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.

The National Housing Finance and Investment Corporation (NHFIC) provides debt financing for social and affordable housing, with Community Housing Organisations (CHOs) typically using their rental income to pay the interest.

Even when combined with other available forms of funding assistance (such as rate and tax rebates, planning concessions and land contributions) these loans are often not enough to fund new social and affordable homes. In short, CHOs are faced with a funding gap that prevents new builds.

Despite the exceptionally low interest rates of the past few years, this funding gap has consistently presented a barrier to scaling up the industry to produce affordable rental housing.

The Housing Boost Aggregator (HBA) is a way to close this funding gap through the creation of a new Commonwealth tax-subsidy alongside 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

The HBA is a proposal that will support CHOs to close the funding gap for new housing developments.

The HBA proposal has two parts.

1. **The Boost:** The Commonwealth government would create a new annual tax-based subsidy (an annual refundable tax offset) – the Boost. CHOs would be able to tender for the Boost to close the project-specific funding gap for new affordable housing developments. This is different to previous Australian programs because it targets each project's specific upfront funding gap, rather than applying a one-size-fits-all approach.

2. **The Aggregator:** The Boost would be paired with a new entity (possibly a government agency) – the Aggregator – to aggregate CHO's capital requirements, create a fund and offer shares in that fund to institutional investors who would provide upfront capital to the CHOs. Investors would then receive low-risk returns generated by the fund in the form of a stream of annual Boost offsets.

Similar solutions have been proven to work internationally – using competition, the tax system and institutional investment to scale up the supply of social and affordable rental housing while delivering value for money to the government.

In the United States, tax incentives have been underpinning affordable rental housing construction for over 30 years with widespread investor acceptance.

Tax credits are also used in Australia. For instance, the Australian Research and Development Tax Incentive is used by the Australian government to encourage private investment in technological innovation.

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

- key workers
- low income earners in rental stress
- people at risk of, or experiencing homelessness
- women escaping domestic and family violence

How it works

The HBA is designed to incentivise high quality, cost effective affordable housing developments and supplement (not replace) existing funding streams.

Boost funding will be awarded through a competitive process – much like a reverse auction

Registered CHOs will bid for the Boost to fill their project-specific funding gap through a contestable process designed to encourage high quality, cost effective schemes.

The Boost will be awarded to CHOs on the basis of value for money – i.e. to projects that create well designed homes meeting local needs at a competitive cost. The competitive bidding process is designed to incentivise CHO's to crowd in additional funding sources and avoid the Boost simply substituting for existing sources of funding.

The Boost (equal to the total upfront capital gap plus an agreed annual return) is provided in installments over time, creating a flow of 10 annual payments (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 cash flow 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.

An important feature of this proposal is that the HBA is a Commonwealth program funded recurrently over time using forgone tax revenue. This is critical to ensure there is enough certainty and credible scale to attract institutional investors.

While HBA is a Commonwealth program, program priorities could be set in conjunction with states and territories reflecting development priorities in their housing strategies.

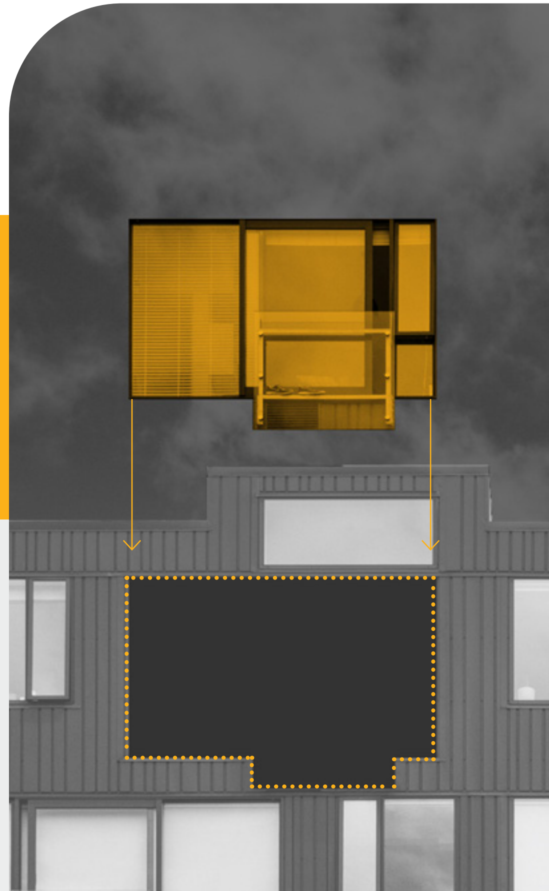
The HBA will close the funding gap by separating:

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

1

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

CHOs often face a significant funding gap for these projects even after all other available funding, incentives, rebates, programs and cross-subsidies are taken into account.

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 (meeting local needs at the most competitive cost).

4

CHOs can use the Aggregator to ‘convert’ their tax credits into upfront capital

The Aggregator acts as an intermediary between institutional investors and CHOs. It combines the annual payments from multiple successful CHO’s affordable housing projects into time pooled funds.

5

The HBA launches the fund and institutional investors purchase shares

Institutional investors provide the Aggregator with the funding that will be passed to participating CHOs to enable construction.

6

CHOs begin project construction

CHOs receive upfront capital from the Boost aggregator, which allows them to start construction.

7

CHOs claim tax credits from the ATO once homes have been built and rented

Institutional investors receive a flow of Boost offsets from operational CHO projects through the HBA.

The Boost — a tax incentive program provided by the government

The Aggregator — a government agency that acts as the intermediary between institutional investors and CHOs

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 government-regulated CHOs, tender for the Boost offsets to fill the project funding gap that remains after designing an affordable rental project and negotiating:

- land or planning concessions
- philanthropic support
- state government programs
- cross-subsidy with market-rate dwellings
- any other funding available in their community.

If successful, the CHO claims the Boost offsets over time, creating a 10-year ‘tax subsidy flow’ that is sold 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 CHO 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 allows housing needs 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 designed 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 (additional tax credits) per annum for 10 years, once the housing projects are operational.

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 cash flow 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’ as 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 are 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.

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