Private capital flows into affordable housing – international trends

This paper looks at the evidence regarding international private capital flows into subsidised housing[1] based on available data. It also includes takeaways from extensive interviews undertaken with local and international investors on investment barriers and enablers, while it also analyses recent private capital trends through a range of case studies, with the focus on the United Kingdom and the United States where there is more available data, but also Canada and some select European countries[2]. tax

The paper shows that investment flows into subsidised housing are prominent and increasing, but to varying degrees and in various forms across different countries[3]. Large institutional investors are driving most of the increased investment, primarily through debt financing, although equity investment is also growing from a low base. Subsidised housing asset classes have emerged more prominently in countries like the UK and the US where there are more longstanding support structures and policy tools in place to catalyse investment, such as tax credits and government backed financing and government (and non-government) financial intermediation.

The key findings from the research are:

- Private investment flows into subsidised housing are larger and growing in markets such as the UK and the US relative to countries like Australia and Canada. Large institutional investors are driving most of the increased investment, primarily through debt financing such as longstanding bond aggregators, government backed finance (including tax exempt housing bonds) and other policy levers.
- Policy approaches used by governments to encourage private capital include longstanding government-backed guarantees for financing, enduring subsidies, financing intermediaries (with similar or broader mandates to NHFIC), tax credit programs, allowing for-profit housing providers to access government support, and planning requirements. Countries with strong private finance also tend to have well-regulated systems which underpins confidence and supports sophistication and development of the sector.
- In the UK around 70% of capital to build affordable housing is currently sourced from private financing, up from 30 - 40% in the 2000s, while private finance to non-profit registered providers (similar to the Community Housing industry in Australia) stands at around £6 billion, up from £1.8 billion in the late 1990s.
- In the US, institutional investment in subsidised housing has grown substantially, with annual transaction volumes standing at around $36 billion in 2021, up from $1.3 billion in 2011. This is supported by longstanding state-based housing agencies which issue tax exempt housing bonds, together with the Low Income Housing Tax Credit (LIHTC) program since its inception. Established in the 1980s, the LIHTC helped catalyse $71 billion in private investment activity between 2005 and 2014, and $18 billion in 2022.

1 For the purposes of this report, subsidised housing covers all sub-classes of housing where below-market rent is charged to low- or moderate-income households.

2 International data on private capital flows and interview feedback was provided by Price Waterhouse Coopers.

3 This paper does not attempt to assess the success or otherwise of whether private finance can deliver better outcomes than publicly funded housing. Rather it provides a snapshot of where increases in private capital are occurring, and the underlying drivers.

National Housing Finance and Investment Corporation

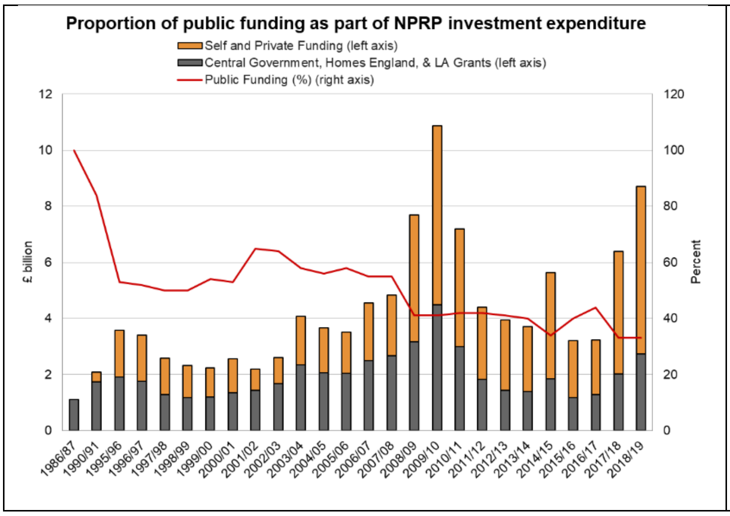
- The recent Canadian Housing Strategy delivered in 2021 by the Federal Government sets out 10-year targets for subsidised housing, and this appears to have helped catalyse private financing commitments. On the back of the National Housing Strategy, two major banks (Scotiabank and Bank of Montreal) have committed CAD$22 billion in financing over the next ten years for subsidised housing.
- Several countries in Europe such as Denmark and Finland rely heavily on private finance to fund subsidised housing, and this is backed by government guarantees which helps to lower the cost of financing. Around 90-95% of all finance for subsidised housing projects in these countries (delivered largely by not-for-profit housing associations) is sourced privately and guaranteed by the government.
- Large global pension and insurance funds invest in subsidised housing in countries with favourable arrangements, such as the UK. For example, in 2021 Legal and General invested £270 million to develop 1,400 new affordable homes across the UK and more recently has announced plans to invest a further £2 billion of retirement funds over the next five years to create 10,000 new homes nationwide.
- International and domestic institutional investors cited several social and affordable housing investment enablers, including tax incentives and subsidies, risk diversification and stability of cash flows, regulatory reform to allow institutional investors to own social housing stock, allowing for profit providers to take on development risk and access government incentives, achieving ESG objectives and providing greater information on tender / funding opportunities.
- Investment barriers cited included subsidised housing projects lacking sufficient commercial returns, insufficient scale, a lack of information on opportunities available, lack of data on vacancy risks, reputational risks around managing subsidised housing tenancies, and unfavourable market conditions.
- Regarding the characteristics of private investment in subsidised housing, acquiring housing stock via turnkey purchase or off the plan is most common. An investment model which is used by several institutional investors is to own land, fund construction, then enter long term leases to receive fixed income from a community housing manager. Most institutional investors seek to keep arm’s length from tenants.
- Given the maturity of their markets, both the UK and US have publicly available data sources tracking private sector capital flows into affordable housing. Australia does not have datasets available on private investment flows into subsidised housing, which is likely to be a result of the nascent and fragmented nature of the industry. Notably, Australia is one of the few OECD countries which does not provide subsidised housing data (i.e. stock, tenure) to the OECD.
- Increases in private investment do not always translate into overall increases to subsidised housing stock. This is because of absorption of existing stock, either by deterioration of the asset, reductions of public housing stock or conversion of existing stock to market rent. This is particularly the case for social and affordable housing in the US.

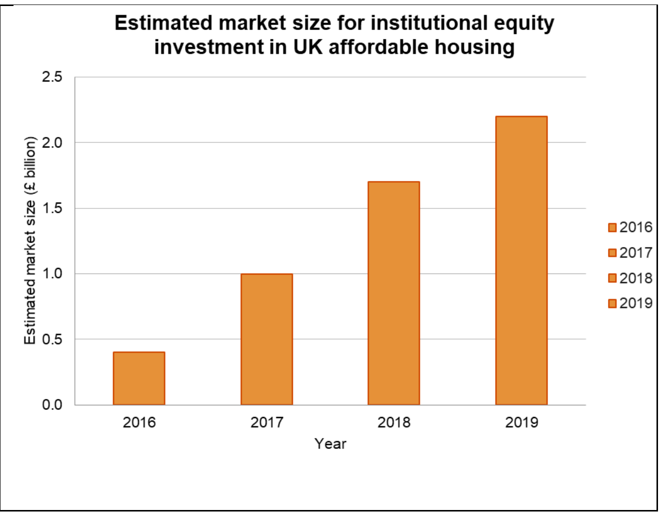
International private capital flows into social and affordable housing – Case studies[4]

United Kingdom

Data highlights

- Private capital has been active in the social-rented sector for a number of years, primarily by providing debt financing via bonds, although equity has been increasing in recent years.
- The proportion of capital to build subsidised housing that is sourced from private financing has risen to around 70%, up from 30 - 40% in the 2000s.
- Private finance to Non-profit Registered Providers (NPRPs) in Great Britain was £33 million in the year 1987-88. By 1997-98 it reached £1.8 billion, peaked at almost £6.3 billion in 2009-10 and was £6 billion in 2018/19. This has been accompanied by a fall in public funding.
- Institutional equity investment in affordable housing grew from an estimated £0.4 billion in 2016 to £2.2 billion in 2019.





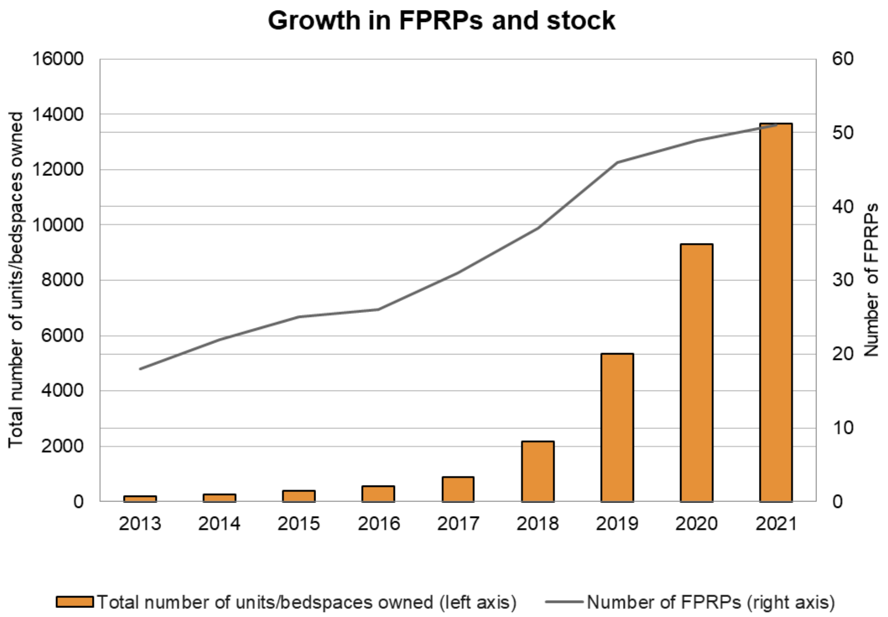
Funding and program drivers

- Affordable housing as an asset class emerged in the UK in the 1980s on the back of the establishment of a bond aggregator, operated through the industry led The Housing Finance Corporation (THFC) which provides low-cost loans to non-profit registered providers. This bond aggregator allows for 'mixed-funding models' blending grant funding with private finance to expand the provision of affordable housing.
- The UK has substantial subsidies available to housing providers, and spends 1.35% of GDP on housing allowances, dramatically higher than any other OECD economy, with the average around 0.26%.
- Investment into subsidised housing assets in the UK has become an increasingly significant component of institutional investment portfolios seeking strong, stable and diversified

4 Source: PwC, NHFIC

cashflows, underpinned by good credit fundamentals and low correlation to other sectors of the property market and the broader economy.

- The Housing Associations industry in the UK is a well established and regulated market, having operated for decades and matured in terms of capability and capacity during this time. As such, partnerships between Housing Associations and private investors are a simpler proposition.
- Changes to legislation in 2008 allowed for institutional capital to invest equity and debt in subsidised housing via For Profit Registered providers (FPRPs), which have grown rapidly in number and in homes owned and managed. This has been a key change enabling a greater role for institutional investors.
- Some large pension and insurance funds invest in affordable housing in the UK. For example, in 2021 Legal and General invested £270 million for 1,400 new affordable homes across the UK and more recently has announced plans to invest a further £2 billion of retirement funds into affordable housing over the next five years, helping to create more than 10,000 new homes nationwide[5].



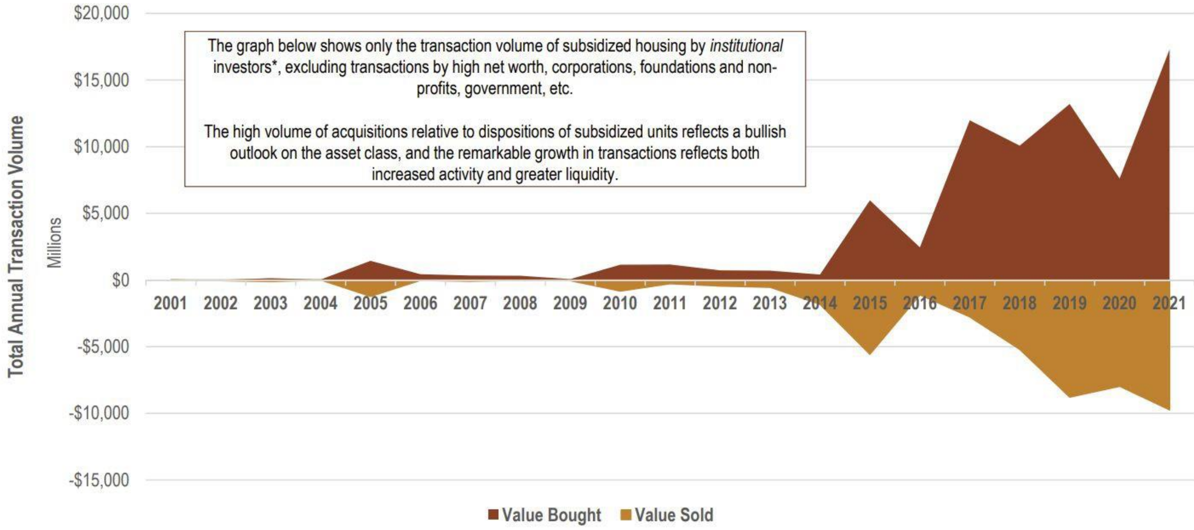
5 See https://group.legalandgeneral.com/en/newsroom/press-releases/legal-general-to-invest-over-2bn-of-pension-funds-into-affordable-homes-over-next-five-years

United States

Data highlights

- Institutional investment in subsidised housing has grown substantially. Annual transaction volume for affordable housing has increased from $59 million in 2000, to $1.3 billion in 2011 to $36.1 billion in 2021. This includes investment via the Low-Income Housing Tax Credit (LIHTC)[6].
- The LIHTC alone helped raise $71 billion in private funds for affordable housing investments between 2005 and 2014. In 2022, its estimated that $18.4 billion of private capital was invested in affordable.

Institutional investor subsidised housing transaction volume



- US States also have independent Housing Finance Agencies (HFA) which rely on tax-exempt housing bonds to attract private finance to provide rental developments for households on low to moderate incomes.
  - HFAs have delivered more than US$500 billion in financing to make possible the purchase, development, and rehabilitation of more than 7.5 million affordable homes and rental apartments for low- and middle-income households.[7]
  - For example, the California Housing Finance Agency (CalHFA) was established in 1975 and has a total of around $721m in net bonds payable (around 50% of its total liabilities) as of 30 June 2020.
- The US government spends a relatively low 0.21% of GDP on social housing (lower than the OECD average and Australia at 0.26%)
- There has been a raft of new programs which are helping to underpin private sector investment, such as Opportunity Zones, Inclusionary Zoning, and other programs.

6 LIHTC involves the US federal government issuing tax credits to state and territorial governments. State housing agencies then award the credits to private developers of affordable rental housing through a competitive process. Developers generally sell the credits to private investors to obtain funding. Once the housing project is complete, investors can claim the LIHTC over a 10-year period.

7 https://www.ncsha.org/resource/hfas-at-the-center/

  - For example, Opportunity Zones were established in 2017 to lure private capital to projects in economically disadvantaged areas. 242 Opportunity Zone Funds have dedicated $29.5 billion to investment in social and affordable housing investment.
- Most organisations in the US that undertake affordable housing investment, management and development are for profit organisations.

Canada

Data highlights

- Canada has limited government or other formalised datasets on key subsidised housing metrics at the national level, such as private investment flows or housing stock delivery. However, subnational sources can be used to provide some information with respect to trends and the impact of government initiatives in different Provinces.
- From 2008-09 to 2017-18, the Canada Mortgage and Housing Corporation (CMHC) spent an average of $2.4 billion per year on housing assistance to improve access to affordable housing for low-income households in housing need.

Funding and program drivers

- The Canada Mortgage Housing Corporation (CMHC) acts like NHFIC in that it is a financial intermediary that borrows funds in the capital markets and provides loans and mortgage insurance products to support the construction, purchase and refinancing of social and affordable housing.
- Canada's recent National Housing Strategy includes commitment to build up to 160,000 new affordable homes by 2023 and this has led to some of Canada's largest financial institutions announcing large commitments to invest in housing affordability in alignment with CMHC's operations. Both Scotiabank and BMO plan to mobilise $10 billion[8], and $12 billion[9], in financing respectively over the next ten years.

Europe

Funding and program drivers

- European countries tend to have well developed housing systems with large amounts of subsidised housing stock vis a vis the total housing stock, with private finance playing a key role.
- Government backed private finance is used as the primary source of finance for subsidised housing across Austria, Denmark, and Finland (together with direct public finance in Austria). Around 90-95% of total finance for subsidised housing is private finance and this is guaranteed by the government in Denmark and Finland[10].

8 See https://www.bloomberg.com/press-releases/2021-04-12/scotiabank-targets-10-billion-commitment-in-support-of-affordable-housing-in-canada

9 See https://capitalmarkets.bmo.com/en/news-insights/news-releases/sustainable-finance/bmo-announces-12-billion-financing-commitment-towards-affordable-housing-canada/

10 See Cost based social rental housing in Europe: The Case of Austria, Denmark and Finland, Housing Europe for the Housing Agency, Ireland (2021)

- Demark has a highly integrated and self-financing mode of housing delivery which relies on public support but also on normal market terms. For example, the National Building Fund is a private fund use to fund the expansion of subsidised housing stock, which is financed by tenants through the rent in dwellings where the loan has been paid off[11].

	Austria	**Denmark**	**Finland**
Funding and financing sources for subsidised housing	**Public loans** – subordinate (30-40%) **Private bank loans** (30-40%) **Own equity** (10-20%) **Tenant equity** (~5-10%) **Public grant** (~5%)	**Loan from a mortgage institution – with state guarantee** (86-90%) **Municipal loans** (8-12%) **Tenant equity** (2%)	**Private loans – with state guarantee** (95%) **Own equity** (5%) **Public grant**

Industry interviews with domestic and international investors in social and affordable housing

NHFIC commissioned PwC to undertake a range of interviews through its international networks to get a sense of the key challenges, barriers and decision points which inhibit or drive investment in subsidised housing. The investor interviews included superannuation and pension fund, investment managers, and investment advisors. They included organisations from Australia (three), UK (one), Europe (one), and the USA (two).

Characteristics of social and affordable housing investments

- **Investment models** – Acquiring housing stock via turnkey purchase or off the plan acquisitions was most common. Some institutional investors take on development risk by developing their own housing stock, and some seek to buy existing assets that need improvements. An investment model which is used by several institutional investors is to own land, fund construction, then enter long term leases to receive fixed income from a community housing manager. Most institutional investors seek to keep arm's length from tenants.
- **Investment instruments** – Some FPRPs (particularly in the UK) receive equity from institutional funders. Sometimes developers are part of the ownership structure, who invest equity. This allows private investors to receive social housing grants and own and manage social housing outright. Some institutional investors used only equity, and some combined equity with debt. Equity sources include superannuation funds, foundations, and internal funds.

11 See here for more detail https://bl.dk/danish-federation-of-non-profit-housing-providers/

Summary of institutional Investor interview feedback

Investment barriers/challenges	Investment drivers/enablers
Achieving target risk adjusted returns: Other real estate and infrastructure investments can achieve much higher returns of 10-12% in Australia, and have a track record of doing so. For most Australian institutional investors, social & affordable housing remains an unproven asset class. **Scale:** many social and affordable housing projects in Australia fail to achieve sufficient scale to incentivise investment, especially compared to US and UK markets. Investors typically require deal sizes of $200-300 million. Aggregation of projects can be an important proposition. **Lack of data:** Information on social and affordable housing opportunities can be difficult to obtain, particularly regarding accessing subsidies and available tenders. Also, new investors do not necessarily understand vacancy risk across subsidised housing classes. **Engaging with the right partners to access tax incentives and subsidies:** Partnering with a CHP would enable access to state subsidies such as stamp duty and land tax relief, which are only available when a CHP owns the property. However, one investor said there are difficulties for investors in engaging and partnering with CHPs and there are only a few CHPs that investors are comfortable partnering with. Another investor stated they would not be able to control for operational risks if a CHP owns the assets.	**Market trends:** Growth in ESG investing and growing demand for particular types of housing (e.g. SDA/youth housing) based on economic, demographic and urbanisation trends gives rise to investment opportunities. An investor noted an opportunity to combine affordable housing with other real estate services such as amenities and connecting residents with employers. **Risk sharing:** NHFIC could take a less passive role in housing support by offering more products, including products with more explicit subsidies (the HAFF may be one such example), and the risk share taken on by NHFIC could be greater for example by offering more favourable credit criteria for projects that have higher impact. There was also interest in an expansion of the NHFIC product offering to include for-profit agencies on subsidised housing. **Policy reform:** UK respondents stated reforms enabling FPRPs have driven investment. In the US, zoning regulations could be used more effectively. Favourable zoning regulations would support inclusion of social housing in larger scale residential developments. **Tax incentives:** US respondents supported expanding the Low Income Housing Tax Credit (LIHTC)[12] model to include more support on middle income tax credits. **Information:** providing information to investors on NHFIC, risks, and opportunities including government

12 LIHTC involves the US federal government issuing tax credits to state and territorial governments. State housing agencies then award the credits to private developers of affordable rental housing through a competitive process. Developers generally sell the credits to private investors to obtain funding. Once the housing project is complete, investors can claim the LIHTC over a 10-year period.

Reputation risks: tenancy management issues are seen be more complex with some forms of subsidised housing and institutional investors are deterred by the risk of receiving negative media attention around substandard treatment of tenants. Investors have concerns with the reputational risk of evicting social housing tenants if they want to liquidate the investment. **Unsuitable forms of government support:** recurrent subsidies to manage stock is more attractive compared to upfront capital. Upfront capital is generally easier to come by and there is an appeal to the security of recurrent subsidies. For equity investors, it is typically challenging to invest in Government infrastructure projects, PPPs and ground lease model projects, given the lack of equity as part of the preferred capital structure and issues around scale. Often these projects require taking on development risk without the opportunity for typical development activity profits. **Current market conditions:** construction industry constraints such as rising costs and interest rates are challenging project feasibility. It is hard to achieve attractive returns in Build-to-Rent opportunities in Australia.	support and funding, how to engage with CHPs and other partners, and lead-in time for tenders.

Conclusion

This research reveals that private sector capital is increasing into subsidised housing, but that different markets are at different stages of maturity. A range of underlying and longstanding policy support mechanisms have helped underpin increasing private capital flows in other countries, particularly the US and UK, but also European countries with highly supportive environments. Understanding the catalysts and impediments to increasing private capital flows into subsidised housing will be considered by NHFIC as the Housing Australia Future Fund is rolled out over the coming period.