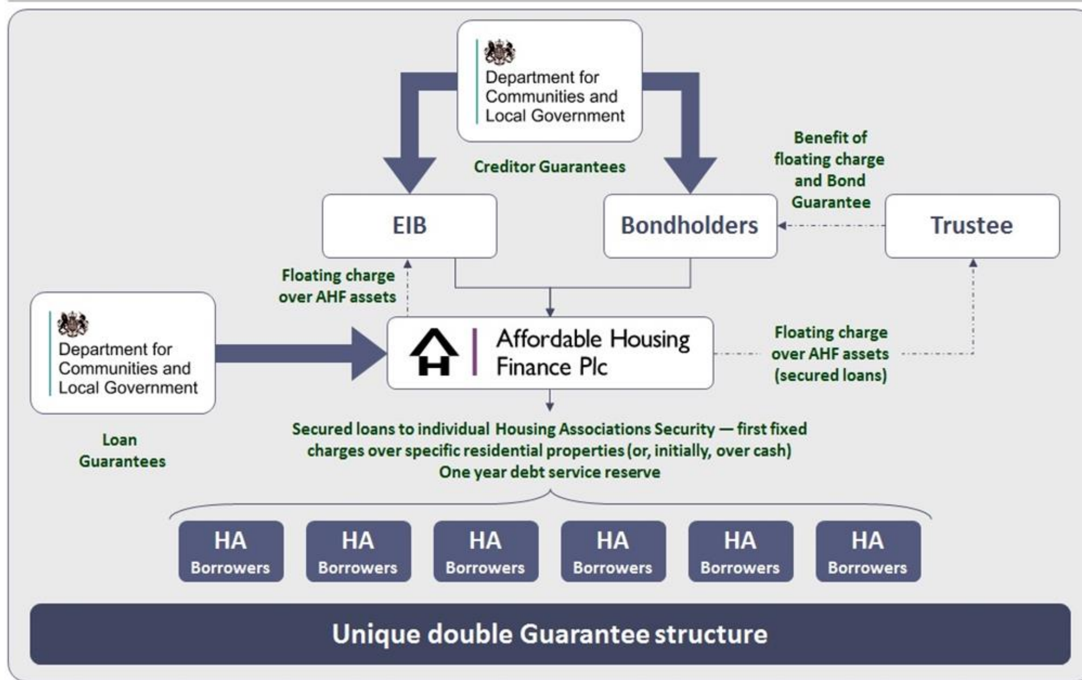
THFC is a financial intermediary, diversifying the risk to those investors wanting to lend to registered housing associations and allowing access to the capital markets for housing association borrowers that would ordinarily not be able to do so, typically owing to their size[1]. THFC creates cost efficiencies for small- to medium-sized (as per UK-definitions of size) housing associations through economies of scale and standardizes loan terms across those that participate in their arrangements. Some larger housing associations that can also access institutional investors directly will participate in THFC aggregations when it makes sense financially for them to do so.

The first TFHC bond was issued in 1987 for £30.75m for six housing associations. As of March 2013, THFC's loan book stood at £3,12m, a substantial increase over 2012 which stood at £2,882m.

THFC is a well-managed single industry vehicle that supports housing association initiatives. It has had a 100% repayment rate on the part of its borrowers over its 26-year period.

THFC works in a group structure, with subsidiaries being established as needed to manage particular bond issues. The structure of its most recent subsidiary, Affordable Housing Finance, is highlighted below:

[1] Standard and Poors, "The Housing Finance Corporation Ltd", 2008.



Key Features

a) Legislative/Regulatory environment
THFC is a not-for-profit Industrial and Provident Society (I&PS) which means that it functions similarly to a charity under UK corporate law. It operates under the rules registered and approved through the Financial Services Authority (FSA). Unlike a commercial bank, it is not formally regulated by the FSA.

THFC has no explicit government support, other than through 1 board nominee from the Homes and Communities Agency (HCA), the government regulator for social housing. Each of the seven non-executive board members (including HCA) holds one share of THFC. In view of this minor holding and HCA's inability to inject capital and the relatively minor role that THFC plays as a lender in relation to the size of the sector, THFC is not considered by investors to be a "government-related entity". If it were, it would be rated differently by ratings agencies.

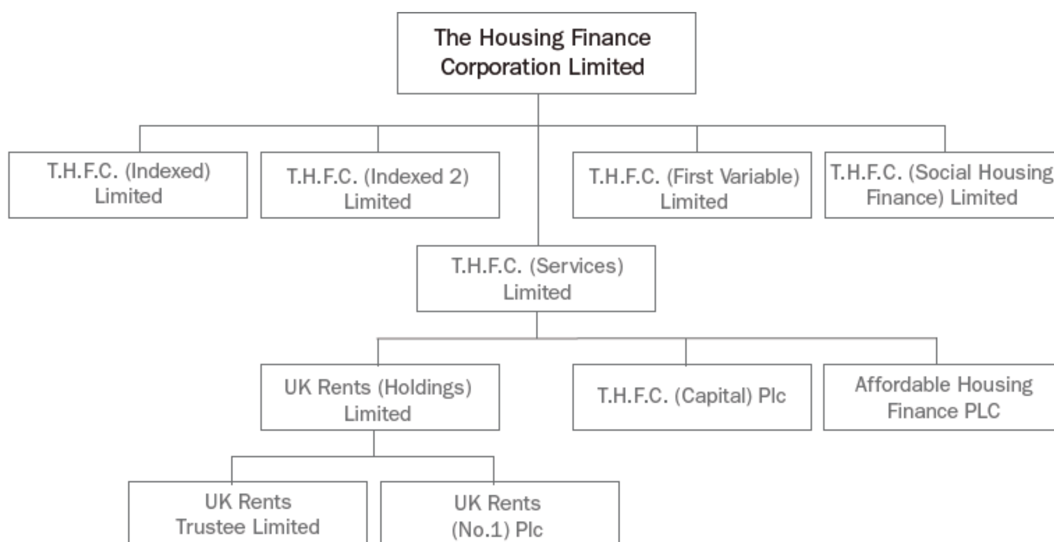
b) Market conditions
THFC operates in a highly competitive financial market with the primarily goal of aggregating capital from institutional investors to meet the needs of UK housing associations. The trick is to match the housing association capital needs with other housing associations seeking similar terms in a cohesive package that is attractive to investors. This requires housing associations to have identified their capital needs and be willing to adjust their needs to fit in with the group and within the boundaries offered by the group package.

c) Governance/Structure

THFC has a 9-member board with 2 nominees each coming from their founders, the HCA and the National Housing Federation (NHF). There are six independent board members and 2 executive members (the CEO and Group Treasurer). All have strong experience from the banking, financial and commercial sectors. Separate committees exist for credit, audit and risk. The credit committee approves all new loans, whether to new or existing borrowers.

THFC has a small operational team of sixteen experienced professionals, with backgrounds in social housing, banking, accounting and corporate treasury. THFC works in a highly specialized market in the UK combining social housing with financial acumen. The current CEO has been in his role for 12 years, having led THFC out of a troubled time in the organization's history.

THFC operates through a group structure, with a service company THFC (Services) Ltd., providing all administrative and management services to THFC and its main subsidiaries. These subsidiaries are individual special-purpose vehicles set up for the purpose of individual capital market bond issuance. They are separately constituted entities legally owned by THFC.



d) Success Factors/Must Have's
  - Unrivaled knowledge and experience of the social housing sector through its status as a specialist lender and its direct links with housing associations and government
  - Track record of continuous independent profitability and viability from inception, through the banking crisis and beyond
  - Proven funding methodology that minimises risks to investors and to THFC itself
  - Excellent relationships with and trust of investors and housing associations

e) Current usage & impacts
At March 2013, THFC had a total loan book value of £3.09 billion and declared an annual operating surplus of £1.410 million (after tax), representing about 6% of private lending to the sector. Their book value has continued to increase since

2013. For example on May 22, 2014, THFC issued a £208m long term guaranteed bond for 13 housing associations with a 'AAA' rating from Standard and Poor's. The 28-year deal offered the tightest spread over Gilts (UK bonds) ever in THFC's history of 0.37%.

Reforms to local authority housing finance were introduced in 2012 which means that local authorities will be able to borrow against their housing assets up to a pre-determined limit. This offers an opportunity for THFC. The challenge for THFC is how to add a greater number of clients, which have smaller scale, to its roster with its small number of staff. There is a complexity in working with local government that will require THFC to adjust its practices.

How it Works

THFC is a small financial intermediary that sources long term capital on the markets from institutional investors. THFC acts as principal and borrows in its own name and immediately onlends only to registered housing providers. THFC secures all of its loans. Loans are ranked pari passu alongside other loans thereby adding to THFC's status on title.

THFC makes and maintains its own independent credit assessment of its borrowers, using its own credit rating system, and approves applications for funding only after a careful review by the Group's credit committee.[2] THFC also monitors the financial position of its borrowers on an on-going basis, including measurement against covenant undertakings.

Over its history, THFC has used a variety of financing instruments to source capital for housing associations – including zero coupon, deep discounted, index-linked and conventional public debenture stocks, private placements and fixed and variable rate bank loans.

THFC's borrowing and lending in the housing sector in the UK is successful due to the following 4 critical factors:

a) Housing associations are highly regulated by HCA (referred to as the Regulator) which gives comfort to investors
b) Housing associations have accessed or will access grant (ie government funding for new housing). Grant is basically undated subordinated capital estimated to be about £43.8 billion. It is subordinated to a private lender's first charge against housing assets. This also gives comfort to investors about the robustness of the sector.
c) THFC only lends on a secured basis. This is standard mortgage financing which is transparent and well understood by investors and housing associations.
d) Housing associations revenues are backstopped by the presence of "housing benefit" which is the UK housing assistance program available to all citizens when needed.

Government does not regulate what THFC does. Given its interest in ensuring the sector has access to low cost capital, it recently held a tender to select an organization that would

[2] Retrieved from: http://www.thfcorp.com/accounts/2013/2013-annual-accounts.pdf

benefit from its offer to guarantee £500 million worth of affordable housing development loans to housing associations. THFC has sole license to write loans to housing associations through it's new subsidiary, Affordable Housing Finance (AHF). It was incorporated in 2013 to receive loans from the European Investment Bank (EIB) which are guaranteed by the UK government and onlent to housing associations. These loans are about 0.40% above the Gilts.

SWOT analysis (Strengths, Weakness, Opportunities and Threats)

f) Strengths
- Efficient means of introducing large investments to housing associations across the UK
- Allows small to medium-sized housing associations the ability to access cheap capital to continue on with their business initiatives.
- Experienced staff who can read credit quickly
- Limited client base of 150 to 200 housing associations
- Good leadership and corporate culture
- Unregulated by government although overseen by "stewards", the HCA and NHF
- Conservative, prudent and patient approach
- Not rapacious in it's approach as it is ultimately an I&PS
- Works as a consensus builder
- The "soft" features of THFC are its key selling points and difference from other market players. This includes the trust on the part of housing associations and the long-standing relationships that THFC has built over time with HA's, the marketplace, investors and government.
- THFC takes minimal interest rate risk as its own borrowings are immediately onlent to RSL's with a similar interest and principal repayment profile.
- THFC is match-funded which reduces interest rate and liquidity risk. They manage liquidity by requiring borrowers to pay interest one month in advance and through the use of cash sinking funds to accumulate funds from borrowers ahead of THFC's own bullet repayments.
- THFC bonds are counter-cyclical in that during the Global Financial Crisis, THFC's offerings increased substantially when banks had no funds to invest in housing.

g) Weaknesses
- Small but experienced team that leaves THFC vulnerable to turnover and key personnel risk
- Reliance on housing associations to identify capital needs which means that THFC is always "herding cats"
- Requires institutional investors in advanced capital markets with a ready supply of investing institutions
- Larger housing associations are able to raise their own bond finance without THFC

- Standards and Poors identify THFC's weaknesses as being weak capitalization and modest liquid financial resources[3]
- THFC only lends to housing associations which means that it is perceived to have a single industry risk

h) Opportunities
   - THFC is a private sector entity with the potential to expand its offerings to other small and medium-sized housing associations which have not yet accessed their services
   - Affordable housing guarantee, which was introduced
   - Offer even tighter pricing than in the past
   - THFC is looking at changes occurring at the local authority level and the possibility of having local authorities participate in their aggregated bonds.

i) Threats
   - Land sourcing and planning restrictions which prevent or delay housing associations from accessing capital when they need it
   - Lessons to be learned from the failed Dutch housing association, Vestia in that they suffered from chronic bad governance and were not functioning as a housing association. A similar situation could occur in the UK
   - THFC rating is intimately related to how much government supports the social housing sector. THFC's rating could be lowered if THFC's reserves are eroded and it absorbs losses in the loan portfolio
   - The Standards and Poor's rating is also tied to the current staff. Loss of key personnel could affect the rating.

Roles:

j) Government
   THFC is unregulated except through the Financial Services Authority. There is one board member appointed from the HCA and who holds 1 of 7 shares in THFC.
k) Housing providers
   Housing associations access loans from THFC which requires them to have a strong asset management strategy and business plan in place. The housing associations must know how much money they need for what purpose and when they need to use the money. They also must be financially sound to undergo THCF's rigorous credit tests before they are assessed by the board's credit committee.
l) Banks/Investors
   Investors are primarily institutional or insurance companies that provide the capital to THFC in large chunks over long time frames (e.g 25+ years). One of the primary investors in THFC is the European Investment Bank (EIB) which also operates on a recovery basis (ie it takes no profit).

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[3] Standards and Poor's, The Housing Finance Corporation Ltd., October 2013

Future outlook and emerging issues

The outlook for THFC is very good. It's net profits jumped to 44% in 2013 compared to an average of 39% between 2008 and 2012 0 thanks to fees from a large issuance of bonds. Ratings agencies have stated that they expect THFC's fees to step up substantially in 2014 and 2015 as a result of its new relationship with the European Investment Bank, the guaranteed nature of future bond aggregations under the Affordable Housing Guarantee.

In Standard and Poor's view, THFC is considered to have a small capital base which provides it with limited flexibility if the credit quality of the housing sector deteriorates. Generally speaking THFC's role in the sector is considered to be quite strong but with uncertainties about housing association business models in the future, THFC may need to adjust it's strategies to address new needs for its main customers.

Comparison to Canada

In summary, THFC's success relies on several key factors as follows:

- size of housing sector which provides a large pool of potential clients
- sophisticated housing providers who can manage complex loans
- housing provider's loan repayment capacity which is based on a government-funded housing benefit program
- reliance on secured loans held by housing providers with debt carrying capacity
- growth-oriented housing providers with business strategies in place for new construction or redevelopment
- regulatory regime which gives comfort to investors
- ongoing pipeline of potential loans

Canada's housing sector is vastly different than the UK housing sector. The Canadian housing sector is significantly smaller than the UK sector and is split between two main ownership types: a) government (either provincial/ territorial Crown Corporations or City/Regional-owned corporations) and b) non-profits. These distinctions matter in a lending context because government-owned entities have the ability to access funds through the corporate treasury function (ie their province, municipality or region). Municipal and regional governments in Ontario for example, usually have excellent credit ratings that would be better than that achievable in the capital markets and regularly lend money to entities they own. Municipalities also may have access to special purpose lending vehicles like Infrastructure Ontario. Non-profits in Canada, on the other hand, are usually small, one or two building community-based organizations. Very few have grown beyond a few hundred units. There is therefore a limited revenue and asset base to draw upon for lending purposes. They also have limited capacity to undertake major capital projects without assistance from government.

Municipal government ownership of housing is the predominant form in Ontario and Alberta although British Columbia and Quebec also have municipally-owned housing corporations with scale. Other provinces continue to be dominated by provincial Crown Corporations (e.g. Manitoba, Saskatchewan and all of the Maritime provinces). Provincially-

owned housing corporations access capital and operating funding through provincial treasuries and do not do any borrowing on their own.

One of the challenges in assessing the potential market for a Canadian THFC is that Canada does not collect information on housing governance structures. The attached Appendix A lists Canada's largest social/affordable housing providers and identifies their ownership. Here is a summary of Appendix A:

- There are no non-profit housing providers in Canada with more than 5,000 units
- There are estimated to be only 5 non-profit housing providers in Canada with more than 1,000 units
- There are estimated to be about 25-35 municipally or regionally owned corporations across Canada with more than 1,000 units
- Of those 25-35, it is estimated that only 8 of these municipally/regionally-owned housing corporations have more than 5,000 units and that those 8 are located in Ontario, Alberta and Quebec.
- Provincial crown corporations dominate the social housing sector in most provinces.

The following chart highlights some of the differences between England and Canada. This matters because the size and shape of a lending entity will be influenced by these factors.

	England (1)	Canada (2)
Dwelling stock	23,236,000	14,569,633
Social housing stock (3)	4,013,000	593,800
Percentage of housing stock that is social housing	17%	4%
Number of registered providers/ non-profits owning more than 10,000 units (4)	71	0
Number of registered providers/ non-profits owning more than 1,000 units but less than 10,000 units (4)	267	unknown – est. 5
Number of registered providers/ non-profits owning less than 1,000 units (4)	1,200	unknown – est. 4,000
Average units owned/managed	7,709	unknown – est. 100

Notes:

(1) 2013 UK government statistics
(2) 2011 Canadian census data
(3) England data includes registered providers and local authorities. Canadian data from 2013 Canadian housing statistics.
(4) For Canada, only non-profit housing corporations are included in this comparison

Canada therefore has a very different need for lending in the social/affordable housing sector. It must ensure that a lending vehicle meets the needs of the sector, which is predominantly larger government owned entities along with smaller community based housing organizations which have vastly different needs than larger ones do. In this regard, the following chart compares THFC's success factors with the situation in Canada

United Kingdom THFC success factors	Canada Comparison
Large size of housing sector which provides a large pool of potential clients	Canada's housing sector is dominated by small community-based housing providers and government-owned entities. There are some larger non-profits providers but these organizations will not generate a significant ongoing large pipeline of potential loans. Smaller housing providers need help undertaking asset management strategies, financial analysis, plan development, etc. This is a function currently carried out by BC Housing and CHF Canada but there is no consistent coverage for this in Ontario
Sophisticated housing providers with scale who can manage complex loans	Canada has a limited number of sophisticated housing providers who can manage complex loans. Estimated between 25-35 across the country including municipal/regional housing corporations
Housing provider's loan repayment capacity which is based on a government-funded housing benefit program Housing association's revenues are backstopped by the presence of "housing benefit" which is the UK housing assistance program available to all citizens when needed.	There is no universal "housing benefit" in Canada. Rent geared-to-income (RGI) assistance does function like a housing benefit but it is limited. The exact number or subsidy amount being spent on RGI units in Canada is unknown. Each province manages it's RGI differently.
Reliance on secured loans and housing providers with debt carrying capacity THFC only lends on a secured basis. This is standard mortgage financing which is transparent and well understood by investors and housing associations.	Canadian housing providers are used to secured loans but their debt carrying capacity is unknown.
Growth-oriented housing providers that	Housing providers can access limited federal

United Kingdom THFC success factors	Canada Comparison
access government grant for new housing. Grant is basically undated subordinated capital estimated to be about £43.8 billion. It is subordinated to a private lender's first charge against housing assets. This also gives comfort to investors about the robustness of the sector	or provincial grant funding. If they do access this funding, the grant would be considered similarly as it is in the UK (ie as subordinated capital). Given that it is limited in nature, investors may not see the sector as robust
Housing providers with business strategies in place for new construction or redevelopment	Many of the larger housing providers in Canada do have business strategies in place. Most smaller housing providers do not. Many municipal governments in Ontario have staff who work with housing providers to get asset management plans in place (eg. York and Toronto). There is a gap in some smaller service areas where the local government does not have staff working with providers on asset management strategies. Typically this work should be done by consultants but the funding to pay for the strategies is often not in place.
Regulatory regime which gives comfort to investors	Non-profit providers are regulated by provinces (or municipalities in Ontario) but the regulation is not consistent across Canada since housing is a provincial responsibility. Furthermore, the nature of that regulation has never been assessed by investors so it is not clear if they feel the necessary comfort about the regulatory regime in place
Ongoing pipeline of potential loans	The potential pipeline of loans in Canada is limited given there are only about 25-35 housing providers across Canada who may be looking for substantial funds from lenders. The remainder of housing providers need a service from either their provincial or municipal government (Ontario) to help them determine their capital repair needs

Conclusion

A special purpose lending vehicle in Canada for affordable and social housing providers is needed but it must be modelled in a way that fits the Canadian housing sector. The sector is predominantly made up of government-owned organizations that must have approval from local or provincial government before proceeding with any plan. This creates time delays in any strategy. While this approval may be forthcoming, borrowing needs of entities that are government-owned impact the credit rating of that government. Municipalities have multiple borrowing needs and housing is just one of a multitude and it may not be the priority in the municipality to receive that approval.

There are other players in the lending arena for government-owned entities – either the municipalities themselves can act as lenders or they can access other organizations that lend specifically to municipalities such as Infrastructure Ontario. There may also be pressure to take out a loan from the municipality or region directly given that credit ratings are sometimes better than what a municipally-owned government entity could achieve on its own in the markets. This suggests that there will be competition for borrowers.

Some of the larger government-owned entities may be interested in accessing alternative capital sources but there are not many of them. Only a handful of them could access the bond market directly. And this is highly dependent on them having solid business and asset management strategies in place so they know what they want to do. There would be the need to aggregate their capital needs, similarly to what THFC does in the UK. The scale of the entity will be significantly smaller because there are very few larger housing providers in Canada. This suggests that there will not be regular capital raises occurring and that when they do occur, they will be smaller in size. The same issue of "herding cats" that applies for THFC will also apply for Canada. This means a significant amount of time must be spent on relationship management.

The sector also has a significant number of smaller housing providers who are too small to access the bond markets directly. Loan requirements can be aggregated but there would have to be a significant collection of housing providers in order to enter the capital markets. They also may not have debt carrying capacity or adequate revenue to support additional debt. They also may not know what they need or what they want to do. This suggests they need help from their municipality or from a special purpose lending vehicle to help them make those decisions.

Recommendation

Canada needs to explore the establishment of a special purpose lending vehicle that has 2 key functions

- aggregated bond raising for housing providers in Canada
- services for smaller housing providers to help them quantify and decide on their capital needs, loan requirements, debt carry capacity, etc.

Appendix A
Canada's largest social/affordable housing providers
Units owned and managed
Identifying ownership type
2014

Organization	Province	Ownership Type	Number of Units (est)
Toronto Community Housing Corporation	Ontario	Municipal government	58,221
Office municipal d'habitation de Montréal	Quebec	Municipal government	22,869
Saskatchewan Housing Corporation	Saskatchewan	Provincial Crown Corporation	18,352
Ottawa Community Housing Corporation	Ontario	Municipal government	14,590
Manitoba Housing	Manitoba	Provincial Crown Corporation	13,023
Housing Nova Scotia	Nova Scotia	Provincial Crown Corporation	12,300
BC Housing	BC	Provincial Crown Corporation	8,576
Peel Living	Ontario	Regional government	7,500
Calgary Housing	Alberta	Municipal government	7,000
Cityhousing Hamilton	Ontario	Municipal government	6,796
Newfoundland and Labrador Housing Corporation	Newfoundland	Provincial Crown Corporation	5,563
Capital Region Housing Corporation	Alberta	Regional	4,900

Organization	Province	Ownership Type	Number of Units (est)
(Edmonton)		government	
Windsor-Essex Community Housing Corporation	Ontario	Regional government	4,705
Société d’habitation et de développement de Montréal	Quebec	Municipal government	4,700
New Brunswick Housing	New Brunswick	Provincial government	3,700
London-Middlesex Housing Corporation	Ontario	Regional government	3,500
Affordable Housing Societies	BC	Non-Profit	3,156
Victoria Park Community Homes	Ontario	Non-Profit	2,900
Metro Vancouver Housing Corporation	BC	Regional government	2,773
Waterloo Regional Housing	Ontario	Regional government	2,722
Housing York Inc	Ontario	Regional government	2,201
Ontario Aboriginal Housing Services	Ontario	Non-Profit	2,000
Centretown Citizens of Ottawa	Ontario	Non-Profit	1,563
Atira Women's Resource Society	BC	Non-Profit	1,255
Capital Region Housing Corporation (Victoria)	BC	Regional Government	1,234

Australia Case Study: Innovating in the Capital Markets to enable Growth Charles Northcote– CEO, BlueCHP Limited

Outline: The Australian paper reflects on the changing capital market environment in Australia and BlueCHP Limited's (BCL) response to the market in light of the Government policy changes impacting on supporting growth.

Introduction

The BCL was created by five of the larger (Community Housing Providers) (CHPs) in New South Wales as response to the changing Federal and NSW policy settings resulting from the 2008 Global Financial Crisis (GFC). The Federal government pumped billions of dollars into the economy for affordable housing. As part of the compact between Federal and State Governments the housing was to be passed to the community housing providers. This happened to some extent nationally – NSW put the housing up for tender based on the ability to leverage the portfolio cash flows.

In addition further government stimulus was pumped into the economy via a different number of schemes. The overall impact was a significant capitalisation of the sector, growth and professionalisation of management.

In addition at the time of the GFC the sector was undergoing a rapid lift in skills as the requirements for registration increased and rating achieved was important for access to government funding – hence many of BCL members where Class 2 and BCL achieved a Class 1 rating.

The set up enabled risk to be allocated more appropriately with creation of BCL – BCL's members had many years of tenancy experience, the creation of BCL aggregated the resources to provide skills in property development.

BCL

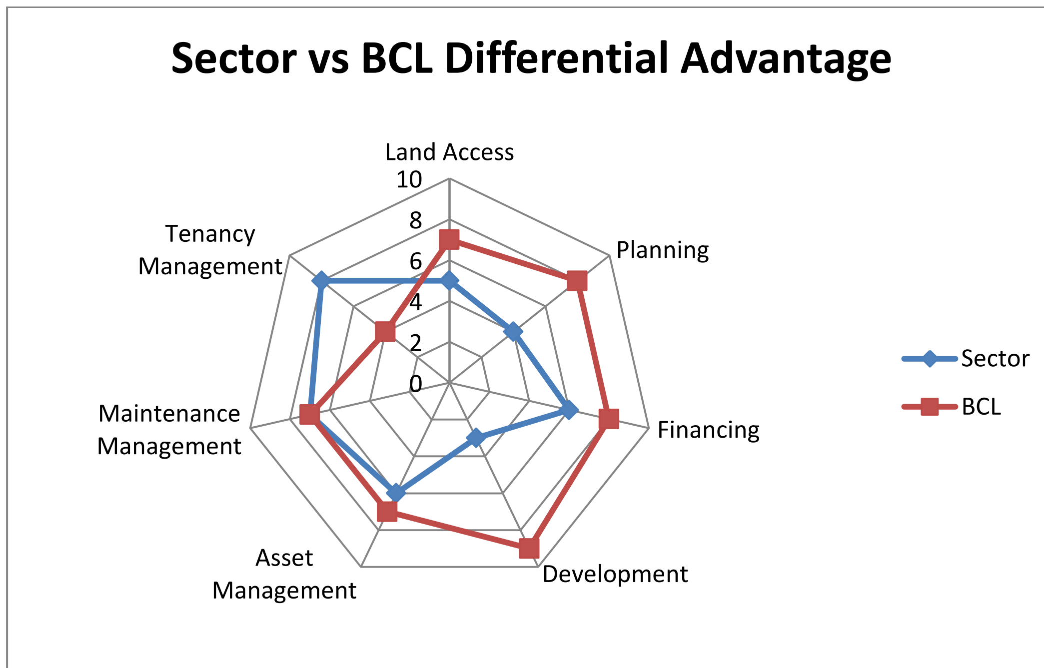
Initially, BCL literally had to live on the 'smell of an oily rag' - no computers, no credit accounts to buy stationery etc. and to win tenders (paying advisors with success fees) plus share offices with a member. Members over a three year period did subscribe subordinated loans up to $5m in total to further facilitate growth.

BCL's core DNA is in the following areas:

- Property Development
- Long Term Asset Management
- Financial/Project Structuring
- Share Service capability

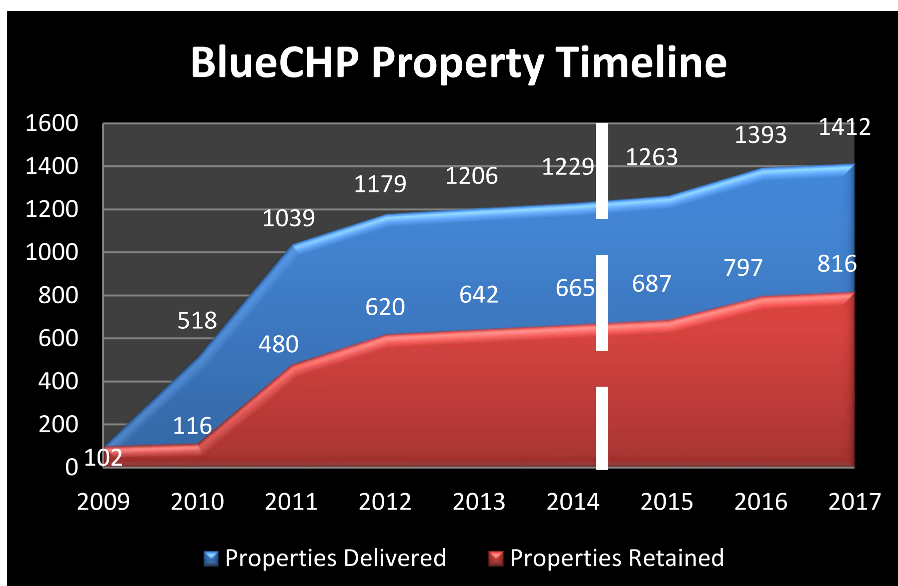
BCL seeks to provide services to its members and others in the sector and has developed a deep pool of experience.

The following table provides a comparative of the differential advantage of BCL to the CHP sector as a whole.



The cost for many organisations of highly qualified development staff is often at odds with the level of development work their organisations can sustain. In Victoria we had the example where the government instructed the CHPs to construct and debt finance 25% of their projects and this resulted CHPs unable to sustain any further development (leverage maximised) and subsequently most of the development staff have been terminated.

Over the past six years BCL has delivered 1229 properties to members and retained 665 of which it owns 637.



- BCL now has assets over $200m and generating EBITDA over $4m excluding property revaluations.

Capital Markets

Past Experience

The debt markets in Australia with respect to this sector remain dominated by bank financing. The bank financing to this sector is predominately from two of the big four banks and smaller community bank organisations.

The nature of debt financing is relatively narrow in terms of options – you normally will get corporate facilities for up to 5 years and project specific financing up to 20 years. Margins charged by the banks vary but the level of competition is low due the bank oligopoly.

After 1 year BCL secured $5m of financing from the Bank of Queensland, this was secured against the first properties delivered – this provided a lifeline for the business to maintain operations. The key risk for the business was achieving a sustainable cash flow whilst winning tenders and securing/constructing properties to gain critical mass.

Over the past 3 years BCL has increased its bank facilities to $55m (bankmecu) at market competitive rates, however the long term issue for Australian organisations is the cost of refinancing and the relatively short time period of fixed rate hedging versus the life of the asset.

Current Challenge

Whilst the capital markets have become more benign over the past 2 years and interest rates remain favourable, government funding has become almost non-existent. This has raised a real challenge for participants. In addition the status of housing though key to the overall economy has been pushed to the sidelines as Federal/State responsibilities are to be clarified.

Principally the Federal Government is putting the responsibility on the States for the provision of housing – whether Community (Social), Affordable & Private Market.

The States are somewhat constrained as they are reliant on Federal revenue, however they control land releases and planning; plus they have large social housing portfolios.

This is a dilemma also impacts the CHP as tenant income for community housing is determined by the Federal Government – the drivers of expenses is more localised and dependent on the State and Local Government Authority imposts.

Target Market Rental streams are as follows:

- Community (Social) – 25% of tenant income (generally low income/government payments)
- Affordable – up to 80% of market rent
- Private Market – Market rent

To provide an example a 2 bedroom home in Sydney outer suburbs:

- Cost $400,000
- Interest @ 5.5% = $22,000
- Rental Community (Social) $180p.w. Annual $9,360
- Rental Affordable $360p.w. Annual $18,720
- Rental Market $450p.w. Annual $23,400

The example above demonstrates that the private market is unable to generate affordable or community housing without government subsidy or a property development program selling a proportion of stock to generate profits to reduce financial leverage.

The operating environment in each state is very different; however the revenue drivers are the same nationwide. This gives rise to very different cost of operations both in urban and regional markets. It also makes sustainable investing very challenging. Furthermore the long term costs are rising faster than the revenue base and if this is sustained for CHPs with only community housing their very existence is in doubt.

In addition we have had the creation of a national regulatory system that with the change in Federal Government in 2013 resulted in it regressing back into a slightly less State fragmented structure. This will continue to add operational costs to doing business inter-state.

To answer these challenges of moving away from government funding support is a challenge that all businesses in this sector face – particularly in markets with high land prices and supply constraints.

BCL seeks to develop its business platform along a number of streams:

- Rebalancing its portfolio allocation over time from 33% to 60% affordable housing
- Turning over stock every 10 years
- Earning additional income through fee-for-service opportunities
- Reducing the 'cost-to-serve' clients

We seek to fund these opportunities by:

1. Using its tax advantages to raise further investment
2. Using partnerships to leverage expertise
    a. Off balance sheet vehicles
    b. Joint Ventures
3. Raising long term debt
4. Government funding

Tax Advantages for Investment

Under the Australian tax rules CHPs are accorded Public Benevolent Institution (PBI) and Deductible Gift Recipient (DGR). The PBI accords operational tax benefits on staff salary benefits and the organisation is tax exempt.

The Deductible Gift Recipient status gives tax deductibility for donations – this field has not been utilised significantly in the sector, it is market opportunity to be exploited as we have some unique benefits we can convey to benefactors. Historically, Christian based organisations have been the most effective in this field.

In addition many listed company organisations are looking at ways of fulfilling their Corporate Sustainability obligations to the community. CHPs provide an appropriate vehicle for them to participate in the community we have seen this particularly in areas of mining development.

Partnerships

Off-balance sheet vehicles are a method to expand the opportunities to bring together our expertise with outside parties; these can be both project and segment based. BCL is in the process of putting together a project based entity utilising the tax benefits with a Fund manager to pilot a delivery vehicle for affordable housing.

The advent of the National Disability Insurance Scheme (NDIS) in Australia will enable variants of this type of model to develop over time – in similar way the retirement industry has grown. As funding packages go to the individual, however the pathway to investing in housing is remains unclear at present.

Joint Ventures

Collaboration is an essential part of the future for participation in this sector due to the professional skills and capital requirements. BCL has partnered with Compass Housing Limited to win the Logan Renewal Initiative Project. This is the single largest tender offering in Australia to date. It is a 20 year tenancy & maintenance management lease of approximately 5,000 dwellings with portfolio redevelopment of 2,600 homes. For BCL it is step change project based on fee-for-service model. The key for the participants was the management of risk where the appropriate risk is carried by government and/or the JV. Compass provides their expertise in tenancy and maintenance management and BCL manages the development aspects.

Long Term Debt

Due to the immaturity of the Australian sector it is now the time to consider long term funding options. BCL along with other CHPs are investigating the opportunity of sourcing long term financing from the global bond market in a similar manner to the UK Housing Associations.

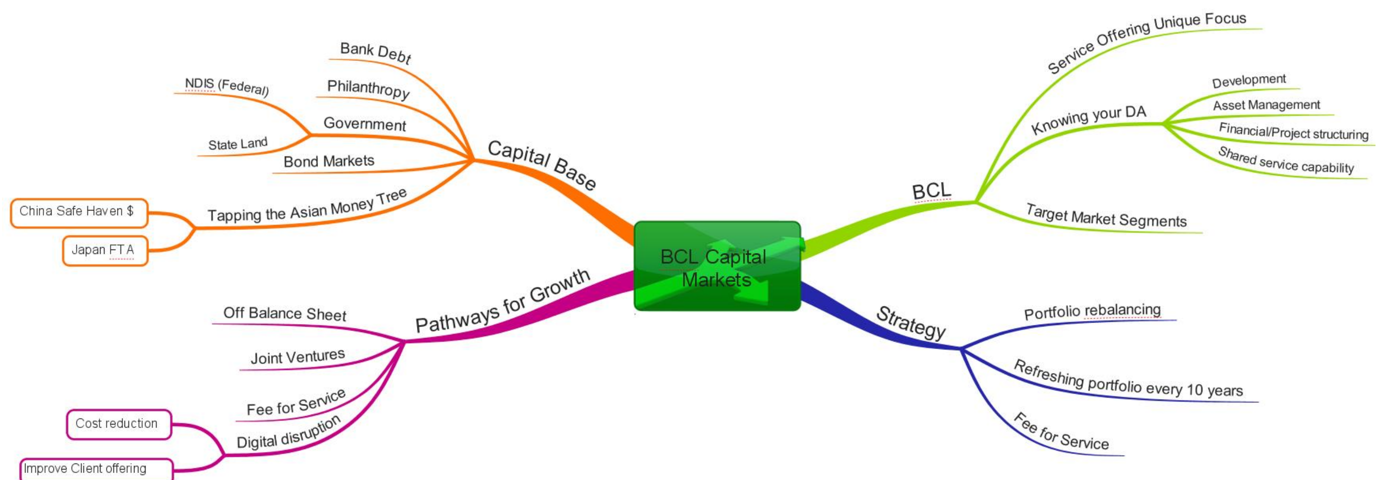
In addition a significant source of money is available from Asia particularly with a tenor between 7 to 10 years. These sources are likely to feature in the use of off balance sheet vehicles.

The advent of the Japanese Free Trade Agreement will over time enhance the depth of the Australian Dollar bond issuance assisting in deepening the pool of long term bonds.

Government Funding

In the current environment the scope is limited, however the Government through planning and its own land portfolio can provide funding by way on non-monetary contributions.

The mind map attached pulls together drivers and outputs for BCL.



The challenge will be opening up government land banks with innovative possibilities to enable them to discharge their social obligations without significant costs to the taxpayer. NSW Government has in the last month announced its 'Innovation Initiative' which will open up the market to a range of new ideas on the innovation with respect to their social housing portfolio. Collaboration will be key to achieve a response to the government with sufficient scale to address the problems they face. This was the case with Compass and BCL in winning the Logan Renewal Initiative in Queensland.

As noted earlier the issue with revenue generation for CHPs is problematic over the long term with revenue rising slower than costs for social housing. The impact is for organisations will be to become as efficient as possible with new technology applications. The mix of BCL's social to affordable housing ratio is required to reduce risk to Federal government revenue policy changes, and as part of the rebalancing of the portfolio BCL will harness development profits to reduce leverage.

The current financing mechanisms in Australia (e.g. primary bank debt) are not well matched to the long term nature of the asset so the industry needs to start building other core capital options such as accessing the global capital markets.

The size of the balance sheets of the CHP sector will necessitate the aggregation of debt to gain critical mass/scale in a similar way to the THLC in the United Kingdom. Putting together such vehicles requires the addressing of legal structures – the dealing with risks and impacts of government policy frameworks over the long term. Flexibility and durability of the legal structure especially in managing participant financial performance over a 20 year period as companies will change and evolve over time; considerations such as need to manage such matters concerning mergers etc. BCL will continue generate opportunities through collaboration both domestically and internationally where skills are appropriate. Financial structuring skills will be at premium to enable growth for the future together with smart IT infrastructure to reduce the 'cost to serve'.

Finally, after several years inaction post the Nation Building program, State governments in Australia are looking at ways to tackle the problems stemming the losses due to mismatch of demand to supply and years of failing to maintain asset quality. This provides that sector with a significant opportunity to be part of and/or the whole solution to the provision of social and affordable housing in the future.

USA Case Study: Low Income Housing Tax Credits
Linda Metropolous– Director of Housing and Neighborhood Development, Action Housing Inc.

Outline: The US paper reflects on the Low Income Tax Credit program and how this enables the delivery of affordable housing

In the U.S. approximately 120,000 new units of affordable housing are developed each year. According to the Department of Housing and Urban Development 105,000 of these are built through the Federal Government's Low Income Housing Tax Credits (LIHTC) Program.

The LIHTC Program, which is based on **Section 42 of the Internal Revenue Code**, was enacted by Congress in 1986 to provide the private market with an incentive to invest in affordable rental housing. Federal housing tax credits, approximately $8 billion allocated each year, are awarded to developers of qualified projects through a competitive process managed by each state. Developers then sell these credits to investors to raise capital (equity) for their projects, which substantially reduces or eliminated amortizing debt that the developer would otherwise have to borrow. Between 1987 and 2012 over 39,000 projects and almost 2,458,000 units of housing were placed in service through the LIHTC program.

Developer Benefits: At a time when local government resources for new affordable housing are hard to obtain, the LIHTC tax credit is one of the only financial opportunities available. The Developer of a LIHTC project benefits by being able to raise typically more than 90% of its initial capital costs from a private investor without having to incur debt which would be impossible to support given the rent restrictions and low income tenant base.

Occupancy Requirements: Projects eligible for housing tax credits must meet low-income occupancy threshold requirements where household incomes are at or below 60% of the Area Median Income, limit rents so that tenant monthly housing costs, including a utility allowance, do not exceed the applicable LIHTC rent limits, and maintain affordability for a minimum of 15 years, with extensions to 30 and in some cases 50 years required by the states.

Investor Benefits: Investors receive a return on their investment, typically in the range of 6% to 12%. The projected return helps to establish the price that an investor will offer for the purchase of the credits. Provided the property maintains compliance with the program requirements, investors receive a dollar-for-dollar credit against their Federal tax liability each year over a period of 10 years. Additional factors that increase the rate of return for the investor include use of depreciation and bridge loan interest for the construction period. Regulated lenders also use LIHTC to meet significant portions of the Community Reinvestment Act (CRA) which was established in 1977 to encourage depository institutions to help meet the credit needs of low- and moderate-income neighborhoods.

In this session we will walk through the details of the LIHTC deal, outlining in greater detail the benefits to both the developer and the investor.

For more information, contact Linda Metropulos, ACTION-Housing, lmetropulos@actionhousing.org

UK Case Study: M&G Sale and Operating Lease
Neil Hadden– CEO, Genesis Housing

Outline: The UK Paper provides a brief outline of a deal struck between Genesis Housing Association and M&G Investments for a sale and operating lease structure.

Introduction

Genesis developed a multi-tenure, mixed use project in Stratford, East London, overlooking the Olympic Park. The scheme covers 14,000m² or 3.3 acres. It comprises 411 sale and market rent homes, a 65 unit extra care facility, 138 affordable rent homes and 91 for shared ownership, plus 31 artist studios and 2000m² of commercial space.

The Deal

Originally all 411 sale/market rent dwellings were for sale but the project came to market in difficult times. We decided to look to switch 401 units to market rent thereby minimising sale risk. We invited proposals on an off-market basis from a very small number of potential investors.

In the event we sold the 401 units to M&G's Secured Property Income Fund on a 160 year lease, retaining the management of the 43 storey tower block on a 35 year operating lease. This brought £125 million into the organisation, more than covering the cost of development and providing us with cash with which to fund other developments.

At the time this deal is the largest of its kind and the first in terms of value and volume. It is also the first institutional investment in residential real estate for M&G's SPIF, something of a holy grail within the UK.

Whilst not a funding deal as such, it provided us with financial headroom as well as a continuing income stream.