



Housing for our future

Incentivising private investment in affordable housing



November 2023

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Housing in Queensland is in crisis with a range of variables exacerbating the issue

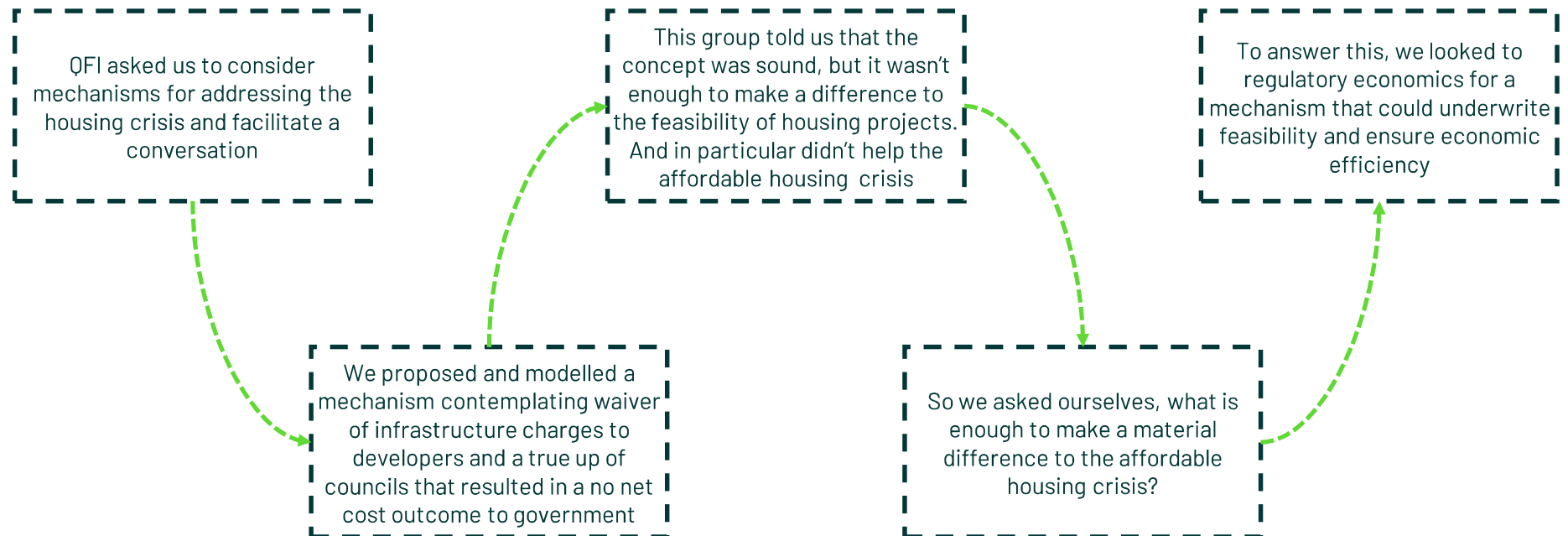
1	Historically high construction costs	Rising inflation, higher cost of capital, and material and labour shortages have contributed to significant growth in residential construction costs. House construction prices in Queensland grew by 45% in the three years to June 2023.
2	Post-COVID migration patterns	Queensland recorded the largest population increase of any state or territory with an additional 265,000 residents in March 2023 compared to March 2020. This strong and sustained population growth in recent years has added to housing demand.
3	Higher interest rate environment	Rising interest rates to curb inflation have made home ownership more expensive, and increased mortgage stress for existing homeowners, pushing more people back into the rental market.
4	Declining household sizes	Households are getting smaller – in 2021, average household size was 2.5 persons, down from 3.3 persons in 1971 – resulting in additional demand for housing over and above population growth. ²

1. budget.qld.gov.au

2. abs.gov.au

3. corelogic.com.au

We have been on a journey with QFI to facilitate a discussion about mechanisms for addressing this crisis



1

Hypothetical Scenario



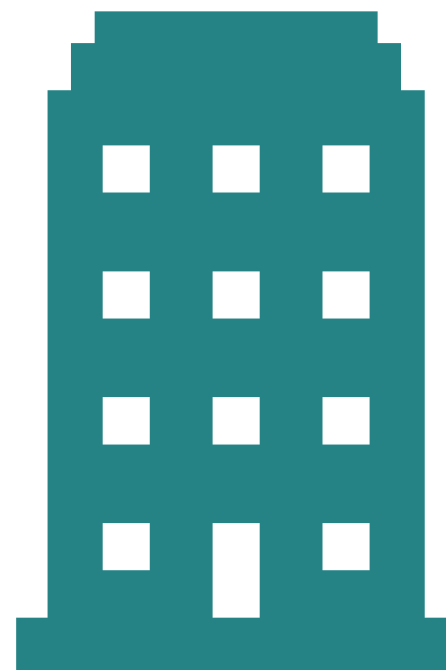
The difference between affordability and feasibility is \$194k for each dwelling, explaining why the market is struggling to deliver stock

Key assumptions (all dollar values in FY23 terms)

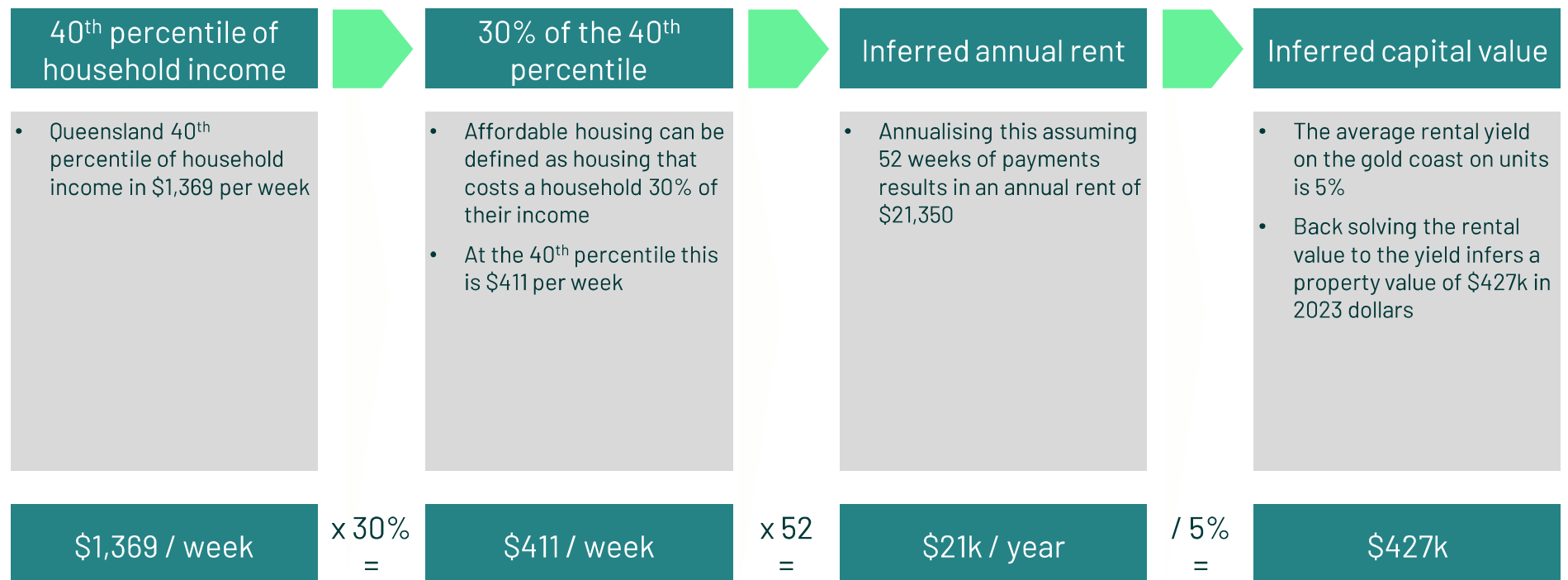
Assumption	Value
Affordable units developed	300
Land purchase price	\$13.5m
Average build cost per dwelling	\$467k
'Affordable' sale price to operator per apartment	\$430k
Weekly rent per dwelling (FY26)	\$445
Government charges	All applied

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Affordable dwellings



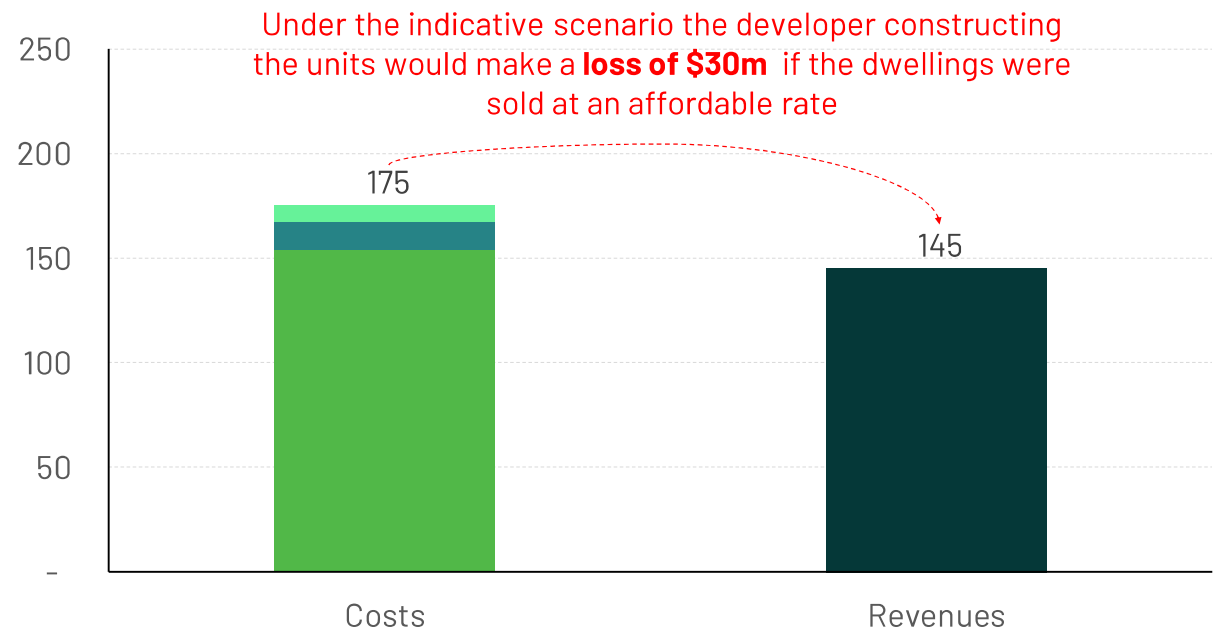
An affordable dwelling can be roughly defined as a dwelling that can be rented for \$411 per week, inferring a \$427k capital value



Using this number, we estimate that a developer would make a loss of \$30m on our indicative development

- Total development costs are \$175m for the 300 units.
- If sold at an affordable rate of \$427k (indexed to \$2026 values) the developer would make \$145m
- This would result in a loss of \$30m on the development
- This clearly demonstrates the lack of feasibility in an affordable housing development

Indicative Development Affordable Feasibility Waterfall



3

Policy outcomes

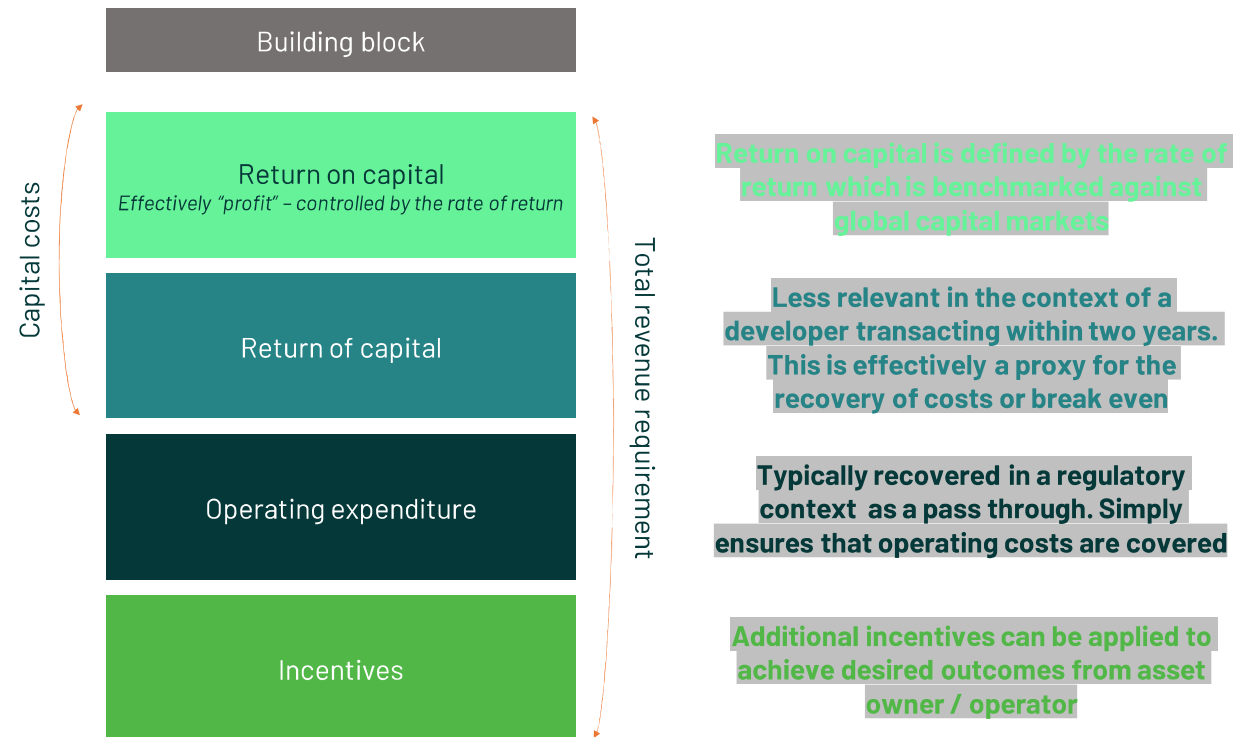


To address this issue via government intervention there are key principles that need to be achieved

- Housing needs to be affordable and remain affordable over the long term
- Private entities investing in these assets must generate a return that is economically efficient
- Any government contribution must be clearly linked to a policy outcome and realise value for money
- Ensure that government balance sheets are not burdened in the long term and budgets aren't dragged down by on-going operating costs

Any contribution of government needs to be demonstrably ‘value for money’, to achieve this we looked to regulated infrastructure

- Bodies such as the ACCC, QCA, IPART and ESC regulate the prices that the operators of monopoly assets can charge
- They ensure that the return these operators make represents an economically efficient return using a mechanism called a building block model



The target market for our model is key workers with median wages or lower in high cost markets

- Supply of 'affordable' housing will be difficult to achieve without government support
- But government support needs to be targeted to ensure both value for money and policy outcomes



Nurses

\$70k per year, \$1,350 per week



Teachers

\$78k per year, \$1,500 per week



Paramedics

\$74k per year, \$1,423 per week



Firefighters

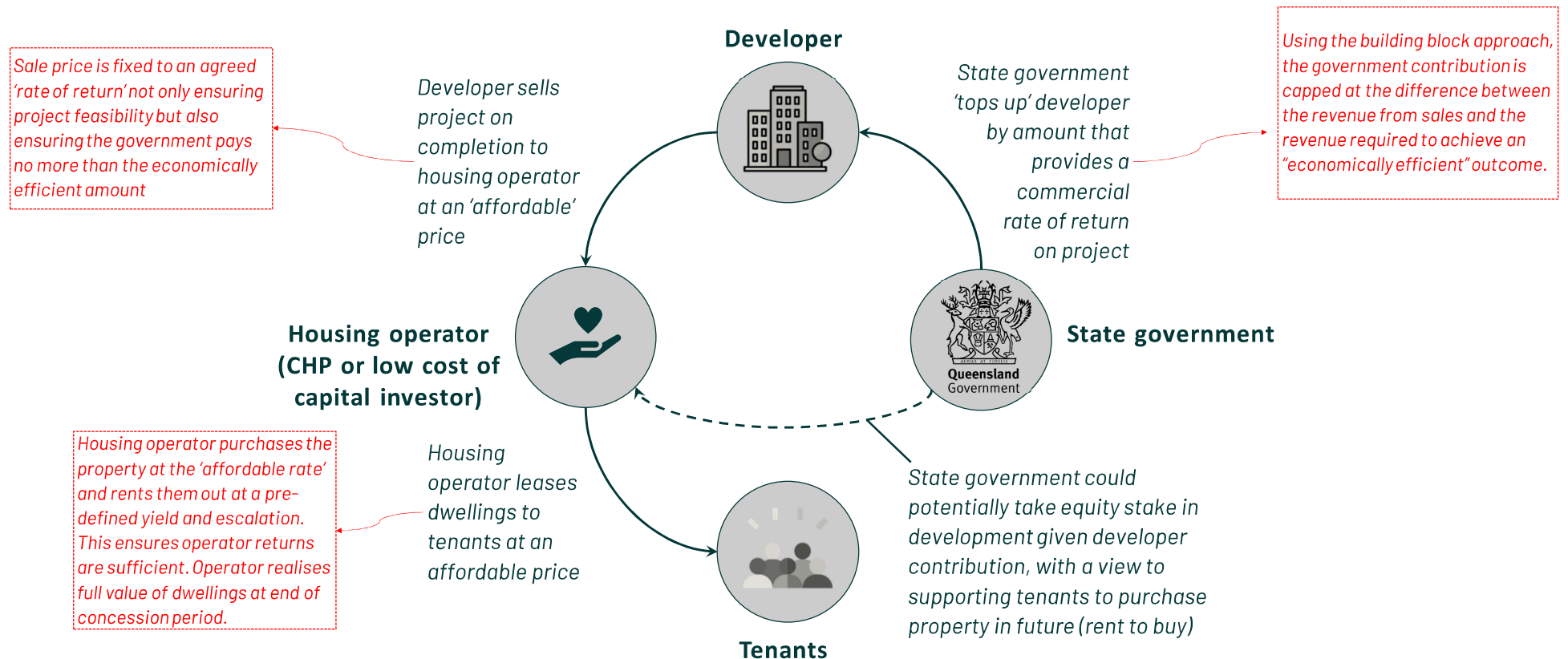
\$73k per year, \$1,400 per week

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The commercial framework



We have developed a model that sees government pay only the difference between affordability and feasibility



This model would realise a range of benefits for stakeholders making the development more attractive to private investment

Government 	Developer 	Operator 	Tenant 
<ul style="list-style-type: none">• Rather than deploying \$175m in balance sheet for development of 300 affordable dwellings, able to deploy \$58m to achieve the same supply outcome• Only required to provide a single capital contribution with no ongoing subsidy• Keeps building industry going and allows for trade skills to be developed	<ul style="list-style-type: none">• Receives full offtake of dwellings to operator• Assuming estimated construction cost holds, has fixed IRR for the development• Doesn't require marketing costs or pre-sales commitments to begin construction	<ul style="list-style-type: none">• Not required to undertake construction• No construction financing required• Able to purchase dwellings at rate depressed relative to market value• Achieves 5% yield on indexed capital through asset life• Realises windfall at end of concession period• Moves assets down the risk curve behaving more like a regulated "core" infrastructure asset	<ul style="list-style-type: none">• Receives accommodation at set affordable level for defined period• Indexed at pre-determined rate (not linked to underlying property values)• Security of housing for key workers in key locations

Additionally, it allocates risk to the actors most able to manage them

Government



- Principally exposed to construction cost risk as pre-determined contribution may not underwrite feasibility if market were to move materially

Developer



- Exposed to construction risk
- Required to manage delivery of construction process to agreed price
- Noting the likely need to put in place KPI schedule to appropriately manage construction risk (although this is minimised due to lack of requirement for pre-sales to underwrite construction)

Operator



- Exposed to volume risk as effectively required to 'offtake' affordable dwellings
- Also exposed to operation and maintenance risk as the asset operator

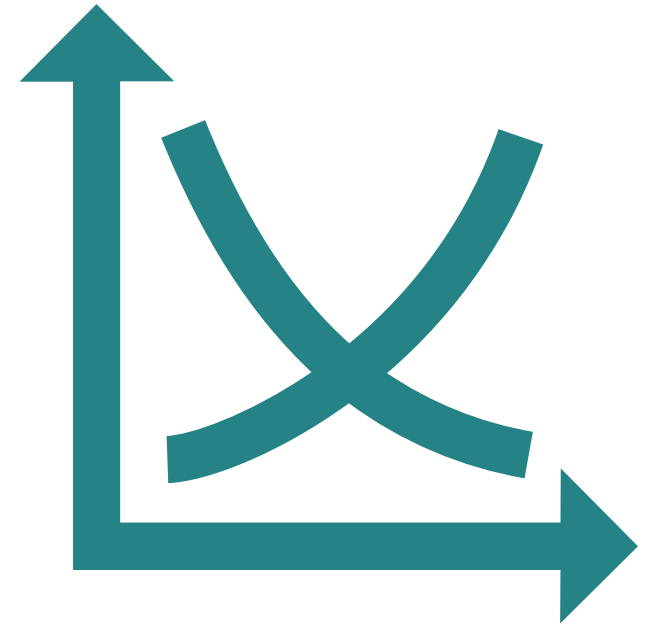
Tenant



- Limited risk
- Although should be noted that this model does not currently solve for end of asset life, so consideration required for build to rent to buy approach

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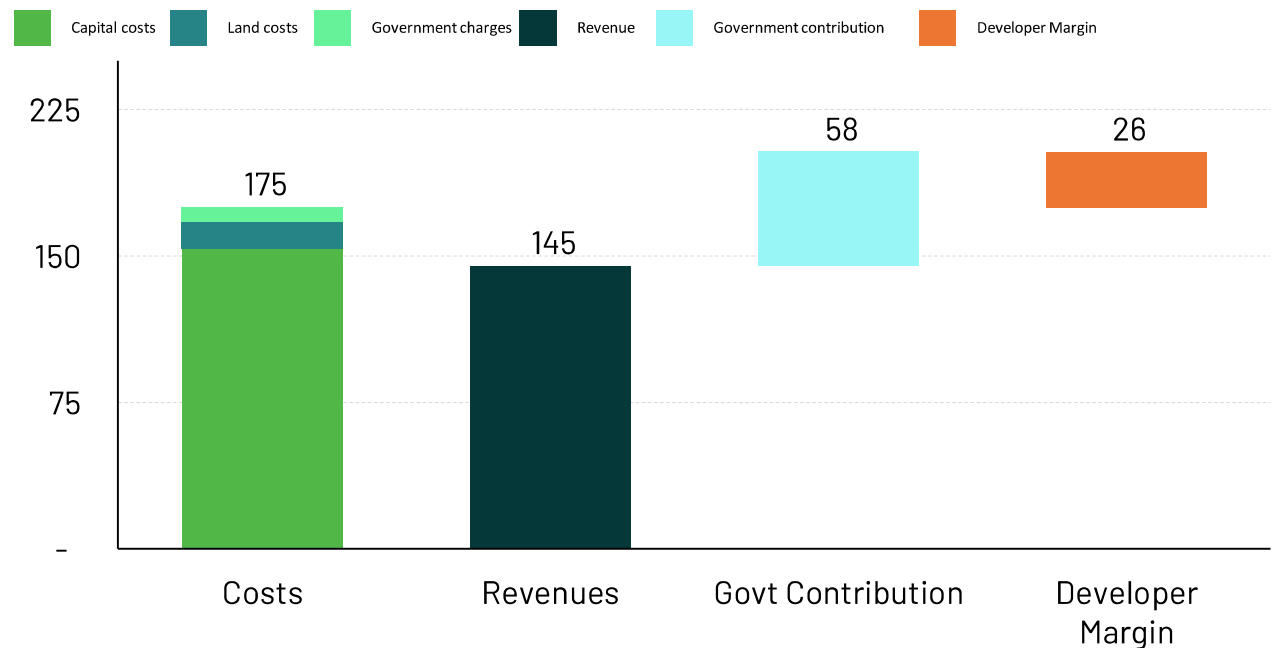
Financial implications



Our model suggests a government contribution in the order of \$194k per dwelling would achieve project feasibility and deliver 300 affordable houses

- We have applied the building block approach to the worked example outlined above
- We have arbitrarily defined the 'rate of return' at 10% to underwrite feasibility
- To take the hypothetical development from loss making to generating a sufficient return to incentivise private delivery, we estimate that a government contribution of \$58m is required.
- This would result in a developer margin of \$26m and an IRR on the development of 10%
- This equates to a \$194k government contribution per dwelling

Figure: Indicative development regulatory contribution feasibility - Developer

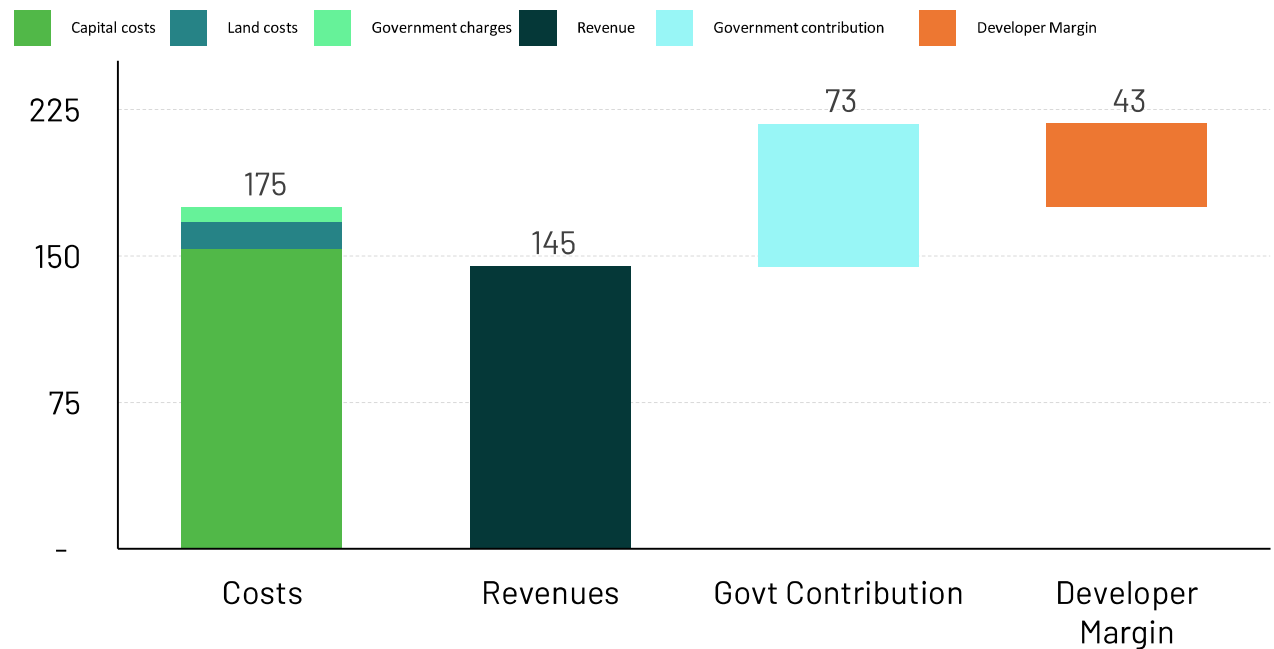


Note: Cashflows used are pre-financing and assume that the transaction receives tax benefits of typical affordable housing CHP transaction. A range of simplifying assumptions have been applied for provide indicative figures for discussion.

A 15% IRR for the development would require \$243k per dwelling, but would likely receive more market interest

- Increasing the IRR requirement for the development to 15% results in a requirement of \$243k per dwelling
- This reflects a total government contribution of \$73m
- The developer margin at this revenue requirement would be \$43m

Figure: Indicative development regulatory contribution feasibility - Developer

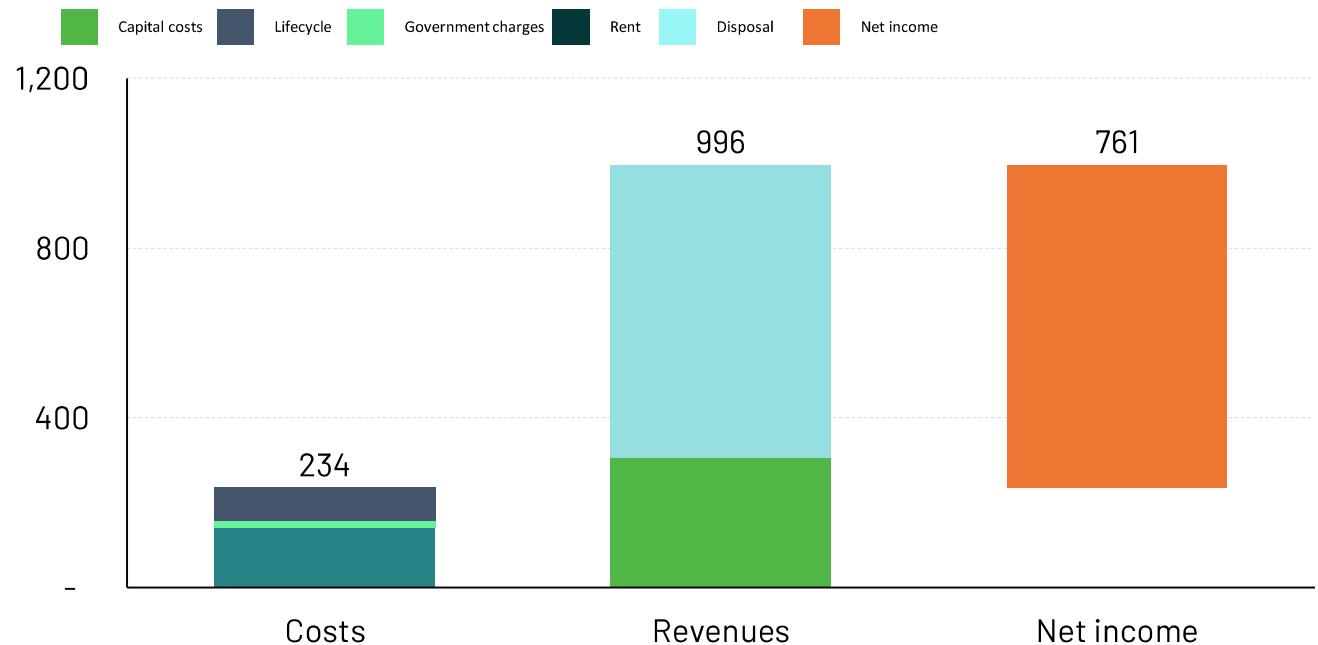


Note: Cashflows used are pre-financing and assume that the transaction receives tax benefits of typical affordable housing CHP transaction. A range of simplifying assumptions have been applied for provide indicative figures for discussion.

The operator generates revenues over the 30-year concession period through rental incomes and realising the full market value of the development

- Under this scenario the operator also makes a commercial return on investment
- Achieving an 8% IRR on the \$234m in costs associated with the acquisition and operation of the development
- This return is driven twofold by the rental yields of the property (\$305m) and the crystallisation of the residual value of the property at the end of the concession period (\$691m)

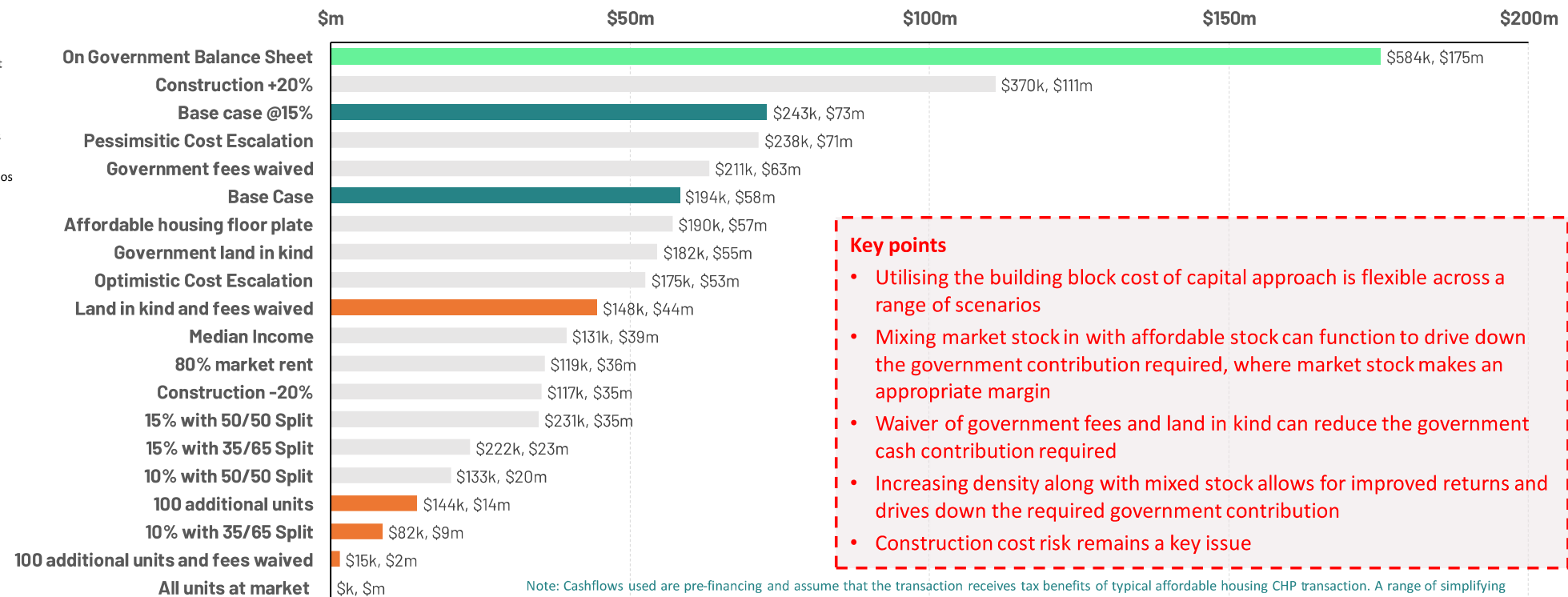
Figure: Indicative development regulatory contribution feasibility - Operator



Note: Cashflows used are pre-financing and assume that the transaction receives tax benefits of typical affordable housing CHP transaction. A range of simplifying assumptions have been applied for provide indicative figures for discussion.

This framework can be used to manage both changes in the underlying capital costs of the development and to accommodate policy interventions

Indicative development regulatory contribution feasibility – Developer Scenarios



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Feedback

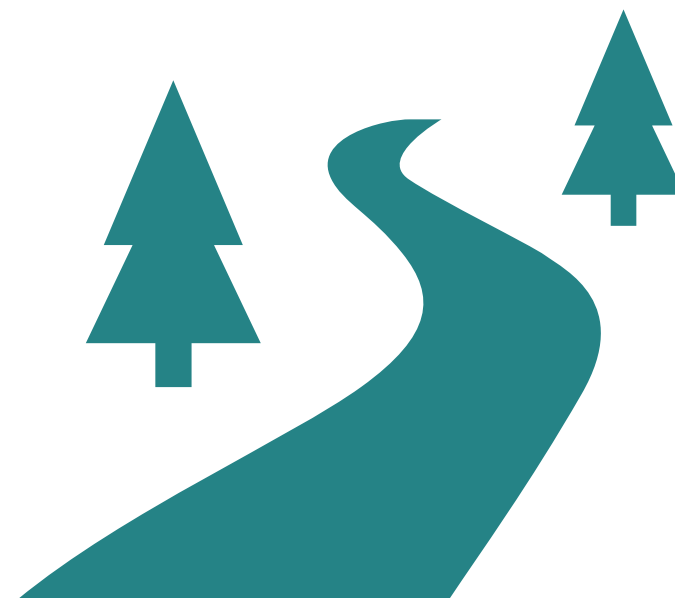


Discussions with government and industry suggest a range of complexities that would need to be addressed

1	Developers / Funds	<ul style="list-style-type: none">• Development phase is appealing as there is a focused risk allocation and fixed return• Operation phase presents difficulties due to sub-investment grade returns and reliance on dwellings residual value
2	Government	<ul style="list-style-type: none">• Programs such as the HIF (in Queensland), HAFF (Federally), and entities such as NHFIC or Housing Australia recognize the opportunity to incentivize private delivery and these models reflect variants of the framework considered above• There is still limited acceptance of treating social and affordable housing assets as infrastructure like investments
3	Financiers	<ul style="list-style-type: none">• Broadly indicated that the upfront payment on practical completion has some benefit relative to an on-going long term rent subsidy• There are some structure financing options that could support the returns to the operator, in particular through making distributions through debt re-financing
4	Community housing providers	<ul style="list-style-type: none">• Suggested that the allocation of development risk to developers was seen as preferable to a model where CHPs fund construction on balance sheet• There is significant complexity with funding the operator stage through CHPs as they have very limited access to equity funding and require a significant share of expensive sub-debt to fund projects

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Discussion



A01

Assumptions

Housing model input assumptions

An indicative 'affordable price' can be estimated using the 30:40 indicator and market rental yields

There is no standardised definition for 'affordable housing' across Australia. A household is typically described as being in 'housing stress' if it is paying more than 30 per cent of its income in housing costs (ahuri.edu.au). Two commonly used definitions for affordable housing include:

- 1. The 30:40 indicator:** Where rents are set at a rate where a household in the 40th percentile of income distribution pays less than 30 per cent of income in housing costs (ahuri.edu.au).
- 2. Discount on market rent:** Where rents are set at 75% or lower than the prevailing market rent (bhcl.com.au)

Our model uses the 30:40 indicator as the base case assumption, with scenarios run on the discount on market rent definition.

How do we derive the 'affordable price', paid by the housing operator?

$$\text{Affordable Price} = \frac{\text{Annual affordable rent}}{\text{Rental yield}}$$

Where:

- Annual affordable rent = Rent a household in 40th percentile of income could afford without housing stress
- Rental yield = Average market rental yield for a unit on the Gold Coast



Private Investment in affordable housing

Assumption	Figure	Notes
Scenario		
Dwellings	300	
Local Government Area	Gold Coast, Queensland	
Timeframes	Construction – 2 years Operations – 30 years	
Developer		
Dates	Site Acquisition – 1/7/2024 Development Sale – 1/7/2026	
Land Acquisition Cost	\$13.5m	Based on Robina land sale data between 2020 and 2023 (\$1,506/m ²) and required land size based on recent similar SEQ residential developments (9,000m ²)
Land Value	\$8.1m	Figure is for purpose of land tax calculation. Assumed on basis that Valuer General's assessment would be generally at a 40% discount to market price.
Transfer Duty	\$760k	Based on the Land Acquisition Cost and assumed corporate/ trustee buyer. Estimated using the rates outlined on Queensland Revenue Office transfer duty rates
Land Tax	\$145k p.a.	Based on the Land Value and assumed corporate/ trustee owner. Estimated using Queensland Revenue Office land tax estimator
Construction Cost	\$4,998 / sqm (\$512k per dwelling)	Propertyupdate.com.au current industry averages with 25% contingency indexed at cost escalation
Dwelling Size	93.5 sqm	Based on recent Robina two-bedroom apartment sales (RP Data, Sep 2022 – Sep 2023 sales)
Infrastructure Charges	\$20k / lot	Based on Council of City of Gold Coast Charges Resolution (No. 1 of 2022) , \$20,000 used as simplifying assumption
Market values	\$656k per dwelling	Median 2-bedroom apartment size in Robina with additional 5% to reflect new build

Private Investment in affordable housing

Assumption	Figure (\$2023)	Notes
Operator		
Rent Revenue	\$445 p.w. (FY26)	Based on 30:40 indicator of affordable housing
Transfer Duties	\$23k / dwelling	Based on the Land Acquisition Cost and assumed corporate / trustee buyer. Estimated using the rates outlined on Queensland Revenue Office transfer duty rates
Operating Expenses	1% of construction costs	Industry benchmark and indexed at cost inflation
Rental Yield Benchmark	5%	Average rental yield for Gold Coast per sgmresearch.com.au
Purchase Price/Dwelling	\$430k	Derived by dividing Annual Rent Revenue Benchmark by Rental Yield Benchmark
Dwelling price escalation	4% p.a.	Approximated long-term Australian residential price growth rate
Rent Escalation	2.5% p.a.	Aligned to RBA inflation target
Cost Escalation	7%, 5%, 3.5% and 2.5% p.a.	Assumes elevated inflation in short run returning to long run target
Discount Rates	Developer: 10.00% p.a. Operator: 8.00% p.a. Government: 5.00% p.a.	Developer: Below private market rate of return due to lower risk and larger volume of development Operator: Aligned to infrastructure core plus cost of capital Governments: Reflects 10-year government bond yield

