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Attention: Will Devlin

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

The Westpac Group (**Westpac**) is pleased to provide a submission in response to the Issues Paper released in December 2020 in relation to the Review of the *National Housing Finance and Investment Corporation Act 2018.*

NHFIC has engaged Westpac as a lead manager on two of its social bond transactions.

Westpac has submitted responses to three sections of the review set out below:

1. **NHFIC's Affordable Housing Bond Aggregator**
2. **Increasing private investment in housing**
3. **The Government's guarantee of NHFIC's liabilities**

1. NHFIC's Affordable Housing Bond Aggregator

Consistent with the terms of reference, the Review invites interested parties to comment on the effectiveness of the Bond Aggregator, giving consideration to the impact of NHFIC on:

1. the CHP sector's access to finance – including whether NHFIC has generated a more efficient source of funds, reduced refinancing risks, and reduced borrowing costs; and
2. the scale and prominence of CHP sector delivery of sub-market rental housing – including through partnerships with the private sector and institutional investors.

- *The Bond Aggregator, via NHFIC's capital market transactions, provides an efficient and stable source of funding for the CHP sector. As a capital market intermediary, Westpac closely tracks the prevailing price and secondary market liquidity of NHFIC's outstanding bonds. While there is no individual CHP bond issuer to facilitate a precise comparison, the benefits of NHFIC's aggregated approach are multiple:*

- ***Liquidity:*** *The volume (A$300m+) of NHFIC's bonds allow a reasonable level of secondary market liquidity due to the number of investors in each line and the willingness of intermediary trading desks to make markets. Compared to an individual CHP issuer, this lowers the cost of debt, as the significantly smaller transaction size of individual CHPs would likely cause investors to demand a 'liquidity premium', an incrementally higher interest rate to account for the reduced ability to buy and sell efficiently.*

- ***Stable investor base:*** *institutional investors in the Australian market tend to require a minimum transaction size to participate. This requirement stems from the liquidity demands outlined above, as well as a cost-benefit trade-off related to the credit analysis and portfolio management time spent versus the allotment that can be made to a specific issuer.*

- *For large institutional portfolios, transactions below A$200-300m draw more sporadic participation given these considerations. NHFIC's aggregated approach clears that hurdle, thereby facilitating consistent institutional investment in the CHP sector. This assists in minimising borrowing costs and builds a stable source of financing for the sector, a fact evident in the willingness of Australian investors to participate in repeat NHFIC bond transactions.*

- ***Tenor:*** *capital markets in Australia are the primary source of long-dated (< 10-years) debt funding for corporations and government entities. Without NHFIC's aggregated approach, the CHP sector would not have access to this source of funding (given the size of individual CHPs). This has a direct impact on the refinancing risks borne by the sector, with NHFIC able to spread refinancing requirements over a long-time horizon and rely on the consistency of capital availability in high-grade institutional markets. It should be noted that NHFIC's access to long-dated funding is also inherently linked to the Government's guarantee of liabilities, giving comfort to institutional investors of the creditworthiness of the bonds.*

2. Increasing private investment in housing

Consistent with the terms of reference, the Review invites submissions regarding the effectiveness of NHFIC in attracting private investment in housing. In particular, the Review will consider:

1. the impact of NHFIC on improving the attractiveness of affordable housing as an asset class for private investment; and
2. NHFIC's role in facilitating additional investment in housing, including social and affordable housing.

NHFIC allows institutional debt investors access to the CHP sector. Long-term debt investors, both in Australia and internationally, are generally conservative and risk averse – a reflection of their role in balancing more volatile investment options for large portfolios. Consequently, NHFIC provides two clear benefits to the sector in accessing a new source of financing:

1. ***Scale:*** *without the scale that aggregation provides, the CHP sector would be unlikely to access debt capital markets, with the individual funding profiles not meeting minimum size requirements. This scale allows institutional debt investors the opportunity to invest in the sector, with the aggregation also providing a level of risk mitigation for investors through diversification across the CHP sector.*

2. ***Risk profile:*** *most funds held by institutional debt investors require investment grade credit metrics. As a government guaranteed entity aggregating loans across multiple providers, NHFIC adjusts the risk of the sector to render it appealing to this risk-focused segment of investors.*

- *Importantly, NHFIC's role in social and affordable housing also fits neatly with an established trend in global capital markets towards social financing. NHFIC is one of a small number of bond issuers offering social bonds in the Australian market, an area of rapid growth.*

- *With the expansion of debt investors' GSS (Green, Social, Sustainable) portfolios, NHFIC is well positioned to benefit from a growing demand profile and sustained relationships with debt financiers who are keen to deploy funds in line with positive social outcomes.*

- *Housing New Zealand provides an example of a peer issuer who has tapped into this demand from global investors. Establishing its first bond line 9 months prior to NHFIC's debut issue, Housing New Zealand has now established seven individual bond lines totalling NZD4.2 billion outstanding with maturities as long as September-2040. Examples from more mature GSS markets, particularly Europe, show clear pricing benefits for GSS issuers, a dynamic that is expected to be observed in Australia with time.*

3. The Government's guarantee of NHFIC's liabilities

Consistent with the terms of reference, the Review invites submissions to comment on the suitability of the liability guarantee and the associated Liability Cap, considering its resulting impact on the CHP sector, Commonwealth's finances and the functioning of private capital markets.

- *The Government's guarantee of NHFIC liabilities is key to its capital market success. As noted above, a key function of NHFIC is the alteration of the risk profile of the sector to render it appealing to risk-averse institutional debt investors. While the structure of the organisation, aggregating risk across multiple CHPs, contributes to this function, it is significantly enhanced by the guarantee. This benefit is evident both in the interest rate paid by NHFIC, and the institutional investor set attracted.*

- *A simple comparison can be made between NHFIC's May-2030 AUD bond, and AirServices May-2030 AUD bond. While both are AAA-rated issuers, NHFIC benefits from an explicit Government guarantee, while AirServices is Government-owned, and an owner/operator of critical national infrastructure, but has no explicit guarantee. NHFIC's line trades (YieldBroker, 21 December 2020) at a spread of 17 basis points over the swap rate, while AirServices' trades (YieldBroker, 21 December 2020) at 65 basis points over the swap rate.*

- *While sectoral differences, regularity of issuance, and market perception all play a role, the materially different pricing outcomes are primarily attributable to the Government guarantee. The Government guarantee provides debt investors' confidence in the financial stability of the organisation, thereby playing a key role in facilitating institutional investment in the CHP sector.*

- *The AUD market is comprised of Australian based investors, as well as a number of institutional investors spread throughout Asia, Europe, and North America. This offshore investor base is most prevalent in the high-grade segment of the AUD market, comprising the Commonwealth Government, state government issuers, as well as government guaranteed entities. NHFIC's guarantee improves its access to this incremental investor base, with a number of offshore fund managers investors in the outstanding bonds. While not quantifiable, this benefits NHFIC in the interest rate paid, as well as the stability of funding offered by capital markets.*

- *The guarantee allows the bonds to be considered HQLA level 1 securities by APRA for the purposes of calculating ADI liquidity coverage ratios, enabling the bonds to be purchased by this investor base to form part of their liquid asset portfolios. The HQLA level 1 status allows NHFIC to tap into a captive investor base, who will be required to increase holdings of HQLA to 30% of total outstanding HQLA over the next 12* *months. The guarantee also lowers the margin required to be paid should the bonds be pledged under a repurchase-agreement with the RBA relative to other AAA rated non-ADI corporations.*

- *NHFIC's current debt outstanding totals AUD 1.192 billion from three social bond transactions. While there remains significant scope to continue funding requirements without breaching the current liability cap of AUD 3 Billion, should demand for social and affordable housing investment increase, the current cap may limit NHFIC's ability to provide low cost funding to CHPs in the future.*

- *For context investor demand for NHFIC's previous two social bonds exceed AUD 2.8 billion. Increasing the liability cap in future in line with growth in the social and affordable housing investment landscape would allow NHFIC to continue to successfully provide a low cost and efficient source of funding to the sector, while meeting the increasing needs of social bond investors.*

For further Information in relation to any of the matters raised in this submission, please contact Michal Choueifate, Group Head of Government and Industry Affairs at michael.choueifate@westpac.com.au.

Yours sincerely

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