AFFORDABLE DEVELOPMENT OUTCOMES

Affordable Housing Financing

Report for Yarra City Council
April 2019

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Executive Summary

Overview of the Paper

Yarra City Council (the Council) is committed to facilitating an increase in Affordable Housing in its municipality. To support this objective the Council is developing a Social and Affordable Housing Strategy. Affordable Development Outcomes was engaged the Council to provide a Report on Affordable Housing financing to inform the strategy development.

The objective of the Report is to provide the Council and key stakeholders with an understanding of residential development financing, and specifically, Affordable Housing financing and feasibility, particularly as it relates to the negotiation of outcomes on privately owned land.

The Report highlights a range of key drivers, constraints and obligations of investors, property developers and Registered Housing Agencies to secure financing and funds to develop housing and then manage it in the long-term as Affordable Housing.

The Report covers:

1. Key concepts, including Affordable Housing definition and translation into planning practice, and an overview of the range of Affordable Housing programs and their key characteristics;
2. The overarching policy context in relation to Affordable Housing delivery in Victoria with emphasis on the State Government framework in relation to voluntary planning negotiations;
3. Key stakeholders and their roles, responsibilities and requirements to invest and deliver residential development, and specifically, to invest, deliver and/or manage Affordable Housing that may be negotiated through a planning process;
4. Emphasis on the critical role of investors in residential development and Affordable Housing delivery and their requirements in relation to risk and return;
5. Key operational and financial factors that influence a Registered Housing Agency's capacity to invest, borrow funds and support Affordable Housing outcomes;
6. Potential Affordable Housing programs and delivery models that could be agreed through a planning negotiation and key financial considerations and impacts of each approach; and
7. Potential planning incentives that would enhance value and/or reduce costs and improve the feasibility of Affordable Housing being delivered by way of a planning negotiation.

Affordable Housing Context

Affordable Housing is defined under the *Planning and Environment Act 1987* as housing, including Social Housing, that is appropriate for the housing needs of very low, low or moderate income households.

Affordable Housing covers a spectrum of programs from crisis accommodation, social rental housing and affordable home ownership. Social Housing is a type of Affordable Housing that is owned or managed by either the State Government (public housing) or a not-for-profit Registered Housing Agency (community housing) and rented to very low or low income households.

Ultimately to address the level of Affordable Housing demand therefore requires the Federal and State Governments to be investing at scale, using the range of funding, financing, planning and land tools they have available.

Financing, Funding and Delivery

As a below-market product, Affordable Housing that is appropriate, affordable and allocated to lower income households at a below-market rent or purchase price is not typically delivered by commercial property developers unless it has been directly or indirectly subsidised, typically by government.

The development of Affordable Housing by the private sector will therefore only occur if it is viable for the land owner/developer to progress a project and in turn, structure an Affordable Housing inclusion that is commercially viable. Management of this outcome over time as Affordable Housing must also be sustainable, with not-for-profit Registered Housing Agencies as the primary owners and operators of this form of housing responsible for ensuring a viable long-term operating cash flow.

Two key aspects of funding, financing and delivering housing and specifically Affordable Housing that the Report highlights are critical to understand:

1. The process, risks and capital costs required to build a dwelling; and
2. The process, risks and costs required to ensure the long-term management of the dwelling as Affordable Housing that is appropriate, allocated and affordable for lower income households in need.

These aspects are explored in detail in Part B of the Report and summarised in Table 1.

Area	Key Aspects
Residential Property Development and Feasibility	• Property development is a complex commercial enterprise entailing significant costs and risks over a considerable period. • Delivery of housing supply depends on development companies actively delivering projects at scale. A range of factors and risks influence and determine whether a development proceeds. • Developers require an adequate return on costs that is relative to risk and with high regards to their investor requirements. If an appropriate rate of return is not realised a project will fail. • Costs are incurred over a considerable period with returns on investment only realised at the completion of a project when revenue from sales is received and after taking into consideration all costs. • A project is highly dependent on the availability and cost of funding which is ultimately controlled by investors who require demonstration of sufficient market interest and a return on their investment relative to the risk and time frame. • Key issues a developer needs to assess and manage from a risk perspective include costs and revenue assumptions, availability and cost of funding, planning processes and outcomes, project timeframes and construction risk. • Assumptions are made at the pre-acquisition stage to determine the Residual Land Value (the price the developer will pay for the land). A developer will take a degree of risk in relation to the development potential of a Site when determining its value. • Costs represent a significant proportion of a development feasibility. Increases in costs that are not countered by an increase or offset in revenue will impact on the developer and investor return and as a result, mean the development is not viable and able to proceed. • An Affordable Housing inclusion does not generate the same return as market sales and may therefore have a negative impact on overall project viability both due to the costs needing to be met and the impact of the foregone opportunity cost on project viability (i.e. the lost opportunity to sell the dwelling at full market revenue has a cumulative impact on the overall revenue and ability to meet the return hurdle).
Affordable Housing Development, Feasibility and long-term provision	• Federal and/or State Government grant funding has been the traditional means of investment in Affordable Housing in Australia. • Whilst there is some new State Government investment, such as the Social Housing Growth Fund, these funds are limited, with future investment availability and terms unknown.

Area	Key Aspects
	• Not-for-profit Registered Housing Agencies are regulated by the government to own and/or operate Affordable Housing for very low to moderate income households. Regulation by the State appointed Housing Registrar provides a high level of oversight of an Agency's performance. • Housing Agencies must receive adequate income from rent to meet all operational costs if they are to ensure organisational and project viability. • Housing Agencies utilise the limited rental revenue to meet all tenancy management and building operating costs. This includes rates, owner corporation costs, insurance and property and tenancy management. • Operating costs and rental revenue assumptions must be carefully managed by a Housing Agency over the life of a building or dwelling. The below-market rental revenue is a significant constraint on a Housing Agency's capacity to save and/or borrow funds for new projects. • A Housing Agency generally has no capacity to borrow funds if a dwelling is to be rented to very low income households as the rent from these households is unlikely to generate a surplus of funds once operational costs are met. • Some larger Housing Agencies have a limited capacity to contribute to the capital costs of Affordable Housing development by utilising equity or by accessing debt financing from investors/lenders and repaying these funds over time. • As a charity a Housing Agency can also draw on taxation benefits to reduce costs such as GST exemptions which provide a small contribution to reducing costs of development and operations. • There is some (limited) examples of the private development sector funding or co-investing to meet the costs of constructing Affordable Housing, typically on sites where other government support or land is provided such as through public housing renewal. • Constraints on title and/or on an Agency's ability to rent a property in addition to the regulatory requirements and objectives to support low income households can impact on revenue and constrain an Agency's ability to borrow and invest in a development.

Table 1: Key aspects of development feasibility and Affordable Housing development feasibility and provision

Investors

Investors in the capital construction and delivery and then the long-term operations and future renovation and eventual replacement of Affordable Housing are critical. The requirements of the investor – which can include multiple parties – is therefore paramount if there is going to be a viable project and in turn, Affordable Housing delivery.

The range of investors in residential development and/or Affordable Housing and their requirements to invest are set out in Part B. Investors include:

- Federal or State Government through direct provision and development, provision of land, grants, loans and/or tax offsets or incentives;
- Institutional and wholesale investors in bonds issued by the National Housing Finance Investment Corporation (NHFIC);
- Local Governments though provision of land and/or planning dispensations or processes that improve development feasibility;
- Institutional funds such as a superannuation entity or real estate trust, who take a long-term view to investment and returns;
- Standard mortgage funders such as banks;
- Registered Housing Agencies through land, equity or management of philanthropic funds;
- Individuals in rental housing through structured arrangements such as occurred under the National Rental Affordability Scheme (NRAS); and
- Individuals in home purchase for household needs.

Investors ultimately require demonstration of the viability of a project before they invest. This entails careful examination of all project cost and revenue assumptions, and an assessment of all the potential risks and mitigations to ensure that the investment will be appropriately managed and the required return realised.

The level of return an investor requires is commensurable to the level of risk they see in a project and with regards to the time value of their investment. Governments also require comfort that their investment is appropriately managed and results in the agreed social outcomes being maintained over time.

Planning system inputs and voluntary negotiations

One means by which the costs of Affordable Housing delivery could be theoretically supported is through the provision of planning incentives or potentially by the change of use of a site to a higher value as a result of a rezoning or permit approval process.

The State Government recently updated the *Planning and Environment Act 1987* to require local councils to consider how they will facilitate the provision of Affordable Housing as an objective of planning. To further this objective the Government is supporting local governments to engage in negotiations with land owners to achieve an Affordable Housing inclusion on privately owned land by way of a planning approval process.

The State Government has not set a mandatory or minimum Affordable Housing requirement or preferred program outcome or delivery model to apply to negotiations but directs that there should be a clear value generation by either application of a planning tool or approach that improves the development viability.

The State Government guidance emphasises:

- Outcomes must give regards to the commercial requirements of a developer to deliver the project and the Affordable Housing inclusion;
- Affordable Housing inclusions must be clearly and voluntarily agreed on a site-by-site and individual planning application basis;
- Affordable Housing program outcomes and delivery models that may be agreed can range from the gifting, discounted sale or leasing of land or dwellings to a Registered Housing Agency through to the sale of dwellings to households under an affordable home purchase arrangement such as a Shared Equity program;
- When negotiating an Affordable Housing contribution, the Council must remain cognisant of the overall development feasibility and the potential cost impacts of any arrangement on a per dwelling basis and on overall project viability.

Under voluntary planning negotiations the way that the capital costs of a dwelling will be met must be clearly understood and agreed, which in part requires assurance that there is sufficient value available to the developer to offset costs. Value from the planning process may come from the change in use (rezoning) or through the provision of other incentives such as additional yield or a streamlined decision-making process that either increase the project value or reduce costs.

In absence of this value, other subsidy or funding will be required to meet the developer's costs and the developer and investor return hurdles.

The availability of third-party investment to support Affordable Housing delivered through voluntary planning negotiations is constrained, particularly if the housing is intended to be rented to very low or low income households. Any negotiated outcome that relies on a third-party investor must therefore give regards to the investor's requirements to purchase as to manage outcomes over time if it is to be commercially viable and achieve a long-term Affordable Housing outcome.

Council's Policy Position

The Council recently updated its Policy Guidance Note *Affordable Housing Outcomes at Significant Redevelopments* (October 2018) that sets out an objective to achieve 10 per cent Affordable Housing on strategic sites as a result of rezoning approval. The Council's priority is for dwellings to be built and gifted for use as Social Housing, which represents the highest cost impact for a developer.

Determining a Financially Viable Affordable Housing Outcome

Hypothetical modelling in Part C highlights that different tenures and delivery models have different cost and foregone revenue implications for a developer. A number of the scenarios also require a Registered Housing Agency to bring funds to purchase properties or develop land either through grants and/or equity and/or debt.

Under a voluntary negotiation the State Government guidance requires that the land owner and the Council determine what is commercially viable with regards to the value generated by the planning process and/or other planning incentives. This will require the parties to consider and balance several variables including:

- The number or percentage of dwellings provided as Affordable Housing;
- The intended household allocation – with any requirement for a housing agency to purchase a dwelling likely to require them to adopt a discounted affordable rental model and allocate dwellings to lower to moderate income households;
- The likelihood of the outcome being delivered, noting that the overall development must be commercially viable in order for the Affordable Housing component to be delivered;
- The acceptable level of dependency on other parties funding or investment, particularly on future Government grants and where a Housing Agency will need to secure debt finance.

This is further explored in Part C and highlighted in Table 2.

Model	Relative cost impact for developer	Potential Tenure	Likely Allocation / Household targeting	Reliance on third party investment (indication of delivery certainty / risk)	Potential number of dwellings (relative)
Gifting of Land	Low	Social and Affordable Rental and/or Affordable ownership (Shared Equity)	Mix very low, low and moderate income	High – depends on Housing Agency funding construction which is likely to also require government funding	High
Sale at 30% discount / developer contribution	Low	Affordable Rental and/or Affordable ownership (Shared Equity)	Low to moderate income	High – depends on Housing Agency securing significant funding and/or finance or an individual securing a mortgage	Moderate
Sale at 40 – 50% discount	Moderate	Social and/or Affordable Rental	Low to moderate income	Moderate to high – depends on Housing Agency securing funding and/or finance. Less reliance on government funds if financing can be secured	Low to moderate
Gifting of completed dwellings	High	Social and/or Affordable Rental	Very low to low income	Low / none	Low

Table 2: Potential outcomes arising from different models

Indicative Costs of Affordable Housing Delivery

Different Affordable Housing programs and delivery models have different cost impacts. This ranges from 100 per cent of costs that need to be met under a gifting scenario to a 15 to 80 per cent reduction in revenue under a discounted sale or land gifting model.

To support the Council's understanding of the financial aspects of Affordable Housing delivery, a high-level assessment of the cost to a developer of providing Affordable Housing into different tenures and program outcomes (rental and ownership) through various hypothetical delivery models has been undertaken, set out in Part C.

This high-level assessment highlights the potential cost impact; being the costs a developer is assumed to have to incur after accounting for any revenue, and the foregone opportunity cost impact; being the lost market value (revenue) as a result of the dwellings not being available for sale to the market. Scenarios covering gifting of land, gifting of dwellings, and sale of dwellings at different discount rates are tested.

The modelling of cost impact, summarised in Table 3, indicates that on a hypothetical development scenario of 100 apartment units with an average market value of $582,000,[1] the cost of delivering 10 per cent of dwellings (10 dwellings) as Affordable Housing could range from $740,000 to over $4.3 m.

Indicative cost of providing land that is capable of being developed for 10 units	$417,000
Indicative cost of selling 10 dwellings at a 30 per cent discount to market value	$640,000
Indicative cost if 10 dwellings were sold at a 40 – 50 per cent discount to market value	$1.22 - $1.8 m
Indicative cost of constructing and gifting 10 dwellings	$4.3 m

Table 3: Summary of potential cost impact of different delivery models

These costs are highly indicative and do not take into consideration site specific considerations or the foregone opportunity cost to the developer, which is greater than the cost impact. For ten dwellings the foregone opportunity cost, assuming an average market sale price of $580,000 per dwelling, is estimated to range between $75,000 and $580,000 per dwelling depending if they are sold at a discount or gifted.

As highlighted in Table 2, the type of Affordable Housing outcomes that may eventuate from these different models may also vary, with a gifted outcome potentially more likely to result in a Social Housing arrangement, whilst a sale at a 30 per cent developer contribution may only be viable for a shared equity home purchase outcome.

Yarra City Council's aspiration for ten percent of housing to be gifted may require, through negotiation, agreement to either a reduction in the number or percentage of dwellings delivered or support for a different delivery model. Gifting of dwellings also raises other financing issues for a developer as they require the financing of costs without any expectation of revenue.

Conclusion

The Report seeks to significantly enhance the Council and its stakeholder's understanding of the range of financing factors that impact on residential development and specifically Affordable Housing development and the capacity of the Council to pursue further negotiated planning agreements that result in 'on-the-ground' Affordable Housing outcomes.

It sets out the range of financial considerations and different program and delivery model options that impact on development financing and feasibility and delivery and Affordable Housing financing and long-term management. It

[1] Victorian Valuer General (2018) Guide to Property Values 2017, Median unit value in City of Yarra in 2018 was $582,000

highlights the critical role of investors and their needs to ensure appropriate return on their investment relative to risks.

It emphasises that Affordable Housing as a below-market response depends on the provision of a significant level of subsidy or investment, particularly if the scale of need is to be addressed. In the case of voluntary planning negotiations, this subsidy is required to be generated from the planning process or provision of other incentives to then be translated to a gifting, sale or long-term lease arrangement.

The setting out of different delivery models and the potential cost impact of each on a per dwelling basis highlights the level of investment that is potentially required.

The Council is encouraged to draw on the learnings within the report and apply a commercial lens to the negotiation of Affordable Housing outcomes to ensure that the delivery of housing that is appropriate, affordable and allocated to lower income households can be viably achieved in agreement with land owners.

Glossary

Affordable Housing

Affordable Housing is defined in the *Planning and Environment Act 1987* as housing, including social housing, that is appropriate for the housing needs of very low, low and moderate-income households. For the purposes of this definition:

- Very low-income households are defined as households earning less than 50 per cent of the gross median household income;
- Low income households are those earning less than 80 per cent of the gross median household income; and
- Moderate income households are those earning less than 120 per cent of the gross median household income.

Maximum income bands for these household groups are published by the State Government for Greater Melbourne and the Rest of State and should be referred to when determining household eligibility.

Affordable Housing should be priced (whether mortgage repayments or rent) so these households are able to meet their other essential basic living costs (generally no more than 30 per cent of income) and be 'Appropriate' for the household's needs which includes consideration of affordability, type, tenure, location, allocation, integration and housing need.

Social Housing

Social Housing refers to Public Housing (owned and managed by the Director of Housing); and housing owned, controlled or managed by a participating Registered Agency (registered as a Housing Association or a Housing Provider).

Registered Housing Agency

A not-for-profit organisation that is a company limited by shares or guarantee, an incorporated association, or a co-operative, registered under the *Victorian Housing Act 1983,* regulated by the Victorian Housing Registrar, with a purpose to own, manage and/or develop affordable rental housing. An Agency may be registered as a Housing Association or a Housing Provider.

Housing Affordability

Housing affordability refers to the relationship between expenditure on housing (prices, mortgage payments or rents) and household income. Housing affordability is particularly an issue for lower income households who have reduced financial resources available to meet housing costs.

Eligible Household

A household that meets the established criteria for an appropriate Affordable Housing program, typically an income limit and asset test.

End Recipient

The intended recipient of an Affordable Housing benefit created as a result of a planning negotiation.

Housing Stress

A lower income household (those in the lowest 40 per cent of incomes) is considered to be in 'housing stress' when it is paying more than 30 per cent of gross household income on rent (the '30/40 rule').

Shared Equity

A form of housing purchase where a component of equity is left in the transaction by either the developer, housing provider, philanthropy, State Government (HomesVic) or Council. Equity can come in the form of grants, foregone value or translation of a land contribution to an equity holding. The equity is typically between 20 to 30 per cent of the market value of the asset. Under separate agreement this equity is required be repaid by the home owner either by way of future repayment on the sale or refinancing of the property or a fixed sum dependant on the intentions of the equity contributor. Two Shared Equity programs are currently operating in Victoria – State Government HomesVic pilot and a not-for-profit driven model 'BuyAssist Australia'.

Key Financial Terms:

Residual Land Value (RLV)

The Residual Land Value is the estimated underlying land value of a site excluding any fixtures or building. It is calculated by estimating the total revenue and subtracting from this total all estimated total development costs, including the required profit (determined as a percentage of costs). The difference is considered the residual land value. A Residual Land Value assessment calculation informs the price an investor or developer will pay for a site if they are to develop and receive their required return.

Highest and Best Use

The use of an asset that maximises its potential and that is physically possible, legally permissible and financially feasible.

Development Risk

Development risk is the actual or potential risks associated with the delivery of a project and the likelihood of the risks arising and impacting on the developer achieving their required development margin and/or Internal Rate of Return and delivery of the project. Development risks include planning, environmental / contamination risks, construction risks and market risks such as changes in conditions that impact on the ability to sell units to the market.

Development Margin

The development margin is one means of expressing the hurdle or return a developer needs to demonstrate for a project to be financed and delivered. The development margin is expressed as a percentage of the total development costs.

Internal Rate of Return (IRR)

The Internal Rate of Return (IRR) is the estimated profit of an investment using a discount rate to determine the Net Present Value of a proposed investment. An IRR check enables an investor to measure how well a project or investment is expected to perform over time and enables a point-in-time comparison between one investment option to another or to determine whether or not a particular project is viable.

Net Present Value

The Net Present Value (NPV) is the total present value of a project after taking into consideration the revenue and costs over a forecast period of time and discounting those back to the value of funds in today's dollars. Net Present Value is a standard method for an investor to assess the time value of money and to assess and compare long-term investment opportunities.

Discounted Cash Flow

A Discounted Cash flow is a method to estimate the present day value of an investment based on its future cash flows by using a discount rate to all revenues and costs. If the value calculated through a discounted cash flow analysis is higher than the cost of the investment, the opportunity is considered positive for potential investment.

Interest Rate Cover Ratio (ICR)

The Interest Rate Cover Ratio is a calculation that an investor uses to check the ability of a recipient project to pay the expected interest on borrowings based on the anticipated project revenue. i.e. it is a check to confirm that the revenue from sales will be sufficient to cover the costs of borrowing. Many financiers will build in a sensitivity buffer to future rate rises to gauge the capacity to service. This sensitisation can be up to 2 per cent.

Time Value of Money

The time value of money (TVM) is the concept that money available in the present time is worth more than the identical sum of money in the future due to its potential capacity to earn money over time. The principle is that assuming money invested today can earn interest, that any amount of money is worth more the sooner it is received. TVM is also sometimes referred to as present discounted value. In relation to development and investment, "time is money" as the value of the money the investor has now is not the same as it will be in the future and vice versa. The longer a development process takes the greater the value of an investment erodes to the point it is not a sufficient return.

Loan to Value Ratio (LVR)

A Loan to Value Ratio is a method of calculating the value of the loan funds as a percentage of the value of the end 'on completion' product value of a project. For example, a LVR of 50 per cent means the investment comprises 50 per cent of the expected end market value of the development on completion. LVR is a measure used by investors to manage risk, for example a lower LVR provides an investor with comfort that in the event of a loan default the asset could be sold, and the investment recovered.

Loan to Development Cost Ratio (LDCR)

A loan to development cost ratio is similar to a LVR, calculating the peak anticipated debt including any capitalised interest against the total cost of the development. Financiers typically look at funding between 70 per cent to 80 per cent of the total cost of the project. Some financiers only capture the hard costs e.g. exclude the soft costs such as land holding costs, rates etc.

Value capture

Value Capture is the process of capturing or sharing a percentage of the value provided as a result of an action or intervention, such as investment in infrastructure or provision of a planning incentive or planning decision. It is typical in large scale infrastructure projects to either assist in cost-recovery, incentivise private investment and support social outcomes.

Foregone Opportunity Cost

The Foregone Opportunity Cost is the value of an asset such as a dwelling that is not realised (foregone) and is therefore no longer available for the developer to sell and achieve a market return. For example, the gifting of a dwelling into an Affordable Housing purpose is a foregone opportunity to sell that dwelling at market price and therefore input that revenue into the project feasibility and support overall project returns.

If gifting is not offset by incentives such as additional development yield and market sale capacity, the value of the gifted dwelling will need to be recovered through either other revenue increasing, or a reduction in the residual land value or the development margin and/or Internal Rate of Return.

Part A: Context

Policy Context

Commonwealth Government

Policy settings and actions of the Commonwealth Government, including fiscal and social policy, impact on the funding and financing for housing development, impacting broader housing affordability. This includes macro and micro level population, economic and taxation policies, as well as specific policy and funding agreements in relation to Social Housing and homelessness services, welfare provision, and assistance for first home buyers.

Monetary policy (interest rates) is determined by the Reserve Bank of Australia (RBA) and this influences the behaviour of borrower and lenders, economic activity and the rate of inflation. These policies and how they play out in the market are all influenced by wider global factors. The Commonwealth also sets the rules for foreign investment including in development and property acquisition.

The Commonwealth Government can also specifically impact on Affordable Housing supply through direct investment.

National Housing and Homelessness Agreement (NHHA)

Funding arrangements between the Commonwealth and State and Territory Governments for Social and Affordable Housing provision and maintenance and homelessness service delivery is provided through the National Housing and Homelessness Agreement (NHHA). Under the Agreement, the Commonwealth will provide Victoria with an estimated $2.0 billion over the first five year term, commencing with $395.5 million in 2018-19. Victoria is required to match the Commonwealth's homelessness funding estimated at $122.8 million over the period. This funding is committed.

National Housing Finance and Investment Corporation and Bond Aggregator

The National Housing Finance and Investment Corporation (NHFIC) is a new corporate Commonwealth entity established in June 2018 that is responsible for managing a new National Housing Infrastructure Facility (NHIF) with the Federal Government committing an initial $1 billion over five years which will provide finance in the form of loans, equity investments and grants to local, state and territory governments, government corporations and community housing providers to support housing-related infrastructure projects.

NHFIC has also established an Affordable Housing Bond Aggregator to drive efficiencies and cost savings in the provision of Affordable Housing by providing lower cost and longer-term financing to Registered Housing Agencies. The Bond Aggregator works by issuing bonds on the market for investors to buy-in, with the funds then leant out to Agencies in the form of low-cost financing.

Commonwealth Rent Assistance

Commonwealth Rent Assistance (CRA) is a Commonwealth Government subsidy provided direct to households that rent in the private market and are in receipt of a Government support payment or Family Tax Benefit. CRA is intended as a supplement to the payment to assist households to meet housing costs and reduce housing stress. It is paid directly to the household and is capped at a maximum payment regardless of rent. Households in community housing managed properties are eligible for CRA whilst households living in public housing are not.

Home ownership assistance

The Commonwealth Government intervenes in the market to support home ownership and private investment in rental housing through provision of taxation benefits, particularly negative gearing and capital gain discounts for investors, and provision of support to first home owners through grants and a small savings initiative that are intended to support households to access to purchase their first home.

State Government

The *Housing Act 1983* and the *Planning and Environment Act 1987* are the key legislative frameworks that relate to Affordable Housing delivery in Victoria. The focus of the Housing Act is on the delivery and management of Social (rental) Housing for very low income households. The Housing Act also establishes a regulatory system for not-for-profit housing agencies who own and/or manage Social and Affordable Housing ('Registered Housing Agencies').

The facilitation of the provision of Affordable Housing became an objective of the *Planning and Environment Act 1987* on 1 June 2018. This objective is supported in the State Planning Policy, which includes objectives and strategies to increase housing choice in terms of type, tenure and cost and encourage a significant proportion of new development to be affordable for households on very low to moderate incomes.

Homes for Victorians, and *Plan Melbourne* set out the State Government policy commitments in relation to Affordable Housing facilitation, investment and delivery. The strategies reflect that there are several tools the Government can use to facilitate increased Affordable Housing outcomes including the application of government land, funding, financing and land-use planning instruments and support for Housing Agencies to grow stock through partnerships.

Key State Government investment and policy initiatives currently being implemented under Homes for Victorians include:

- Social Housing Growth Fund – providing capital and recurrent grants to Registered Housing Agencies to deliver and manage new Social Housing supply;
- Low cost loans and loan guarantees for Registered Housing Agencies;
- Support for home buyers through a shared equity pilot program HomesVic;
- Sale of underutilised government land with a Social Housing requirement; and
- Investment in public housing renewal.

The State also invests in other public infrastructure that impacts on land values, particularly when these significantly improve local amenity, such as new train lines, open space or educational facilities.

Whilst the State Government has not mandated a requirement for developers to include Affordable Housing in a project, they have committed to a range of planning initiatives including:

- Clarifying that planning has a role in relation to Affordable Housing delivery through establishment of a new objective of planning 'to facilitate the provision of Affordable Housing';
- Establishing a definition of Affordable Housing in the *Planning and Environment Act*;
- Supporting and providing guidance for Responsible Authorities and land owners to enter an agreement in relation to Affordable Housing agreements on privately owned land;
- Streamlining planning processes for public housing redevelopments;
- Committing to develop a value share tool in the case of rezonings.

Regulation of Not-for-Profit Housing Agencies

The State Government regulates the provision of Affordable Housing that is owned, managed or operated by a not-for-profit Housing Agency by way of the *Housing Act 1983* which establishes a Housing Register, a range of performance standards that a registered agency must meet and a position of Housing Registrar. The Housing Registrar has powers to register and monitor the performance of registered agencies. Failure to meet any measure of a standard may result in intervention by the Housing Registrar and in a worst-case scenario, could result in de-registration. Performance standards apply regardless of the size of the registered agency but are tailored depending on whether the organisation is registered as an Association or a Provider.

Voluntary Planning Negotiations

In 2018 the State Government released policy guidance to support Responsible Authorities and land owners to undertake voluntary negotiations and reach agreement to an Affordable Housing inclusion as part of the planning approval process.

The guidance sets out the steps and evidence required to underpin a Responsible Authority's decision to seek an agreement with a land owner, which includes requirements to:

- Establish a strategic justification for a proposed Affordable Housing request;
- Identify value to support the Affordable Housing being delivered;
- Ensure clear land owner agreement prior to the application of any requirement in the planning controls;
- Give regards to a Registered Housing Agency's support for the proposal;
- Not unduly impact on the commerciality of the development; and
- Refer to and test a proposal against the definition and list of matters.[2]

The State Government guidance also highlights the importance of giving regards to the commercial viability of delivering a negotiated Affordable Housing outcome and emphasises that contributions should not unduly impact on development progression, market supply or affordability.

Part C of the Report outlines potential delivery models that could be negotiated and agreed to be delivered through a planning process, and highlights the key financial considerations of each.

Local Government

Local Government generally has a limited role in the direct provision of Affordable Housing and homelessness support in Australia.

Local Government is however responsible for developing and implementing local land use planning and administration in accordance with the *Planning and Environment Act 1987*, the Victorian Planning Provisions (VPP) and Planning Policy Framework (PPF). Councils typically have several policies that relate to housing, planning and community development.

Yarra Council has objectives in its current Housing Strategy and its Policy Guidance Note *Affordable Housing Outcomes at Significant Redevelopments,* to seek to increase the supply of Affordable Housing in the municipality. An Affordable Housing Strategy is currently being developed and is expected to set out the evidence base of need and the range of actions the Council will pursue, including in relation to voluntary planning negotiations.

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2 Department of Environment, Land, Water and Planning (2017) Planning mechanisms for Affordable Housing, https://www.planning.vic.gov.au/policy-and-strategy/affordable-housing, last updated 2/11/18

Defining Affordable Housing at the Planning Application Stage

In 2018 the Victorian *Planning and Environment Act 1987* was updated to include the following definition of Affordable Housing:

> *'Affordable Housing is housing, including social housing, that is appropriate for the housing needs of any of the following - very low income households; low income households; and moderate income households.'*

This definition includes key elements defining what constitutes 'Affordable Housing'. These concepts are:

- 'Housing' – a built form that is suitable for a household to live in;
- 'Social Housing' – a type of Affordable Housing that is owned or operated by the State Government (public housing) and/or a Registered Housing Agency (community housing);
- 'Appropriate' – is appropriate for occupation by a very low, low or moderate income household in terms of location, size, amenity, built form, integration within the building and/or neighbourhood; and
- 'Very low, low and moderate income households' – the household groups, determined by income, that are the intended recipients of Affordable Housing.

Affordable Housing as a built form therefore provides appropriate and affordably priced shelter, amenity and ideally long-term housing security for the household. It may be in the form of an apartment, townhouse, duplex or free-standing house.

The key difference to market housing is that Affordable Housing is specifically targeted and priced to be affordable and available for lower income households and is appropriate for their household needs in terms of location, size and amenity, thereby ensuring households do not face undue economic stress and compromise in other essential expenses or find themselves homeless.

Affordable Housing covers a spectrum of program and tenure responses including supported, crisis and transitional housing, Social Housing (Public and Community Housing), disability housing, discounted rental housing, shared equity home ownership and home ownership (Figure 1).

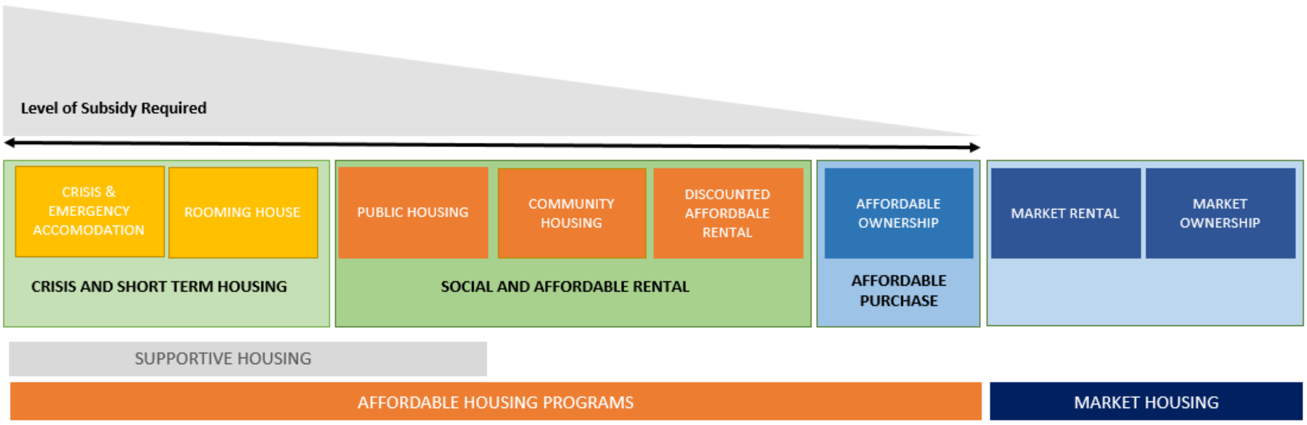


Figure 1: Housing spectrum illustrating Affordable Housing programs (Whitzman, Newton & Sheko, 2015 - Adapted by Affordable Development Outcomes and City of Yarra)

The State Government has published income bands that define who very low, low and moderate income households are (Table 4) and has set out a list of 'matters that are required to be given regards to' when determining the appropriateness of the intended built form for these households (Figure 2).

This provides a framework for Councils and developers to translate the definition at the planning application stage to assess the likelihood of a proposed built form resulting in an appropriate Affordable Housing outcome.

Household type	Very low	Low	Moderate
Single adult	Up to $25,220	$25,221 - $40,340	$40,341 - $60,510
Couple, no dependent children	Up to $37,820	$37,821 - $60,520	$60,521 - $90,770
Family (1- 2 adults with dependent children)	Up to $52,940	$52,941 - $84,720	84,721 - $127,080

Table 4: Greater Melbourne Affordable Housing income bands, 2018-19 (gross household income per annum)

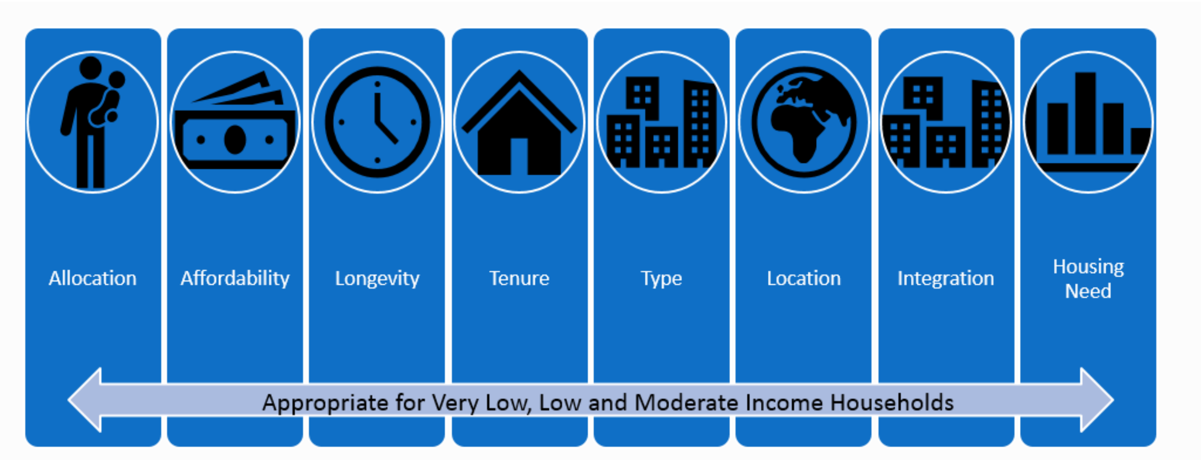


Figure 2: State Government published Matters required to be considered when assessing 'appropriateness' of proposed Affordable Housing

Affordable Housing Programs

Table 5 highlights three types of programmatic outcomes that are all considered to be Affordable Housing and that subject to the evidence of local need, could be agreed to be delivered through a voluntary planning negotiation. In the case of Social Housing, it is expected the housing would be owned and/or managed by a Registered Housing Agency, not the State Government.

Other emerging programs such as rent-to-buy and build-to-rent could also deliver Affordable Housing if appropriately structured. If proposing a different arrangement, the Council or developer will need to demonstrate how the expected built form will meet the State Government definition and list of matters to ensure the resulting housing outcome will be appropriate, affordable and allocated to very low, low or moderate income households.

Housing Program	Key Characteristics
Social Housing	• Social Housing is rental housing that is owned or managed by the State Government (public housing) or a Registered Housing Agency (community housing). • Social Housing is rented to households that meet Government published income eligibility and asset requirements and that are registered on the Victorian Housing Register, which categorises applicants into 'priority access' and 'register of interest' households. • A Registered Housing Agency is a not-for-profit incorporated organisation with a purpose to own and/or operate housing for lower income households. Agencies undergo a process of registration through the State Government appointed Housing Registrar and are registered as either an Association or a Provider. Agencies must meet a range of performance standards and reporting obligations and are also regulated by the Australian NFP and Charities Commission and the Australian Taxation Office. • Social Housing outcomes that may be agreed under a planning negotiation are expected to be owned and/or managed by a Registered Housing Agency. • Rent for dwellings managed by Registered Housing Agency is generally set at a maximum of 30 per cent of household income plus Commonwealth Rent Assistance. • Social Housing generally provides a significant level of assurance as to the long-term provision of the housing for tenants, with housing generally 'for life'.
Affordable Rental Housing	• Affordable rental housing is housing that is provided at a discount to market rent to households that meet Social Housing or *Planning and Environment Act* Affordable Housing income eligibility requirements. Generally, a minimum 25 per cent discount is provided to ensure a Housing Agency maintains its charitable tax status. • An affordability test applies, with rent expected to be set at either a discount to market or no more than 30 per cent of a household's gross income. • Affordable rental housing may be provided on a long-term basis if owned by a Registered Housing Agency or could be for a set period of time such as dwellings rented under the National Rental Affordability Scheme (10 years).
Shared Equity Home Ownership	• Shared equity home ownership is a program whereby a household that has some (limited) capacity to borrow funds is able to purchase a dwelling through an affordable purchase shared equity arrangement. • Typically, the household borrows between 70 and 80 per cent of the value of a property from a bank, with the remaining percentage or 'social equity' provided by either a government grant, a land contribution or a developer contribution in the instance of a voluntary negotiation. • Shared equity programs require an appropriately regulated arrangement to be put in place to source an eligible purchaser and for the social equity to then be appropriately secured and captured on future sale. This requires the initial social equity contribution to be appropriately secured, for instance by a second mortgage. • On the future sale of the dwelling by the first purchaser the proportional equity provided at the start (i.e. 20 – 30 % of market value) is repaid based on the property's (future) market value. • The State Government is piloting a shared equity program HomesVic, where the government is providing the social equity. There is currently one not-for-profit supported model, BuyAssist Australia, operating in Victoria that can facilitate and manage shared equity outcomes and secure the developer contribution and other

Housing Program	Key Characteristics
	Housing Agencies are also investigating participation in similar programs as part of "staircasing" residents into home ownership. • In a planning negotiation the land owner would meet the land and development costs with the purchaser paying the agreed (reduced) proportion of market value at settlement. The difference between the market value and the amount paid by the purchaser is the social equity that is then secured. • The land owner does not receive a return on their contribution, rather the social equity is reinvested in accordance with an agreement between the social equity holder and the Council.
Affordable home purchase	• Affordable home purchase entails the sale of dwellings at the established market price to low or moderate income households if the market price of a property is demonstrated to be affordable for that household without a subsidy or discount. • This is a potential new model for Victoria that is operational in other jurisdictions and is a way for a greater number of Affordable Housing being achieved on a site without a cost impact for the developer. A sale program is required that ensures only eligible households that meet the defined income bands are able to purchase the property (requiring a process of income verification). • The model will only apply in areas with lower market prices and where the dwelling is clearly appropriate in size, amenity and quality for the purchasing household. • The model does not require the dwelling to be secured or managed as Affordable Housing in the long term as there is no subsidy or discount that is required to be secured, rather it can encourage more lower priced dwellings to be delivered in an area.' • If a discount is required, then the product should revert to a shared equity arrangement where the discount or contribution is appropriately secured for reinvestment. • Affordable home purchase models are expected to result in a higher number of outcomes and are also expected to be coupled with a Social and/or Affordable rental arrangement as part of a negotiation.

Table 5: Summary of Key Affordable Housing models

Key Stakeholders

Table 6 highlights stakeholders that have key roles in the financing, development or management of Affordable Housing and whose requirements to operate and invest are critical to understand.

Stakeholder	Role	Requirements to operate and invest	Key Financial Requirements
Land owner	• Owner and vendor of land for development • May be planning applicant and developer or may own land for other purpose and sell a permitted or non-permitted site for others to develop	• Market interest and capacity to purchase a site • Planning capacity and certainty as to use • Incentives to divest (i.e. an appropriate return)	• Appropriate return on land, reflecting value in market, cost of sale (including potential costs of securing a planning permit)
Developer	• Purchaser of land for development • Developer of land • Typically planning applicant	• Certainty and stability of market and government conditions • Clear and timely planning controls and approval processes • Access to finance • Labour force and material availability • Capacity to innovate and appropriately manage risks	• Development margin that supports a required Rate of Return on investment after costs and taxes, including financing costs
Financier and/or investor	• Provider of funds for land acquisition and/or development on expectation of financial return	• Certainty and stability of market and government conditions • Access to funds • Liquidity of funds • Security over the investment • Repayment of debt	• Rate of Return on the investment that is commensurate to the level of risk, time and quantum of investment
State Government	• Legislative and policy • Owner and manager of Public Housing • Direct investor in Social and Affordable Housing • Provision of support for home owners	• Regulatory oversight • Community support • Partnerships • Effective administration • Assurance as to the outcome	• Value for money / public benefit for investment
Affordable Housing owner and/or operator	• Owner and/or manager of Affordable Housing	• Partnerships • Access to stable, long term funding (subsidy) • Access to low cost funds • Flexible tenant selection • Opportunities to extract value and manage • Flexible asset management	• Positive revenue (rent) relative to costs to maintain a viable not-for-profit business • Access to subsidy • Access to low-cost, long-term financing

Table 6: Key Stakeholder and roles

Investors

Investors in property development and Affordable Housing delivery are critical. Without some internal investment capacity supported by investment (typically debt financing) from an external investor such as a bank a developer cannot deliver a project and a Housing Agency cannot purchase and/or develop.

Investors include governments, housing agencies, and financial institutions. Individual home purchasers are also investors in their own home as are a large number of 'mum and dad' investors in private rental.

A summary of key investors is outlined in Table 7.

Investors often require another investor party to also invest to support a development or purchase. For example, a developer may have the funds to invest and purchase a parcel of land but will require significant bank funding to meet the costs of construction, just as an individual may have a deposit saved but requires a bank loan to purchase their own home or an investment property.

On a residential development project, up to 80 per cent of the total development value could come from external investors, generally provided as debt financing that is required to be repaid at the completion of the development. For a Housing Agency, debt financing is generally limited due to the lower rate of return (lower rents that can service the debt) with banks requiring a lower Loan to Value Ratio. For a Housing Agency to develop land and/or to purchase properties that are negotiated through a planning process, other sources of investment are expected to be required, primarily capital or recurrent grant funding from government.

Of note:

- State and Federal Governments are crucial investors in Affordable Housing, providing funding in the form of grants, low-cost loans, or tax offsets or direct investment in public housing renewal. Significant new government investment is required to address demand;
- Whilst not a significant investor to date, institutions such superannuation funds invest in some scale in residential property and have indicated an interest in new models such as long-term market based 'build-to-rent' (long term single ownership rental buildings) and Affordable Housing. A key challenge for consideration is the risk weighted return expected from this asset class. Various State and Federal Government initiatives seem to be pointing to alleviating this risk hurdle (NHFIC and Treasury Guarantee);
- Registered Housing Agencies are key investors in Affordable Housing with their business mission and operations structured around this objective.
- Individuals are also investors both in private rental housing and in home purchase. Residential projects depend heavily on individuals committing to purchase a dwelling in a pre-sale period in order for a developer to secure construction finance. Any Affordable Housing requirement that adversely impacts on the pricing of market dwellings is subsequently not going to be viable as the developer will not be able to reach pre-sale hurdles and deliver the project.

Registered Housing Agencies

As the only regulated entities to own and/or manage Affordable Housing and subsequently the preferred managers of outcomes delivered through a planning negotiation, Registered Housing Agencies are singled out as key stakeholder and investor. Of note, Housing Agencies are:

- Mission driven organisations with a clear charitable objective to increase Affordable Housing supply for lower income and vulnerable households;
- Regulated by the State Government to own, manage or operate Affordable Housing, particularly Social Housing that is rented to very low and low income households, requiring Agencies to adhere to and report on a range of regulated performance standards;

- Highly experienced property and tenancy managers of Affordable Housing, with clear systems in place to confirm household income eligibility and to determine the allocation of properties with regards to social objectives, conditions of grant funding and requirements to maintain a charitable status;
- Have significant regards to the long-term operational viability of any single project as well as overall organisational viability to ensure the mission can be delivered;
- The preferred State Government vehicle of Social Housing growth, with often exclusive access to funding opportunities such as the Social Housing Growth Fund;
- Experienced in partnering with governments, Councils and the private sector and bringing together different investment sources to realise an outcome;
- Limited due to their operating structure to generate any or significant revenue that can then support borrowings.

As long-term investors in Affordable Housing, Registered Housing Agencies are very well placed to inform a planning negotiation to determine the optimal program and delivery model, and to provide comfort that any Affordable Housing outcome will be appropriately managed and allocated to households in need.

Housing Agencies depend on other investors to provide funding and financing to support the capital costs of development. Whilst Agencies accept and adhere to Federal and State Government condition in relation to grant funding and subsequent household allocation requirements, restrictions on the use of a property that are placed on title as a result of a planning negotiation are an issue as they can impact on a lending institution’s capacity to finance a project and/or an Agencies ability to manage and allocate the property in response to need over time.

Investor	Key Characteristics
Governments	• Federal and State Governments have a long history of investing in Social Housing, particularly in Public Housing, albeit this investment has been limited and varied over time relative to demand. • Investment has included provision of land, grants and tax incentives to Registered Housing Agencies, developers and investors and direct government investment in public housing development and renewal. • New models of investment include low cost loans and upfront and long-term grant funding particularly from the State (for example, the Social Housing Growth Fund and debt guarantee).
Land Owners	• Land owners invest in property for a range of reasons including to use the site for a direct business purpose or to rent the asset to another entity for a rental return. • The owner of land identified for development may also be a developer entity that has purchased a site for the purposes of redevelopment or may be an entity that has owned the land for some time and is now seeking to enhance their land value to then on-sell a rezoned or permitted site. • Land owner objectives and consideration of feasibility and risk can vary depending on their status and objectives. • Land owners are driven to achieve the highest and best value for their land and will only willingly sell the land if there is an acceptable return. Land may also have an existing revenue generating use that a land owner will take into consideration when looking to sell a site.

Developers	• Property developers are diverse organisations ranging from small, boutique companies through to listed property companies that operate nationally. The scale and type of development a developer will undertake typically reflects their experience and capabilities. The developer may have owned the land for a long period or may have recently acquired the site.
	• Property development is a commercial business that trades in assets to make a risk-adjusted return to the development company and its investors, to then support further land trade and development. Ensuring an appropriate profit is a fundamental requirement to ensure organisational viability and project delivery.
	• Developers draw on equity sources to support land acquisition and development and typically depend heavily on access to financing to support project delivery.
	• The level of return or development margin varies considerably depending on a range of factors including:
	  ◦ Sources and costs of finance and the terms of repayment;
	  ◦ Risks associated with the development and the estimated costs and time associated with mitigating or removing these risks. Risks include remediation, planning financing availability, construction risk and uncertainty and changes in market conditions;
	  ◦ The time frame that is estimated to be attributed to progressing the development;
	  ◦ Market conditions which impact on revenue and sales rates (timing);
	  ◦ Costs including construction costs and government taxes and charges;
	  ◦ The internal rate of return that is required to ensure a profitable business after costs and taxes.
	• Checks a developer will make to determine whether a project is likely to be viable an the price they will therefore pay for land include assessing the development margin (profit after costs including taxes) and the Internal Rate of Return – the return on the investor's funds taking into consideration time cost of money.
	• A developer's experience has a significant influence on the ability to manage the process and risks and is a key consideration of project investors who are seeking to invest to generate a return on funds that is relative to the risk they take and how this compares to other investment options.

Registered Housing Agencies	• As the primary ownership and/or managers, not-for-profit Registered Housing Agencies are key long-term investors in Affordable rental Housing supply.
	• A housing agency's capacity to invest is dependent on and limited by the below-market revenue it receives as rent, the project operating costs and the overall portfolio approach and capacity. Agencies must be able to respond to cyclical and long-term maintenance costs to ensure long-term portfolio sustainability.
	• Limitations on who an agency can tenant a property to, and therefore what rent can be charged, and the operating costs are critical variables that influence how much return (equity) an Agency has to invest in a project.
	• As not-for-profit entities, Registered Housing Agencies can access charitable taxation benefits such as GST exemption. Some agencies can play a developer role when they have access to land which can also enable them to deliver housing that does not depend solely on a achieving a development margin.
	• The amount an Agency could borrow from an investor is limited by the below-market revenue and the value of assets it can offer as security and depends on:
	  ◦ Project return available to meet borrowing costs;
	  ◦ Appropriate level of securitisation available to secure the loan against in the case of a default;
	  ◦ Financiers assessment of risk; and
	  ◦ Organisational risk appetite and capacity.

Investor	Key Characteristics
Financial institutions	• Authorised Deposit-taking institutions (ADIs) in Australia are the primary source of debt finance for housing development and investment in Australia for both developers, Registered Housing Agencies and individual home purchasers and investors. • Traditionally delivered through mainstream banks, ADIs provide mortgages and charge interest over a set time frame. Bank financing supports construction and purchase of sites and/or competed dwellings by individuals or organisations including developers and Housing Agencies. • Critical measures of an institutions assessment in determining the availability and cost of mortgage funds that may be provided is serviceability (ability to repay) and loan-to-value ratio (LVR) – the amount of funding provided relative to the end value of the project or dwelling. • A maximum loan of 50 - 80 per cent of the expected end market value of a project is a typical hurdle for developers and individual investors and provides comfort to the bank that in the case of default the bank could sell the asset and recover their investment. • Bank financing for Housing Agencies has traditionally required a lower LVR, with ranges between 16 and 65 per cent and has been generally provided on shorter 3 – 5 year terms due to the below-market nature of the investment. Given the nature of the business model, bank financiers pay more attention to the underlying operational efficiencies (Earnings before interest, tax, depreciation and amortization (EBITDA)/servicing) capability of the Housing Agency than the LVR.
Institutional Investors	• Institutional investment is undertaken by banks, superannuation funds or pension funds or trusts that use cash reserves (equity), bonds or finance raised through other investor sources. • Institutional investors typically trade in the stock market and may also have funds invested in property – typically commercial or industrial through direct investment or through property trusts. Some institutional investors have a development entity arm (such as CBUS or ISPT) which undertake development for the parent institution. • Institutional investors in property require a significant scaled portfolio that delivers long-term, stable rate of return. Institutions typically discount the value attributed to capital gains instead focussing on rental yield over time. Liquidity of investment (ability to readily translate to cash) is important for institutional investors. • Whilst institutions are yet to invest in residential property or Affordable Housing in Australia at any scale as it is not yet considered a tradeable asset class providing the liquidity required, there is increasing indicators of interest from ethical and responsible investors both institutional and wholesale/sophisticated. • Institutional investment in residential housing and Affordable Housing overseas is common where the asset class is treated more as 'infrastructure' and the project returns backed by government, thereby reducing the risks of investment. It is expected institutional backing will increase over time in Australia line with overseas examples. NHFIC bond issuance is one such example of changes.
Individuals	• A significant proportion of Australian households are investors in property through purchase of the family home (owner-occupiers). • Typically, a household uses savings and potentially accesses First Home Owners Grants, together with debt (mortgage funds) to purchase, with the equity position increasing over time as loan funds are repaid. • Home purchasers depend on traditional bank financing which requires evidence of the household's ability to pay back the funds. • Capital gains for these households are relevant in that they increase the household's equity position and their ability to either purchase a new dwelling, invest in other property or realise value on a future sale.
Retail Investors	• Private rental housing in Australia is nearly all owned by individual investors (private landlords). As with owner-occupiers, the majority of investment to purchase these dwellings is sourced from ADIs. • Retail investors also depend on capital gains which depends on prices increasing and the investor realising a return on the future sale of the property. Individual investors are able to negatively gear their investment if the total costs including interest on the loan is greater than total income. • Retail investors may also hold assets through Self-Managed Superannuation Funds which provides access to taxation and capital gain discount benefits. • A number of individuals invested in property under the National Rental Affordability Scheme which provided a tax benefit in exchange for investors receiving a lower rental and allocating dwellings to rent by lower income households.

Table 7: Overview of different investors

Part B: Residential Development and Affordable Housing Financing and Feasibility

Residential Development Overview

An understanding of the development process, the underlying commercial and financial structures of the development phase is critical to understand as without a viable overall development, the delivery of Affordable Housing will not be achieved. Understanding the financing and feasibility of the operational phase is therefore also critical when considering how a potential Affordable Housing contribution could be structured within a planning negotiation.

Table 8 summarises the key sources of funding and financing within the various stages of development and operations. Each has different financing, costs, revenue and risk assumptions that impact on the viability of delivery and long-term management.

Stage	Typical Sources of Funding and Financing
Land acquisition	• Development company equity • Investors • Bank financing
Development - Holding costs	• Land owner equity or potentially bank financing
Development - Planning permit process	• Development company equity
Development - Construction	• Development company equity (small proportion) • Bank financing or other investor funds (large proportion)
Development - Affordable Housing sale	• Individuals purchasing under an Affordable Housing Purchase option using equity (savings) and bank financing (mortgage) • Commonwealth or State Government grants and low-cost loans • Registered Housing Agency equity or debt
Operational - Affordable Rental Housing management	• Rental revenue • Potential recurrent government subsidy under the Social Housing Growth Fund (limited)

Table 8: Key phases and sources of funding and finance

Development Feasibility

It is important to understand the principles and influences on residential development feasibility more broadly prior to examining each phase in detail and the implications for Affordable Housing delivery. Ensuring the feasibility of a development proposal is critical – if a developer does not expect to generate a sufficient return then the project is not viable and will not proceed. A projected rate of return must also be demonstrated to the developer's financier if they are to secure development finance.

The process of development feasibility involves an iterative method of setting and updating a range of assumptions, with the process part 'science' and part 'art' with developers needing to make an assessment as to the likelihood of a cost or revenue assumption being achieved. The soundness of a development feasibility therefore heavily depends on the reliability and certainty of a range of assumptions that are inputted in to the model and the risks of these assumptions not being realised.

Early in the process a developer would typically use a simple feasibility to determine the indicative project viability and Residual Land Value. At the point of a planning application a developer will have undertaken a number of iterations and 'long-form' feasibility that is informed by detailed analysis and independent advice on cost and revenue assumptions. This feasibility will factor in interest rate payments over time and consider peak debt, project Internal Rate of Return (IRR) (return from the project to then pay interest and investors), and equity IRR (return on equity funds provided by the investor or development company).

Two key sets of assumptions underpinning any feasibility are broken into revenue and costs. These can change considerably over the development timeframe and include several sub-components reflected in Table 9. Key cost stages, assumptions and potential impact on viability is further outlined in Attachment 1.

Timing Stage	Key Cost Inputs	Key Revenue Inputs
Pre-acquisition	Preliminary Due diligence	-
	Land acquisition	-
	Purchase taxes	-
Pre-development	Further due diligence	-
	Planning approval	-
	Marketing and Sales	-
	Legal	-
	Land holding taxes	-
Development	Site remediation	-
	Early works	-
	Construction	-
Across project timeline	Project financing	-
Practical Completion and Settlement	Legal	Sale of property on practical completion

Table 9: Development Costs and Revenue Assumptions

A developer will typically assess the indicative viability of a development prior to acquisition by estimated each cost and revenue to then calculate the indicative Profit or Return on Costs, and how this compares against a required Internal Rate of Return (IRR) measure. Some investors also use other profit checks including margin and discount rate.

This process supports a developer to determine the 'highest and best use' and in turn the Residual Land Value of a potential development site, taking into consideration a multitude of factors including the likely cost and timing of planning, market and development risk, feasibility and return expectations.

The costs are notably emphasised with significant costs incurred over the acquisition and development phase prior to any revenue being received. Revenue is significantly dependent on interest and capacity of external parties and market conditions – risks that are difficult to predict. If costs escalate then either revenue must also increase or the profit or the value of the land will be impacted. Too great an impact will make a project unviable.

Figure 3 provides an illustration as to the estimated breakdown of costs on a dwelling with a market value (estimated revenue) of $500,000.

It highlights the significant proportion of costs that are required to purchase land and develop and meet other costs such as fees and charges before an investor return before tax and reinforces the large percentage of revenue that is required to meet costs.

In this example:

- 55 per cent of costs, or $250,000 is in construction plus a further 20 per cent, or $100,000, in land costs; and
- A 15 per cent return on costs or $75,000 is expected before tax is paid. [3]

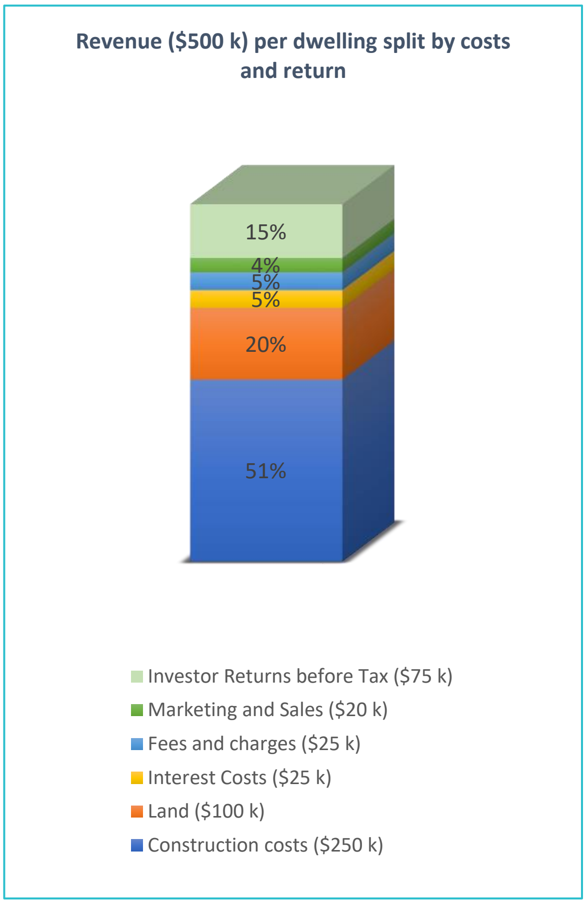


Figure 3: Hypothetical development Scenario – revenue split by costs and returns

Examples of standard industry hurdle rates at the pre-development feasibility assessment stage are summarised in Table 10.

	Land Subdivision	Speculative Office development	Pre-committed Office development	Pre-committed and pre-sold Office
Margin/Profit	20%+	25%	15%	10%
Internal Rate of Return	15 – 20%	20%	15%	10%
Discount Rate	20%	20%	15%	10%

Table 10: Indicative required rates of return

[3] Adapted from Affordable Housing Industry Advisory Group and Affordable Development Outcomes (2019) Affordable Housing Masterclass

Time Value of Money

The time value of money (TVM) is an important concept in relation to understanding development feasibility and process. The concept of TVM that money available in the present time is worth more than the identical sum of money in the future due to its potential capacity to earn money over time. A developer and/or an investor must therefore consider the time it will take for a return to be made on their investment and whether this return is greater or less than if they did not make the investment and instead put the funds into another immediate interest generating investment. This is because the value of the money the investor has now is not the same as it will be in the future and vice versa.

The longer a development process takes, the greater the value of an investment erodes to the point it is not going to generate a sufficient return. Risks, outlined below, that impact on the development timeframe once a development proceeds therefore impact on the value of the investment and can result in an investor seeking to withdraw from the project, or the development margin being significantly eroded to compensate.

Risk

An assessment of risks and identification of mitigations is critical with risks assessed and refined during each stage of the feasibility process. An investor will also give significant regards to the risk profile of a project before determining whether to invest and the cost of the investment funds (the risk-adjusted Required Rate of Return).

A prudential development management approach will therefore seek to understand the risks associated with each assumption and will then either adjust the assumption, allocate a provision against it (a contingency) or adjust the required rate of return by increasing the development margin that is required to reflect the risk profile (increased risk requiring a greater return).

Key development risks include land or building related risks such as environmental, contamination, structural issues, risks associated with planning approval, design and construction, financial risks associated with the structure, availability and cost of funds, the procurement method and construction price, program and market risks.

The developer needs to carefully manage cost and revenue assumptions through the project lifecycle to ensure that assumptions are upheld, or where there are changes, that these can be mitigated by other factors to ensure that the investor requirements and company return requirements can be met.

Sensitivity testing assists the developer and investor to understand the impact of different variables in order to focus on those areas with the greatest feasibility impact. Weightings on the likelihood of the risk occurring support decision making in relation to the final assumption.

Understanding the risks associated with planning approval processes can assist Local Council's to consider what role they can play to mitigate and in turn improve development feasibility and the capacity for a developer to support an Affordable Housing inclusion.

Phases of Delivery

There are two key stages involved in Affordable Housing development and financing:

1. **Acquisition and Development phase**, which relates to land acquisition, planning, sales, and construction of the built form. Under a voluntary negotiation these processes and risks are taken by the land owner/developer; and

1. **Operational phase**, which relates to the ongoing property and tenancy management and associated costs and risks which are expected to be managed by a Registered Housing Agency for Social Housing or Affordable Rental Housing.

Figure 4 illustrates the general stages in the development phase for a large project against an indicative timeframe and highlights that decisions that are made at the early stage of acquisition impact on outcomes at a later stage.[4] These two stages are explored in greater detail below.

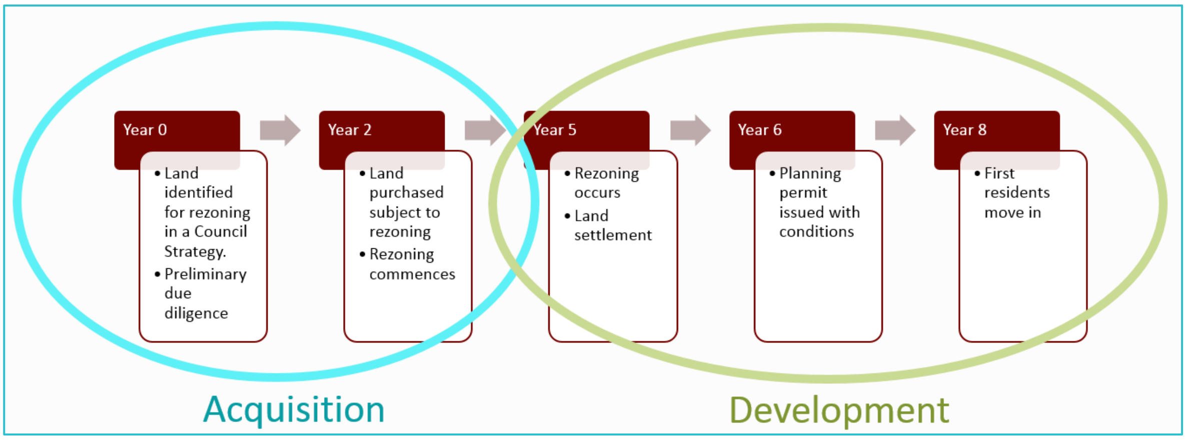


Figure 4: Example acquisition and development phases

Acquisition Phase

Acquisition of land that is suitable to develop is a critical stage. For some developers, land acquisition occurs significantly in advance of any development, whilst for others the land is purchased and immediately progressed to planning application stage, or in the case of a permitted site, pre-sales and construction.

Make an estimate as to the land value is a significant step in the acquisition stage, particularly in large sites that require a rezoning where there are several unknown costs and risks. As noted, a range of assumptions inform this assessment. Other factors will also be taken into consideration including the opportunity and the value of it to a developer's portfolio and project pipeline or market positioning.

There is no single formula for determining the value of land, with the calculation as to what a developer will pay for a site based on estimates as to each assumption and a degree of speculation in relation to the land's future use. Competition for land in markets with scarce development opportunities increases the land value. This is particularly the case in relation to well-located industrial land has potential for future residential or mixed-use subject to a rezoning.

[4] Affordable Housing Industry Advisory Group and Affordable Development Outcomes (2019) Affordable Housing Masterclass

The acquisition is a complex and often resource intensive process, typically entailing careful and informed assessment of a range of factors to enable a developer to take a view on the potential 'highest and best' value of the land (i.e. how much they will pay the land owner for the rights and opportunity to develop). This includes consideration of:

- Local Council planning policies and existing planning controls and what they allow in terms of built form and where there may be potential for changes to support a higher land use;
- The current and estimated future market conditions and therefore the best built form outcomes and pricing (revenue assumptions) to maximise the land use;
- Estimated planning approval timeframe;
- Estimated development costs;
- Estimated timeframe to deliver; and
- Developer and investor return requirements.

The more information a developer has when considering whether to purchase a site, the greater level of assurance they can make on the assumptions and the value they will place on the land. For example:

- If purchasing a permitted site, the risks and timing associated with planning approval are considered mitigated which in turn increases the value of the site as it is considered ready to develop; or
- If purchasing a site that will require a rezoning to enable a proposed built form and use (such as rezoning from an industrial use to residential), the developer will undertake an assessment as to the likelihood of this occurring, for example, whether a proposed rezoning is contemplated within government or Council policy documents, whether other investment is committed that is likely to result in a change of land use, or whether other Council policies will result in other obligations should the land be rezoned. The greater the likelihood then the greater the land value estimate.

The value of land can increase over time without any change in planning controls as the likelihood that a rezoning will be viable increases due to locational attributes or a direct response to policy change. In this regards the value of the rezoning is expected to be increasingly reflected in the price that is paid for a site that has future development potential even if the purchaser is not intending on developing. Whilst there is no guarantee of the rezoning, this is part of market practice with the purchaser taking the risk – and therefore adjusting their return expectations accordingly.

If there was a mandatory Affordable Housing system in place in Victoria with a clear legislated requirement to include a proportion of Affordable Housing as a condition of rezoning would, in theory, be reflected in future land value estimates. The greater level of certainty as to what a requirement would entail (for example, gifting of completed dwellings, or provision of cash), the greater the ability for the potential purchaser to factor in those costs in determining the Residual Land Value. In a competitive land purchase market this level of information is critical to ensuring each bidder is competing on the same terms.

A key challenge to this premise is that land values over time adjust in response to policy and market conditions and assumptions on the potential highest and best use of the land, and therefore land prices are likely to have already adjusted upwards over time. This makes any new policy requirement to deliver Affordable Housing more difficult for developers to absorb. As there is not a mandatory requirement for Affordable Housing in Victoria any proposed inclusion must recognise this issue and ensure an outcome is clearly agreed and expected to be viable at the point of the planning application as it cannot be assumed to have been calculated into the land pricing.

Construction Phase

Once land is acquired there is a significant and often lengthy process to deliver a project to completion. The development and construction phase involve significant costs and risks that impact on feasibility, including:

- Costs of developing the planning application and the impact of delays in decision making or changes to the planning outcome;
- Changes in construction costs which can be impacted by a range of labour and material supply factors; and
- Changes in market conditions during project delivery.

The potential development capacity of a site is ultimately determined by the planning approval. Assumptions made at the acquisition stage also need to be maintained as these established the land value and set the basis for the developer and investor returns.

Reflecting the level of investment and the range of risks highlighted above, financiers require sufficient comfort the development will generate the required revenue and returns.

Significant pre-commitments or pre-sales of residential dwellings to end purchasers (individuals or investors) are required to be achieved before a project goes from planning approval to construction commencement with investor financing depending on a pre-sale hurdle being achieved (typically between 70 – 80 per cent of all dwellings). At this point construction project financing is able to be locked in and construction commence.

Affordable Housing Operational Feasibility

Affordable housing is an appropriate and affordable built form outcome for households that:

- Cannot typically afford market prices and would be/are in housing stress if paying market prices;
- May face other disadvantage in the market;
- May require specialist built form and/or other support services; and
- Would benefit from enhanced security of tenure provided by Affordable Housing managed by government or not-for-profit Housing Agencies.

A Registered Housing Agency as the owner and/or manager of Social Housing is required and regulated to ensure the long-term operational viability of a project and their overall portfolio to ensure the business model is sustainable and the tenure security and affordability of housing for lower income residents is not put at risk.

Funding and financing for Housing Agencies to deliver on their mission has traditionally relied on government grants. Several Registered Housing Agencies, primarily the larger Housing Associations have been able to utilise their balance sheet to secure borrowings and in turn finance new projects. Potential sources of funds and value for an agency to access and leverage to meet capital costs of a project include:

- Rental income (typically below market) unless vacant;
- Borrowings (private finance) – serviced by rental income;
- Taking risk and capturing the developer margin;
- Developing Agency owned land; and
- Revenue through shared equity sales or market sales.

Households cannot pay market prices therefore Housing Agencies cannot achieve the same return hurdles as a private investor. As an example, Table 11 highlights the maximum rent that could be charged for Single Person if a maximum 30 per cent of income is paid in rent depending on their income level.

Income (Single Person)	Maximum Rent (30 per cent income)	Maximum Rental Revenue Received per annum
NewStart	$149 / week	$7,748 per annum
Aged Pension	$201 / week	$10,452 per annum
Very Low Income (P&E Act)	$146 / week	$7,592 per annum
Low Income (P&E Act)	$233 / week	$12,116 per annum
Moderate Income (P&E Act)	$349 / week	$18,148 per annum

Table 11: Maximum rental income for different Single Person Households (December 2018)

Capacity to invest

A Registered Housing Agency will develop an indicative cash flow when assessing a project opportunity to determine the estimated costs and revenue over time. This requires estimates as to all operational costs and revenue. Critical is consideration as to the likely households that dwellings will be rented to and the likely revenue (rent) that can be charged to ensure housing affordability.

The cash flow analysis then supports an Agency to determine:

- Costs and revenue over time and the subsequent estimated return or surplus after costs that could potentially service borrowings (debt);

- The gap between capital costs or purchase price and the agency equity;
- The amount of subsidy or investment, such as government grants require to meet the gap.

A range of assumptions including those summarised in Table 12 are considered.

Assumption	
Revenue	Rent (market rent less discount or estimated income-based rent based on household allocation)
	Government grants or other subsidy provided over time
	Revenue from market sales or other sources such as leases of commercial or retail
Costs	Management Fee
	Maintenance – planned
	Maintenance – responsive
	Rates
	Insurance
	Owners Corporation
	Utilities
	Financing costs (debt)
	Corporate overheads

Table 12: Revenue and Cost Items

Operating costs can range between $8,000 - $11,000 per property per year, comprising of tenancy management, rates, body corporate fees, maintenance and vacancies and corporate overheads is normal.

For example, on a project with a rental revenue of $260 per week ($13,520 per annum), operating costs are estimated to total $9,700 (Figure 5). This leaves approximately $3,800 after costs as surplus.

After costs there is subsequently a very slim and often negligible margin between rents collected and costs, particularly if lower income and single person households are housed. Any positive cash flow return (surplus) could be directed to supporting portfolio operations or a reduction in portfolio borrowings, providing other support services for tenants, contributing to another project or servicing debt on the project. In the example illustrated, up to $3,800 per annum could service a loan.

Any expectation on a Registered Housing Agency to bring investment will result in a different household income profile than if the dwellings are gifted as the Agency requires a greater rental return in order to service debt in the absence of government grants.

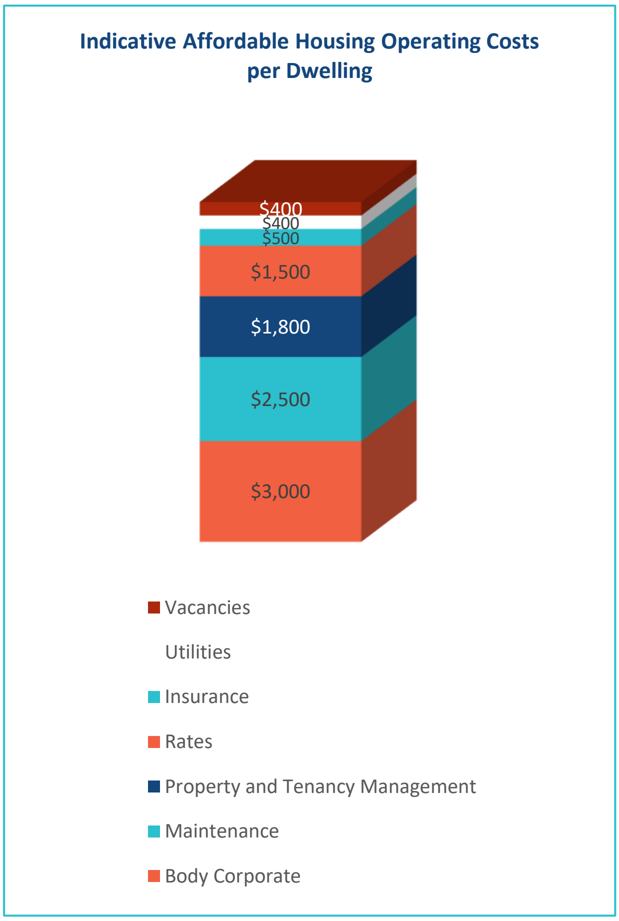


Figure 5: Indicative Affordable Housing operating costs per annum based on a rental revenue of $260 / week

The not-for-profit and below-market nature of Affordable Housing provision requires there to be other investment for a Housing Agency to meet the capital costs of construction, or the capacity to purchase a completed dwelling from a developer.

For example, on a dwelling with a market value of $500,000, a Housing Agency may be able to bring $90,000 in borrowings, $50,000 in GST recovery and up to $110,000 in equity either through already owning the land, being gifted the land or utilising cash reserves.

This still leaves a gap of $250,000 that needs to be met by a developer discount, government grant or philanthropic donation (Figure 6).

A developer discount of 50 per cent of market value would be required if there was no other government funding expected or available. The contribution of the Housing Agency may also be more or less depending on the size of the dwelling and the Agency determination as to which household it would be likely to allocate it to by size, income and rent setting approach.

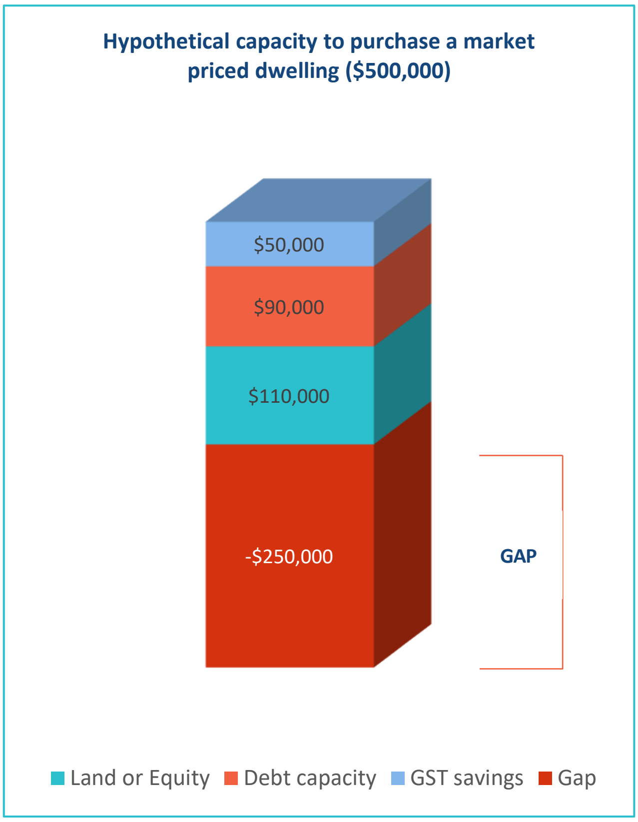


Figure 6: Hypothetical purchasing scenario on a dwelling with a market value of $500,000

Capacity to support Voluntary Planning Negotiations

The State Government guidance highlights that there should be enough value created by the planning process and provision of incentives to support the planning requirement and costs of delivering the outcome to be met.[5]

Affordable Housing inclusions negotiated by a Council should not therefore, in the first instance, depend on a Registered Housing Agency, government grants or other investors to provide investment to supplement or replace a contribution agreed to be made by the developer as a result of the planning support.

In practice, developers are likely to find it difficult to gift any reasonable number of dwellings, particularly in the early years of negotiations and/or where land was recently transacted, and Registered Housing Agencies may have some limited financial capacity to bring investment to support negotiated outcomes.

The State Government policy guidance notes the importance of engaging with Registered Housing Agencies in the negotiation process. Noting the context set out above, this is particularly important when there is an expectation a dwelling will be sold at a discount to an Agency or land provided for an Agency to develop at their own cost.

Restrictions on tenant allocation or use of the dwelling once it is delivered should be avoided, noting that this can significant constrain on the capacity of an Agency to ensure project viability and to secure and service debt and therefore impede on the outcome being achieved. Of note lenders and valuers will mark down the assets as an impaired asset if a Section 173 Agreement requires it to be used 'in perpetuity' as Affordable Housing as it cannot be assumed to be able to be sold at full market value in the event of a mortgage default This will then increase the Loan

[5] Affordable Housing Industry Advisory Group (2018) Masterclass Resource Manual

to Value requirement (lowering the amount an Agency can borrow) and reduce the notional gross realised value of the development which in turn can increase the cost of funds.

Ownership by a Registered Housing Agency provides a high degree of certainty that the housing will be appropriately managed and used as Affordable Housing, noting that Agencies are regulated by the State Government for this purpose.

Use of Section 173 Agreements in relation to voluntary negotiations are therefore strongly recommended to only be limited to the arrangement between the developer and the responsible authority to ensure the agreed outcome is delivered (such as construction and gifting of units or discounted sale).

Part C: Planning Negotiations, Delivery Models and Indicative Feasibility Impacts

Affordable Housing Delivery Arrangements and Program Outcomes

The State Government has not set specific Affordable Housing percentage, program type (such as tenure), delivery arrangement or model that they expect or require outcomes negotiated through a voluntary agreement to be delivered. Nor has the State set an Affordable Housing price point that dwellings could be sold and be affordable either for a Registered Housing Agency or an individual to purchase.

Affordable Housing program outcomes that are highlighted in the State Government guidance that could result from a planning negotiation include:

1. Social Rental - income-based rental housing for very low or low income households;
2. Affordable Rental - discount to market rental housing for low or moderate income households;
3. Shared Equity home ownership – sale to an eligible low to moderate income households with an agreed 'social equity' component provided by the land owner and subsequently managed by a not-for-profit entity, with future sale proceeds on a proportional basis reinvested;
4. Affordable home purchase - sale to an eligible moderate income household at market value if the market value is clearly able to be demonstrated to be affordable for these households without any discounting.

A combination of programs may be agreed to result from a planning negotiation.

There are also variations of some of these programs, with new emerging programs including build-to-rent and rent-to-buy having the potential to include a dedicated Affordable Housing component.

Each model has different cost impacts and dependency (and risks) on third parties to bring investment that influences the quantum of outcomes that could be viably delivered and the likely household allocation and term of affordability.

These program outcomes could be realised through several different delivery arrangements or models that could be agreed under a voluntary planning negotiation. These range from:

- Gifting of completed dwellings;
- Discounted sale of completed dwellings for rental or home purchase arrangements; or
- The transfer of land for development as Affordable Housing.

Long-term lease arrangements with the land owner are also another potential delivery arrangement, however it is not recommended as a first option noting the model requires a specific lease time-frame and the use reverts to private control at the end of the period.

Table 13 sets out these different delivery arrangements with reference to a likely Affordable Housing program outcome and highlights the key financial structure and considerations of each model.

Delivery Model	Overview of the Model	Financial structure and considerations
Gifting of completed dwellings for use as Social or Affordable Rental	• Requires the developer to construct an agreed number of dwellings and transfer the title at no cost to a nominated housing agency. • Highest cost impact for developer which will likely limit the total number of Affordable Housing dwellings that can be achieved. • Provides Council will a greater degree of certainty as to delivery assuming the development proceeds and the gifting arrangement was clearly agreed and is commercially viable. • Subject to operating costs, will result in housing that supports very low and/or low income households to rent at an affordable price, compared to a scenario where debt is required to be serviced and therefore a higher rent is required. • Can result in a baseline delivery arrangement of gifted dwellings, which can then be built on to increase the number of outcomes if the developer instead sold dwellings at a discount, e.g. one gifted dwelling could be instead delivered as two dwellings sold at 50 per cent discount.	• The developer must carry all development and transfer costs which requires sourcing of funds. • Bank financing implications as developer carries all costs for no financial return. • In high end developments a gifting arrangement may still be difficult for a housing agency if rental revenue will not support operating costs (i.e. if high body corporate costs).
Discounted Sale of Dwellings for use as Affordable Rental Housing	• Requires the developer to sell an agreed number of dwellings at a defined discount to the established market value to a registered housing agency. • Estimated to typically require between 40 and 60 per cent discount to market sale price. • Depends on a housing agency bringing equity and having sufficient access to debt finance to support the purchase arrangement. May also require government grants or access to philanthropic funds. • Outcomes are more likely to target low to moderate income households as there needs to be sufficient revenue to service all costs including borrowing costs.	• The developer must carry all development and transfer costs which requires sourcing of funds. • Relies on a housing agency or other investor to purchase which in turn requires bank financing. • Requires a discount rate that an agency can afford and that is still commercially viable. • An agency can claim back GST. • Government funding is not guaranteed but if available would reduce requirement on the housing agency and in turn support a lower income household allocation profile.

Delivery Model	Overview of the Model	Financial structure and considerations
Gifting or discounted sale of land for development as Affordable Housing (rental or purchase)	• Requires the land to be transferred at nil consideration by the developer to a registered housing agency to then develop. • The housing agency would be required to fund the development using equity and borrowings and would most likely require government grants or other philanthropic funds. • The discounted sale model indicates this level of borrowing could be achievable, but the outcomes would not target very low or potentially low income households. • A mix of shared equity sales and discounted rental would support a more feasible model as the sale of dwellings into a shared equity arrangement would lessen risk, improve bankability and also support an improved social mix and integration of households within a building. • The transfer of land model requires some different consideration as to the timing of delivery compared to the gifting or discounting of dwellings as the land transfer needs to occur prior to a third party securing a permit and delivering. • Outcomes likely to include a mix of rental for very low and low income households (particularly if government grants are provided) and potentially purchase options for moderate income households.	• The land owner must either forego revenue or the developer must forego the land value and development opportunity of the land parcel. • The land value is treated as Housing Agency equity and security for any lending. • Requires a housing agency to secure the funding and financing required to construct the built form. This is expected to require access to low cost financing and direct government funding (grants). • An agency can claim back GST and can better manage operating costs, particularly Owners Corporation charges. • If selling some of the completed units under an Affordable Housing program, also requires the Agency to take on development and market risk.
Sale of dwellings to individual purchasers under a Shared Equity Home Purchase Model	• Requires a process of setting an Affordable Housing purchase price and the developer agreeing to forego the difference between the market value and the price a household can afford. • A process of marketing and selling the property to eligible households (determined by income) is required. Households must have capacity to access standard bank financing for the pre-determined amount (for example, 75 per cent of the market value). • On settlement the purchaser will pay (using mortgage funds), the agreed proportion of market value (i.e. 75%) with the difference foregone by the developer and secured through a second mortgage. • On re-sale or refinancing by the purchaser, the social equity provided and secured by the mortgage is repaid (calculated as a proportion of the total market value on sale). These funds can then be reinvested in further shared equity arrangements supporting more households.	• The developer must carry all costs of construction and sale and must forego a percentage of market value – typically 25 – 30 per cent. • A household must have capacity to secure standard bank financing. • Sales fees apply as the not-for-profit agency needs to source and confirm purchaser eligibility.

Delivery Model	Overview of the Model	Financial structure and considerations
Dwellings sold to individuals at Market Value, defined as Affordable Housing	• Sale to individual households at full market value if the price of the dwelling is confirmed to be affordable without discounting. • Must require clear evidence there will be no discounting and that the dwelling will be appropriate in size and affordable to purchase for the assumed purchaser who must earn within the State Government published Affordable Housing income bands. • Likely to require a third-party such as a Housing Agency to undertake a process of verifying the household's income eligibility. • There is no long-term retention of the dwelling as Affordable Housing as there was no subsidy provided. Rather the dwelling is expected to remain relatively more affordable in the market as it was a lower priced product on initial development.	• The developer must carry all construction and sale costs but will receive 100 per cent market revenue on sale. • May require the developer to pay a small fee to a housing agency to conduct the income eligibility testing. • Sale fees apply as the dwelling is sold to the market.
Leasing of dwellings for use as Social or Affordable Rental for an agreed period	• Dwellings are provided into an Affordable (rental) Housing purpose (could be social or affordable rental) for an agreed period of time. • Requires a Housing Agency to be appointed to manage the dwellings and an agreement as to whether there is any rental revenue return to the owner during the lease period. • The Housing Agency is responsible for managing the tenancy allocations and rent setting and meeting some of the costs. • Full control reverts back to the owner at the end of the lease term and the dwellings may then be sold or rented at full market value.	• The developer must carry all construction costs and the developer will not receive any revenue until the dwellings are sold at the end of the lease term, or if the dwellings are on-sold to an investor who must meet the Affordable Housing leasing requirements. • The owner will not receive market rent during the lease terms and is expected to have to meet all typical investor/owner costs such as Body Corporate fees. • A tenancy management fee is payable to the Housing Agency.

Table 13: Overview of models and fiancing considerations

Affordable Housing Funding and Cost Implications

The cost of delivering an Affordable Housing inclusion that has been agreed to be delivered through the planning process ultimately needs to be met if an outcome is to be realised.

Whilst the cost is expected in the first instance to be met by the developer as a result of a planning incentive or value uplift provided through the planning process, the level of investment (subsidy) the developer can support is ultimately dependent on the value created, either through the rezoning and the resultant development occurring, or through provision of other value-enhancing incentives.

The investment could either deliver the total agreed Affordable Housing component or be leveraged with other investment by a third-party such as the Government, a registered housing agency and/or a private investor or individual purchaser.

In practice, agreements reached to date have relied on other investment being available to support the arrangement.

Ways in which the costs may be met include:

- Council provision of incentives to offset the loss of revenue (e.g. value uplift and sharing through provision of additional density);
- Developer meeting the costs of either land, or land and construction costs, and foregoing part of their development return through a gifting or discounted sale arrangement for land or dwellings;
- Government investment through the provision of grant funding typically to a registered housing agency;
- A third-party such as a Registered Housing Agency bringing equity and/or debt to support a discounted sale or development of land;
- Individual purchasers bringing debt through mortgage financing and equity through a deposit under a shared equity or market sale arrangement; or
- A combination of the above.

In theory, costs should also be reflected in the land value when the land is sold from one party to another, but this requires a more certain inclusionary requirement to be put in place by the State Government.

Of note:

- Each delivery model has a different cost impact on the developer with gifting of completed dwellings the highest cost and sale to purchasers at market value the lowest cost impact;
- A discounted sale arrangement where a Housing Agency purchases using equity, debt and/or grant funding, is a co-investment approach with the developer foregoing part of their return, which is expected to be offset by a planning incentive;
- It is critical that the cost of delivering Affordable Housing does not result in the costs being passed on and borne by purchasers of the market dwellings through increased sale pricing that ensures the developer margin continues to be achieved for the overall project;
- If the costs are too high the developer will not be able to sell in a competitive market where other land owners do not have the same obligation and as a result, the development may not proceed.

The way a financier views different models is also critical and takes into consideration cost and revenue assumptions and risks.

Variables

There are a number of key variables that can impact on the amount and type of Affordable Housing that can be feasibly achieved that are important to consider in a planning negotiation. These have direct financial implications and include:

- The value that is being provided through the planning approval process or other mechanisms or incentives that the developer can access through the planning process;

- The location, land values and built form typology and size and development costs;
- Any proposed tenant targeting and allocation requirements including any requirements on rent setting put in place as a condition of government funding, and the subsequent impact this can have on a third party's capacity to raise finance or contribute equity to meet delivery costs;
- The level and type of investment that may be provided by different parties to an agreement and any conditions on this investment such as tenant allocation requirement (see below);
- End ownership and management arrangements
- Proposed affordability term.

These variables in relation to the different delivery models and program outcomes are highlighted in Figure 7.

Model	Gifted completed dwellings	Gifted land	Dwellings or land sold at a discount	Dwellings sold under shared equity arrangement	Dwellings sold to eligible households (no subsidy)
Cost impact	Highest cost impact (100% market value)	Low to moderate cost impact (estimated 15% - 40% of market value depending on site)	Moderate cost impact (estimated 20% - 50% discount depending on market value)	Moderate cost impact (between 20% - 30% of market value)	Very minimal cost impact as no discount to market rent
Delivery certainty	High level of certainty as to delivery	Moderate level of uncertainty as dependent on third party capacity and financing	Some level of uncertainty depending on funding required and whether dependent on other investment	Subject to contribution, low level of uncertainty as individual's purchasing (no dependency on NFP)	Very low level of uncertainty as to delivery
Third-party dependency	Does not depend on third party capital or capacity to develop	Depends on third party capital and capacity to develop	Dependency on third party capital is subject to discount rate	Depends on individuals securing bank finance for 70 – 75% market value	Depends on individuals securing finance for 100% of market value (less deposit)
Likely household allocation & tenure	Very low or low income households for rent	Very low, low or moderate income households for rent and/or shared equity	Low or moderate income households for rent	Moderate income household to purchase	Moderate income households to purchase
Likely quantum of dwellings	Smaller number of dwellings	Potential for moderate to high number of dwellings subject to development site & funding structure	Low to moderate number of dwellings required depending on discount	Low to moderate number of dwellings depending on shared equity contribution required	Potential for moderate to high number of dwellings depending on market values
Affordability Term	Long-term	Long-term for rental, medium to long term for ownership (proceeds reinvested)	Medium to long term depending on owner	Medium term for individual units but long term as future proportion of sale proceeds are reinvested	Long-term relative affordability (no ongoing control or resale requirements as no subsidy)

Figure 7: Example delivery models and key considerations, Affordable Development Outcomes, 2019

Indicative Cost Impacts

An estimate as to the indicative cost and foregone opportunity cost of including Affordable Housing in a hypothetical development of 100 units highlights the potential significant financial impact of including Affordable Housing at different percentages.[6]

The example assumes an average market value of $580,000 which was the median price of a unit in the City of Yarra in 2017.[7]

Estimated Cost Impact

The cost impact is the estimated cost of construction a dwelling, including land and financing costs. It excludes the profit margin that the developer would otherwise expect to realise.

Table 14 highlights the indicative cost impact of different Affordable Housing delivery models on a development of 100 dwellings, assuming a medium apartment price of $580,000, a construction cost (including land at full market value and all marketing and sales costs) of $470,000, or $430,000 if sales costs are not paid in the case of gifting.

Percentage Affordable Housing	1%	2%	3%	4%	5%	10%
Number Affordable Housing	1	2	3	4	5	10
Gifted land	$41,760	$83,520	$125,280	$167,040	$208,800	$417,600
Dwellings sold into shared equity (30% contribution)	$64,000	$128,000	$192,000	$256,000	$320,000	$640,000
Dwellings sold at a 40% discount	$122,000	$244,000	$366,000	$488,000	$610,000	$1,220,000
Dwellings sold at a 50% discount	$180,000	$360,000	$540,000	$720,000	$900,000	$1,800,000
Gifted completed dwelling	$430,000	$860,000	$1,290,000	$1,720,000	$2,150,000	$4,300,000

Table 14: Indicative cost impact of different delivery models at varying percentage rates[8]

In summary, whilst indicative, the estimated cost impact, assuming a medium dwelling price of $580,000, ranges from:

- Approximately $42,000 per dwelling if the land is provided at its estimated cost price;[9]
- $64,000 if one dwelling is sold into a shared equity arrangement with the developer delivering the dwelling but only receiving 70 per cent of market value in return, increasing to $640,000 if ten dwellings were sold in this way;
- Between $122,000 and $180,000 per dwelling if dwellings are sold at a 40 – 50 per cent discount to a registered housing agency, increasing to between $1.22 m to $1.8 m if ten dwellings were sold at these discount rates;

[6] Note, a detailed project feasibility has not been undertaken with the cost impacts will vary considerably across projects and once a range of other feasibility assumptions are accounted for. This advice should therefore be taken as indicative only for the purposes of illustration.
[7] Median apartment price, City of Yarra, 2017 was $582,000, Source: Valuer General Victoria Guide to Property Values 2017 (published 2018)
[8] Estimated cost based on 100 dwellings with a market value of $580,000 and cost of $480,000 including sales and marketing for discounted sales arrangements but not on gifting.
[9] Note land value on purchase is lower than the estimated value of land once a site is developed.

- $430,000 per dwelling if a dwelling is constructed and gifted (assuming no sales and marketing costs), increasing to an estimated $4.3 m if gifting ten completed dwellings.

Estimated Foregone Opportunity Cost

Whilst the developer bears the costs of delivery as indicated above, the overall feasibility impact can be higher as the developer is not able to realise the profit margin on the dwellings that are gifted or sold at a discount and therefore the return either needs to be lowered or carried by the rest of the development in order meet financing and investment hurdles and returns. This is referred to as the 'foregone opportunity cost'.

The estimated foregone opportunity cost of different Affordable Housing delivery models based on a development yield of 100 units and a medium apartment price of $580,000 is summarised in Table 15.

Percentage Affordable Housing	1%	2%	3%	4%	5%	10%
Number Affordable Housing	1	2	3	4	5	10
Gifted land	$104,400	$208,800	$313,200	$417,600	$522,000	$1,044,000
Dwellings sold into shared equity (30% contribution)	$174,000	$348,000	$522,000	$696,000	$870,000	$1,740,000
Dwellings sold at a 40% discount	$232,000	$464,000	$696,000	$417,600	$1,160,000	$2,320,000
Dwellings sold at a 50% discount	$290,000	$580,000	$870,000	$1,160,000	$1,450,000	$2,900,000
Gifted completed dwelling	$580,000	$1,160,000	$1,740,000	$2,320,000	$2,900,000	$5,800,000

Table 15: Indicative foregone opportunity cost impact of different delivery models at varying percentage rates (based on 100 dwellings and a market price of $580,000)

Whilst indicative, this highlights a potential estimated foregone profit could range from:

- $104,400 if the land is provided for one dwelling, increasing to $1.04 m if land is provided to enable development of 10 dwellings;
- $174,000 if one dwelling is sold into a shared equity arrangement with the developer delivering the dwelling but only receiving 70 per cent of market value in return, increasing to $1.74 m if ten dwellings were sold in this way;
- Between $232,000 and $290,000 per dwelling if dwellings are sold at a 40 – 50 per cent discount to a registered housing agency, increasing to between $2.32 - $2.9 m if ten dwellings were sold at these discount rates;
- $580,000 per dwelling if a dwelling is constructed and gifted, increasing to an estimated $5.8 m if gifting ten completed dwellings.

Noting the City of Yarra has a policy position to achieve 10 per cent Affordable Housing through negotiations on strategic sites and that a land contribution is unlikely to be realistic in this scenario, the cost and foregone opportunity cost impacts on a development of 100 apartment type units with an average market value of $580,000 is estimated to range from:

- $640,000 being the cost of selling ten dwellings to purchasers under a shared equity arrangement;
- $5.8 m (foregone opportunity cost if gifting 10 dwellings).

These cost impacts need to be carefully considered when determining an appropriate delivery model and percentage outcome under a negotiation, with particular regards to the value uplift or provision of incentives to support the outcome.

Value Creation Opportunities

The State Government guidance emphasises the importance of there being sufficient value available as a result of the planning process, or provision of other incentives to offset or support the costs of Affordable Housing being met.

Examples of other planning based value uplift opportunities that are identified in the State guidance that the Council could pursue include:

- Floor area uplift or other additional development rights;
- Dispensations for planning requirements such as car-parking; and/or
- A truncated planning approval process.

Rate exemptions or other supports for community housing organisations are also noted by the State Government, and although these are not technically a planning incentive they could be linked to a specific development by the Council. At between $1,000 - $2,500 per dwelling per annum, this represents a significant cost that must otherwise be met from the rental revenue.

A discussion on the key opportunities and potential value share outcomes in terms of Affordable Housing is summarised below. This is an area that the Council could undertake further analysis and consideration, recognising there are a range of trade-offs and considerations associated with each option.

Value creation through rezoning

The rezoning of land is noted to be one value uplift and share opportunity, with some caution that the actual increase in value and the capacity for this value to be shared a vexed question and area that is difficult to quantify.

There is contention as to whether a rezoning justifies an Affordable Housing inclusion as planning decisions that result in a change in use is considered by large parts of the development industry to be normal market practice as opposed to a process that provides additional value that wouldn't otherwise be realised.[10]

In practice, several Councils and in some instances land owners, have agreed in principle that a rezoning or application of revised and improved planning control can support an Affordable Housing inclusion.

It is outside the scope of this report to model the estimated value uplift that may occur as a result of a rezoning, with every rezoning a complex and site-specific process of determining feasibility.

Of note, any proposed uplift value from the process of rezoning is expected to have already been partly capitalised within land sales over time as the market makes assumptions as to the the potential highest and best use of the land when determining the price they will pay for the land.

Several other development considerations including environmental overlay costs and costs of delivering other desired community infrastructure outcomes also impact on development feasibility and make any generalisation difficult. What is reasonable and feasible in terms of a cost impact on the land owner, is ultimately going to be determined by each land owner, taking in to regards a range of factors. This is going to depend in large part on what the new planning

[10] Affordable Housing Industry Advisory Group (2017) Discussion Paper

controls will allow for and how this relates to assumptions made at the purchase stage in relation to cost and revenue assumptions.

Value generated by the planning rezoning and approval process is therefore very difficult to assess, particularly as land prices will have adjusted over time to account for expected eventual changes in the land use. This is expected to be the case for the sites identified as strategic as they are often recognised by Councils as areas of future change considerably before any rezoning is considered. The Yarra Council policy statement is intended to go some way in supporting developers to early identify sites where an Affordable Housing inclusion will potentially apply and therefore should be reflected in land value. For this to work in practice there must be:

- Sufficient notice and clear guidance as to the required delivery model that enables the developer to factor the costs in to the land acquisition feasibility;
- A willing land owner prepared to sell at a reduced market value to account for the Affordable Housing requirement;
- Clear agreement with the land owner at the time of the planning application, reflecting that the outcome must still be achieved through voluntary negotiation.

Floor Area Uplift ('density bonus')

The application of floor area uplift arrangements requires a range of policy considerations. From a development feasibility perspective, floor area uplift:

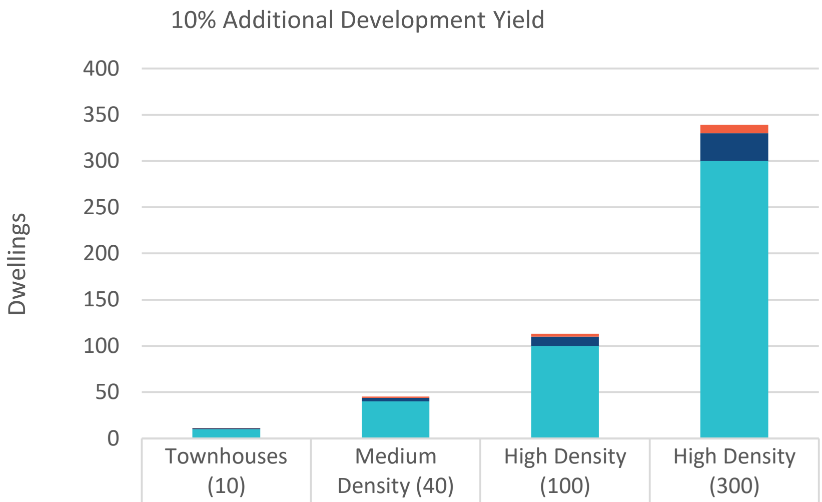
- Provides the developer with enhanced development opportunity through the ability to sell more market priced units;
- Needs to be considered in relation to market demand and sales rate absorption estimates. Too much additional yield may not be profitable if it cannot be sold;
- The additional costs of delivering additional yield, particularly if it takes a development from medium to high density;
- The number of dwellings that would be required to be provided as Affordable Housing and whether the value of the additional units sufficiently offsets and incentives the outcome;
- Whether there is a clear floor area ratio and uplift arrangement in place with a methodology for calculating the Affordable Housing requirement prior to land acquisition, or if it is less defined and there is a position that heights above preferred heights are already reasonable from an urban design perspective (i.e. is there actual additional value being offered?).

Floor Area Ratios and Floor Area Uplift arrangements are in place in the central Melbourne CBD and the Fisherman Bend Urban Renewal Area. In the later, an additional nine dwellings above a defined Floor Area Ratio is allowed on the basis one dwelling is built and gifted into a Social Housing purpose.

The Affordable Housing Industry Advisory Group undertook modelling in 2017 that highlighted potential Affordable Housing outcomes on different hypothetical development scenarios with either a 10 per cent (Figure 8) or 20 per cent (Figure 9) uplift in market dwelling yield.

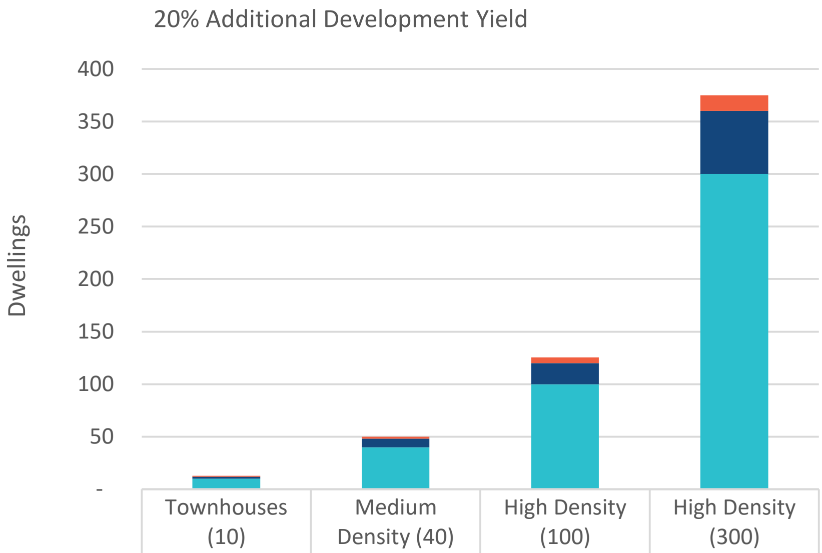
These scenarios highlight the potential for:

- Gifting of three Affordable Housing dwellings (representing 3.5 per cent of total end yield) on a development of 100 units if an additional 13 dwellings could be built; or
- Gifting of 5 – 6 dwellings (4.3 per cent of total end yield) on a development of 100 units if an additional 25 – 26 dwellings could be built.



	Townhouses (10)	Medium Density (40)	High Density (100)	High Density (300)
Total	11.4	45.2	113.3	339.1
Affordable (Benefit)	0.4	1.2	3.3	9.1
"Bonus" Private	1	4	10	30
Base Private	10	40	100	300

Figure 8: Hypothetical Floor Area Uplift and potential share in Affordable Housing (10% additional market units)



	Townhouses (10)	Medium Density (40)	High Density (100)	High Density (300)
Total	12.9	50.0	125.4	374.9
Affordable (Benefit)	0.9	2.0	5.4	14.9
"Bonus" Private	2	8	20	60
Base Private	10	40	100	300

Figure 9: Hypothetical Floor Area Uplift and potential share in Affordable Housing (20% additional market units)

Attachment 1- Key cost assumptions and impact

Stage	Purpose	Key Cost Assumptions	Cost and / or Revenue impact	Typical Funding Source(s)
Due Diligence	Determine development potential and establish land value	Costs to undertake sufficient investigation to determine purchase price which may include consultant charges or internal business costs	Cost depends on level of due diligence. Can entail environmental studies, preliminary planning assessment and yield study, market analysis	Land purchaser equity
Land Acquisition and Holding	Purchase of land Holding of land during development stage	Estimated land value Rates Insurance	Deposit followed by full settlement. Associated costs include taxes and potentially costs of finance Depending on the size of the site and location, the cost impact can be significant.	Land purchaser equity which may be combined with bank financing and/or or other investor financing
Planning	Secure planning approval	Consultants Planning lodgement fees Approval process (time) Appeal costs	Costs can be between $200,000 and $2 m depending on the project size. Typically, costs are incurred for architectural services, environmental due diligence, planning advice and preparation of the planning application, and a range of other consultancies such as traffic, civils and engineering, landscaping, etc. Significant costs may also be incurred if the planning application is required to be presented to Planning Panels as the land owner typically engages legal advisers for this process	Land owner or investor equity

Stage	Purpose	Key Cost Assumptions	Cost and / or Revenue impact	Typical Funding Source(s)
Construction	Secure investor or bank financing to enable development to proceed	Valuation – for financing Demolition, remediation, environmental audit and other site works to enable development to proceed Cost to construct (type of construction, labour changes, materials, labour, time to deliver) ESD requirements Other infrastructure contributions in-kind, such as open space Taxes including Land Tax, Stamp Duty, Council rates, GST, Infrastructure charges, Developer contributions Contingency	Significant cost stage (generally 60% - 80 % of total development value, particularly on larger sites and where site remediation is required	Majority of funding is debt secured from bank financing or other investors Developer equity
Settlement	Support legally binding purchase and sale arrangements and potentially planning agreements	Costs to develop and execute contractual documents (land acquisition, planning agreements and sale of units)	Typically, around 2 – 3 % of market value of a unit	Revenue from sales (private individuals)