ESSAYS & REPORTAGE

What would it really take to supercharge social housing?

With governments unwilling to fix taxes or borrow, perhaps even Ronald Reagan has something to teach us

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When the construction industry's superannuation fund announced it was investing in new homes for very low-income renters, the *Financial Review* reported the plan under the headline "Cbus Super-charges Social Housing with NSW Plan."

The pun might have been too tempting to resist, but the article tells a more modest tale. For a super fund managing more than $54 billion in super assets, an investment of "up to" $10 million is barely a drop in the vast ocean of unmet housing need. And it's not clear how much of it will go to housing people on the lowest incomes.

Cbus is joining with the National Housing Finance and Investment Corporation to finance a ninety-six-dwelling pilot project across six "shovel-ready sites" owned by the NSW Land and Housing Corporation. The land will be offered to community housing providers on a forty-nine-year lease, creating a subsidy that will help deliver housing at lower rents.

But it's unclear how many of the new homes will qualify as "social housing" — dwellings reserved for poor tenants who would pay no more than 30 per cent of their income in rent. The pilot will provide "mixed tenure dwellings," and the not-for-profit housing organisations are allowed to partner with private developers and investors to deliver them. This suggests that the numbers will only stack up if the lowest-cost homes are cross-subsidised by dwellings rented out at full commercial rates.

The project is also likely to include an "affordable" component pitched at "key workers" on low to moderate incomes. These homes, rented at 20 per cent below market prices, may come closer to profitability but are unlikely to generate the level of returns super funds require.

NSW housing minister Melinda Pavey says this "innovative build-to-rent and financing model" will deliver on the state government's objective "to build new and better social housing by renewing ageing assets that are expensive to maintain." In other words, rather than invest public money or take on extra debt to directly expand and upgrade the state's declining and outdated public housing stock, the government hopes super funds will finance community organisations and private developers to do the job for it.

Beyond the pilot, the Land and Housing Corporation will invite bids to develop a further 300 homes on sixteen sites in metropolitan and regional areas across New South Wales. And the model could be extended to other states. Cbus has suggested its lending to the sector could exceed $100 million within three years. "We need more of this type of innovative thinking and collaboration that provides the best possible bang for our buck we can get," says Pavey.

But whether this really represents the best possible bang for the public buck is open to dispute. With Commonwealth bond rates at 0.8 per cent, as former prime minister Paul Keating recently told Fran Kelly on *Radio National Breakfast*, "we could be building public housing now till the cows come home." Australia's leading housing researchers make a similar case: the most efficient way to build homes for low-income renters is "direct public investment," and Australia should avoid "overly complex private financing 'innovations' that have proven ineffective elsewhere."

"Yes, putting it simply, that's correct," admits Stephen Anthony, chief economist at Industry Super Australia and lead author of a recent report on affordable housing for the NSW Community Housing Industry Council. The problem is that the federal government has no appetite for investing in social housing, despite joint calls for action from unions and industry bodies and compelling arguments from economists and housing experts that it is an ideal form of job-creating stimulus. Canberra believes it already has enough pump-priming planned and sees social housing as a responsibility of state and territory governments.

While state governments are stepping up their own efforts — Tasmania, for example, is promising 1000 new units of social housing over the next three years — only the federal government has the resources to make any kind of dent in the national social housing shortfall of more than 430,000 dwellings — a figure that, without action, will grow to well over 700,000 by 2036.

So, in the absence of federal investment, what would it take for super funds to play a role in housing the Australian nation?

When I put this question to Stephen Anthony, he responded by asking me to step back and consider why it is difficult to turn a buck from rental housing in the first place. The main reason is

simple: residential property is very expensive. And every time prices go up, so does the investment needed to develop a project. Since tenants — especially low-income tenants — can't afford to pay proportionately higher rents, the rate of return on capital goes down and rental housing become less attractive to institutional investors.

And why are property prices so high? The rot set in with financial deregulation in the 1980s, says Anthony, when banking was "handed over to the money changers" and became "all about collateralised lending." Instead of providing small and medium-sized enterprises with capital to expand their businesses and increase employment, the banks' "main game" shifted to "unproductive" property loans. (As of March 2020, about two-thirds of new lending by deposit-taking institutions was for housing.)

Combined with negative gearing, the capital gains tax discount and record low interest rates, this shift in lending fuelled the rise of "amateur" landlords — the "mum and dad" investors — who are more focused on rising property values than on rental returns. Because they mostly buy existing dwellings, they add little to the overall supply of rental housing. (Almost three-quarters of housing loans are for existing properties.) Instead, they bid up prices and inflate real estate values, especially in Sydney and Melbourne.

Treasurer Josh Frydenberg's latest push to wind back responsible lending laws and make it easier to borrow from the banks (in the hope that looser credit rules will boost economic activity) is likely to ramp up speculative activity. If prices start rising again, super funds will be even more wary of investing in housing projects focused on rental returns rather than capital gains.

As Stephen Anthony points out, superannuation funds gain no benefit from negative gearing because they can't borrow to invest in property and so can't claim interest payments as a deduction. While they do get a capital gains tax discount, it is 33 per cent rather than the 50 per cent available to small investors — and capital gains shouldn't be the main game in build-to-rent projects anyway. The way states levy land tax further discourages large-scale rental investments.

All this helps to explain why Cbus's involvement in the NSW housing project takes the form of debt rather than equity. The return to its members will come as interest payments on a loan rather than as an income stream from tenants' rent, which also means that the community housing providers, rather than the super fund, will bear most of the risk.

The point here is not to disparage the Cbus loan, or other recent initiatives by industry funds like HESTA, Aware (formerly First State), NGS and Australian Super to provide homes for low-income renters and key workers. Rather, it is to argue that investment in rental housing on a significant scale — rather than in once-off niche projects — will remain unlikely while Australia's tax and financial arrangements encourage landlords to focus on rising property prices rather than a steady flow of long-term rent income.

The higher real estate prices go, the lower the return on investment in rental housing, and the less attractive it becomes to super funds. What's more, rising property prices discourage governments — state or federal — from developing social housing because the required subsidy keeps getting bigger.

A 2018 report for the Australian Housing and Urban Research Institute, or AHURI, calculated that the average subsidy needed to build a unit of social housing in Australia was $13,000 per dwelling

per year. Costs vary greatly between regions, of course: in parts of rural New South Wales the figure could be as low as $5000 annually; in parts of Sydney it could be as high as $35,000.

Let's imagine that we want to get a super fund to invest in a hundred-unit social housing project (with rents set at 25 per cent of tenants' income) in one of Sydney's middle or outer suburbs. For the project to generate a gross rate of return of 6.5 per cent, Industry Super estimates that every two-bedroom townhouse would require an annual subsidy of around $25,000. If investors settled for a lower rate of return — say 4.5 per cent — then the annual per-dwelling subsidy would be about $15,000. If the state government (or a local council or a non-government organisation) provided land at no cost, then the required subsidy would almost halve. And of course, the subsidy can be reduced even further, or wiped out altogether, if, like the Cbus project, the development is a mix of social, affordable and market-priced rentals.

According to AHURI's modelling, overcoming the NSW shortfall in social and affordable housing would require a state government investment of about $3.5 billion every year until 2036. This might sound like a great deal of money, but since the broader housing sector already receives billions of dollars via negative gearing and the capital gains tax discount, governments could tackle the challenge by changing priorities rather than borrowing more.

This is not just about targeting support to those who need it most, but also about dampening the fires that propel property prices.

In the current low-growth environment, says Stephen Anthony, institutional investors could be attracted to an affordable housing project that offered a return of something like inflation plus 3 per cent. In the first instance, the investment may come not from Australian super funds but from their North American and European counterparts, which will settle for lower returns based on reliable income streams like rent payments because their members are generally older.

But broadscale institutional investment is unlikely until we close the gap between the cost of new housing and the rents low-income tenants can afford to pay. "To make a market work you have to have a market price in there," says Anthony. "We have to fill the subsidy bucket somehow."

In the absence of significant tax reform or debt-financing of social housing, prospects might seem bleak. But Stephen Anthony says there are still things governments could do.

One would be to create an Australian version of the Low-Income Housing Tax Credit that operates in the United States. The scheme allows not-for-profit organisations that build social and affordable housing to generate tax credits that they can then sell to private companies looking to reduce their tax liabilities. It helps develop about 110,000 units of housing each year, worth around US$8 billion.

Anthony, who once worked briefly for the conservative Heritage Foundation in Washington, says the tax credit was created by Ronald Reagan's administration**.** "It is a game-changing policy that can appeal across the political aisles," he says. "The ability to trade in tax credits is gold for corporations trying to manage their tax liabilities."

In operation since 1987, the scheme has an established record and the confidence of corporate investors. It's no free lunch — just like negative gearing, it means revenue forgone for the federal government — but it may be a more palatable option than extra borrowing.

Another suggestion is for the federal government to set up a housing investment fund along the lines of the Clean Energy Finance Corporation. While this would require a big up-front injection of capital — the CEFC got $10 billion — it has the advantage of taking housing funding off the government's balance sheet. The NSW Social and Affordable Housing Fund and Victoria's Social Housing Growth Fund are initiatives of this kind, but their capital of just $1 billion each falls well short of the scale required to match the problem.

A much larger national fund could support social housing developments with equity investments as well as discounted loans to help attract additional private investors. Again, though, it wouldn't alter the fundamental equation in which rents from low-income tenants are insufficient to generate a positive return on investment (as the CEFC is expected to do across its portfolio).

Anthony argues that the states could also use their planning powers more aggressively to increase the supply of social and affordable housing. His report singles out Western Australia's integrated property development model, which requires that new land releases or urban redevelopments include various types of affordable and social housing, from discounted rentals to shared equity. It's rare to see inclusionary zoning used in Australia, but it is common in many other countries.

As the Cbus example shows, super funds can be attracted to social housing if sufficient support is on offer — whether it's free or discounted land, capital grants, cross-subsidies through market rentals, tax credits, or some other method or combination. Another way to change the equation, of course, is to permanently increase and properly index JobSeeker payments and Commonwealth Rent Assistance so that social housing tenants can afford to pay more rent (though some of the gains would flow to private landlords).

For social housing to be developed at scale, Anthony and other analysts say that Australia needs an agency similar to the National Housing Supply Council, created by the Rudd government in 2008 and abolished by the Abbott government in 2013. "This is not central planning but coordination," says Anthony. "It's overall guidance to identify where the shortages are, what resources are available and which players might come to the table."

The other key requirement is certainty. "You need an institutional constant to establish the framework and leave it in place for future governments," says Anthony.

The potential rewards of tackling the problem are considerable, as are the potential risks of not acting. As Anthony's housing affordability report warns, Australia is experiencing its biggest peacetime economic shock since the Great Depression, and our approach to housing finance could make matters much worse.

Australia's pre-1980s banking system was "framed by the tragedy of the 1890s property bust," says Anthony, and "forged under fire during the Great Depression of the 1930s," and "eventually informed by the 1936 Banking Royal Commission." Deregulation, though, has "reawakened the old boom-bust property cycle" and fostered "an addiction to household debt," which as a share of disposable income is much higher in Australia today than it was in the United States immediately before the global financial crisis.

If we transform financing and tax arrangements for housing then we can lay the foundations for future prosperity, just as we did after the second world war. And even if government has to take on

extra debt to build homes for low-income renters, it's a public investment that will return a dividend in higher productivity, lower health costs, lower welfare spending and changed lives.

"That's indisputable," says Anthony. "The bottom 30 per cent of the population by income just need a roof over their head. They want to live in one suburb for as long as possible. They want stability. And anything that brings stability to the family unit ticks all the boxes for investment and saves government a motza in the long run." •

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