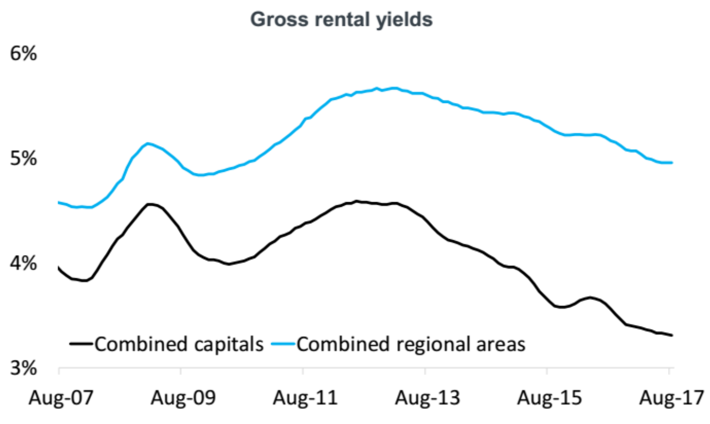
# Creation of a bond aggregator for social housing – some scale benefits but no panacea for low residential yields

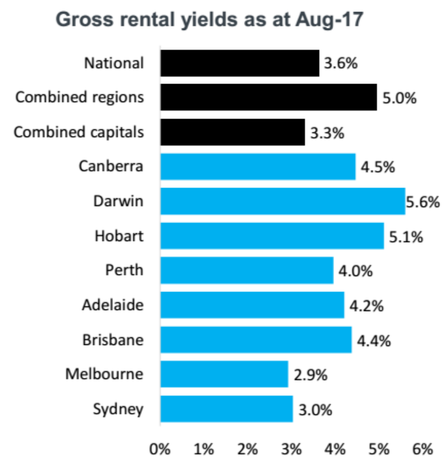
This month the Commonwealth Treasury have launched a consultation process regarding the potential structure of a bond aggregator for social and affordable housing. A bond aggregator is a government owned intermediatory that acts as a collective borrowing agent for community housing providers (CHPs) allowing them to access capital markets. A bond aggregator is intended to allow CHPs to access longer tenor and cheaper funding than they could otherwise access through banks. The purpose of this funding would be both increase and improve Australia's social housing stock.

Social housing is often mooted as a broader opportunity within the social infrastructure asset class. 'Social Housing is rental housing provided by not-for-profit, nongovernment and government to assist people who are unable to access suitable accommodation in the private rental market' (NSW Government, 2017). To date it has struggled to attract capital in scale, principally due to opportunity (investable deals). There are approximately 430,000 social hosing dwellings in Australia – 75% of which fall under the control of State and Territory governments. Additional properties are leased or owned CHPs – there are 285 registered CHPs providers in Australia – the largest being Compass which manages 3,245 properties.

In Infradebt's view, a bond aggregator is likely to deliver CHPs a modest saving in borrowing costs (particularly if the aggregator benefits from a government guarantee) but is likely only to have a modest effect on the capacity for the social housing sector to expand. In our view, the more significant barrier to the growth in the sector is the low level of net residential property returns – particularly for investors who don't share in the tax benefits available to individual private investors (ie negative gearing and discount capital gains).

The chart below shows CoreLogic's estimate of gross yields – both over time and by city. Importantly these are before expenses – rates, land tax, agents' commissions, repairs and maintenance. Net yields will be significantly lower – probably at least 1% lower – simply not enough return to compensate for the risk, in absence of tax benefits (or particularly strong view of long-term rental growth). It is this low yield challenge that underpins the lack of institutional build to rent residential accommodation in Australia (and is different to other markets, such as the US, where yields are much higher).



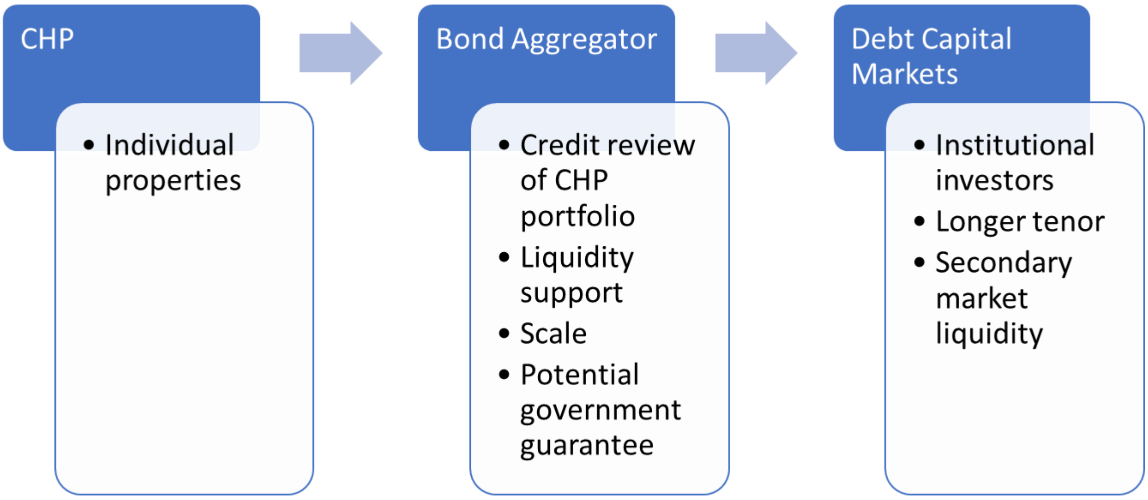




Source: CoreLogic, 2017

A flow-on effect of this is that it is difficulty to raise capital to fund social housing. Social housing has all the return issues of build to rent residential property, with additional challenges through lower rents (to extent rent is subsidised below market), higher expenses (unique challenges and costs of service provision to low income and disadvantaged groups).

***What is a bond aggregator?***

A bond aggregator is a government owned intermediatory that acts as a collective borrowing agent for community housing providers (CHPs) allowing them to access capital markets. Under a bond aggregator structure a government owned entity would issue bonds in capital markets and on-lend the proceeds to CHPs. By aggregating the borrowing requirements of multiple CHPs, the bond aggregator would be able to issue bonds at meaningful size for bond markets which would assist with secondary liquidity (although likely to be very much at the small end of Australia's bond market). A key role of the bond aggregator would be to develop standardised due diligence and credit criteria for participants in the program.




A bond aggregator delivers funding costs savings via economies of scale and, if provided, through the risk reduction of the government guarantee. EY has estimated the potential benefits to be of the order of 0.9-1.4% reduction in effective borrowing costs. The extent of the saving is quite sensitive to pricing of the bond aggregator's issued bonds – which will depend on the nature of the government guarantee (if any) as well as the scale of the offering (which will be a big driver of secondary liquidity).

Effectively a bond aggregator currently replaces the role provided by banks for CHPs. Banks currently provide individually negotiated loans to CHPs and then finance these loans via their broader funding activities. While a government owned provider – particularly one with access to a government guarantee – will no doubt be able to do this more cheaply – it is important to note that debt financiers play a role beyond providing capital – they often help transactions be commercially structured with sensible risk allocation, provide due diligence and transaction structuring advice. It is not clear if the bond aggregator will be able to provide these functions.

***Conclusion***

A Bond aggregator is not a panacea to the need for increased social and affordable housing in Australia– substantial increase in social housing will require either substantial government capital investment (which is unlikely given fiscal position of governments) or a revival NRAS style schemes where additional revenue is available – above and beyond market rents.