15 January 2021

Mr Chris Leptos AM
NHFIC Act Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

By email: NHFICSecretariat@treasury.gov.au

Review of the operation of the *National Housing Finance and Investment Corporation Act 2018*

Dear Mr Leptos,

National Australia Bank Limited (NAB) welcomes the opportunity to respond to the Department of Treasury's review on the operation of the *National Housing Finance and Investment Corporation Act 2018*. This response addresses some of the questions raised in the Issues Paper and builds on NAB's verbal contributions to the NHFIC review process.

As a key provider and arranger of capital into Australia's housing sector, NAB is aware of the challenges many Australians face in accessing affordable housing in the mainstream market. In October 2019, NAB made a $2 billion commitment to help finance the construction of more affordable and specialist housing across Australia. We have focused on providing loans and developing new financing avenues for Not-for-Profits (NFP), other organisations including developers, and all levels of government that are involved in the affordable and specialist housing sectors. We are keen to continue to work with NHFIC to help find innovative solutions to improve the availability of affordable housing across Australia.

The role of NHFIC in increasing home ownership

We welcome NHFIC's contribution to the sector and have worked closely with NHFIC across a range of areas, including on the First Home Loan Deposit Scheme (FHLDS). First home buyers are back in the market at levels we haven't seen for a decade. Demand has been supported by historically low interest rates as well as government support, including through the FHLDS, which has had a clear positive impact on helping facilitate earlier access to the market for first home buyers. NAB was the first bank chosen to support the FHLDS and we have helped more than 3,000 Australians buy their first home through the Scheme since 1 January 2020. We welcome the recent expansion of the Scheme and look forward to ongoing collaboration with NHFIC on the FHLDS.

The impact of NHFIC on the Community Housing Provider sector

NAB believes Government is a natural long term, low cost lender to the Community Housing Provider (CHP) sector. CHPs play a critical role in providing secure, affordable and appropriate housing for individuals and families on moderate to low incomes. Government's role is not limited to that of a lender and accordingly, Australia would benefit from a more co-ordinated approach to the underlying funding for tenants at levels that encourage CHPs to appropriately maintain and sustainably re-invest into future housing stock. This would encourage increased sophistication across the CHP sector and help build scale, similar to the United Kingdom.

NHFIC's Affordable Housing Bond Aggregator

The long term, low cost nature of NHFIC's loans is beneficial to CHPs. NHFIC is not bound by the limitations of APRA-regulated lenders (like NAB) and as a result, NHFIC has the opportunity to help increase the size and maturity of the sector. While NHFIC's initial focus appears to have been on refinancing bank loans, there also seems to be some appetite for additional risk, including development risk, which could potentially put pressure on the structuring and origination capacity within NHFIC (particularly if numerous development projects require concurrent close management).

In NAB's view, the aggregation of refinanced CHP bank loans to NHFIC creates an obvious concentration risk and accordingly, we would encourage the Government to consider expanding the investment mandate of NHFIC to other areas within the transitional housing environment including but not limited to NFP student accommodation providers. Student accommodation enables access to education, which has a direct link to financial inclusion and ultimately, there is a correlation with employment and housing. NAB believes the natural evolution of NHFIC in its journey as a standalone corporation will be dependent on a diverse range of socially-aligned borrowers with a variety of revenue streams. Expanding NHFIC's investment mandate into the NFP student accommodation sector could deliver diversity through stronger financial metrics (relative to community housing) and a range of socially-aligned counterparties (ranging from colleges to direct university exposures). This increased diversity would ultimately enhance the credit quality of the NHFIC portfolio whilst also providing access to cheaper funding for these accommodation providers as they continue to manage the impacts of the COVID-19 crisis on Australia's tertiary education sector.

In our view, the relatively long-term and single maturity date of CHP loans from NHFIC also gives rise to refinance risk. It may be beneficial for NHFIC to focus on not only increasing the capacity within the treasury functions of the CHPs, but also to build the foundations that enable more Australian CHPs to access capital markets in their own right, providing another avenue for long term funding and reducing the sector's reliance on NHFIC.

<u>NHFIC's Capacity Building Program Grants</u>

While NAB sees merit in the aims of NHFIC's Capacity Building Program Grants, we are yet to see a clear correlation between the grants program and an improvement in the financial and management capability of CHPs.

NAB has a specialist London-based team that supports the UK social housing market. Based on our experience in the UK, we see a number of opportunities to enhance NHFIC's impact on the financial capability of the CHP sector in Australia, potentially through Capacity Building Program Grants. These include:

- allowing CHPs to access unsecured debt (which would also reduce costs and other administrative burdens for NHFIC)
- encouraging CHPs to obtain investment-grade credit ratings
- helping CHPs develop the capacity to access capital markets in their own names
- encouraging CHPs to employ treasury staff (in addition to accountants and Chief Financial Officers) to manage debt raisings, and
- encouraging CHPs to develop sustainable financing frameworks and access sustainability-linked funding.

NHFIC's role in driving private investment in affordable housing

While acknowledging the Government's intention for NHFIC to operate in conjunction with and complement commercial lenders, our experience suggests that NHFIC, as the lowest cost lender, has replaced other financing sources and is likely to continue to be the most attractive funding option for CHPs. In this way, NHFIC has effectively assumed the role as the primary lender to the sector which extends beyond the refinance of bank loans with CHPs to the more structured and higher risk 'limited recourse' project finance transactions. NHFIC can look to improve 'bankability' of project finance transactions by taking on certain risk profiles (for example market rent risk for Build to Rent accommodation) and/or facilitate higher levels of leverage through provision of a subordinated debt tranche. This approach could be applied to existing state programs such as the Victorian Public Housing Renewal Program and the NSW Communities Plus program. In addition, there may be a role for NHFIC to help facilitate the significant affordable and social housing programs announced by various state and territory governments last year in response to the COVID-19 crisis.

In NAB's view, one potential way to facilitate additional private investment in social and affordable housing would involve a change to the current APRA classification. We believe there is a strong case for APRA to consider adopting an exception or alternative classification to Commercial Real Estate for social, affordable and specialised disability accommodation providers, to recognise that the risks associated with the latter are very different to a typical commercial real estate arrangement. This would reduce the capital that banks have to hold for lending to this sector, which would in turn make lending to this sector more competitive.

NHFIC could also consider removing the current self-imposed requirement to take physical security and move to an unsecured (negative pledge) lending structure. As mentioned above, the provision of mortgage security adds a significant layer of cost and complexity while offering very little practical benefit to NHFIC as the lender, and that benefit is further lessened by the caveats which exist in most states and territories preventing the mortgage holder from exercising its rights. APRA regulated lenders did receive a capital benefit from the slightly lower 'loss given default' position that the provision of security facilitated, but this is not relevant to NHFIC and adds unnecessary cost and complexity for the CHPs. Another long-term benefit of unsecured lending structures includes simplifying access to other debt providers (including banks and debt capital markets investors) in the event NHFIC wishes to reduce the reliance of CHPs on it as the primary lender to the sector.

The Government's guarantee of NHFIC's liabilities

NAB believes the Commonwealth's guarantee of NHFIC's liabilities has value and the current structure is completely dependent upon the ongoing provision of this guarantee. However, in NAB's view, a range of models exist around the world or are emerging as alternatives which deliver a similar or superior outcome without the need for the underlying government guarantee. One such example is an interest subsidy with a zero per cent interest rate. The benefits of moving to such a model include:

- the time limited nature of a subsidy
- the potential for significantly more dwellings to be built, and
- the opportunity to require borrowers to use surplus cash to repay the principle, thereby reducing refinancing risk.

Other examples, such as the previously mentioned UK model, include a more appropriate housing support payment which enables the CHPs to not only maintain, but reinvest annual surplus funds into new housing stock to meet future demand. These UK CHPs are investment grade borrowers in their own right and do not require government guarantees.

Conclusion

NAB appreciates our engagement with NHFIC to date and we look forward to continuing our productive relationship. If you have any questions about this response, please contact Mary French, Associate Director, Government Affairs & Public Policy (0436 911 142 or mary.french@nab.com.au). We would be happy to provide further detail.

Yours sincerely,

David Gall
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Member of the Executive Leadership Team
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