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Exploring philanthropy's role in addressing the affordable housing crisis

A synthesis of the evidence

A report funded by:

LORD MAYOR'S CHARITABLE FOUNDATION

Executive summary

Context

Sefa was commissioned by The Lord Mayor's Charitable Foundation (the Foundation) to undertake desk-based research, exploring the role that philanthropy has played in addressing the shortage of affordable housing. The affordable housing shortage is acute in Australia, and common internationally. Evidence from the UK, US, New Zealand and Australia has been considered. These research findings and insights gained through development of a series of case studies have been augmented with financial modelling for five different scenarios. We have reflected on the research findings, the modelling outputs and our experience as impact investors (with a portfolio that has traditionally been weighted towards affordable housing and specialist accommodation). This report provides suggestions about ways that philanthropic funds can be deployed to alleviate the barriers that constrain development of affordable housing in Australia.

We have considered the financial and non-financial barriers to affordable housing and the role that philanthropy can play in addressing both. We start from the position that philanthropists are interested in supporting the availability of appropriate, affordable, safe, secure, healthy, well located, stable housing for everyone. We know that philanthropy is not generic, and our research found that philanthropists:

- will have different levels of interest in engaging across the housing continuum. For example, some will seek to focus only on build-to-rent solutions for very low-income earners; others will look for mixed development opportunities for diverse communities, and an associated blend of private ownership and affordable rental; while others will be more interested in catalysing affordable ownership options for middle income key worker cohorts and are comfortable with supporting private asset ownership. There is need in all these areas, but funding is limited. While philanthropy typically has a higher risk appetite and interest in underwriting innovation than the public sector and / or traditional, commercial finance providers, there is a keenness to understand the implications associated with each of the options.

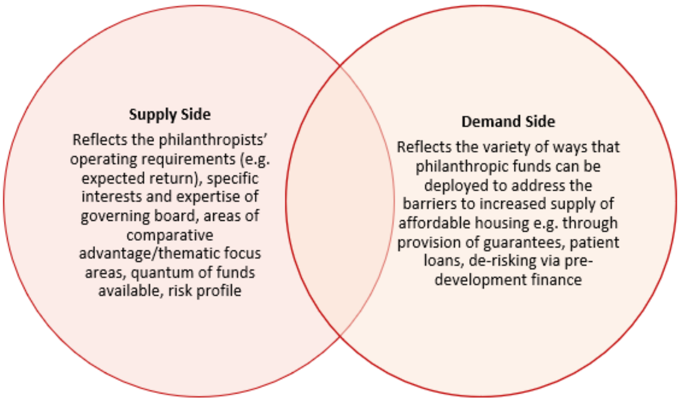
- can provide support when there is a limited track record as 'early' investors in innovative approaches and via support for evaluation, research, impact measurement and capability building. In doing so they contribute to the evidence base for policy and financing decisions and advocacy for system level changes that underpin an enabling environment for investment in affordable housing.

- will work collaboratively – to pool funds, share risks and opportunities and according to their specific area of expertise e.g. as grant makers / investors / advocates / networkers and conveners. Philanthropists generally have the freedom to operate in a flexible way which means that they can build to scale over time when there is evidence or a proven approach. They can also draw on the suite of tools available to them beyond finance.

We anticipate that our findings are applicable among philanthropists in Victoria (and Australia), however, a deep dive into the sector to better understand the philanthropic supply of capital (i.e. 'the supply side') was beyond the scope of this research. Instead, the research has focused on the demand models for philanthropic intervention (i.e. the 'demand' side), providing insights about the implications associated with the use of different types of finance and financing structures to address the financial barriers constraining affordable housing development.

Philanthropists can, with this knowledge, consider which approaches are most aligned with their and support effort / catalyse action where there is alignment. Figure 1 illustrates the relationship between supply and demand with the area where there is overlap representing the most suitable pathway for action. There are consequences associated with whichever decision is made, and this research explores the implications of the various pathways, thereby addressing the 'demand' side of the equation.

Figure 1 Understanding supply to address demand



We found that, despite the variances in population and market size and political / economic regimes, the market conditions and failures that resulted in affordable housing shortfalls, the barriers to stimulating supply of housing, and the associated 'solutions' to these challenges were consistent across the countries included in the research. There are six finance related barriers identified and there are numerous ways to address these barriers. Figure 2 presents a compilation of some of the financing options that have been applied to address the corresponding barrier. Philanthropy has contributed to the 'capital stack' associated with each of these.

Figure 2 Exploring how philanthropy can address financing barriers that constrain supply of affordable housing

Barrier	Options explored
1 Cost of land	Supporting efforts to unlock unused / underused land
	Long term lease arrangements / Community Land Trusts
	Demonstration of value of meanwhile use of land
2 Cost of finance	De-risking role to make investment more attractive for traditional finance / leverage private investment e.g. guarantees, first loss
	Patient capital • Below market interest rates • Bespoke repayment terms • No security requirements
	Top-up provider
3 Ongoing operating costs	Renovation / revitalisation / retrofitting dwellings to be energy efficient
	Payment by results / Social Impact Bond models – taking an integrated / holistic approach to housing as an enabler of better life outcomes
4 Cost of development	Modular housing – pre fabricated, offsite production with rapid onsite construction
5 Return on Investment	Stable return vs exit with capital growth
	Hybrid– risk absorption, long-term asset ownership option
6 Risks	Subsidised pre development funds

Assessing the financing options

A framework-based approach has been developed to enable objective and consistent assessment of the financing options (see Figure 3). By applying this framework when considering the variety of financing pathways that are possible, philanthropists can narrow down options to those that are most aligned with the character and capability of the trust or foundation over which they have distributive responsibilities (i.e. the supply side). The financial modelling of the shortlisted options augments the evidence base upon which decisions can be made.

Figure 3 An assessment framework for consideration of financing options

Feasibility	
Risk	Considers: • philanthropist's risk threshold (i.e. whether comfortable to invest in opportunities with limited track record v's established evidence base); • how much risk the philanthropy section of the capital stack will need to absorb to secure commercial finance • type of finance that will be deployed i.e. grant v's investment • timeframe and expectations about program performance and return of capital • whether working as part of a consortia or independently • external operating conditions and market perceptions
Ability to Manage	About collating and using the data and information contained in program reports/acquittal information to continuously improve decision making about financing for impact. Considers whether the trust/foundation has inhouse or access to the capability and capacity required to adequately oversee / manage the investments.
Achievability	
Sustainability	Considers whether philanthropy is contributing to a rational market solution. Addresses time and expectations for demonstration of sustainability v's need for ongoing subsidisation / contribution. Considers sustainability beyond finance – e.g. environmental sustainability
Scalability	Considers • the potential for an approach to be appropriate for delivery at a scale that makes it more economic and / or increases the return on investment • the size of the gap and potential for philanthropy to fill it / catalyse others to contribute to filling it
Desirability	
Impact	Requires decision making up front about the nature of the impact that philanthropy is looking to achieve through its contribution – e.g. whilst the ultimate goal may be to increase supply of accessible and affordable housing, funds might be used to support research which could be used as evidence for policy reform, or, impact could be viewed through a lens of leverage, investment in innovation etc
But for …?	Would this happen without philanthropic support? *Should* this happen without philanthropic support e.g. is this the government's role?

The application of the framework will likely have slightly different outcomes for individual philanthropists, depending on the context and parameters within which decisions are made. Sefa acknowledges the need for nuance and variation, but, at a high level we have considered 'philanthropy' as an overall grouping and have worked through the framework for each of the financing options. Findings are summarised by barrier.

Barrier 1: Cost of land

Land cost is often the single biggest factor in improving the economics of affordable housing development. In this report we have focused on mechanisms that are relevant for philanthropists in Australia, in particular looking at examples where land as a barrier to development of affordable housing has been addressed via the outright gifting of land or making it available on long term leases, for example, using a Community Land Trust approach. We have also considered meanwhile use of otherwise unused land. The assessment framework has been applied to each of these options (Figure 4).

Figure 4 Considering philanthropy's role in addressing cost of land

Options explored	Feasible • Risk • Ability to manage	Achievable • Sustainability • Scalability	Desirable • Impact • But for?	Commentary
Supporting efforts to unlock unused / underused land	• There is value associated with knowing where unused land is and who owns it (public/private) • Beyond identification, need for activation of the site • Need for cooperation across stakeholders including levels of government which can be time consuming and effort intensive • Low / no management impost on philanthropy after supporting efforts to identify and unlock the land	• Alleviation of the cost of land from the cost of development makes it viable for developers, with philanthropic input, to develop projects with mixed income cohorts – low and moderate • Unlocking of public land could be a contribution at scale to addressing housing supply – takes political will and will require some regulatory reform.	• Unlocking of underused land and making it available for free or at a substantially reduced value will enable development of affordable housing at scale. It is a key lever that should be used by governments (across levels) • Government responsible for developing policy positions that enable access to land for affordable housing development.	• Requires curating the right partners to work with – local gov, finance, developers, community • There is increasing awareness of potential of 'lazy land' in both the public and private sectors (e.g. that owned by religious organisations). When it has been identified philanthropy can catalyse its rapid development through pre development phase financing • **Philanthropy could advocate for policies that encourage use of lazy land e.g. idle land policies, transport oriented development, release of public land and inclusionary zoning**
Long term lease arrangements/ Community Land Trusts (CLTs)	• Examples of ownership structures that can protect availability of affordable housing in perpetuity. Track record of success in the UK and US but limited use in Australia • Aligned with place-based and community centred development approaches • Low / no management impost on philanthropy after support for the establishment of the CLT or legal structure to protect long term lease/access to land	• Challenge for CLTs to function with economies of scale. The process of establishing a CLT, securing land, and developing housing which has community need and co-design at the core is complex. CLTs have particular application when applying a place-based approach and addressing the particular needs of those seeking affordable housing in specific locations/population cohorts. • There is value in investigating the viability of streamlining the process of establishing CLTs (as has been done through a peak body in the UK)	• Impact will be at the community level – CLTs give community voices opportunity to inform housing policy	• CLTs are ownership structures that preserve affordability. They are an important element of community led housing. • **Philanthropic contributions could cover the costs of establishment – which can be reasonably high based on the need to develop a legal and democratic ownership and management structure suitable for the community in which it is operational**
Demonstration of value of meanwhile use of land	• Culturally and attitudinally challenging in Australia and will require support for planners and financiers • Financing could be challenging based on short turnaround required • Considered risky and could be challenging in the social housing sector where security of tenure is important	• No precedent for meanwhile use of land for affordable housing -need for investigation of financial sustainability, which will be affected by the type of housing solution that is applied to the site. Temporary modular housing likely an option • Scalable based on the availability of unused land with 8-10 year horizons over which they will be dormant	• Impact will be similar to that associated with unlocking unused land however perceptions about risk associated with the relatively short time for which the land is available will need to be taken into account when assessing impact • Will need government level support and regulatory and planning reform	• Goes hand in hand with mobile/modular housing • Enables access for new/small players • **Role for philanthropy in demonstration projects** • **Philanthropy can support the advocacy efforts that will be required for this shift by investing in research and evidence about the impact of such an approach.**

Whilst the policy, financing and legislative levers that could mitigate the cost of land as a barrier are largely the responsibility of government, there are other non-profit land holders that have an opportunity to contribute to affordable housing supply through leveraging their land assets – an example of which is religious organisations. **Philanthropy can catalyse new ways of approaching access to land – e.g. by supporting the establishment and operations of community land trusts; by supporting pilot projects that consider the community within which the development will be located (considering the suitability of location for potential residents with respect to transport, employment, health, education etc); by working with councils to explore vision for 'community', identifying underused land (even when it is earmarked for use in a decade), and considering how this land can be used to support affordable housing that fits within council's planning and regulatory framework.**

Barrier 2: Cost of finance

Affordable housing developers are met with greater challenges than mainstream property developers when seeking the funds upfront to initiate the project and developing a revenue model that makes meeting the property management costs associated with the development feasible. It is challenging to bring the right type and scale of finance to a deal in a sector that doesn't usually attract market rates of return and which has operating/revenue models that are unfamiliar to many in the traditional financing sector. Figure 5 outlines how we have considered options for philanthropy to address the cost of finance

Figure 5 Considering philanthropy's role in addressing cost of finance

Options explored	Feasible • Risk • Ability to manage	Achievable • Sustainability • Scalability	Desirable • Impact • But for?	Commentary
De-risking role to make investment more attractive for traditional finance / leverage private investment e.g guarantees, first loss	• Philanthropy can de-risk through money or with time • Pre development work can be a costly part of a project for developers as the outcome of the DA application is uncertain and timelines may be hard to determine. • Support through a fund is of particular value if application timelines are extended and developers are smaller	• Needs topping up • Will help unlock difficult or uncertain land prospects • Fund will work best at a scale that can afford to employ experienced specialists and over time increase the success rate of approvals	• Providing a fund for NFP developers that takes the risk out of pre-development will facilitate more projects • Developers do not get finances tied up on one project	• Can catalyse development at scale • Until significant changes in policy e.g. land zoned for affordable homes only, this aims to reduce the disadvantage NFP developers face compared to larger organisations with balance sheets able to manage the uncertainty and delays of approval process and land-banking
Patient capital • Below market interest rates • Bespoke repayment terms • No security requirement	• Patient capital may involve a large facility and therefore appropriate level of oversight and due diligence would be required • Some management by philanthropy will be needed to manage/monitor after setup of financing • There is some repayment risk but this can be mitigated through careful management	• Effective on an individual project basis, may slightly accelerate the rate at which current projects are achieved. • Unless to prove the potential for a NHFIC-like financing for (non-CHP) NFP developers or the involvement of institutional investors who favour stable long term returns	• Supports projects unable to access commercial financing due to inflexible terms, unable to meet repayments or lenders requirements • Patient capital ties up philanthropic funds which may be competing with alternative impactful projects, those with competitive returns or smaller capital outlay • While unlikely considered an impact investment given the low rate, the generation of long term returns as opposed to a grant may be attractive	Transaction focused not system focused
Top-up provider	• Risk involved is determined by the amount of top-up required and inherent risks of any specific outcome generation expected • For top-ups related to positive outcomes there needs to be some method of monitoring and managing the payment based outcomes	• Effective on an individual project basis, may slightly accelerate the rate at which current projects are achieved • Best used to demonstrate the wider benefits to society or collective government savings to encourage project adoption at scale	• A very simple way of enabling projects to happen • The desirability will depend on the trade-off between the amount to top-up and the outcomes being delivered	

Philanthropic capital can contribute to the capital stack for affordable housing developments, and by doing so, can mitigate risk perceptions amongst investors. This can result in reduced financing costs and increased availability of capital. Moreover, doing so can catalyse development at scale. The other way for philanthropy to complement market-driven investment activities is through the provision of 'patient capital.' This could include sub-market returns or other non-traditional investment conditions such as sequence of repayment, unrestricted use, no security requirement, timing of repayment and acceptance of uncertain and/or alternative exits and by acting as the provider of 'top-up' financing. There is significant enthusiasm about the potential for patient capital to play a role in innovative housing solutions. However, in its nascent form philanthropic players find it challenging to transform an idea into a workable transaction structure given that this type of capital sits in between their granting and their corpus investment arm from a governance perspective. Furthermore, specialist social finance resources are not always available inhouse or contracting in assistance comes at additional cost. Therefore, this type of finance tends to be focused on a transaction level and led by disruptive / catalytic foundations rather than at a system level, thus limiting the scale of its impact.

Barrier 3: Ongoing operating costs

Ongoing operating costs relate to operations / maintenance and the provision of supportive services for tenants with complex needs. There is a role for philanthropy in both areas and our assessment is provided in Figure 6. We consider that there is a vital role for philanthropy to contribute to the development and testing of integrated models that position housing as an enabler of social and economic outcomes.

Figure 6 Considering philanthropy's role in addressing ongoing operating costs

Options explored	Feasible • Risk • Ability to manage	Achievable • Sustainability • Scalability	Desirable • Impact • But for?	Commentary
Renovation / revitalisation / retrofitting to be energy efficient	• Can be expensive to retrofit dwellings that have previously been poorly maintained • Depending on requirements there may be a need for tenants to be relocated during the renovation/revitalisation period – this is disruptive and could exacerbate vulnerabilities of tenants	• Sustainable and scalable when operating at a portfolio level which means access to economies of scale. Tends thus to work best for large community housing providers	• Better housing conditions for tenants – associated with more positive health outcomes • Better environmental performance of the buildings • Lower costs for housing providers – savings can be reinvested into the affordable housing sector	• Sweat equity is one way to subsidise the costs of renovation. • Philanthropic funds can be applied when the costs of renovation are unaffordable to community housing providers
Social impact bonds / payment for success models – integrated / holistic approach to housing as an enabler	• Typically involve complex structures and time consuming to establish and confirm indicators that will trigger performance payments • Multiple stakeholders involved in every transaction which can mean they are cumbersome to manage • Tend to be designed around complex social problems which inherently means that there is risk of achieving desired outcomes/impact	• This is not a scalable nor sustainable approach – every transaction needs to be designed to be bespoke to the particular requirements of the participating stakeholders • Tend to be associated with high 'transaction costs' – associated with upfront design requirements as well as need for rigorous monitoring and evaluation across the duration of the intervention	• Payment for outcomes as an approach tends to be associated with more impact that payment for activity/input • SIBs support demonstration projects – should the model that has been applied prove successful then there is evidence that can inform structural and system level change	• **Philanthropic funds can make the initiation of activity feasible for delivery partners.** • **There is also opportunity for philanthropy to participate beyond being providers of up front working capital, and through investments in the delivery partners, philanthropists can participate in the financial upside that becomes available should performance targets be achieved.**

Whilst the evidence base around the effectiveness of holistic approaches to affordable housing from a social outcomes perspective is building, the funding models needed to underpin the approaches remain project based. **Philanthropy can play a key role in both funding the delivery of integrated approaches and evaluating the financial (and social) impact of the approach. This can build the evidence base to shift public policy and / or public and private financing of such approaches. One way to do this is via social impact bonds which involves philanthropy 'front loading' the operating costs associated with delivering the "housing plus" services for implementing partners, mitigating cash flow constraints and enabling them to focus on program delivery. Subsequent payments to the implementing partner are contingent on achieving agreed outcomes, which reduces risk for the payer (usually government).**

Barrier 4: Cost of development

There are a number of measures that can be applied to reduce the cost of development, including

- standardisation of significant elements in the build
- efficient procurement, and
- adoption of industrial approaches such as the use of prefabricated components.

We have focused on the use of modular (off-site, prefabricated) housing in this report – an approach that combines all of the cost reduction elements outlined above and which we have assessed in Figure 7. At the core of the benefits associated with modular housing is speed. This includes speed of production in off-site, factory conditions and speed of construction of dwellings in situ (with reduced labour requirements). Using less time, minimising wastage and reducing labour costs means lower cost of construction. It also means faster solvency for developers who are able to get renters into premises quicker.

Modular housing could be a game changer for housing affordability. The acceleration of home-building could pull down rents and prices, benefiting all residents who buy or rent market-rate homes. It could also be a major boost to non-profit affordable housing developers, helping them maximise limited funds to create more subsidised homes for people who can't afford market prices. There is precedent for modular housing developments at scale in the UK and US however it remains at an emergent stage in Australia. There are some barriers that need to be addressed including: increasing the scale of manufacturing and transportation to drive efficient production; attracting financing as traditional lenders secure against land and its progress, and not offsite assets; and perceptions of poorer quality buildings**. It will require government stewardship for the development of a modular housing industry standard and this could be achieved over a medium term. Philanthropy can contribute to this ambition by supporting innovation, documenting exemplars and contributing to addressing the negative perceptions associated with this type of housing.** A model that incorporates mobility and modular housing with meanwhile use of land would be extremely innovative and could be worth exploring.

Figure 7 Considering philanthropy's role in addressing cost of development

Options explored	Feasible • Risk • Ability to manage	Achievable • Sustainability • Scalability	Desirable • Impact • But for?	Commentary
Modular housing	• Currently at small scale in Aust – there is need for more demonstration across diverse sites • Will need to address scepticism/attitudinal barriers associated with previous, poor experience with modular construction • NIMBY phenomenon – anticipate need for regulatory and planning reform as well as investment in community attitudinal change about this style of housing	• Proven scalable and sustainable overseas • Distances in Australia could make sustainability challenging. Will depend on size and location of industry that is incubated by government to spearhead this as an option • Enables quick capital recycling because houses can be built quickly allowing income stream from sale or rental	• Rapid demonstration of impact with short fabrication and construction processes • Can design homes that minimise environmental impact • Need for philanthropy to catalyse activation in this sector – support innovation, document exemplars and contribute to addressing the negative perceptions associated with this type of housing	• Need government stewardship to invest in the development of industry that can build at the scale required for cost effectiveness • Part of a multipronged solution that sees modular housing erected on previously underutilised land • Could have mobility built into the modular housing design which could make it suitable for meanwhile use sites

Barrier 5: Return on investment

When making a decision about investing in affordable housing **a long-term outlook** is an essential underpinning, rather than a desire to realise capital gains through a sales strategy. This long-term view is supported by the fact that compared with market-rate apartments, affordable housing is, in a sense, recession-proof and provides downside protection to investors. Strong demand exists for affordable properties both in times of economic prosperity and economic uncertainty which means that there is:

- relatively little risk and a reliable return on investment (if slightly sub-market)
- consistent cash flow because of subsidised rent for tenants.

That being said, misconceptions about affordable housing being a risky ‘asset class’ that does not attract commensurate returns persist. Moreover, the operating conditions mandated for institutional investors (i.e. the sole purpose test) mean that investors are obliged to direct investments to prioritise maximum return. This constrains institutional investors who might otherwise be interested in diversifying their portfolio with an allocation to secure, slightly sub-market returns for the long term. Assessment of two options that address return on investment are included in Figure 8.

There is precedent internationally for philanthropy to step in and address the issue of return on investment - through financing and structuring arrangements that account for risk that stems from the notion of time. For example, in one case study we explore how an investor has taken into account the payback period as part of their considerations about return on investment and has, with appropriate structuring, been able to prioritise investing in long term assets which derive ongoing stable returns over premium rentals or build-to-sell investments. One of the features of this case study is the securitisation (i.e. the ability to sell off debt and future cashflows) to institutional investors which enables developers to recycle the original capital and increases the capacity of the developer to deliver new projects.

Figure 8 Considering philanthropy's role in addressing return on investment

Options explored	Feasible • Risk • Ability to manage	Achievable • Sustainability • Scalability	Desirable • Impact • But for?	Commentary
Stable return vs exit with capital growth [Interest only loan]	• Takes into account payback period as part of its considerations about return on investment and has, with appropriate structuring, been able to prioritise investing in long term assets which derive ongoing stable returns over premium rentals or build-to-sell investments • Low and simple ongoing maintenance costs and processes due to long term nature of investment and availability of existing infrastructure/processes i.e well trodden loan terms and distribution processes	• Scalability variable based on the respective size of development and size of philanthropic corpus. Locks up capital but provides a sustained return. Options for recognising difference in return rate available • One of the features of this case study is the securitisation (i.e. the ability to sell off debt and future cashflows) to institutional investors which enables developers to recycle the original capital and multiplies the capacity of the developer to deliver new projects	• Ensures long term supply of affordable/social housing stock • Ability to work in partnership and mitigate the pressures on providers, supports an impact first approach e.g provides a runway for evolution and improvement of service provision • Consistent long term impact achieved • Philanthropy not subject to the same variables as impact investors or the traditional banking/finance market	Sole purpose test –while many institutional investors still apply the sole purpose test in terms of maximising financial returns, increasing numbers of financiers are adapting and attributing a part of their portfolio to reflect a triple bottom line approach: people, planet and profit. Charitable institutions with invested corpus could consider this approach, though tension may exist between the volume of grant contributions able to be made and the impact of the core finance investment supplying the distribution funds
SASC approach – risk absorption, long-term asset ownership option	• Enables organisations to provide housing for their beneficiaries • Absorbs the risks associated with buying or renting property • Satisfies investors regarding risk and return • Requires minimal new resources to manage on behalf of the borrower. Amplifies their existing skillset in managing low income tenancies [builds on their strengths]	• Provides for a market segment not covered by other government initiatives • Especially suitable for place based small to medium providers • Gives the borrower the benefit of long-term asset ownership	• Allows for the shift of assets from the general market to a regulated one. Creates a two fold impact effect, both in the securing of new assets for the affordable/social housing market and by increasing the financial asset base of key service providers, reducing the variables long term in their operating costs • 100% finance would not be achievable from the traditional financing market	Would be new in Australia

Barrier 6: Risk

Risk and the perception of risk, impact the actions of all stakeholders involved in the development, construction and management of social and affordable housing. The ability to understand, reconsider, reframe or directly address these assumptions has potential to shift the dial on the rate of engagement in affordable housing development.

Since land acquisition and soft development costs (e.g. architect, consultants, development application fees and authority charges) are incurred before construction begins, traditional investors and lenders often consider pre-development and land acquisition loans to be high risk and set the interest rates at unfeasible levels for smaller organisations to get projects off the ground or for innovative models to build a track record.

Philanthropy can be deployed to address these risks and there are international examples of philanthropic funds being used to de-risk the pre development phase through use of zero interest loans. The application of the assessment framework to this approach is detailed in Figure 9. Beyond contributing to the capital stack for investment, **philanthropic funds could be used to support research to tackle the basis from which risk perceptions about affordable housing stem and how these perceptions manifest**.

Such an understanding could contribute to resetting the market's approach to risk and the drivers of perceptions of risk and could unlock new opportunities for investment in provision of affordable housing at scale.

Figure 9 Considering philanthropy's role in addressing risk

Options explored	Feasible • Risk • Ability to manage	Achievable • Sustainability • Scalability	Desirable • Impact • But for?	Commentary
Subsidised pre development funds	• Not all development applications will be approved – need to factor in 'failure' when thinking about maintaining/recycling capital in a pre DA fund • Extended timeframes for approval will mean a need for patience among providers • Would need to appoint a fund manager	• A fund will not be self sustaining because some pre development costs will not be able to be recouped so there will be the need for 'top up' funding from philanthropy on an ongoing basis • The scale of the fund can be adapted according to the scale of the developers that are targeted, but it is envisaged that this fund would be most useful for less experienced, more innovative and perhaps smaller scale housing developers • Could have national remit and pool philanthropic contributions from a variety of sources	• Relies on the developer being able to recoup pre development costs through commercial finance that is secured for the development • Reduced time required upfront to secure finance for the pre-development activities which means that applications can get to approvers quicker and housing can be built to address the shortfall more immediately	• Could be a pooled fund open for applications from all eligible (i.e. NFP) developers • Recycles capital • Will require patience because of delays often incurred in approval process

Running the numbers: financial modelling of some options

A series of high-level financial models were developed to explore the implications of five different potential financing pathways that could be considered by philanthropists interested in contributing to increasing the supply of affordable housing.

We note that affordable housing represents a spectrum of demand from those on very low, low and moderate incomes. We also note that it sits as part of a broader journey out of homelessness and housing insecurity. Stable, safe and affordable housing is the best intervention at any stage of the homelessness / housing insecurity cycle. The lack of supply of properties, exacerbated by the increasing housing finance stress being experienced by moderate income households, perpetuates the current cycle of housing vulnerability.

It is also important to note that while philanthropy may have historically looked to target social housing development interventions for those solely on low and very low incomes, there is evidence that the increased demand for social housing and the decreasing affordability of its construction is corelated with the decrease in supply of affordable housing for low *and moderate* income earners. The demand for affordable housing among low and moderate income earners is especially critical when considered over time, particularly with forecasts of increasing numbers of households experiencing poverty relating to housing stress. While philanthropy has traditionally understood its mandate to sit within the realm of those on low to very low incomes, an increase in affordable supply for moderate income earners would decrease pressure on social housing demand. To this end, the models presented in this report include moderate income earners. The decision to include the moderate income cohort is based on the following factors:

- it is growing (and currently underserved)

- inclusion of moderate income alongside low in mixed tenancy models serve as a reasonable intervention to reduce future poverty
- the scale of philanthropic funds available to generate an intervention shows greater leverage when including moderate income tenancies.

Modelling outputs and what they mean

The options that have been modelled are exemplars of approaches that philanthropy can consider as options for supporting affordable housing. These are high level, hypothetical models – the intention is to highlight the reasons why particular approaches might be attractive, when they might be deployed and the implications of selecting the particular option.

Five options have been modelled. All options assume land is gifted and that there is no profit on the development except financing costs.

Option 1: Pre-Development Approval (DA) Fund

This option explores the impact of having philanthropic contributions pooled into a revolving fund that not-for-profit developers can access to cover costs associated with activities undertaken prior to submitting for development approval. The fund is useful for three main reasons:

1. it mitigates risk of cost blow outs associated with the extended timeframes usual for development approval to be provided (pre-DA loans attract higher interest costs when they are available (sometimes it is not possible to access a loan which means that equity has to be available to the NFP developer in the form of cash reserves, which is unlikely) and delays in approvals mean delays to rental revenues which puts additional financial strain on the project)
2. it absorbs the cost of failed DA applications (the model assumes 30% of the DA applications are unsuccessful)
3. it can be delivered as wraparound solution with the Fund being administered by experienced development managers who make development of 'lazy' land accessible for landowners without any in-house development expertise.

Option 2: Top up of income payments to help balance project

From a financial modelling perspective, this option provides the balancing payment where the cumulative project income cannot meet the outgoings. This could be adapted to suit payment by results or a social success note in combination with wraparound support services such as financial literacy education or employment search. This option could also gather implementation evidence for advocacy work with government to consider housing solutions and associated payment streams from a holistic, 'place based' perspective rather than in silos of housing and social welfare.

Demonstrating the validity of this approach to government and instigating structural system change of how public monies are spent can make lower-income housing more sustainable from an investor lens and contribute to the effective solution framework.

Option 3: Interest Only Development Loan

This option is feasible for philanthropists able to contribute large amounts of funds (or for a syndicate of philanthropists). It sees the provision of an interest only loan whereby the project will pay interest in perpetuity - the capital outlay is never repaid as long as the housing is maintained in the rental pool and not sold off to recoup the principal outlay. An alternative approach would be to consider selling off some of the units at a future point decided by the foundation (possibly capturing capital uplift) which would represent an exit strategy over the long term.

Option 4: Hybrid – Pre DA-Fund and Top up

This is a combination of Options 1 and 2 - it enables viability of the Pre-DA fund under some scenarios by providing smaller top-up amounts.

Option 5: Community Land Trust (CLT) selling 10 units @ 50% market discount in later years

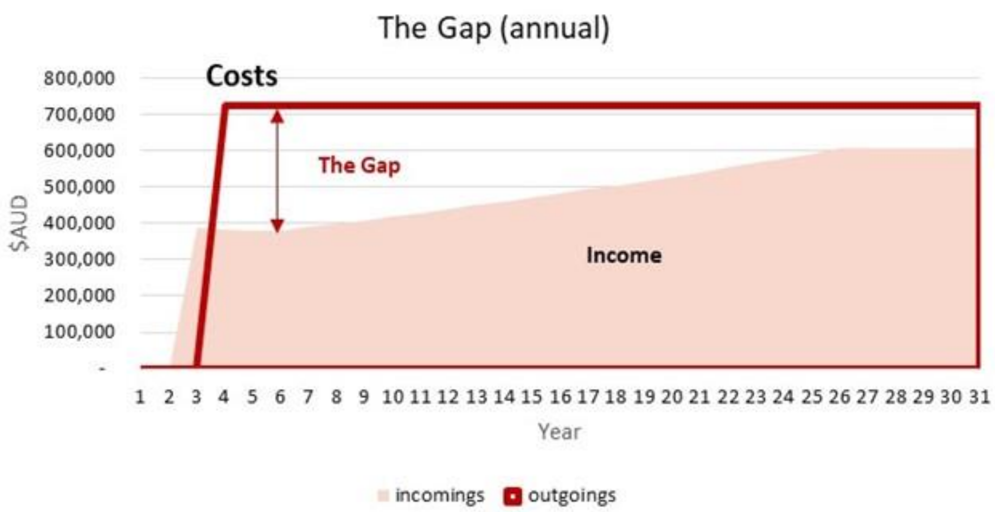
There are set up and ongoing operating costs associated with the creation of a CLT structure. Doing so however, locks in the value of the land, and so when units in a CLT are sold it is possible for them to be an affordable price (having avoided rising land costs). In the modelled scenario, the sell off of units doesn't happen at the point of construction completion (as is often required for cash injections back into the developer), rather, the units are sold over a number of years which means that tenants are able to save for a deposit over that time and can benefit from being able to purchase the unit at a 50% discount to market.

A base case was developed to enable comparison across the models. The base case looked at building a 100% rental development of 40 units (1, 2 and 3 bedrooms), located in Melbourne. The land was assumed to be gifted and the developer a not-for-profit organisation. 60% of the units were allocated at 'very low income' and 40% at 'low income' affordability. We used Victorian Government income definitions for affordable housing and set rent prices at 30% of the relevant levels.

For all options it is assumed they are able to attract commercial financing to cover the development costs (4% over 30 years) and for pre-development costs (a short-term facility of 8%, with the exception of the pre-DA fund options). Where the options have not used these rates they have been noted.

The low rental income means that it is not possible to meet the repayments associated with commercial development loans. Figure 10 highlights that, without philanthropic intervention, there is a significant, recurring annual revenue gap.

Figure 10 The base case: a significant revenue gap



Options were modelled to close the gap and comparisons made re costs to philanthropy considering:

- the financial outlay required i.e. the amount paid by philanthropy towards the project
- return - being any payment the project makes back to philanthropy
- total net costs - which is the net amount, i.e. outlay less return.

To account for the impact of timing on the cash inflows or outflows, we have applied a small discount factor of 2% (e.g. $100 today is the equivalent of $98 next year and so on).

Figure 11 summarises the costs to philanthropy associated with application of each of the models with more details provided in the narrative below.

Figure 11 Comparing costs to philanthropy associated with the models (60% very low income and 40% low income)

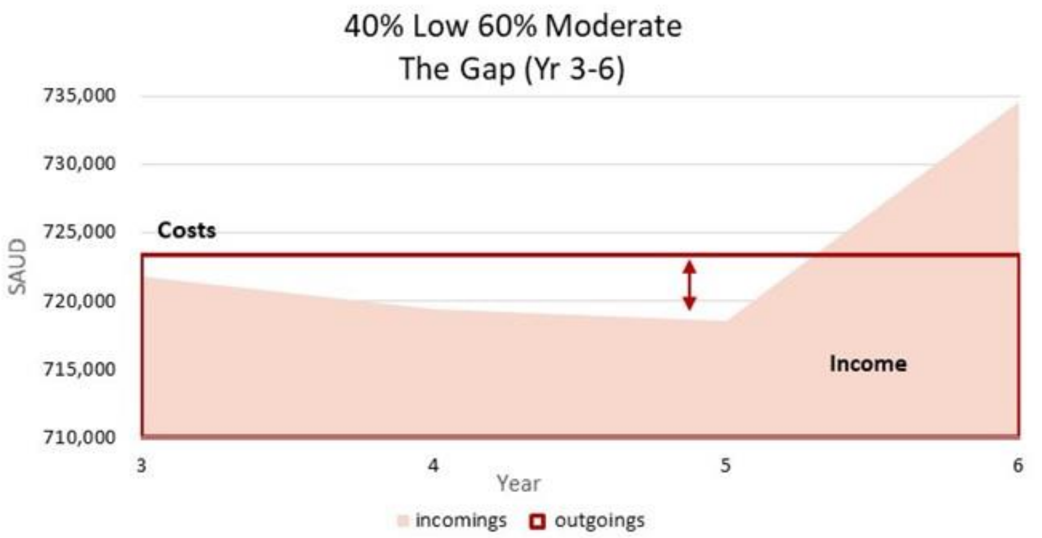
Cost to Philanthropy	Pre DA Fund	Top Up	IO loan	Pre-DA Fund & Top Up
items considered	pre-DA, inc. failures and 5% charge	top up amounts paid	investment less interest paid	as per Option 1 & 2
Outlay	cannot meet repayments	(6,491,041)	(12,508,100)	(7,876,253)
return			11,396,224	1,006,950
total costs		(6,491,041)	(1,111,876)	(6,869,303)
over c. 30yr period discounted future cashflows @2%		(5,027,571)	(4,582,409)	(5,421,156)

- **Pre DA-Fund** was not able to meet the commercial Principal and Interest (P&I) loan repayments at 4% under this tenancy mix.
- **Top-up funding** was able to meet the loan repayments although needed to provide $6.5m in total to the project for the entire period of the commercial loan repayments (4% P&I), essentially filling in the large gap in Figure 10.
- **A 2.95% Interest Only loan** of $12.5m meant by not having to repay the capital, the reduced loan payments could be serviced by the cohorts' rental income. Assessed over 30 years, the interest payments going back to the philanthropist is $11.4m, meaning this has a net cost of just over $1m. However, as the loan is structured to run in perpetuity this eventually becomes a positive return. In later cohort mixes the project can afford to service higher interest rates.
- **Hybrid of Pre-DA Fund and Top-up** required an outlay of $1.4m at the start of the project, with $1m of this returned when commercial finance (4% P&I) had been secured. However, to continue to meet the loan payments, a further $6.5m is needed as a top-up, bringing the total outlay to over $7.9m.

When the different options are evaluated using the discounted cashflow method (taking into consideration the reduced value of money over the 30-year time period), the results are reasonably similar, a cost between $4.6m and $5.4m.

We also explored an alternative tenancy mix with the development comprising 40% low and 60% moderate income tenants. The revenue gap in this case occurred in the early years of the project, as per Figure 12.

Figure 12 The timing and scale of the revenue gap when tenant cohort is 40% low income and 60% moderate income



Under this final tenancy mix (40% low and 60% moderate incomes) a fifth option was modelled – establishment of a CLT with 75% (10) of the units eventually sold at a heavily discounted rate.

All the five options explored were viable, and the interest only option even delivers a positive discounted **cashflow** (circled) **albeit over 30 years.** Figure 13 summarises the costs to philanthropy with details provided below.

Figure 13 Comparing costs to philanthropy associated with the models (40% low income and 60% moderate income)

Cost to Philanthropy	Pre DA Fund	Top Up	IO loan	Pre-DA Fund & Top Up	CLT setup & sell @50%
Items considered	pre-DA, inc. failures and 5% charge	top up amounts paid	investment less interest paid	as per Option 1 & 2	CLT setup/working Capital
Outlay	(1,370,000)	(10,346)	(12,508,100)	(1,381,867)	(788,825)
return	1,006,950		19,700,258	1,006,950	
total costs	(363,050)	(10,346)	7,192,158	(374,917)	(788,825)
over c. 30yr period discounted future cashflows @2%	(382,794)	(9,883)	1,192,767	(394,140)	(775,601)

- **Pre-DA Fund** required an outlay of $1.4m at the start of the project, with $1m of this returned when commercial finance had been secured. This option is unable to meet the repayments of a 4% commercial loan, as with the other options, but can do at the slightly lower rate of 3.95%.
- **Top-up funding** needed to provide only $10k in total to the project during the early years of the project.
- An **Interest Only loan** of $12.5m could be serviced as high as 5% supported by the increased rental income of the tenants. Assessed over 30 years, the interest payments going back to the philanthropist is just under $20m, meaning this has a positive return of just over $7m. As before, the loan is structured to run in perpetuity, so these returns will continue.
- **Hybrid of Pre-DA Fund and Top-up** required an outlay of $1.4m at the start of the project, with $1m of this returned when commercial finance (4% P&I) had been secured. A small top-up payment is required to meet the 4% loan rate.

- **CLT** option in addition to using the commercial loan facilities (8% and 4%) requires an outlay of just under $800k over a 7-year period to assist in meeting the running costs of the CLT. In later years the project is able to offer 10 of the units for sale at a 50% discount to market value.

When the different options are evaluated using the discounted cashflow method (taking into consideration the reduced value of money over the 30-year period), the results vary significantly; from a cost of nearly $800k for the CLT to a positive return of over $1m via the interest only loan. It is worth noting the CLT does support 10 households to purchase their own home, while securing the asset values to ensure the unaffordability cycle is not added to upon resale.

Conclusions

This report has applied an assessment framework to some of the types and structures of finance that can be used to tackle the financing barriers constraining affordable housing development. The quantum of finance and associated terms (duration, return) required to address the gap between revenue and costs associated with the development of a 40-unit affordable housing project has been modelled. We find that it is not feasible for philanthropy to address the revenue gap that is associated with renting the units to 60% very low and 40% low income earners.

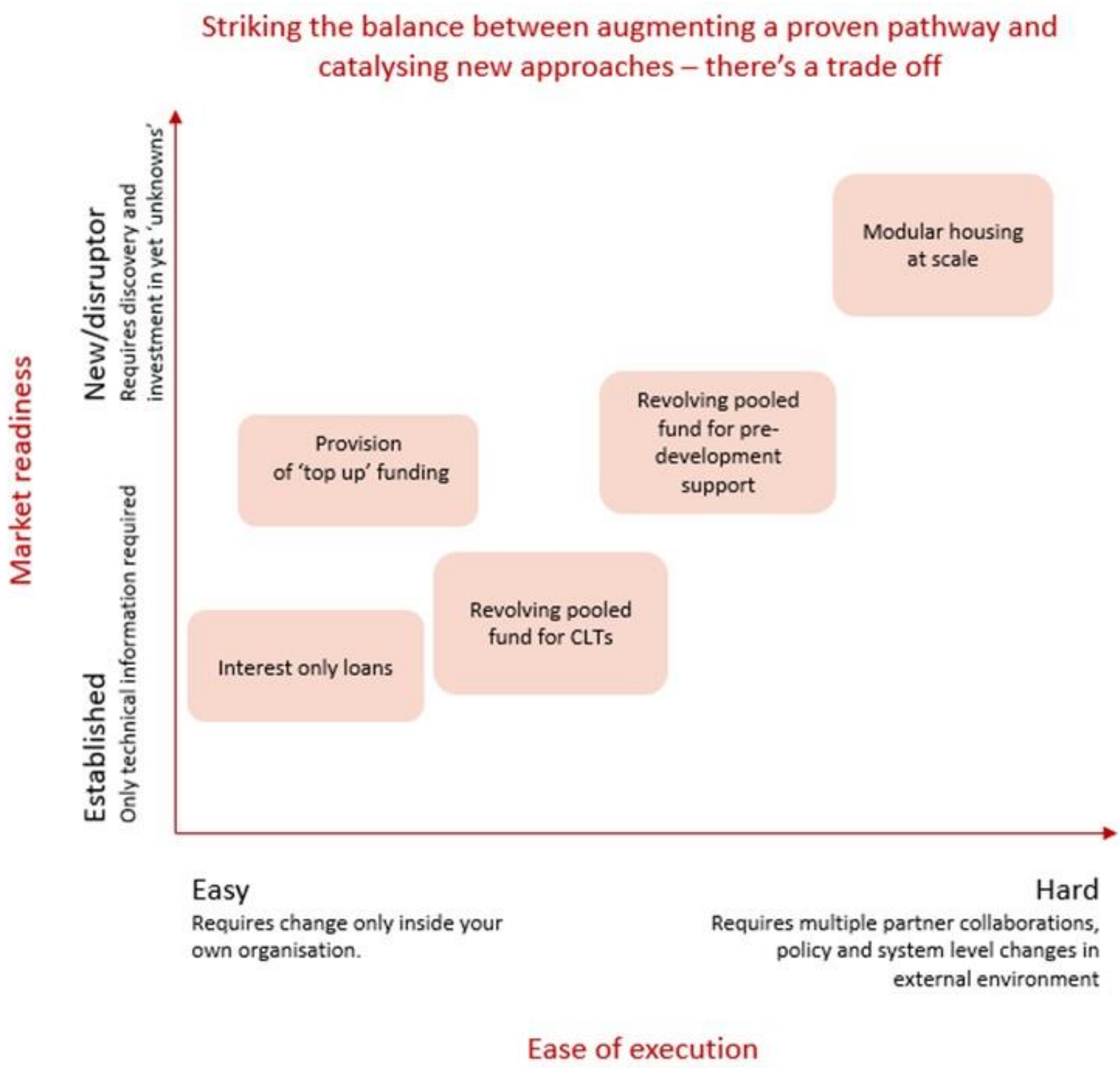
By shifting the tenancy composition to be 40% low income and 60% moderate income the feasibility of philanthropic funding being able to minimise or even fill the gap is increased. This mix of tenancy is most likely in affordable (rather than social) housing. Faced with the opportunity to make a real contribution to affordable housing supply targeting this cohort, there are four financing pathways that we recommend to philanthropy for further investigation:

1. offering interest only loans to not-for-profit housing developers
2. establishing a mechanism to provide top-up funding
3. initiating a pooled fund to support establishment and operating costs of CLTs
4. initiation of a pooled fund for pre-development support for not-for-profit developers.

Some projects are more suited to certain financing options, for example, in general lazy land projects are likely to be more suitable for the pre-DA fund. When this alignment has been established then philanthropy's role within the financing option can be assessed. There are different requirements of philanthropy associated with each of the recommended options. On the one hand, an interest only loan facility requires commitment of substantial amounts of capital over a long term (30 years) and comfort accepting a low but steady return. On the other hand, a pooled fund for pre-development support can be scaled according to the amount of funding available from philanthropists which will be correlated with the number of developments that it can support. Regardless of size however, the fact that not all development applications will be approved means that while a development management fee for such a fund in a NFP structure might result in 'top ups' to the fund, a shrinking fund should be expected. There is precedent for all these options internationally, they are implementable in Australia and we have presented them in Figure 14, considering the relative ease of implementation and whether or not the market is familiar with and has capability to support the product.

Philanthropy also has a role to play in catalysing innovation, helping build a track record and signalling impact potential. For this reason, we also recommend that philanthropy consider the opportunity to spur action in the modular housing market. Widespread availability of affordable, high quality modular housing could rapidly alleviate some of the barriers in the market. This market disruption will require collaboration across multiple stakeholders.

Figure 14 Recommended pathways for philanthropic capital



Philanthropic effort should be deployed in ways that complement or amplify public (and private) sector efforts and fill gaps where wicked problems persist. This means that in addition to addressing the financing element of the affordable housing challenge (as is the focus of this report), there is also value in considering how philanthropy can contribute to an enabling environment and influence the factors that will shape overall success. In this regard we recommend that philanthropists consider the following guiding principles when considering how and who to engage with in pursuit of better access to affordable housing for all:

- there is value associated with curating the right players/partnerships to work with philanthropy - local government, finance, developers, housing service providers and wrap around offerings
- philanthropy can support access for new players – solutions need to be not just about structuring for those providers that are already in, and at scale. There is value in enabling small players to do things differently

- place ‘need’ at the centre and support the development of solutions that are locally responsive / appropriate and financing on the back of that, rather than finding the funding and retrofitting the housing solution against it
- use pilots to test financial products and approaches and build an evidence base over time to drive policy changes and reform.