The potential to fund remote Indigenous housing in Australia through social impact investment

Input to the Review of the National Partnership Agreement on Remote Indigenous Housing

14 March 2017

This page is intentionally blank.

© Nous Group

Contents

[Executive Summary 3](#_Toc477337135)

[This paper considers social impact investment for remote Indigenous housing in broad terms 5](#_Toc477337136)

[1.1 There is a clear funding gap in remote Indigenous housing 6](#_Toc477337137)

[1.2 Social impact investment approaches could bridge the funding gap and enhance social outcomes in the long run, but face significant challenges in the short term 7](#_Toc477337138)

[1.2.2 In the absence of a functioning market and financial returns, there is a role for direct government funding 8](#_Toc477337139)

[1.2.3 There are a number of other issues that limit the options for non-government investment in remote Indigenous housing 9](#_Toc477337140)

[1.3 There are two broad classes of social impact investment that warrant further exploration for remote Indigenous housing 11](#_Toc477337141)

[1.3.1 Social Impact Bonds are a promising financing option in the long term 11](#_Toc477337142)

[1.3.2 Direct investment approaches could attract private finance, but would require significant government incentives 15](#_Toc477337143)

[1.4 The government must create the enabling environment for social impact investment and build the remote housing market 17](#_Toc477337144)

[Reference List 20](#_Toc477337145)

[Appendix A Lessons learned from urban affordable housing finance 21](#_Toc477337146)

# Executive Summary

**There is the potential to leverage government funding through social impact investment approaches to more effectively meet the resourcing needs of remote Indigenous housing. However, given the current lack of financial returns in remote Indigenous housing and the high costs of establishing social financing mechanisms, social impact investment is unlikely to be viable in the short term. It will never totally eliminate the need for ongoing government funding of remote Indigenous housing. Trialling social impact investment mechanisms in more favourable markets first, such as urban social housing, is recommended before applying them to the more challenging environment of remote Indigenous housing.**

Historically, government funding has constituted the primary source of funding for housing in remote Indigenous communities. Remote Indigenous housing has substantial ongoing resourcing needs and limited opportunities to recover costs through rent or other charges, while government funding sources are increasingly strained. As part of the Review of the National Partnership Agreement on Remote Indigenous Housing, Nous Group was commissioned to explore whether government funding can be leveraged to allow the entry of other sources of investment to assist with the ongoing resourcing requirements for remote Indigenous housing.

The experience with social impact investment mechanisms in a range of other settings has demonstrated the potential to leverage government funding to increase the pool of capital available. Prima facie these mechanisms could be applied to remote Indigenous housing, and thereby improve the quality of service delivery and enhance the social outcomes achieved.

There are two main classes of social impact investment mechanisms that warrant further exploration for their suitability in the context of remote Indigenous housing.

1. Social impact bonds are a compelling instrument to attract upfront investment and target the achievement of specified social outcomes. Typically, a social impact bond is structured as a partnership between government, investors and service providers. For example, investors provide the upfront payment for a provider to deliver a remote repairs and maintenance service, receiving a repayment of the investment plus returns from government, based upon the achievement of an agreed social outcome such as improved health conditions of the population serviced. The outcomes payments can be derived from downstream cost savings to the government due to reduced burdens on the healthcare system, for example.
2. The government could stimulate direct investment in a social enterprise for tenancy management or maintenance, increasing the pool of available finance for remote Indigenous housing delivery. The role of government is to establish the appropriate market mechanisms, incentives and regulations to enable this investment. Part of this role could include the government acting as the first loss investor to improve the risk-return ratio to meet the requirements of external investors.

However, social impact investment mechanisms are not a panacea. The establishment costs are high, and there are a range of conditions that need to be met for social impact investment to become a viable financing option for remote Indigenous housing.

* The absence of a market for housing in remote areas is a key challenge, resulting in a lack of return on investment. Remote communities typically do not have strong economies, and there is a heavy reliance on government service provision. Given the lack of a housing market, there is limited capacity for residents to buy houses or pay market rent, and in turn limited potential to sell houses or to achieve returns on housing investment through capital appreciation or rental income. Tenure complexity in remote communities is also an issue for private sector investment certainty.
* The costs of maintaining remote housing stock is high, with typically only an average of 16 per cent of recurrent costs offset by rental incomes collected[[1]](#footnote-1). This shortfall makes achieving a return more challenging. In order for external investment to be feasible, government must play a significant role in bridging this gap through providing incentives or funding.
* Service providers’ capability to support investment or increase the scale of housing provision is limited, as is their ability to coordinate a robust social outcome measurement system. There are few providers who service remote areas and these are typically small and with limited capacity, and while some evaluations have been undertaken in the sector, there is not a strong history of outcomes measurement.

Government must play a strong role in building the market for social impact investment in general as well as in supporting capacity development in the remote Indigenous housing sector. There is a triple role for government as market builder, market participant, and market steward.

Given the significant challenges in terms of the quantum of investment required, the lack of depth and capacity within the sector, and lack of suitable outcomes measures, it would be prudent for social impact investment mechanisms to be piloted initially in mainstream social housing markets before being contemplated in the remote Indigenous housing context. External investment in remote Indigenous housing is likely to be feasible only when the economies in remote communities are mature enough to sustain a functioning real estate market.

## This paper considers social impact investment for remote Indigenous housing in broad terms

As part of the Review of National Partnership Agreement on Remote Indigenous Housing (NPARIH), Nous Group (Nous) was commissioned to examine alternative financing mechanisms for the ongoing delivery of remote Indigenous housing to enhance the outcomes of the program, increase efficiency and reduce the calls on government funding.

As part of this project social impact investment approaches are explored. Nous conducted a comprehensive desktop literature review and selected consultations with social impact investment and indigenous housing experts from both the private and public sector. This is not intended to be a comprehensive design of feasible investment approaches, but rather an initial assessment that will recommend further areas for investigation. In this paper, we present a conceptual overview intended to prompt discussion about areas that would warrant further exploration and to identify important elements that have not yet been considered.

Social impact investments are investments made with the intention of generating measurable social and/or environmental outcomes in addition to a financial return[[2]](#footnote-2). In this paper we consider *social impact investment* in the broadest sense; investments that target not only financial returns, but also social outcomes. Given that all forms of financing remote Indigenous housing will contribute to the positive social outcomes of housing provision for communities in need, all forms of private financing will fall under this broad term.

It should also be noted that the cases considered in this paper are for funding rental housing rather than housing under Indigenous home ownership. This is because the majority (57 per cent) of households in remote and very remote areas live in social housing[[3]](#footnote-3), and this is the area which is most in need of sustained investment. The focus is on housing, although we recognise this could also be extended to include the broader infrastructure requirements within which housing is delivered.

The structure of this paper is as follows:

* Section 1.1 of this paper considers the size of the challenge: the significant funding gap in remote Indigenous housing.
* Section 1.2 explores the possibility of attracting private investment into remote Indigenous housing and the value that this could bring to the sector, through the social impact investment lens. It unpacks the barriers that are currently preventing non-government investment and what would be required to facilitate it in the future.
* Section 1.3 starts from the premise that the requirements laid out in Section 1.2 can be met in the long term, and analyses two potential social impact investment approaches for their utility in remote Indigenous housing: social impact bonds and direct investment approaches.
* Finally, Section 1.4 outlines the role for government in building both the social impact investment sector as well as remote housing markets, and proposes a series of steps to unlock the potential for social impact investment into remote Indigenous housing.

## There is a clear funding gap in remote Indigenous housing

From 2008 to 2018, the Commonwealth Government has committed $5.4 billion to Indigenous housing and housing-related infrastructure in remote Australia through the National Partnership Agreement on Remote Indigenous Housing (NPARIH). Under this scheme, the States and Northern Territory have responsibility for the provision of housing in remote Indigenous communities through State and Territory housing authorities and through contracting third party providers.

At 30 June 2016, 3,233 new houses and 7,350 refurbishments/rebuilds had been completed under NPARIH, with the overarching objectives of helping to address significant overcrowding, homelessness, poor housing condition and severe housing shortages in remote Indigenous communities.[[4]](#footnote-4)

Commonwealth funding has been the primary source of funding for both the capital works and ongoing property and tenancy management for housing stock in remote Indigenous communities. The work of the broader review of NPARIH has identified that significant ongoing funding is needed to ensure the ongoing maintenance of the existing stock and provision of new dwellings.

The lack of financial return in remote Indigenous housing has been a barrier to any private sector financing to date. Core issues are:

* the absence of a functioning real estate market underpinned by a local market economy
* high costs of ongoing maintenance and management of housing stock
* low rental returns
* a lack of a functional market to trade stock
* high costs of construction which are not reflected in asset values (construction costs exceed willingness or capacity to pay)
* deterioration of housing stock due to climatic conditions.

In mainstream social housing, expenditure on the ongoing management of properties and tenancies (not including asset depreciation) can be largely offset by rental revenues[[5]](#footnote-5). In remote Indigenous housing, currently rent revenues typically only cover an average of 16 per cent of the recurrent expenditure on managing housing stock[[6]](#footnote-6).

This significant gap between revenue and cost is driven to a large extent by the increased cost of housing delivery as a result of the remoteness and small size of remote Indigenous communities and the associated costs and challenges in servicing them, and shortened asset lifecycles due to harsh climatic conditions. While improvements in delivery may reduce the costs of property and tenancy management or increase rent collection, it is very unlikely that there will be sufficient improvements to fully bridge the revenue-cost shortfall.

Figure 1 Rental income as a proportion of annual recurrent costs of remote Indigenous housing under NPARIH compared to urban public housing

 

View the [text version for Figure 1.](#Figure1)

Social impact investment approaches could bridge the funding gap and enhance social outcomes in the long run, but face significant challenges in the short term

Social impact investment approaches can capitalise on the strong social returns to remote Indigenous housing provision to bridge the funding gap. There are significant social returns to providing remote Indigenous housing including: reduction in overcrowding and homelessness; enhanced educational and employment opportunities; and improved health outcomes.[[7]](#footnote-7) These outcomes are valuable policy objectives in their own right, and may also constitute material cost savings to government through the reduced usage of public services, such as healthcare. Social impact investment can capitalise upon these broader social outcome achievements.

By utilising a social impact investment approach, the government may be able leverage its funding to attract additional investment and increase the pool of capital available for remote Indigenous housing.

* As an example of this leverage effect, a US tax credits scheme (New Markets Tax Credit) uses tax credits to attract business and real estate investment to low income neighbourhoods. It has been estimated that for every $1 of federal subsidy, over $8 of capital are generated under the scheme.[[8]](#footnote-8)
* Another example is the Australian Governments National Rental Affordability Scheme (NRAS), which has stimulated significant private sector finance to boost the supply of affordable rental housing by offering incentives to private investors to provide rental housing at below-market rents for low income households.[[9]](#footnote-9)
* Through a $4.5 million (AUD) investment as “catalytic first loss capital”, the Australian Government’s Social Enterprise Development and Investment Fund (SEDIF) has been able to catalyse $6 million (AUD) of private investment into a community finance fund that provides access to finance for low income populations. A portion of the government’s contribution covers any loan losses, thereby de-risking the investment for the private investor so that they can meet their fiduciary constraints. By committing “first loss” capital, the government has been able to attract greater investment into the fund than would otherwise have been possible.[[10]](#footnote-10)

Social impact investment has the potential to not only provide the necessary capital to support the program, but also enhance its effectiveness and efficiency through its focus upon outcomes.[[11]](#footnote-11) Through outcomes-based commissioning, social impact investment stimulates innovation and prioritises the achievement of outcomes by allowing flexible service provision in order to meet a prescribed social outcome. This is in contrast to traditional service-based commissioning which necessitates a prescribed service delivery model and measurement of activities and outputs as opposed to outcomes.

A number of major reviews of government policy, in particular the 2014 review of Australia’s welfare system (A New System for Better Employment and Social Outcomes a.k.a. the McClure Report[[12]](#footnote-12)) and the report of the Financial System Inquiry[[13]](#footnote-13) both recommended that the government consider moving towards a social impact investment model for funding some social services. Impact investing is already being used for the provision of social services in Australia, and best available estimates of the size of the Australian impact investing market project that it could reach $32 billion within a decade.[[14]](#footnote-14)

##### The benefits of social impact investment are only likely to be achieved over the long term. The introduction of a social impact investment mechanism is likely to result in higher overall costs in the early stages with the possibility of reduced costs over time (investment horizons are commonly in the 5 to 10 year range). It is important to recognise that social impact investment approaches are (1) typically time consuming to establish, (2) involve lengthy negotiations between many different actors – service providers, investors, and different levels of government, and (3) require a significant amount of work to prepare the sector for investment readiness, such as capacity building for outcomes measurement. There are some significant barriers in the remote housing sector that must first be overcome before social impact investment is feasible. These are discussed in the following sections.

### In the absence of a functioning market and financial returns, there is a role for direct government funding

The absence of a deep and liquid market for housing in remote areas is a key challenge. There are currently limited incentives or opportunities for home ownership options, with the majority of residents in remote communities living in rental government-supplied housing. There are few providers who service remote areas and these are typically small and with limited capacity. The absence of a real estate market with depth and liquidity is in large part due to the absence of a functioning economy. Without many residents in remote communities having capacity to buy houses or pay market-equivalent rents, the potential returns that investors would expect to achieve through capital appreciation or rental income streams are limited, or even eliminated.

The lack of market returns not only poses challenges to leveraging private investment; it also very likely precludes alternative modes of government financing, such as equity investments or government loans. Based on our understanding of Department of Finance requirements, equity investments would need to generate a real financial return to avoid being classified as grants in the Budget. Similarly, loans to states or other housing providers would need to have a reasonable prospect of being repaid. While the Commonwealth could provide loans to state governments to reduce the cost to the Commonwealth of financing remote housing stock, this is dependent upon a reasonable likelihood of the states being able to repay the loan, and ultimately would serve to shift the burden rather than address the unavoidable cost of financing remote Indigenous housing.

Another option for government that has been raised is taking a ‘portfolio approach’ to the financing of social housing, bundling remote Indigenous housing with urban housing. Where this could work is if the scale of remote Indigenous housing component within the portfolio is so small so that it doesn’t affect the value of the overall portfolio. However, a portfolio approach doesn’t address the underlying issue of the absence of a functioning real estate market nor the significant losses associated with the delivery and maintenance of remote housing. Importantly, it would likely undermine the ambitious but achievable task of attracting non-government financing for public housing in metropolitan locations.

Given the scale of the revenue-cost shortfall, remote Indigenous housing will never be commercially feasible on its own. Even if a social impact investing approach is used, there will always be a role for government at the minimum in bridging the gap between costs and revenue through incentives to make it a viable prospect for external investors. More importantly, social impact investment will not replace the core role of the government in service delivery and the commissioning and funding of services.

### There are a number of other issues that limit the options for non-government investment in remote Indigenous housing

There are currently some significant hurdles that must be overcome to enable sufficient returns to make private social impact investment in remote Indigenous housing viable.

Returns can be improved to some degree through improving the efficiency of service provision and through the government providing incentives to improve the risk-return profile for investors. However, to improve returns to the extent that private investment is viable, there needs to be a maturation of the housing market in remote Indigenous communities. The dimensions that are required to enable non-government investment are discussed in turn below.

|  |  |
| --- | --- |
| Issue | Explanation |
| **1. Need to build market** | As explained above, there is not a functioning market for real estate in remote Indigenous communities, which are typically very small, isolated and dependent upon government services. The absence of market depth and liquidity limits (or even eliminates) the potential returns – through capital appreciation or income streams – that investors may be able to achieve from their investments. The absence of a liquid real estate market diminishes the value of a housing asset. Significant work will be required to build a suitable market for investment. Part of this work will require resolving land tenure agreements as is currently being done under NPARIH, so that rental housing or home ownership options can be established.  |
| **2. Scale** | The remote Indigenous housing sector is small, which may prohibit investment due to the disproportionately high burden of administrative costs relative to returns. Communities are typically very small and isolated, and since 2008, just over 3,000 new houses have been constructed under the NPARIH program. It is questionable whether the scale of the market as well as the pipeline for ongoing projects is sufficiently large to attract investors and make administrative tasks such as due diligence worth the time. According to a 2013 research report on financing rental housing through institutional investment released by the Australian Housing and Urban Research Institute (AHURI)[[15]](#footnote-15):*The scale of investment required to attract institutional players is between $50 million and $250 million for an individual institution and at least $500 million per annum in aggregate to create liquidity and establish a sustainable market.*A similar challenge of scale (albeit to a lesser extent) occurs in the urban affordable housing sector. Models such as a bond aggregator have been suggested to address this problem by creating an intermediary to pool the loans required by community housing providers to enable financing at lower prices on the wholesale market. |
| **3. Housing provider capacity** | There are few housing providers that are able to service remote Indigenous communities. Finding a suitable provider in which to invest and building the required capability in that provider may be challenging. Many remote Indigenous housing tenancies are directly managed by State Housing Authorities due to a historic perception of mismanagement and poor outcomes when managed through small Indigenous Community Housing Organisations (ICHOs)[[16]](#footnote-16). The thin market also means that there is little competition between providers, diminishing the effectiveness of competitive bids processes in enhancing value delivery. Capacity building will be required to enable expanded roles for existing community housing providers in outcomes measurement or the management of more housing stock.  |
| **4. Outcomes measurement** | Suitable outcomes measures for social impact investment will need to be developed and tested to ensure that the right targets are being measured accurately, reliably and viably.Whilst there are some examples of evaluations and surveys recording the outcomes of remote Indigenous housing, there is not a standardised framework for measuring the outcomes, let alone agreement upon which outcomes should be targeted. There is significant work to be done here before an investment approach tied to outcomes-based payments could be considered. |
| **5. Risks** | There are some key risks that would need to be considered before investors commit to remote Indigenous housing:* Policy risk: Investors would require a high degree of confidence in the longevity of any given policy approach, government incentives or delivery framework. The expectation is that these will not change over the course of their investment horizon. Long-term consistent policy settings are a key requirement for investor confidence and the ultimate success of an external investment approach.
* Lack of data: Given there is historically poor data in the sector, it will be challenging for investors to see an exit strategy or measure the true risks of their investment. There can be a role for investors who prioritise impact (‘impact-first investors’) to demonstrate the viability of investment in remote Indigenous housing, build up a base of data and an understanding of the risks and returns. This can subsequently stimulate the entry of more risk-adverse investors (‘finance-first investors’). The government can assist by providing the initial capital to de-risk external investment and demonstrate the potential for remote Indigenous housing as an investment opportunity.
 |

## There are two broad classes of social impact investment that warrant further exploration for remote Indigenous housing

Provided that the requirements in the previous sections are met – primarily, that the economy in remote Indigenous areas has developed sufficiently to the point where returns on investment are more possible – there are two classes of social impact investments that present strong potential for application to remote Indigenous housing finance:

1. Social Impact Bonds
2. Direct Social Impact Investment

In this section, both mechanisms are discussed in terms of their application to remote Indigenous housing in the long term along with an assessment of their benefits and feasibility requirements.

### Social Impact Bonds are a promising financing option in the long term

A social impact bond (SIB) is a partnership between government as the outcomes funder, a service provider and investors. Investors provide capital up-front to fund a program or set of interventions and the government will repay the investors their capital plus return based on social outcomes on an agreed basis if the targeted outcomes are achieved. The basic mechanics of the SIB applied to the context of remote Indigenous housing are illustrated in the figure below.

Figure 2 Indicative Social Impact Bond mechanism for remote Indigenous housing



View the [text version for Figure 2](#Figure2).

SIBs are a promising option to bridge the funding gap of remote Indigenous housing if they can be structured to offset the losses incurred in maintaining remote Indigenous housing stock through public sector savings. These savings can be achieved by reduced healthcare costs to government that result from improved housing condition, for example. Payments are awarded based upon the achievements of the designated social outcome.

Improved housing is known to have health benefits which can reduce healthcare costs to the government. In 2010, NSW Health conducted an evaluation of communities receiving a program of proactive maintenance (the ‘Housing for Health’ program) and found that there was a 40% reduction in hospital separations due to infectious disease compared to areas which had not received the targeted maintenance program.[[17]](#footnote-17) While this impact has not yet been mapped to a cost saving to government, it would be possible to do so in order to quantify the extent of financial gains. These cost savings could then be used by the government to ‘pay for’ the costs of delivering the housing maintenance program and to provide investors with a financial return. This is similar to the way in which many existing social bonds capitalise upon downstream public sector savings to fund preventative programs.

A social impact bond could be used by the government to attract investors to support initial construction, ongoing property and tenancy management or the full value chain of remote Indigenous housing delivery. Below are a few indicative examples to contextualise how a social impact bond could be structured:

1. **SIB for health-targeted maintenance**: Investment into service provider(s) which deliver maintenance services for remote Indigenous housing stock. Government payments are based upon improved health outcomes:
	1. One outcome could be condition of the house according to a minimum requirement for a score against the ‘critical healthy living practices’ (cHLPs) as set out in the National Indigenous Housing Guide[[18]](#footnote-18). The ‘Housing for Health’ maintenance methodology sets a precedent for this measurement: the program surveys houses and provides a score of the housing quality based upon its ability to support the cHLPs, and then targets repairs to improve this score.
	2. A second outcome could be reduction in hospital separations due to infectious disease resulting from improved housing condition. The measurement of this outcome could build upon the methodology used in the NSW Health evaluation.

The government could pay investors based upon projected cost savings due to reductions in hospitalisations due to infectious disease. The capital provided by investors could be guaranteed by government, but the extent of additional returns could be based upon achievement of the social outcomes.

1. **SIB for construction of remote housing stock to reduce homelessness and overcrowding:** Investment into service provider(s) which construct or perform significant upgrades to houses in remote Indigenous communities. Government repayments to the investor are based on improved outcomes for homelessness and overcrowding:
	1. Reduction in overcrowding at the community level from a baseline value to a designated benchmark, based upon independent assessment using the Canadian National Occupancy Standard (CNOS) measure
	2. Reduction in homelessness at the community level as measured by the ABS
	3. Sustained asset condition of the house to a designated benchmark over 1, 5 and 10 year period.

This measurement approach may prove challenging as the long-term outcomes (such as sustained quality of the asset condition) would be measured over a longer timeframe than the involvement of the construction service provider, and would be influenced by many factors outside of their control. Attribution of the social outcomes to the intervention would be challenging. Such a bond may be more effective if awarded to a partnership of service providers who deliver across the full value chain of remote housing services.

1. **SIB for delivery across the full value chain of remote Indigenous housing:** The government could commission a social impact bond for delivery across the full value chain: construction, tenancy management and property maintenance of remote Indigenous housing. This would facilitate investment in providers who service the full value chain, or more plausibly would build a strong incentive for collaboration between providers across the value chain. Outcomes measures could include a combination of those already discussed:
	1. Overcrowding and homelessness reduction to an agreed benchmark
	2. Sustained asset condition of the house (including health hardware) to an agreed benchmark
	3. Health outcomes (reduced hospitalisation due to infectious disease) to an agreed level.

There are some variants of traditional SIB mechanisms that could be explored, such as tax credits models.The government could distribute tax credits to state housing authorities to award to property and tenancy management service providers through a competitive process. The providers could use the tax credits to raise equity capital from investors to scale their operations. Award would be based upon a commitment to deliver a social outcome agreed by the State Housing Authority, such as the outcomes defined in the examples above. This would enable greater flexibility in the determination of the outcomes benchmarks and the service providers to receive investment.

There are some compelling benefits to SIBs for government.[[19]](#footnote-19),[[20]](#footnote-20)

* SIBs can stimulate innovation to deliver better outcomes and achieve better value for money in service delivery by focusing on prescribing outcomes rather than the method of achieving those outcomes.
* SIBs enable more flexible and innovative models of service provision as there is less need for the government to be prescriptive about the methods of service delivery than under traditional contracts.
* SIBs can be an effective mechanism of transferring implementation risks away from the public sector to those service providers who are better placed to manage those risks and achieve agreed outcomes. The government will only pay the agreed sum if social outcomes are met.
* SIBs can also foster collaboration and build stronger partnerships between service providers, investors and all levels of government.

#### The feasibility of SIBs depend on a number of factors

A SIB will have high set-up costs, but may present a feasible long-term option to stimulate outside investment into remote Indigenous housing, improve the delivery of social outcomes and generate government cost-savings. Under a SIB, there will always be a requirement for government to ultimately fund the program, but up-front investment may be sourced from external investors.

Feasibility depends on a number of factors. As an example, the health-targeted maintenance SIB would need to account for the following considerations:

* A rigorous and efficient approach to measure the outcomes must be developed. It must be able to link health gains arising from improved housing condition to government cost-savings. Matters of attribution and causality are highly complex, and there is not a simple correlation between changes in service use and actual operational savings.
* The cost savings must outweigh the additional costs of establishing the bond and sustaining ongoing measurement and evaluation that is required to support it. Given that data is currently not collected on these metrics, the extent of the potential return is unknown, and the investment required to establish a robust measurement framework will be high.
* In the Australian federation, Commonwealth and State and Territory Governments must collaborate to establish funding parameters. This is especially important for SIBs or other instruments which seek to capture benefits from other areas. For example, a SIB such as the one described above which seeks to deliver a return on improvements to housing by capturing the resultant cost savings would need to account for the fact that the Commonwealth government currently funds remote Indigenous housing through NPARIH, but state governments fund hospitals.
* SIBs have so far have proven difficult to replicate with different contexts or service providers, as the outcomes measures and partnership agreements need to be renegotiated to suit the context. Rolling out SIBs in different jurisdictions or with different Indigenous housing service providers could require extensive set-up costs in each context.

### Direct investment approaches could attract private finance, but would require significant government incentives

Direct social impact investment involves debt or equity investment into enterprises or organisations that deliver impact. Returns come from the revenue stream or capital growth of the enterprise. This may be supplemented with technical assistance or other support for capacity building. Commonly, this method is used to fund social enterprises or provide start-up capital necessary for enterprises delivering services to traditionally under-served populations.[[21]](#footnote-21)

Figure 3 Indicative direct social investment mechanism for remote Indigenous housing



View the [text version for Figure 3.](#Figure3)

As an indicative example of direct investment into remote Indigenous housing, a private investor may directly invest through debt or equity in a social enterprise that provides an innovative method of tenancy management in remote Indigenous communities. Their model could generate proven social outcomes. For example, the provider may be:

* a local Indigenous housing organisation (ICHO),
* a small provider that delivers repairs and maintenance targeted at improving health outcomes and building the skills of local employees and trainees, or
* an organisation that has developed a new method of tenant support, education and rent collection that has been shown to improve tenant satisfaction or reduce repair costs.

The investment would provide the social enterprise or organisation with start-up capital or the finance necessary to scale its operations. Returns to the investor come from the revenue stream or capital growth of the enterprise.

The role for the government is in supporting the enabling conditions necessary for the investment to succeed, such as capacity building for the service providers or favourable regulations for investment. For example, the government could set up procurement rules such that the social enterprise is the provider of choice in certain circumstances.

#### The government can improve the risk-return profile for direct investment by contributing “catalytic first loss capital”

The government can also play an important role in providing the “catalytic first loss capital” (CFLC) to de-risk the investment and make it viable for private investors. CFLC is a credit enhancement tool used to improve the credit worthiness of a particular investment tool. An investment opportunity such as remote Indigenous housing is currently unattractive to investors as it does not produce sufficient financial returns for its level of risk, and there is a lack of information or track record given the nascent state of both social impact investment mechanisms as well as the remote housing market. Credit enhancement can encourage the flow of capital to remote Indigenous housing by improving its risk-return profile, and thus incentivising more investors to invest.[[22]](#footnote-22)

In the context of remote Indigenous housing, the government could act as the grant-maker/investor that provides first-loss protection for other (external) investors. The combined pool of money could be invested in Indigenous housing providers (ICHOs). The government would bear the first loss if there was a loan default. At present, the magnitude of the risk and the gap in financial returns is large enough that a first-loss protection is not likely to be sufficient to attract private capital. However, as the economy matures in remote Indigenous communities and the efficiency of housing delivery improves, the government may be able to attract private investors through providing the catalytic first loss capital.

A similar structure has been used in the California Freshworks Fund – Term Debt Facility, with the aim of increasing access to healthy food in low-income communities.[[23]](#footnote-23) It has leveraged $125 million USD in investment capital for $7.5 USD million in CFLC. The debt structure has three layers: senior debt contributed by commercial investors, junior debt contributed by mission-driven investors, and first-loss capital in the form of grants from a number of foundations. Each loan made by the credit facility is composed 80% from the senior tranche and 20% from the sub-tranche. In the event of a loss, the CFLC fund (the grant reserve) can be accessed only to make the senior investors whole, not the junior lenders. This model has been successful in offering flexible loans to help grocers enter traditionally under-served markets, while giving regulated investors the comfort they need to participate in the fund.

Figure 4 Structure of the California Freshworks Fund Catalytic First Loss Capital Mechanism23

 View the [text version for Figure 4.](#Figure4)

#### Tax credits or other incentives could be used to improve returns for investors

There is a significant shortfall between the amount of rent collected from remote Indigenous tenancies and the amount required to maintain the properties and manage the tenancies. Rather than government funding the full cost of property and tenancy management, they could just fund the shortfall between the amount of rent collected and the amount spent by providers on property and tenancy management. This could be done through tax credits. Outcomes benchmarks would be set to ensure that there wasn’t an incentive to cut corners or undermine service quality.

This is similar to the National Rental Affordability Scheme, in which the Australian Government uses tax credits to stimulate investment in affordable housing.

#### There are key barriers to the feasibility of direct investment in remote housing

The lack of returns from remote Indigenous housing is an obvious barrier to direct investment, although mechanisms such as government incentives or first loss capital may be used to overcome some (but unlikely all) of this lack of return. Beyond this, there are some other challenges that must be addressed before direct investment can be a feasible financing approach.

* In order for a direct investment approach to succeed, there will need to be strong service providers or social enterprises that are investment-ready. Given that providers that service remote Indigenous communities are typically small and have limited capacity, there may be a need for government to support capacity building in the sector before this approach is feasible.
* To attract investors, the government will need to build investor awareness and sufficiently de-risk the market. There is currently a lack of data to inform investors’ decisions about the risk of the investment or appropriate exit strategies, which is likely to impede their entry into the market. Awareness of social impact investment in general is also relatively low, given that it is a nascent industry.
* The small size of service providers and their loan requirements may discourage investors given the cost of due diligence and administrative costs of the loans would be too high proportional to the returns. Aggregating loan requirements of service providers may be required, for example using a bond aggregator model such as the one proposed in the case of urban affordable housing.[[24]](#footnote-24)

## The government must create the enabling environment for social impact investment and build the remote housing market

The market for social impact investing in Australia is nascent, and there is a significant role for government to create the enabling environment for social impact investment in general, in order to facilitate alternative financing into remote Indigenous housing. The Australian Advisory Board on Impact Investing frames the role of government in three parts: market builder, market participant, and market steward.[[25]](#footnote-25) As with any new market, the government must have responsibility for driving the market’s development through creating the appropriate regulatory environment and fiscal policy.

|  |  |
| --- | --- |
| Market builder | In order for impact investment to flow into the remote Indigenous housing sector, the government must display leadership that signals interest and legitimacy and builds confidence in the market. Levers that the government may pull include providing incentives to encourage greater participation or catalytic funding that de-risks investments or stimulates demand.  |
| Market participant | The government can and should play a role as a direct market participant. In doing so, it should aim to leverage private capital into priority policy areas and collaborate to develop greater outcomes orientation in the sector.  |
| Market steward | The government has an important role to play in reducing regulatory barriers and removing obstacles to investment.  |

While social impact investment demonstrates strong potential as a means to supplement direct government funding of remote Indigenous housing, there is a long road towards its successful implementation. We propose that the following steps be considered as a pathway towards implementing alternative financing in remote Indigenous housing.

**1. Build the housing market in remote Indigenous communities.**

As discussed in preceding sections, in order for there to be sufficient returns possible from housing investment and for non-government finance to be feasible, there needs to be a maturation of the housing market in remote communities. A real estate market will enable houses to be bought and sold, and the value of housing assets to appreciate over time. Given that the backbone of the economy in remote Indigenous Australia is currently public finance[[26]](#footnote-26) and there is currently very minimal home ownership potential, there is work to be done to build the housing market. Initial steps could include investing in education and building employment pathways to increase income in communities, and working with institutions such as Indigenous Business Australia to strengthen home ownership pathways.

##### 2. Conduct further scoping of the possible options.

The ideas presented in this paper are presented at a high level of detail only. While they have strong potential for supporting the financing needs of remote Indigenous housing, they do not negate the requirement for government funding. Further scoping will need to be done to determine whether they are worth pursuing, and in what form.

##### 3. Pilot social impact investment mechanisms in mainstream social housing markets.

Social impact investment is in its early stages in Australia, and there is still work to be done in establishing appropriate financial instruments, an enabling policy environment and market confidence. The remote Indigenous housing sector would be a challenging sector in which to pioneer the establishment of new social impact investment mechanisms. The remote sector faces challenges beyond those of the mainstream social housing sector. Namely, absence of a functional market due to the small and isolated nature of communities, extremely high recurrent costs, low rates of rental return, shortened asset lifecycles and low capacity among service providers. An alternative approach would be to build social impact investment mechanisms in more viable markets, such as the mainstream social housing market or in regional - as opposed to remote - Indigenous communities. Frameworks and lessons learned in this context could then be applied to the remote Indigenous housing sector.

##### 4. Build capacity in remote Indigenous housing service providers.

There is significant work to be done in building the capacity of remote Indigenous housing service providers, to:

* deliver housing services to the required quality and scale
* perform the outcomes measurement and evaluation required for social impact investment.

Currently, there are few housing providers that service remote Indigenous communities and weak capacity in the sector. Many remote Indigenous housing tenancies are directly managed by State Housing Authorities due to a historic perception of mismanagement and poor outcomes when controlled by small Indigenous Community Housing Organisations.[[27]](#footnote-27) Building the capability for these providers to manage more housing stock and run an effective outcomes measurement system will be a necessary precondition for the establishment of social impact investment financing.

##### 5. Refine agreed outcomes measures and invest in a robust measurement approach.

Given that social impact investments rely upon measures of social outcomes, the outcomes which are targeted through remote Indigenous housing provision need to be refined, and a robust method developed to measure achievement against them. Building consensus around agreed outcomes measures and building and testing an outcomes measurement approach will take some time.

##### 6. Test thoroughly with the market before implementation

Before the introduction of any new financing approach, there should be sufficient testing with the market to ensure that it meets the needs and requirements of service providers and investors. One criticism of the NRAS scheme is that there was insufficient testing with the market before implementation which resulted in a failure for it to appropriately target the needs of the financial industry.

# Reference List

Addis R, Bowden A & Simpson D, *Delivering on Impact: The Australian Advisory Board Breakthrough Strategy to Catalyse Impact Investment*, Impact Investing Australia, 2014.

Brackertz N & Wilkinson A, *Research synthesis of social and economic outcomes of good housing for Aboriginal and Torres Strait Islander People*, Australian Housing and Urban Research Institute, 2017.

Council on Federal Financial Relations, *Innovative Financing Models to Improve the Supply of Affordable Housing: Affordable Housing Working Group Report to Heads of Treasuries*, Treasury, 2016.

Davies T, Newman J, Hill R & Addis R, *Breaking the Deadlock: A social impact investment lens on reducing costs road trauma and unlocking capital for road safety*, FIA Foundation Research Series, Paper 3, 2015.

Department of Families, Community Services and Indigenous Affairs, *Indigenous Housing: Findings of the Review of the Community Housing and Infrastructure Programme*, 2007, available at: <https://www.dss.gov.au/sites/default/files/documents/05_2012/livingsunburntcountry.pdf>.

 Department of Families, Community Services and Indigenous Affairs, *National Indigenous Housing Guide: Improving the living environment for safety, health and sustainability*, 3rd edition, 2007.

Department of Prime Minister and Cabinet, *National Partnership on Remote Indigenous Housing,* 2016, available at: <https://www.dpmc.gov.au/indigenous-affairs/housing/national-partnership-agreement-remote-indigenous-housing-nparih>.

Department of Social Services, *About the National Rental Affordability Scheme (NRAS),* DSS, 2014, available at: http://www.dss.gov.au/our-responsibilities/housingsupport/programs-services/national-rental-affordability-scheme/about-the-national-rentalaffordability-scheme-nras.

EY, *Social impact investing research: Department of Social Services for the Prime Minister’s Community Business Partnership: Final Report*, DSS, 2016.

GIIN (Global Impact Investing Network), *Catalytic First-Loss Capital: Issue Brief*, 2013.

Habibis et al, *Reviewing changes to housing management on remote Indigenous communities*, AHURI, 2016.

Impact Investing Australia, *Submission to the Working Group on Affordable Housing*, 2016.

Miguel A & Abughannam S, *Housing First Social Impact Bond Feasibility Study*, MaRS Centre for Impact Investing and Social Finance UK, 2014.

Moran M, Porter D & Curth-Bibb J, *Funding Indigenous organisations: improving governance performance through innovations in public finance management in remote Australia*, Issues paper 11, Closing the Gap Clearinghouse, 2014.

Nous Group, *Efficient system costs of Remote Indigenous housing*, 2017.

Treasury, *Social Impact Investing Discussion Paper*, 2017, available at: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2017/Social-impact-investing.

McClure P, Sinclair S & Aird W, *A New System for Better Employment and Social Outcomes*, Department of Social Services, 2014.

Milligan V, Yates J, Wiesel I & Pawson H, *Financing rental housing through institutional investment*, Australian Housing and Urban Research Institute, 2013.

Standen J, Closing the Gap: 10 Years of Housing for Health in NSW, NSW Health, 2010.

Treasury, *Financial System Inquiry: Final Report*, 2014.

1. Lessons learned from urban affordable housing finance

In November 2016, an Affordable Housing Working Group delivered a report on innovative financing models to improve the supply of affordable housing, in response to a request from Treasurers at the Council on Federal Financial Relations (CFFR).[[28]](#footnote-28) The Working Group outlined four potential mechanisms for financing social housing, and recommended the establishment of a bond aggregator taskforce to design a bond aggregator model by mid-2017. Whilst there are some stark differences between the remote Indigenous housing sector and the urban social housing sector, there are useful lessons and principles to be derived from exploring bond aggregator model proposed for financing affordable housing by the Working Group. The National Rental Affordability Scheme (NRAS) is also discussed, as there are some useful lessons to be learned from this approach.

**Bridging the ‘financing gap’ is the key requirement to enable investment in affordable housing**

The Working Group focused upon ways to boost the supply of affordable rental housing through innovative financing models to attract private and institutional investment at scale. Currently, the biggest impediment to improving the supply of sub-market rental housing is a lack of investment. This is driven by the ‘financing gap’: the difference between the rates of return available in affordable housing compared with the market rates of return available in other private developments. The below-market rents and heightened tenancy management costs associated with social housing mean that there will always be a financing gap in social housing. However, the government can reduce this gap by offering financial incentives to attract private investors. In this way, the government can leverage its funding of social housing to catalyse a flow of private investment. One example of this in action has been the National Rental Affordability Scheme (NRAS) which increased the supply of sub-market rental dwellings by providing financial incentives. However, the NRAS has only attracted small-scale investment, as opposed to institutional investment. The models explored by the Working Group are targeted at larger scale, institutional investors.

In the case of remote Indigenous housing, the ‘financing gap’ is significantly bigger, increasing the scale of this challenge.

**There Working Group highlights three elements required to attract large-scale investment in affordable housing**

1. An effective interface to the capital markets to efficiently raise wholesale funds;
2. A dedicated intermediary to manage the relationship with capital markets and aggregate, allocate and manage associated finance to housing providers; and
3. An appropriate and effective affordable housing delivery system.

##### Model 1: Housing loan/bond aggregators

The Working Group recommended a housing loan/bond aggregator model as its preferred model. Under this model, a financial intermediary would aggregate the borrowing requirements of affordable housing providers and issue bonds on their behalf.

In the current system, housing providers cannot attract finance to expand housing supply because the loans that they seek are too small for institutional investors. An intermediary (housing bond aggregator) can pool their loans and enable housing providers to obtain funding from the wholesale market at a cheaper price and over longer timeframes. This will enable them to expand and increase the supply of affordable housing. Bonds can be traded on the market, which is favourable for private investors. A similar model has been used successfully in the UK to finance affordable housing.

A bond aggregator model could be used to overcome the same problems of small-scale loans required by providers of remote Indigenous housing. However, this is not the core issue faced by remote Indigenous housing providers, and would not alone address the significant revenue-cost shortfall in remote Indigenous housing which is the primary barrier to private investment.

##### National Rental Affordability Scheme (NRAS)

The national rental affordability scheme (NRAS) was introduced by the Australian Government in 2008 to address growing concerns about rental housing supply and affordability. This scheme offers incentives (mainly in the form of a refundable tax offset) to private investors and community organisations to provide newly built rental housing for low income households at below-market rents. The incentive lasts for 10 years. A key aim of NRAS is to increase large-scale investment and innovative delivery of affordable housing. This has been successful. The scheme has stimulated significant private sector finance to underpin affordable rental housing supply.

The scheme has shown mixed results: the number of actual dwellings built is considerably less than initial targets and there has been limited success in attracting private investment in the affordable housing sector. However, the scheme appears to be at least more cost effective than the previous Social Housing Initiative on a cost per unit basis and it will add a significant number of affordable housing units for at least the next 10 years.[[29]](#footnote-29)

Financial incentives and credit support will be essential to achieve increased supply at the affordable end of the market, to overcome investor perceptions of risk and to meet their yield requirements. The impact of government support is demonstrated by the way that NRAS has catalysed increasing specific interest from the finance industry in investment in the supply of affordable rental housing.[[30]](#footnote-30)

A similar concept could be used to bridge the ‘financing gap’ in remote Indigenous housing, such as a tax credit provided to incentivise the delivery of remote Indigenous housing.

1. Alternative Text

Figure 1: shows that the revenue cost shortfall between NPARIH and urban public housing in percentages. NPARIH’s revenue cost shortfall is 84% compared to 13% in urban public housing.

Go back to [Figure 1](#Figure1Return).

Figure 2: shows a flowchart regarding process for utilising a Social Impact Bond in remote Indigenous Housing.

Go Back to [Figure 2](#Figure2Return).

Figure 3: shows investment flowchart.

Go back to [Figure 3](#Figure3Return).

Figure 4: is the structure of the California Freshworks Fund Catalytic First Loss Capital Mechanism.

Go back to [Figure 4](#Figure4Return).

1. Nous Group, *Efficient system costs of Remote Indigenous housing*, 2017. [↑](#footnote-ref-1)
2. Treasury, Social Impact Investing Discussion Paper, 2017, available at:: <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2017/Social-impact-investing>. [↑](#footnote-ref-2)
3. Australian Institute of Health and Welfare, *Housing circumstances of Indigenous households: tenure and overcrowding*, 2014, available at: <http://www.aihw.gov.au/WorkArea/DownloadAsset.aspx?id=60129548056> . [↑](#footnote-ref-3)
4. Department of Prime Minister and Cabinet, *National Partnership on Remote Indigenous Housing,* 2016, available at: <https://www.dpmc.gov.au/indigenous-affairs/housing/national-partnership-agreement-remote-indigenous-housing-nparih>. [↑](#footnote-ref-4)
5. Nous Group, *Efficient system costs of Remote Indigenous housing*, 2017. [↑](#footnote-ref-5)
6. Figures based upon the gap between rental income and total recurrent costs in 2017/18 budgets (not including depreciation) for the NPARIH program from data provided in February 2017 from four jurisdictions. Further explanation and analysis can be found in: Nous Group, *Efficient system costs of Remote Indigenous housing*, 2017. [↑](#footnote-ref-6)
7. N Brackertz & A Wilkinson, *Research synthesis of social and economic outcomes of good housing for Aboriginal and Torres Strait Islander People,* Australian Housing and Urban Research Institute, 2017. [↑](#footnote-ref-7)
8. Impact Investing Australia, *Submission to the Working Group on Affordable Housing*, 2016. [↑](#footnote-ref-8)
9. Department of Social Services, *About the National Rental Affordability Scheme (NRAS),* DSS, 2014, available at: <http://www.dss.gov.au/our-responsibilities/housingsupport/programs-services/national-rental-affordability-scheme/about-the-national-rentalaffordability-scheme-nras>. [↑](#footnote-ref-9)
10. GIIN (Global Impact Investing Network), *Catalytic First-Loss Capital: Issue Brief*, 2013. [↑](#footnote-ref-10)
11. R Addis, A Bowden & D Simpson, *Delivering on Impact: The Australian Advisory Board Breakthrough Strategy to Catalyse Impact Investment,* Impact Investing Australia, 2014. [↑](#footnote-ref-11)
12. P McClure, S Sinclair & W Aird, *A New System for Better Employment and Social Outcomes*, Department of Social Services, 2014. [↑](#footnote-ref-12)
13. Treasury, *Financial System Inquiry: Final Report*, 2014. [↑](#footnote-ref-13)
14. R Addis, A Bowden & D Simpson, *Delivering on Impact: The Australian Advisory Board Breakthrough Strategy to Catalyse Impact Investment,* Impact Investing Australia, 2014. [↑](#footnote-ref-14)
15. V Milligan, J Yates, I Wiesel & H Pawson, *Financing rental housing through institutional investment*, Australian Housing and Urban Research Institute, 2013. [↑](#footnote-ref-15)
16. Department of Families, Community Services and Indigenous Affairs, *Indigenous Housing: Findings of the Review of the Community Housing and Infrastructure Programme*, 2007, available at: https://www.dss.gov.au/sites/default/files/documents/05\_2012/livingsunburntcountry.pdf. [↑](#footnote-ref-16)
17. J Standen, *Closing the Gap: 10 Years of Housing for Health in NSW*, NSW Health, 2010. [↑](#footnote-ref-17)
18. Department of Families, Community Services and Indigenous Affairs, *National Indigenous Housing Guide: Improving the living environment for safety, health and sustainability*, 3rd edition, 2007. [↑](#footnote-ref-18)
19. Treasury, *Social Impact Investing Discussion Paper*, 2017, available at: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2017/Social-impact-investing. [↑](#footnote-ref-19)
20. A Miguel & S Abughannam, *Housing First Social Impact Bond Feasibility Study*, MaRS Centre for Impact Investing and Social Finance UK, 2014. [↑](#footnote-ref-20)
21. T Davies, J Newman, R Hill & R Addis, *Breaking the Deadlock: A social impact investment lens on reducing costs road trauma and unlocking capital for road safety,* FIA Foundation Research Series, Paper 3, 2015. [↑](#footnote-ref-21)
22. GIIN (Global Impact Investing Network), *Catalytic First-Loss Capital: Issue Brief*, 2013. [↑](#footnote-ref-22)
23. GIIN (Global Impact Investing Network), *Catalytic First-Loss Capital: Issue Brief*, 2013. [↑](#footnote-ref-23)
24. Council on Federal Financial Relations, *Innovative Financing Models to Improve the Supply of Affordable Housing: Affordable Housing Working Group Report to Heads of Treasuries*, Treasury, 2016. [↑](#footnote-ref-24)
25. R Addis, A Bowden & D Simpson, *Delivering on Impact: The Australian Advisory Board Breakthrough Strategy to Catalyse Impact Investment*, Impact Investing Australia, 2014. [↑](#footnote-ref-25)
26. M Moran, D Porter & J Curth-Bibb, *Funding Indigenous organisations: improving governance performance through innovations in public finance management in remote Australia, Issues paper 11*, Closing the Gap Clearinghouse, 2014. [↑](#footnote-ref-26)
27. Habibis et al, *Reviewing changes to housing management on remote Indigenous communities*, AHURI, 2016. [↑](#footnote-ref-27)
28. Council on Federal Financial Relations, *Innovative Financing Models to Improve the Supply of Affordable Housing: Affordable Housing Working Group Report to Heads of Treasuries*, Treasury, 2016. [↑](#footnote-ref-28)
29. EY, *Social impact investing research: Department of Social Services for the Prime Minister’s Community Business Partnership: Final Report,* DSS, 2016. [↑](#footnote-ref-29)
30. V Milligan, J Yates, I Wiesel & H Pawson, *Financing rental housing through institutional investment,* Australian Housing and Urban Research Institute, 2013. [↑](#footnote-ref-30)