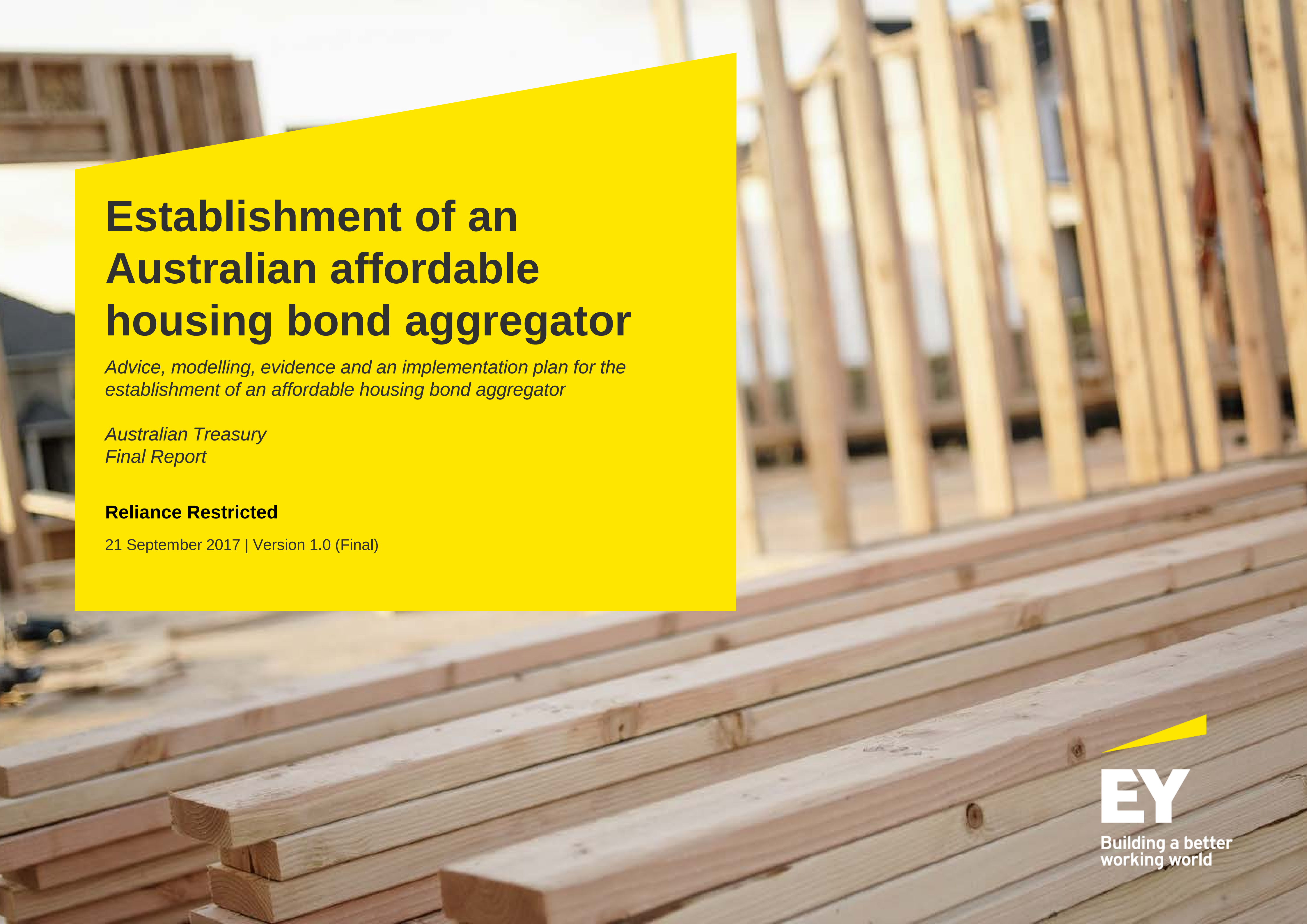


Establishment of an Australian affordable housing bond aggregator

Advice, modelling, evidence and an implementation plan for the establishment of an affordable housing bond aggregator

Australian Treasury
Final Report

Reliance Restricted

21 September 2017 | Version 1.0 (Final)

Building a better working world

EY Canberra
121 Marcus Clarke St
Canberra ACT 2601

Tel: +61 2 6267 3888
Fax: +61 2 6246 1500
ey.com/au

Reliance Restricted

The Commonwealth of Australia as represented by the Department of the Treasury
Langton Crescent
Parkes ACT 2600

21 September 2017

FINAL REPORT: Advice, modelling, evidence and an implementation plan for the establishment of an affordable housing bond aggregator.

In accordance with the Engagement Agreement between Ernst & Young ("we" or EY) and the Commonwealth of Australia Department of the Treasury ("you" or Treasury) dated 10 March 2017, Official Order number 000642 commencing 14 March 2017 and accompanying Deed of Variation dated 18 May 2017, we have prepared this report in relation to our advice regarding the affordable housing bond aggregator (the BA).

The result of EY's work, including the assumptions and qualifications made in preparing the report, are set out in EY's report dated 21 September 2017. The report should be read in its entirety including the transmittal letter, the applicable scope of work and any limitations. A reference to the report includes any part of the report. No further work has been undertaken by EY since the date of the report to update it. The report was initially issued in draft on 11 August 2017, and in finalising the report, we have not reviewed or performed any analysis subsequent to that date.

Purpose of our report and restrictions on its use

This report was prepared on your instructions solely for the purpose of advising Treasury on specific financial advisory services in relation to the BA. EY has prepared the report for the benefit of Treasury and has considered only the interests of Treasury. EY has not been engaged to act, and has not acted, as advisor to any other party. Accordingly, EY makes no representations as to the appropriateness, accuracy or completeness of the Report for any other party's purposes.

Our report may not have considered issues relevant to any third parties. Any use such third parties may choose to make of our report is entirely at their own risk and we shall have no responsibility whatsoever in relation to any such use. This report should not be provided to any third parties without our prior approval and without them recognising in writing that we assume no responsibility or liability whatsoever to them in respect of the contents of our deliverables.

No reliance may be placed upon the report or any of its contents by any recipient of the report for any purpose and any party receiving a copy of the report must make and rely on their own enquiries in relation to the issues to which the report relates, the contents of the report and all matters arising from or relating to or in any way connected with the report or its contents.

EY disclaims all responsibility to any other party for any loss or liability that the other party may suffer or incur arising from or relating to or in any way connected with the contents of this report, the provision of this report to the other party or reliance upon this report by the other party.

No claim or demand or any actions or proceedings may be brought against EY arising from or connected with the contents of the report or the provision of the report to any party. EY will be released and forever discharged from any such claims, demands, actions or proceedings.

EY has consented to the report being published electronically on the Treasury website for informational purposes only. EY has not consented to distribution or disclosure beyond this. The material contained in the report, including the EY logo, is copyright and copyright in the report itself vests in EY. The report, including the EY logo, cannot be altered without prior written permission from EY.

EY Canberra
121 Marcus Clarke St
Canberra ACT 2601

Tel: +61 2 6267 3888
Fax: +61 2 6246 1500
ey.com/au

Reliance Restricted

The Commonwealth of Australia as represented by the Department of the Treasury
Langton Crescent
Parkes ACT 2600

21 September 2017

FINAL REPORT: Advice, modelling, evidence and an implementation plan for the establishment of an affordable housing bond aggregator.

Scope of our work

Our work in connection with this assignment is of a different nature to that of an audit. Our report to you is based on inquiries of, and discussions with management. We have not sought to verify the accuracy of the data or the information and explanations provided by management. Our work has been limited in scope and time and we stress that a more detailed review may reveal material issues that this report has not.

We further note that our scope was required to build on, and not replicate or challenge, previous work undertaken by Treasury. It has therefore not considered alternative financing or funding solutions, but seeks to support the role of Treasury to determine the design features and an implementation plan of the proof of concept for a national affordable housing Bond Aggregator.

Assumptions and Limitations

In preparing this work, we have relied on the following information sources:

- Written and verbal guidance provided to us by Treasury and its advisors
- Publicly available information including Community Housing Provider (CHP) annual reports and financial statements; the national provider register maintained by the National Regulatory System for Community Housing (NRSCH); and Australian State and Territory Governments (States) regulatory documents
- The credit rating methodologies of Moody's and Standard & Poor's (S&P)
- Data from the Debt and Finance Requirement Survey (the Survey) undertaken as at 2 June 2017

Our report does not constitute an audit in accordance with Australian Auditing Standards, and we note the following assumptions and limitations when undertaking this work:

- We have not carried out a review or audit of any information provided to us by Treasury, nor independently verified or assessed information presented to us by other parties, including data provided in response to the Survey
- No formal legal, accounting or taxation advice has been provided at this time
- It should be noted that data constraints exist regarding the CHP sector that may hinder the accuracy of our analysis. On that basis, the CHP shadow credit rating analysis has been limited to 48 CHPs comprising Tier 1 and Tier 2 providers on the basis of publicly available data and time available, as agreed with Treasury
- No adjustments were made to any financial statements. Ratios have been calculated on the full number contained within the information provided. We note that past performance is not indicative of future performance
- We have relied on representations made by banking officials in market sounding interviews, which may not represent the views of the market at the time of any transaction

Building a better working world

EY Canberra
121 Marcus Clarke St
Canberra ACT 2601

Tel: +61 2 6267 3888
Fax: +61 2 6246 1500
ey.com/au

Reliance Restricted

The Commonwealth of Australia as represented by the Department of the Treasury
Langton Crescent
Parkes ACT 2600

21 September 2017

FINAL REPORT: Advice, modelling, evidence and an implementation plan for the establishment of an affordable housing bond aggregator.

Scope of our work

- In conducting our analysis, we have assumed that no fundamental future changes to Commonwealth Rental Assistance (CRA) and the distribution of the National Affordable Housing Agreement (NAHA) / National Housing and Homelessness Agreement (NHHA) funding to the States are applicable to the BA, as instructed by Treasury. We understand that Treasury is undertaking other work in regards to housing reform, of which we have had no sight
- We have assumed that the BA is not required to obtain a Financial Services License or obtain Australian Prudential Regulation Authority (APRA) registration as it is not a deposit taking institution, nor is it making loans to individuals. It is understood that Treasury will legal advice on this matter, which is outside of our scope

If you would like to clarify any aspect of this review or discuss other related matters then please do not hesitate to contact.

Yours sincerely

Sarah Phillips
Partner

Jason Lowe
Partner

Report Structure

Table of contents.

Report Structure

Chapter overview and reconciliation to scope of work.

This report is structured in a Treasury agreed format that combines the analysis and modelling undertaken within the six original work streams into five distinct chapters for the purpose of presentation. The revised structure reflects the iterative nature of the analysis undertaken and the interdependencies between the workstreams.

Chapter 1 is a standalone executive summary setting out the key findings and recommendations for the BA to meet the feasibility study objectives. Chapter 2 combines two of the complementary work streams on borrower viability and consequent ability to support a BA. Chapter 2 therefore establishes if there is indeed a financing gap and the issues surrounding it. This analysis feeds into consideration for where Government could provide assistance in Chapter 3. Chapter 4 builds the potential assistance measures into the entity structure. It also provides an overview of the aggregation and issuance processes - including the analysis under work stream 3 where we analysed the types of bonds to be issued by the BA (and by definition roles, process, resources and therefore costs involved). Chapter 5 then takes this structure and overlays a Proof of Concept (PoC) by quantifying the likely benefits. It concludes by setting out the timeline required to achieve a capital markets issuance by the end of 2018.

The chapters are aligned to the workstreams as summarised in the diagram below.

Content outline

Chapter 1
Executive Summary – Key Findings and Recommendations

Chapter 2
CHP Sector Viability and Capacity

Chapter 3
Government Assistance

Chapter 4
Entity Structure

Chapter 5
Proof of Concept & Implementation Plan

Scope of Work (SoW)

"Detailed advice, modelling and evidence to support Government decision making about the potential implementation of an affordable housing bond aggregator…Treasury also requires the successful service provider to outline their preferred option for the structure of a housing bond aggregator, citing the relevant benefits and potential shortcomings associated with their proposed approach"

Original SoW Work streams

1. The ability of the affordable housing sector to sustain an affordable housing bond aggregator

4. Financial viability of affordable housing providers to sustain a bond issuance program

Original SoW Work stream

5.Government Assistance

Original SoW Work streams

2. Structure of an affordable housing bond aggregator

3. Type of bond/s to be issued by the aggregator

Original SoW Work stream

6. Proof of concept and implementation plan

1

Executive Summary

Key Findings

1 Executive Summary

A Bond Aggregator is a feasible policy option to enhance the Community Housing sector's capacity, delivering a number of qualitative and quantitative benefits.

Key findings

- Internationally, Community Housing Providers (CHPs) are able to access long term finance via capital markets. In Australia, the Community Housing sector has yet to access this capital source, instead relying on shorter term bank debt (typically 3-5 years). Longer term capital markets finance can lower interest costs and better match the sector's asset life – a core principle of good corporate finance practice – and can therefore make a meaningful contribution to the Australian sector's growth in scale and sophistication
- The CHP sector's ability to access to the Australian Corporate Bond market is negligible compared to international comparators. Whilst the sector can expect to obtain similar pricing benefits via capital markets funding, the tenor obtained in markets such as the UK are uncommon in Australia at this time
- Our analysis demonstrates that the Australian Community Housing sector could benefit from the creation of a bond aggregator (BA), set up with a pass-through structure with borrower funding requirements equally matched to funding sourced from the debt capital markets (DCM) with a standardized product to reduce complexity and enhance transparency. This approach has proven to be effective across comparable structures including international precedents such as the UK
- A key benefit of a BA is that it could deliver longer tenor finance at a lower cost. We estimate the savings to be indicative and in the order of 1.4% p.a. for 10 year debt, depending on the final structure and provision of a Government guarantee. Our analysis shows that there is sufficient sector debt (~$1bn) to supply market demand, and that the higher Tier CHPs in Australia exhibit strong - but debt constrained - financial metrics
- The BA will not solve the sector's primary concern – the funding gap and level of Government intervention required to make projects commercially viable – as the BA is not intended to loan to ventures or entities that cannot meet its credit requirements. The drivers of the funding gap and other sector challenges are detailed within the report but may be summarised as a function of a low margin, regulated business model largely dependent on Government intervention. Options to address the funding gap are being further considered by the Affordable Housing Working Group (AHWG) and were not part of this scope of work. The BA will however, enhance the sectors commercial viability by providing more efficient debt finance, and other qualitative benefits as listed on page 12
- The role of Government intervention and support internationally varies. In some specific instances and countries, Government guarantees facilities. In others, no guarantee is provided. In the case of the latter, a BA's strong credit rating can be a function of robust and strict lending criteria which may actually be uncompetitive when compared to current bank loan covenant requirements
- A standalone BA is therefore considered unlikely to be successful because the need to maintain an investment grade credit standing would result in onerous credit policies which may disincentivise borrower (CHP) participation
- There are different regulators and sector regulatory complexities in regards to the perfection of security interests that are ambiguous and need resolution to successfully deliver a BA that meets the stated objectives. A nationally consistent framework - in application and intent - that enables an appropriate framework for the management of lenders' security interests is required. National CHP governance and financial deregulation also needs to be applied consistently across State and Territory jurisdictions to provide Investor confidence that the regulatory safety-value is functional. Government support therefore has to bridge the gap between capital markets requirements, the standalone creditworthiness and debt needs of CHPs and the unique Australian regulatory and policy environment
- We assess the most efficient route for Government and the sector is the establishment of a BA as part of the to-be-established National Housing Finance and Investment Corporation (NHFIC). On the current timeframe, if the BA is established as part of the NHFIC by 1 July 2018, the BA should be able to issues its inaugural bond by the end of calendar 2018
- Depending on the resolution of policy and regulatory issues on security interests, Government could elect to guarantee the BA to optimise outcomes. The full list of recommendations required to deliver a BA that meets the project objectives is listed overleaf

1 Executive Summary

In concluding that the Community Housing sector is capable of sustaining a Bond Aggregator, and that Government has a role to play in the establishment, we have made eight recommendations.

Recommendations

The table below sets out eight recommendations which, as a result of our analysis, would be required to deliver the project objectives. Due to the interdependencies between report sections, the recommendations below may not be in the order of appearance within the main body of the report.

1	Government should commence work to establish the BA as part of the NHFIC, noting that CHPs are likely to be the primary agents to maintain and expand the stock of affordable housing.
2	The BA should issue wholesale bonds, as opposed to retail bonds, into the Australian DCM. This approach offers cost effectiveness, a deeper market and greater investor demand.
3	The optimal structure for the BA is a pass-through model where borrower funding requirements are equally matched to funding sourced from the DCM. Doing this through a standardised product reduces cost and complexity, and enhances transparency. This approach has proven to be effective internationally.
4	The BA should provide borrowers with general corporate debt finance. The longer tenor provides the immediate benefit of addressing the refinancing risk being faced by the sector in the short to medium term.
5	Government should fund staffing costs and leverage existing expertise in Government to help sustain the BA prior to the entity attaining a critical mass. The BA should develop an investment mandate and credit policies which balance borrower requirements, prudent risk management and regulatory frameworks.
6	Government should work with States and Territories to ensure that the regulation of the community housing sector better supports the activities of the bond aggregator, with specific regard for the way in which regulation applies in the event of a default. Given investors value certainty, consideration should be given to standardising the way in which investors are able to obtain security for the finance provided through the BA.
7	To the extent that questions around security over stock and the procedure in the event of default can be resolved ahead of the implementation of the BA, it may be preferable for Government to not guarantee the BA's issuances. Alternatively, an explicit guarantee would provide greater investor confidence and also deliver an enhanced pricing advantage for CHPs.
8	Government should begin set up activities (such as accounting and legal advice regarding final structure, sector consultation/awareness/education, detail of FTE roles and responsibilities) concurrent with development of BA policies (such as credit policies and approach to sector for expression of interest) to support the proposed July 2018 timetable.

**Compared to bank debt, on a like for like basis for the indicative medium term issuance size.*

1 Executive Summary

A Bond Aggregator can enhance sector viability by lowering debt costs and better matching loan tenor to asset life. These benefits better align the sector's borrowing practices to corporate finance best practice.

Strategic Context

The provision of safe, secure and affordable accommodation is the foundation for a broad range of social and economic outcomes.

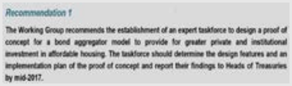
This report analyses the feasibility of a BA in the Australian context, following previous work undertaken by the AHWG.

The BA alone will not address all housing sector challenges. This report therefore needs to be viewed in the context of concurrent AHWG work streams which are considering broader complementary reforms, including those that address sector policy and funding challenges.

Jan 16: AHWG formed and release discussion paper on four potential financing models

AHWG undertake stakeholder consultation and review of submissions

Oct 16: AHWG recommend further development of the bond aggregator model and engage EY


Recommendation 1

The Working Group recommends the establishment of an expert taskforce to design a proof of concept for a bond aggregator model to provide for greater private and institutional investment in affordable housing. The taskforce should determine the design features and an implementation plan of the proof of concept and report their findings to Heads of Treasuries by mid-2017.

Affordable Housing Taskforce (Taskforce) created, and appoint EY to provide services to establish a BA through six work streams. Our methodology is discussed in the Report

1. The ability of the sector to sustain a BA
2. Proposed structure of a BA
3. Type of bond/s to be issued by the BA
4. Financial viability of providers to sustain a bond issuance program
5. Government Assistance
6. Proof of concept & implementation plan

Market Context

Affordable Housing is defined as rental housing provided to lower income or disadvantaged households below market-rate rent. These are households typically in the bottom two income quintiles who do not have the incomes required to support normal market rental returns. In Australia, it is commonly provided as housing that charges a set proportion of a household's income (social housing) and is provided by Governments (public housing) or CHPs. The other main form of affordable housing is housing provided at some discount to the market rental rate, generally 20-25% for households that meet income or key worker criteria in line with rent setting policies and the National Rental Affordability Scheme (NRAS). This type of housing is also generally provided by CHPs.

There are 364 CHPs[1] in Australia as at June 2017 (and a further approximately 600 unregistered CHPs)[2]. Many are not-for-profit (NFP) entities or faith-based organisations with strong mission statements to support vulnerable cohorts facing housing stress. By providing safe and affordable housing, CHPs deliver broader outcomes such as social and economic independence. Many CHPs missions see them work across different housing types - including crisis housing (as illustrated below), Indigenous and disability housing – to support the most vulnerable. Tenant rental receipts, Commonwealth Rent Assistance (CRA) and Government funding are the primary CHP revenue sources.

Without intervention, typically by Government, there is a tendency for the market to fail to deliver adequate supply in this space. Recent studies[3] have identified five key challenges: 1) lack of an integrated national/state housing policy, 2) lack of an industry-wide strategic plan and affordable housing targets, 3) inadequate planning policies supporting developments, 4) the lack of suitable financing opportunities in the current debt market attuned to sector needs and 5) the funding gap between revenue streams available and costs incurred in service delivery.

The BA objectives are to address market challenges and support the delivery of housing to those on low income through:

BA Objective 1

Creation of a sustainable mechanism that facilitates a pipeline of private and institutional investment opportunities into the sector by building scale and a structure to attract domestic and international investors.

BA Objective 2

Simplification of the finance raising process, reducing re-finance risk and interest costs, and in the process enhancing the capacity of the CHP sector through education and Government support during set up and implementation.

BA Objective 3

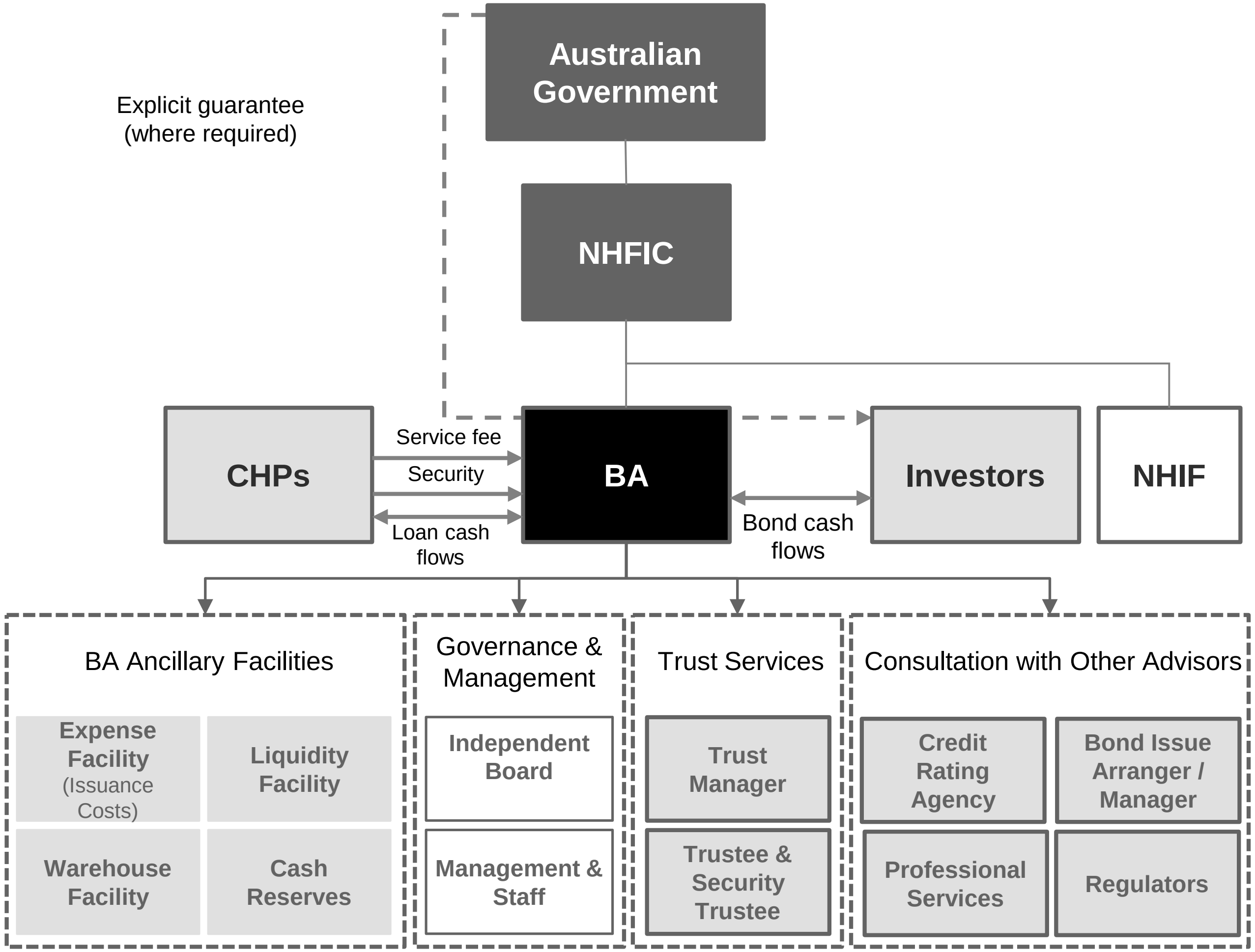
Diversification of financing, opening access to capital sources that reduce price and increase tenor when compared to current debt profiles, in turn better aligning to the asset class and risk profile of the CHP sector.

1 Executive Summary

The proposed BA structure is crafted to the Australian sector context. It balances Capital Market requirements, sector debt needs and meets the three set policy objectives.

The diagram below provides an overview of the BA (preferred option), highlighting key cash flows and relationships with stakeholders.

It is important to note that the BA is not intended to support financing applications that would be unacceptable to an external financier and does not seek to address the funding challenges being faced by the sector at this time.



Key Characteristics

- The BA draws upon international precedents to facilitate the pooling of loans (not securitisation of CHP assets) to generate sufficient scale and achieve optimal pricing and longer tenor through a market parcel size attractive to institutional investors
- CHPs would apply for debt as and when required. Once a marketable pool is aggregated and issued, a fee of approximately 0.2% p.a. is applied to cost recover issuance fees. This is an approximation and is based on an assumption of $400m issuance over 10 years*
- A pass-through structure means that the BA issues bonds and on-lends the proceeds on materially similar terms to CHPs. The provision of an Australian Government guarantee, if offered, seeks to maximise access the wholesale DCM through optimisation of the investor risk profile (refer to page 40 for a comparison of the BA structure with a guarantee vs. without a guarantee)
- The BA may provide additional ancillary facilities that assist with liquidity risk management and financing timing mismatches. Additional training and development services may be provided to further enhance sector capacity
- The governance model is based on either NHFIC Board sub-committee or executive management, with BA staff focussed on relationship management and credit risk and complemented by administrative support from a trust services provider. These roles may be undertaken by existing Australian Government staff to further optimise the cost of delivery and therefore quantitative benefits to borrowers
- The BA operating environment has a broad range of stakeholders including third parties which are required to perform its functions in a robust manner

* See Chapter 5.

1 Executive Summary

Analysis indicates that the BA can provide immediate qualitative and quantitative benefits to the sector and is flexible to adapt to Government and sector priorities in the medium to long term.

BA benefits:

- ✓ Realises direct financial benefits principally in the form of cheaper funding. Our analysis suggests that CHP's could achieve pricing benefits of up to 1.4% p.a. based on a like for like comparison with the bank market
- ✓ Longer tenor reduces refinancing risk and is more aligned to corporate financing principles of matching asset and liability tenors
- ✓ Diversification of funding sources, providing access to the DCM
- ✓ Efficient fund raising platform which should drive efficiency in procuring financing and best practice through standardised documentation and processes
- ✓ Reduces amortisation requirements, improving ongoing cash flows and allowing reinvestment into existing or future projects
- ✓ Improves access to bank funding for developments/construction (project risk profile) given confidence by the bank market given refinance options / certainty of repayment
- ✓ Encourages institutional wholesale investment into the sector. Additional market issuances may enhance the Australian bond market
- ✓ Utilises existing Government skill sets and capabilities to create a robust and accountable structure that is streamlined and efficient during set up and operations
- ✓ Builds on the existing regulatory environment to optimise attractiveness in the market
- ✓ Accounts for experiences from international initiatives, refined for the unique Australian environment
- ✓ Is a flexible model that is scalable and adaptable to changes in future policy priorities

Capturing BA benefits: a likely timeframe

- The CHP sector is estimated to realise the benefits of the BA's activities in a staged process over the next four to five years
- Tier 1 and 2 CHPs who meet credit metrics and have sufficient debt to contribute to a DCM issuance predicted to be the first beneficiaries. They can expect savings of approximately 1.4% p.a. (compared to bank debt, on a like for like basis, for a 10 year tenor and the indicative medium term issuance size) in interest costs and reduced refinance risk as it should effectively underwrite their debt obligations and refinance risk
- Savings at the Tier 3 level are likely to be higher (due to their prima facie higher funding costs) but the ability to aggregate their debt is more complex given the lower value and outstanding issue of the BA perfecting its security interests. The realisation of benefits here is subject to inter-Governmental agreement and likely revised BA credit policies
- Complementary business accelerator services may be offered by the BA to assist to drive further sector growth. In addition, the BA may be utilised in conjunction with a broader housing package to drive sector expansion with the confidence that the benefits of financial efficiency should ensure an effective outcome
- Overall, the BA's role in the sector should contribute to broader spill overs and positive transformation. Key benefits here include: providing construction finance take outs thereby de-risking projects from a bank's perspective and enhancing bank appetite for construction finance and educating and enhancing the sector on optimum capital management practices to contribute to supply. Other benefits are set out on page 12

1 Executive Summary

The BA's development is not without risk but these key risks can be effectively managed during implementation.

CHP Default

The Australian Government (in the event of a BA guarantee) may incur liabilities associated with any CHP loan default if an acceptable resolution can't be achieved via negotiations with the CHP and the State to restructure the CHP / loan.

Risk mitigants to reduce the likelihood of the Australian Government guarantee being called includes prudent BA credit policies, oversight and monitoring and a resolution period where the BA can negotiate with the CHP and the States in the same way as a bank currently would in the event of CHP loan default. In addition, the Australian Government should focus on the resolution of regulatory issues relating to perfection of security via negotiation with the States (either upfront or over time).

Resolution of Regulatory Issues

A nationally consistent approach to maximising its security interests over CHP properties is not achieved. Consequences include greater risk borne by the Australian Government in absence of acceptable security arrangements or reduced credit appetite at lower Tier 2 and Tier 3 CHP sector segments. A nationally consistent governance and regulatory framework assists Investor confidence.

International precedents (such as the THFC) have stringent security requirements to secure their loan book and achieve a ratings outcome. The Australian Government guarantee reduces the requirement for this but the BA's position – and good commercial practice – hinges on prudent lending and capital management practices. Australian Government can carry the risk for a period but national consistency is required. Furthermore, regulation is important for investors and rating agencies in providing assurances as to CHPs' credit quality.

CHP Participation

The BA may not be able to achieve an indicative market share of 30-50% in the medium term due to lack of willingness of CHPs to participate in the BA or the BA loan product not being in line with specific CHP borrowing requirements. In particular due to the lack of flexibility owing to standardised terms and conditions and a conflict between price and tenor.

The BA structure has been proposed based on an assessment of CHP borrowing practices and feedback from the Survey. Education, marketing and ongoing engagement with the CHP sector is predicted to be a key factor to ensure that there is sufficient awareness, limited barriers to participation and that the benefits are communicated and understood by the sector. With sufficient sector education, a longer term target market share of 50-100% should be pursued noting the pricing and tenor benefits.

Misperception of BA pricing benefits

CHPs may not assess the BA pricing benefits on a like for like basis. The 1.4% p.a. indicative saving rate is based on comparing a 10 year fixed rate interest only loan to BA Government guaranteed debt cost. Comparison of BA loan pricing to shorter tenor bank loan pricing may challenge perceived benefits as cheaper pricing and longer tenor are uncorrelated in that longer term debt is more expensive (due to the upward sloping forward yield curve).

The BA loan structure has been proposed based on an assessment of CHP borrowing practices and feedback from the Survey, which highlighted longer tenor and cheaper pricing as key objectives. Education and marketing of the pricing benefits should be a key success factor.

Driving longer term BA growth

Beyond the medium term BA indicative issuance size of $300-500m of bonds, the ability of the BA to continue to grow is likely to be dependent on achieving increased market share above 50% with an ultimate target of up to 100% of total CHP sector debt together with moving down the risk curve and servicing the Tier 3 CHPs.

The establishment and operation of the BA should drive borrowing efficiency and best practice corporate finance principles through standardisation of borrowing terms. BA loan portfolio growth may also be enhanced depending on the willingness of Governments to make more subsidies available in the future to expand the supply of CHP-led affordable housing and stimulate future debt appetite and/or complementary business accelerator services to drive the same outcome. In addition, the BA may be utilised in conjunction with a broader housing package to drive sector expansion with the confidence that the benefits of financial efficiency ensure an effective outcome.

These risks have been identified from the perspective of the Australian Government and are not exhaustive. Additional risks are present and may relate to the design of the credit assessment policies and interactions with other stakeholders during the implementation phase which is detailed in Chapter 5 (e.g. investors, rating agencies).

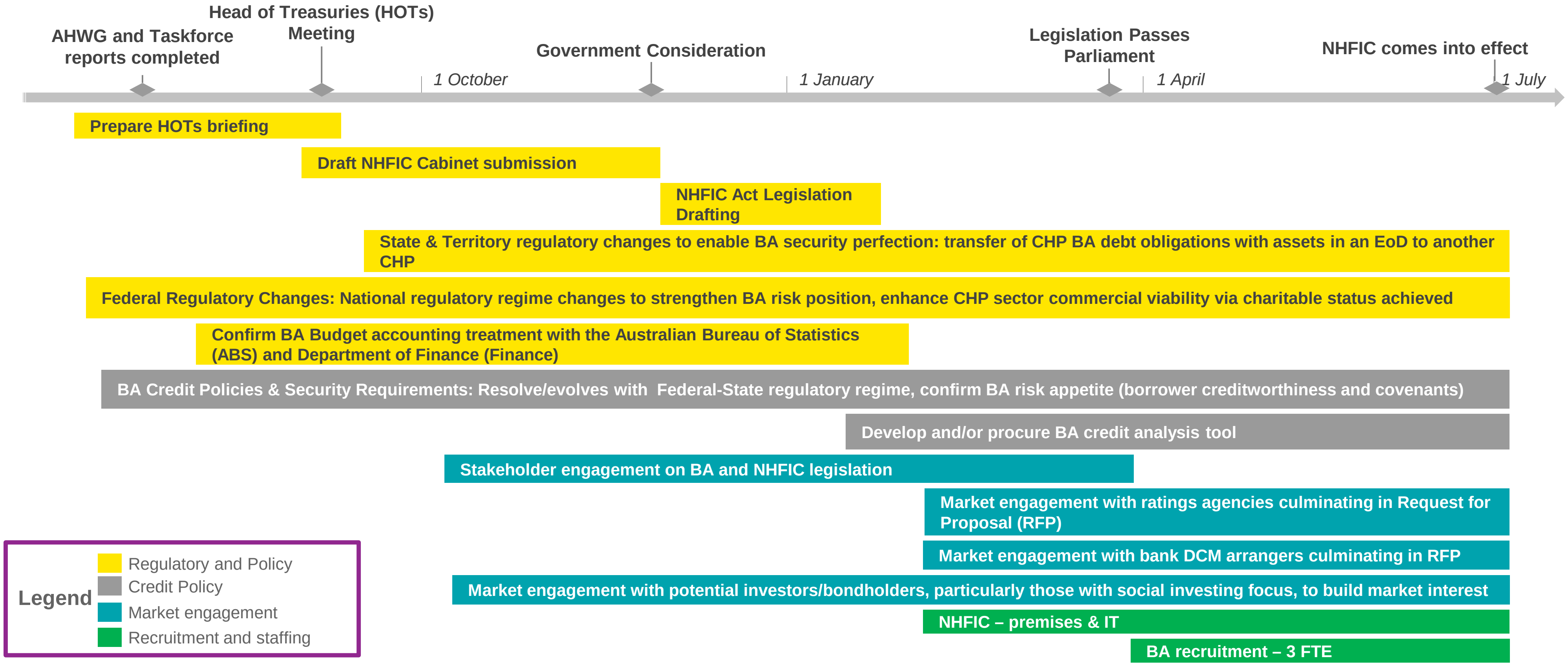
1 Executive Summary

Implementation Timeframe: Operational activities.

Implementation Timeframe

The indicative timeframe is summarised below. Under the proposed approach, the BA will be in a position to issue bonds in the second half of calendar 2018. Key considerations for the implementation phase include activities which could commence immediately and concurrently, including:

- **The Market Approach:** Stakeholder management to ensure that the purpose and objective of the BA is communicated to the various stakeholder groups (e.g. CHP sector, banks, DCM investors). Relationship managers have a key role to play in ensuring that the preferences of the stakeholder groups are balanced
- **Entity Structure and Resourcing**: Timely completion of the set-up activities (e.g. corporate functions and governance, Budget accounting treatment, passing of legislation) for the BA and NHFIC from a staffing and legislative perspective
- **Regulatory and Policy**: Interactions across all levels of Government (including at a State level) to ensure that the proposed BA vehicle aligns, supports and works within the current regulatory and policy parameters at a Federal and State level and provides assurances for investors regarding the credit quality in the CHP sector



2

CHP Sector Viability and Capacity

Financial viability of affordable housing providers and their capacity to sustain a bond issuance program

2 CHP Sector Viability and Capacity

Overview and key findings.

Overview

This chapter provides an assessment of the CHP sector capacity and financial viability associated with establishing the BA. It addresses the following:

- *Work stream 1: The ability of the affordable housing sector to sustain an affordable housing bond aggregator; and Work stream 4: Financial viability of affordable housing providers to sustain a bond issuance program*

Capacity (i.e. demand for CHP loans under the BA) is a function of various factors including sector characteristics and CHPs current and future borrowing requirements. Financial viability relates to the capacity of the CHPs to service the debt obligations. This is driven by a combination of business and financial risk profile considerations which are assessed utilising a credit rating methodology. Demand and viability are interrelated, noting that the credit profile is instrumental to the maximum sustainable debt capacity and may create an upper limit on potential demand; aside from additional subsidies to drive the new supply of affordable housing.

Methodology

In completing this chapter, we have undertaken the following:

- Considered the CHP sector characteristics including their current debt levels, landscape and challenges faced by the CHP sector and the impact that this may have on demand for loans under the BA
- Utilising Moody's methodology, we assessed the financial viability of a sample of 48 Tier 1 and 2 CHP's by estimating shadow credit ratings for individual CHPs and the BA
- Following our assessment of CHPs existing financial viability, we then considered the level of additional debt headroom and key ratios applicable to the sample size
- The Survey was distributed to the sector to ascertain sector interest and validate assumptions in regards to initial debt re-finance requirements under the BA

Key Findings

- 364 CHPs are registered through the NRSCH or other State regimes (VIC and WA) with ≈600 CHPs not registered. Whilst different regulatory regimes exist, they largely have the same intent and approach; which is considered important for investors in the context of a national BA
- CHP income comprise rental receipts, CRA and Government grants. CHP's financial metrics do not support ongoing organic growth without Government intervention. A low margin business model combined with a mission focus, NFP status and regulatory issues constrains growth
- Recent studies have identified five key challenges facing the CHP sector: 1) lack of an integrated policy, 2) lack of an industry-wide strategic plan and affordable housing targets, 3) inadequate planning policies, 4) lack of financing opportunities in the current debt market attuned to sector needs and 5) the funding gap between revenue streams available and costs incurred in service delivery
- The BA can only meet a portion of the funding gap in the CHP sector. Complementary programs are required to fill this gap. This issue is being considered by other Taskforce work streams. A supporting pipeline of transactions to increase supply is also required to grow the sector's capacity and sustain on-going interest in the BA
- Based on our analysis, there is sufficient sector debt for BA bond issuances, with issuances primarily focussing on refinancing existing CHP sector debt. An indicative BA bond issuance of $300-500m appears reasonable based on achieving 30-50% market share of CHP sector debt, with awareness and education to increase this amount over the long term provided the BA maintains pricing and tenor benefits to CHPs
- The demand for CHP loans via providing cheaper pricing and longer tenor debt is in line with key objectives of the CHPs as seen in the Survey (noting objectives may counter each other)
- The financial viability of the CHP sector is considered sound, with shadow credit ratings of Moody's A2 to Aa2, highlighting med-high financial viability. Whilst CHPs' debt capacity are constrained, we assess that additional balance sheet leverage can be obtained with an increase in total debt of up to 35% ($360m). Long term viability may however be subject to improvements in the capability and sophistication of CHPs (e.g. governance and reporting)
- The BA's shadow credit rating without Australian Government support is expected to be A1, based on Moody's CHP weighted average approach. However, linkages to the Australian Government will likely be viewed favourably by investors given the attractive risk vs. reward dynamic

Recommendation:

- Government should work with States and Territories to ensure that the regulation of the community housing sector better supports the activities of the bond aggregator, with specific regard for the way in which regulation applies in the event of a default. Given investors value certainty, consideration should be given to standardising the way in which investors are able to obtain security for the finance provided through the BA

2 CHP Sector Viability and Capacity

The Australian CHP Sector context: an evolving provider of key services to those in need. Almost half of all renters in Australia are on lower incomes and just over 40% of those are in housing stress with rents in excess of 30% of income.

Snapshot: Current state of the housing market in Australia[56]

31%

In 2013-14, 31% (2.7m) of all households were renters. 47% (1.3m) of these households were classified as lower income households

3.6%

In 2013-14, approximately 3.6% of households rent public housing

42.5%

42.5% is the proportion of low income households renting with housing costs above 30% of income

0.8%

In 2013-14 approximately 0.8% of households rent in community housing

191,535

191,535 households were on waiting lists for public and community housing as at 30 June 2015

403,767

In 2015, there were 403,767 social housing dwellings across Australia (comprising 321,627 public housing dwellings, 72,105 community housing dwellings, and 10,035 State owned and managed Indigenous Housing (SOMIH) dwellings)

The delivery of social housing in Australia continues to evolve.

As addressed in the AHWG Report[4] to HOTs in 2016, evolution is critical to managing the affordability divide between income and rent for households in rental stress. Central to this evolution is the increasing role of CHPs in the delivery and management of community housing.

CHPs are managing a growing share of social housing. Scale has increased from 4% in 1997 to 18% in 2015, primarily due to transfers, targeted investment and organic growth[7]. This increase evidences Government and regulator acknowledgement that CHPs are effective service providers. However, the CHP sector as a whole is a diverse group in terms of capacity, maturity and scale of operations; presenting implications for the ultimate beneficiaries for the BA.

The following pages detail the current CHP landscape in terms of size, scale and location of operations. Further, the challenges of CHPs in improving their operating position and specifically their debt requirements are also explored to provide context to the underlying objectives of the BA and how the BA can support the practical development of the CHP sector.

2 CHP Sector Viability and Capacity

The CHP sector is expanding across all Tiers with increasing registrations under the NRSCH. Sector concentration is acute with Tier 1s accounting for 13% of registrations but with over 75% of sector capacity.

Number of registered CHPs in Australia[8]:

364 **as at June 2017**

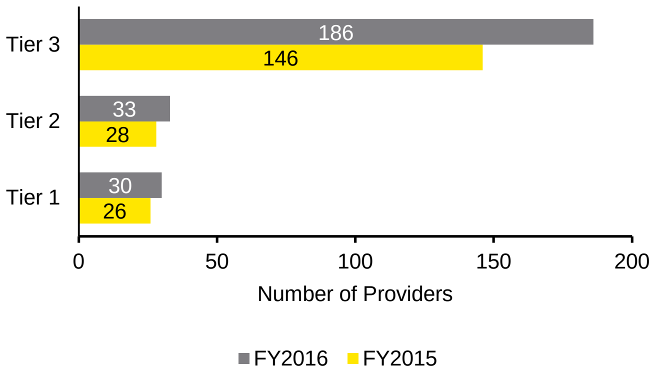
Number of Tier 1 (or Tier 1 equivalent) [9] providers[10]:

46 **(approx. 13% of total providers)**

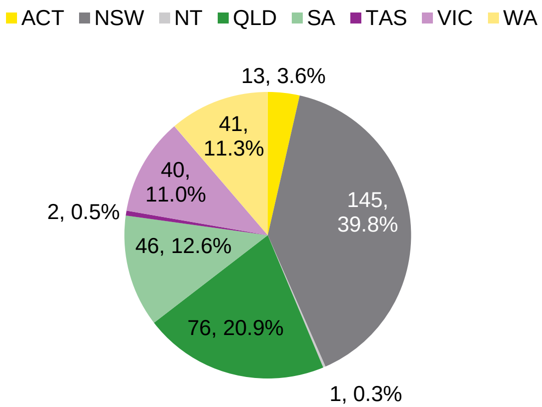
Key features of the CHP sector

- As at June 2017, there are 364 registered CHPs in Australia. CHPs in NSW, QLD, SA, ACT and TAS are registered under the NRSCH while VIC and WA operate under State-based regulations that are considered broadly comparable to the NRSCH for the purpose of this paper. The geographic dispersion of CHPs and an overview of the regulatory environment are detailed overleaf on pages 19 and 20
- Under the NRSCH, providers are registered at a tier level that is allocated on the basis of risk across three tiers. Further information relating to CHP regulation is outlined on the next page and in Appendix 1
- The CHP sector is diverse and consists of NFP entities, faith-based organisations and providers with a diverse mix of services and revenue streams. Rental receipts, CRA and Government funding are the primary sources of revenue for CHPs
- The latest NRSCH snapshot reveals the following highlights:
  - The CHP sector is growing with an increased number of CHPs across the three Tiers from the 2015 to 2016 Financial Year (FY) and increased prevalence of CHPs operating across multiple jurisdictions. Over 64,000 properties are managed by NRSCH registered providers. The below charts illustrate that Tier 1 CHPs take on more stock, larger developments and manage larger asset and debt bases than Tier 2 and 3 CHPs
  - Average total debt for Tier 1 CHPs was $22m compared to just over $1m for Tier 2 CHPs and average net assets for Tier 1 CHPs was $130m compared to $31m for Tier 2 CHPs

NRSCH Registered Providers: NRSCH Sector Snapshot 2015-16[11]



Total no. of registered CHPs[12]



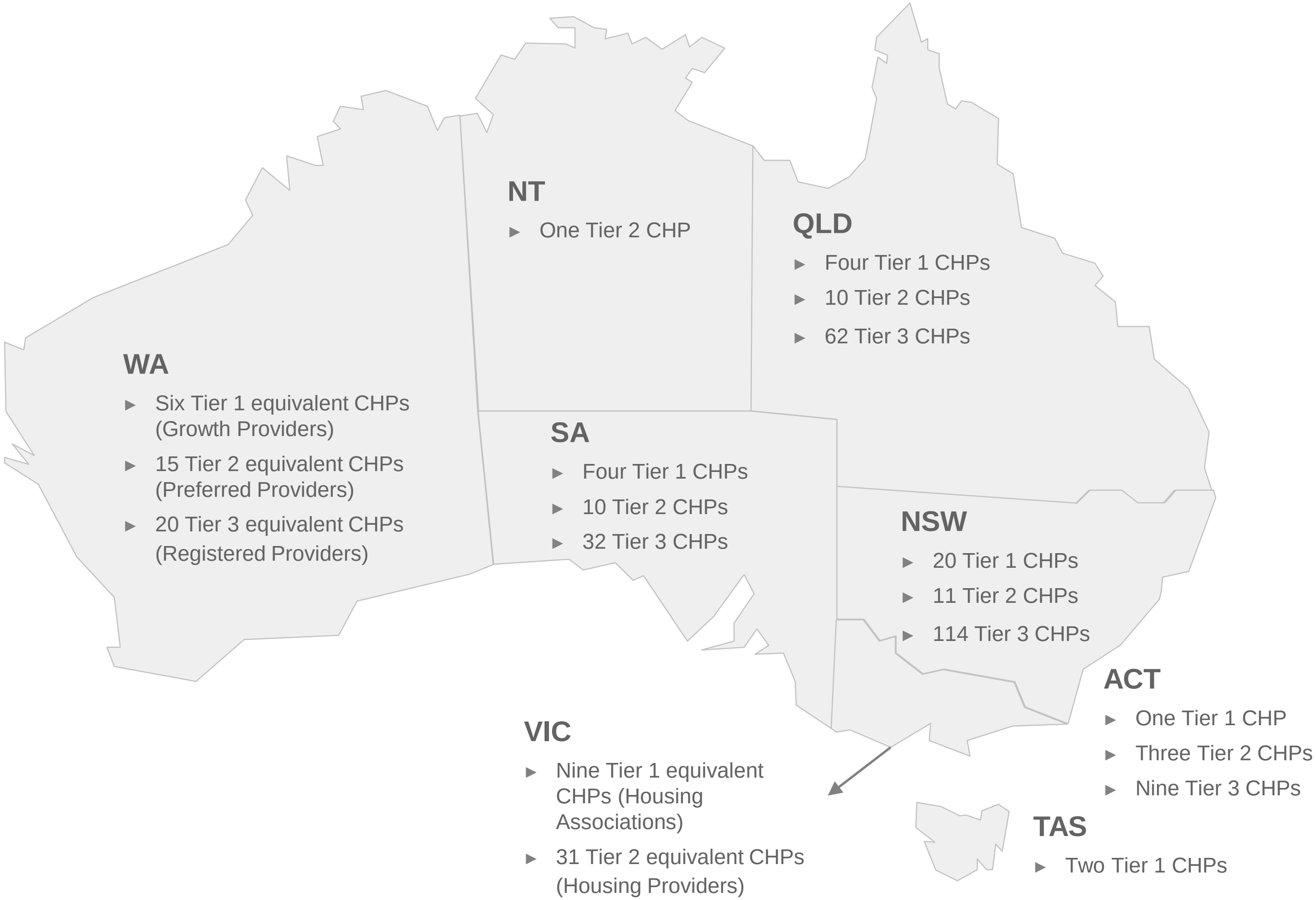
Summary financial information for Tier 1 and Tier 2 providers who completed a compliance assessment in 2015-16[13]

Key Financial Metrics	Tier 1	Tier 2	Total
Net Assets	$2,733 m	$557 m	$3,290 m
Total Assets	$3,326 m	$1,121 m	$4,547 m
Housing Assets - Written Down	$2,954 m	$169 m	$3,123 m
Total Debt	**$467 m**	**$19 m**	**$486 m**

2 CHP Sector Viability and Capacity

The CHP sector is dispersed nationally with the highest level of concentration in NSW (42%) and QLD (22%). Relative to the other States, QLD is showing the most growth with an increase of 76% in registered CHPs from March 2016.

CHP distribution in Australia[14]



Key Characteristics

- The sector is growing. An Australian Housing and Urban Research Institute (AHURI) report in 2016 noted 323 registered CHPs. Currently, 364 are registered with the growth primarily due to the Tier 3 segment of providers in QLD (an increase of 32 providers since March 2016)
- There are 46 Tier 1 or Tier 1 equivalent CHPs across the country. 43% are located in NSW 20% in VIC and 13% in WA
- The 81 Tier 2 or Tier 2 equivalent CHPs are predominately distributed across VIC (38%), WA (19%), NSW (14%), QLD and SA (both 12%)
- NSW, QLD and WA account for 83% of registered Tier 3 CHPs
- TAS and NT only have three registered CHPs
- In some instances, a CHP registered in one jurisdiction may service another or multiple geographies

2 CHP Sector Viability and Capacity

CHP sector: The regulatory environment consists of multiple frameworks but all are designed to be largely consistent in intent and application.

Objectives of regulation

Regulation within the CHP sector is set at a national level under the NRSCH and a State-based level in VIC and WA. Regulations seek to promote economic objectives such as prudential management and governance as well as consumer objectives that focus on the tenant.

The primary objectives of the NRSCH are as follows:

- Provide a consistent regulatory environment to support the growth and development of the CHP sector and to facilitate a national market – making it easier for CHPs to operate across jurisdictions
- Reduce the regulatory burden for housing providers that operate across multiple jurisdictions
- Provide a "level playing field" for providers seeking to expand and enter new jurisdictions

Registrars enforce the NRSCH and the Regulatory Code. All States are signed up to the NRSCH with the exception of VIC and WA (see Appendix 1). VIC and WA operate under systems that are comparable in application with WA having adopted many of the principles of the NRSCH in their framework. The NRSCH Charter limits Registrars' functions to regulatory activities to ensure that the State agencies maintain oversight over policy and funding.

Tier guidelines

- Tiers are determined with respect to an entity's level of risk based on the scale and scope of its community housing activities. This assessed risk informs the intensity of regulatory engagement and oversight
- Tier 1 CHPs are subject to the highest level of performance requirements and regulatory engagement; Tier 2 CHPs are subject to a moderate level of oversight and Tier 3 CHPs are subject to the lowest level of oversight from the Regulator
- Importantly, the guidelines have a performance threshold that is commensurate with tiers of registration and the relevant risk and scale of operations managed by CHPs

Legislation

- The NRSCH has been introduced through a collaborative "applied law scheme" whereby each participating jurisdiction must adopt or mirror the National Law. In 2012, NSW Parliament passed the *Community Housing Providers (Adoption of National Law) Act 2012*, with the Act coming into effect on 1 January 2014. QLD, SA, TAS, ACT and NT followed NSW in adopting the National Law within their jurisdiction
- Prospective providers must meet the Conditions of Registration as per section 15(2) of the National Law as a precondition for registration under a tier as part of the NRSCH. Conditions of registration include maintaining an accurate asset list (s15(2)(i) of the National Law)

Evidence and enforcement guidelines

- The National Regulatory Code sets out the performance outcomes and requirements that CHPs must meet. Evidence guidelines are set under the code for CHPs to follow to manage risk, measure performance and ensure compliance with the tiers of registration. The guidelines consider governance, financial viability and asset management et al. They are not intended to be prescriptive and aim to minimise unnecessary administrative burdens
- Registrars have powers under the National Law to monitor non-compliance, give binding Instructions, cancel registration and appoint a statutory manager in the EoD or winding up
- Compliance assessments are conducted on an annual basis to monitor performance. To support the BA, Governments must ensure there is consistent and diligent application of these assessments to enhance Investor confidence in the regulatory framework

Rent setting policies

- Rent setting policies are an integral feature in the regulatory landscape. Across Australia, there is commonality in rent setting policies – primarily in relation to a proportion of household income plus inclusion of a CRA entitlement. There is some flexibility afforded to CHPs in rent setting (e.g. VIC, TAS) and this is usually monitored at a Registrar level. This is detailed overleaf and in Appendix 1

2 CHP Sector Viability and Capacity

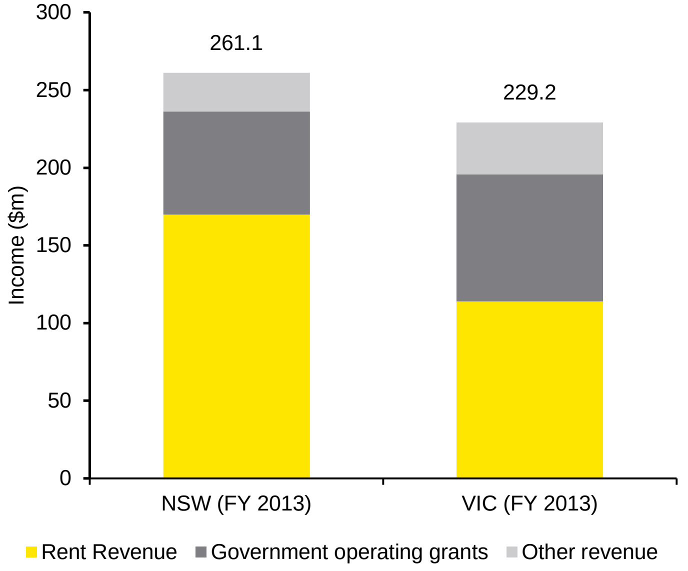
CHP sector fundamentals: "regulated" rents set by the States are the primary income source. An inability to diversify income sources - whether due to regulatory regimes and/or mission focus - limit capacity growth.

Rental income is not sufficient to cover all costs, resulting in a funding gap that requires Government support.

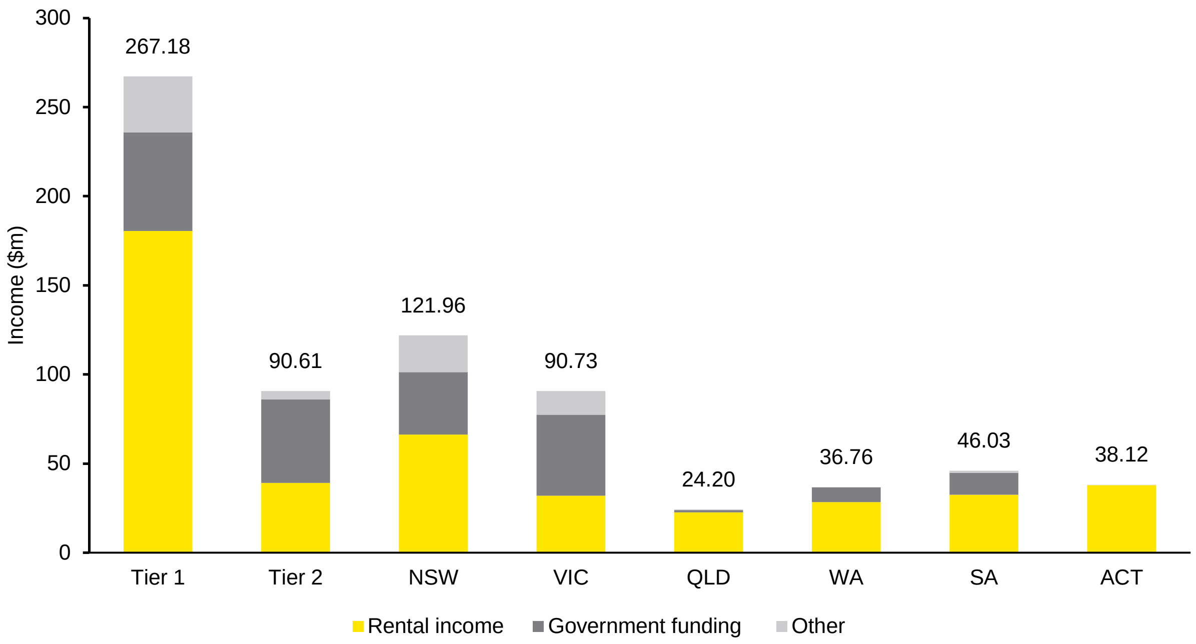
Basis of understanding

- Rental income is the predominant source of income for CHPs. A snapshot of most recent data of NSW and VIC CHPs shows rental income comprises 65% and 50% of income respectively (see below left)
- As a comparator, we reviewed the breakdown of income sources across 16 CHPs where income was arranged by type (e.g. rental income, grants) based on publicly available data for FY16. This analysis showed that:
  - Rental income comprises 68% of total income for Tier 1 CHPs in the sample. The median result for rental income as a percentage of total income across the States (NSW, VIC, QLD, WA, SA and ACT) is 74%
  - However, rental income is not always the dominant source as shown in VIC and for Tier 2 CHPs – noting this result was influenced by a VIC CHP, with their 2016 FY reports suggesting that grants attributed to 83% of total income

Summary of Income Sources - NSW and VIC Sector Snapshots (FY 2013) (FACS and DHHS data)[15]



Summary of Income Sources - CHP sector snapshot - FY2016 data[16]



2 CHP Sector Viability and Capacity

Growing service delivery capacity is challenged by “regulated” rents set by the States and underwritten by the Australian Government payments. These contribute to low margins and limit capacity growth.

Revenue Sources

The primary revenue sources for CHPs include rental receipts from tenants, CRA, fees for service or other Government subsidies, donations and contributions and also benefit from tax concessions and levies.

A 2014 paper prepared by the Community Housing Peaks Policy Network, sampled a group of 24 CHPs and found that CRA made up between 30% and 39% of the majority of organisations’ rental income. 21 out of 24 CHPs surveyed noted that the removal of CRA would have a negative impact, stating that the “viability of many CHPs would be threatened... and would stymie growth in the sector”[17]. A 2015-16 AHURI survey[18] noted that the lack of durable public subsidies was considered as a barrier to growth by 53% of CHPs surveyed.

To increase their net income and support growth, CHPs have a range of options, including:

- Diversification of revenue streams through provision of new services to existing clients (e.g. wraparound support)
- Seeking transfer of land or stock and leveraging assets to raise finance
- Fundraising efforts through community engagements
- Entering new jurisdictions to service comparable tenant cohorts and access Government funding
- Mergers or acquisitions to take on new stock and services existing in the sector
- Diversification of services to new cohorts to access funding streams (e.g. National Disability Insurance Scheme (NDIS))
- Provision of commercial activities (e.g. development for on sell or private rental)

We note that Mission, regulatory or legislative obligations may restrict any or all of the above, depending on organisation status and geographic location.

Barriers to growth

Recent studies have identified five key challenges facing the sector:

- Lack of an integrated national / state housing policy
- Lack of an industry-wide strategic plan and affordable housing targets
- Inadequate planning policies supporting developments
- Lack of suitable financing opportunities in the current debt market attuned to sector needs
- The funding gap between revenue streams available (i.e. the reduced rental returns associated with social housing compared with private rentals) and costs incurred in service delivery (i.e. tenant services and maintenance costs to ensure stock is fit for purpose)

We recognise that CHPs are not a homogeneous group and challenges facing one CHP may not be applicable to another. However, an AHURI survey of 95 CHPs identified concerns regarding the alignment of policies and regulations as a barrier to growth, specifically:

- A lack of housing policy integrated across all levels of Government. This lack of direction prevents informed decision making and does not allow for scaled investment which could access optimised financing in regards to price and tenor
- Different States provide widely varying Tri-partite Agreements to secure debt. This frustrates the standardisation that debt financing could achieve under a BA model, even with the leap forward of national regulation for CHPs

This has created a market gap and the BA seeks to address these through the objectives below. In addition to the objectives, the strengthening and consistency of regulations in application and intent will likely provide confidence for investors and CHPs to ultimately assist the BA and other Government programs.

BA Objective 1

Creation of a sustainable mechanism that facilitates a pipeline of private and institutional investment opportunities into the sector by building scale and a structure to attract domestic and international investors.

BA Objective 2

Simplification of the finance raising process, reducing re-finance risk and interest costs, and in the process enhancing the capacity of the CHP sector through education and Government support during set up and implementation.

BA Objective 3

Diversification of financing, opening access to capital sources that reduce price and increase tenor when compared to current debt profiles, in turn better aligning to the asset class and risk profile of the CHP sector.

2 CHP Sector Viability and Capacity

To assess sector financial viability, a robust, internationally recognised financial viability assessment model was developed based on specific CHP sector requirements to assess the largest CHPs on a standalone and collective basis.

Shadow Credit Rating Analysis

- A credit rating is an *opinion* of the credit worthiness of the rated entity. The purpose of credit ratings is to provide investors with a simple system of gradation to determine indicative creditworthiness of security issuers and debt securities
- Credit ratings assigned by Moody's and S&P* are internationally recognised. The methodologies employed by Moody's and S&P to form their opinions are available via subscription from each respective entity. A shadow credit rating analysis involves using the available methodology to replicate their assessment process and gain an indication of how the BA might rate should it obtain a public rating.
- We have utilised a shadow credit rating analysis as a proxy of financial viability of the sector and the capacity of the CHPs to service the debt obligations, which is driven by a combination of business and financial risk profile considerations included in the methodologies
- We have chosen the Moody's methodology on which to base our analysis (see Appendix 3 for reasoning)
- Our analysis comprises three steps in assessing the credit quality of the BA, as per the methodology. These are outlined below:

Step 1

Standalone Credit Profile[19]

The SCP represents an indication of credit worthiness of the individual CHPs – its ability to service and repay outstanding debt in isolation of any extraordinary Government support.

- A rating scorecard, covering five broad qualitative and quantitative factors considered important in assessing a social housing provider, is a reference tool used to approximate a standalone credit rating. Each factor is assigned a weighting based on its importance
- The scorecard comprises three qualitative factors, (i) institutional framework, (ii) market position, (iii) management and governance, and two quantitative factors, (iv) financial performance and (v) debt and liquidity

Step 2

Government-Related Issuer Uplift[20]

Government-Related Issuers (GRIs) may be subject to an "uplift" in their standalone creditworthiness due to credit links to their supporting Governments, giving rise to a GRI-adjusted SCP (CHP Rating).

- The GRI uplift assigned to each CHP reflects the probability of the supporting Government providing extraordinary support to the issuer, as distinguished from the day to day support that may be received from the supporting Government
- The uplift accounts for the supporting Government's ability to provide support through its credit rating, interdependence of each party through analysis of the likelihood of joint default and the willingness of support being offered by assessing historical activity, political linkages and economic importance

Step 3

Pooled Vehicle Shadow Rating[21]

The Pooled Vehicle Shadow Rating (PVR) represents the credit rating of the BA; the GRI-adj rating of all the CHP participants pooled together as a single issuer.

- The PVR is determined by the CHP Rating of the participants and the structural and legal attributes of the pooled financing
- If the financing includes strong structural elements, the PVR is equivalent to the weighted average CHP Rating
- In the absence of structural enhancement, the PVR is assessed as the lower of (i) the "weakest link" of the pool participants plus two notches, and (ii) the weighted average CHP Rating of the pool participants

* See Appendix 2 and 3

2 CHP Sector Viability and Capacity

A worked example of steps one and two of the Moody's shadow credit rating analysis is provided below. It highlights the comprehensive range of qualitative and quantitative factors considered in assessing financial viability.

Shadow credit rating – NSW Tier 1 CHP

- The table below provides a summary of the shadow credit rating for a single Tier 1 CHP ("the CHP") based on the Moody's methodology
- The CHP scored strongly under the qualitative considerations for institutional framework and management governance. Furthermore, the CHP returns **investment grade ratings for multiple quantitative sub-factors including liquidity coverage and debt to revenue**

The Standalone Credit Profile

Sample CHP Standalone Credit Profile — **aa2**

Each of the broad factors are assessed with reference to two – three relevant sub-factors. To estimate the SCP, each sub-factor is given a score and the weighted total of the scores are then referenced to a rating grid to determine the final rating.

The table below provides a summary of the analysis undertaken to determine the SCP of a sample Tier 1 provider:

Broad Factors[22]	Sub-Factors	Sub-Factor Weighting	Sub factor Rating
Institutional Framework	Operating Environment	10%	a
	Regulatory Framework	10%	aa
Market Position	Units Under Management	10%	ba
Financial Performance	Operating Margin	5%	a
	Social Letting Interest Coverage	10%	aaa
	Cash Flow Volatility Interest Coverage	10%	aaa
Debt and Liquidity	Debt to Revenue	5%	aaa
	Debt to Assets	10%	aaa
	Liquidity Coverage	10%	aaa
Management and Governance	Financial Management	10%	aa
	Debt and Investment Strategy	10%	aa
Total Scorecard Indicated Outcome		**100%**	**aa2**

Impact of GRI Uplift

GRI-Uplift

Sample CHP GRI-adjusted Credit Rating — **Aa1**

The GRI uplift is assessed with reference to sub factors representing a measure of (i) Dependence and (ii) Support. Dependence is calculated as the highest rating of its component sub-factors, whilst support is calculated as a weighted average score of its sub-factors.

The tables below provide a summary of the analysis undertaken to determine the GRI uplift applied to the SCP:

Broad Factors[23]	Broad Factor Rating
Dependence	High
Support	Moderate
Total Scorecard Indicated GRI Uplift	**1.2 notches**

Support[24]	Low	Moderate	Strong	High	Very High
Dependence	Low	Moderate	High	Very High	
Aaa	Australian Government rating				
Aa1				Aa1	
Aa2	Sample CHP SCP			Aa2	

2 CHP Sector Viability and Capacity

The Moody's shadow credit rating analysis covered 48 CHPs. Once their GRI-adjusted SCPs were established, we then estimated the BA's shadow credit rating based on a Moody's weighted average approach.

Rating Ranges

CHP Rating A2-Aa1

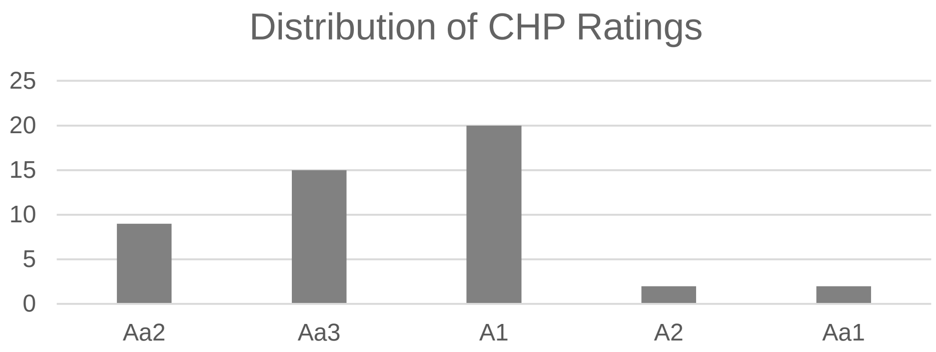
Includes GRI uplift of approx. 1

BA Rating A1

Excludes Government assistance.

The overall financial viability of the CHP sector is sound - evidenced by the investment grade CHP credit ratings of A2 to Aa1 and a weighted average BA credit rating of A1. These credit rating levels represent medium to high financial viability according to Moody's rating scale

- The strong CHP credit ratings are underpinned by the solid institutional framework and management and governance oversight as a regulated industry*
- The distribution of CHP ratings is largely a function of scale, financial ratios (which are impacted by debt levels) and status of CHPs as Tier 1 or 2
- We have assumed strong BA structural elements (refer Chapter 4) to drive an optimal weighted average BA rating



Moody's Global Long-Term Rating Scale[25]

Aaa	Highest quality, subject to the lowest level of credit risk	Investment grade
Aa	High quality and are subject to very low credit risk	Investment grade
A	Upper-medium grade and are subject to low credit risk	Investment grade
Baa	Medium-grade and subject to moderate credit risk	Investment grade
Ba	Speculative and are subject to substantial credit risk	Sub-investment grade
B	Speculative and are subject to high credit risk	Sub-investment grade
Caa	Speculative of poor standing and are subject to very high credit risk	Sub-investment grade
Ca	Highly speculative and are likely in, or very near, default	Sub-investment grade
C	Lowest rated and are typically in default	Sub-investment grade

* Whilst the regulatory environment assists with the shadow credit rating analysis and high individual ratings, the complexity and market gaps identified herein require an intervention instrument, such an Australian Government guarantee

2 CHP Sector Viability and Capacity

Improving sector income coverage ratios has the potential to improve debt serviceability in the sector. This should however be considered in conjunction with other financial metrics to obtain a comprehensive view on the sector's total debt capacity.

As part of the shadow credit rating analysis, we have assessed two income coverage ratios relevant to the sector[26]:

Social Letting Interest Cover (SLIC)

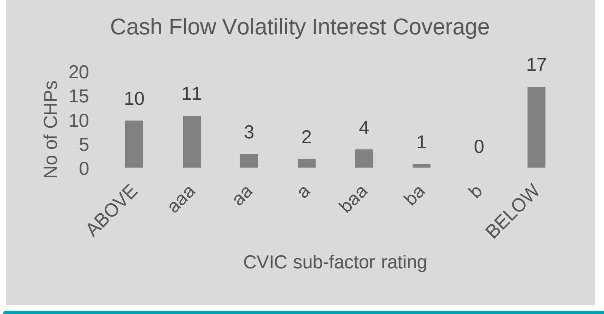
Calculation

- SLIC represents the ability of profit derived from low-risk social housing letting landlord activity to cover interest obligations
- A ratio that consistently exceeds 1.0x indicates an ability to cover its annual financing costs from its lowest-risk activities which is considered core in maintaining a solid standalone credit profile
- SLIC is calculated as the ratio of social rent surplus to net cash interest paid

Observations

- The graph to the left depicts the distribution of SLIC sub-factor ratings in the CHP sector
- It was observed that the sector had a relatively strong SLIC, with a score higher than baa indicative of a SLIC above 1.0x. The majority of the sector achieved a score equal to or higher than aaa, indicating a SLIC of above 3.0x
- This was largely attributable to the low debt observed in the sector resulting in a low net cash interest paid as opposed to strong low-risk social housing letting landlord activity margin

Cash Flow Volatility Interest Coverage (CVIC)



Calculation

- CVIC represents the entity's ability to cover its interest obligations from operating cashflows, with consideration for historical volatility in operating margin
- The ability to consistently meet interest obligations despite historical fluctuations, or demonstrate low fluctuation in operating margin, indicates a stronger credit profile as compared to an entity that is not able to consistently meet interest obligations
- CVIC is calculated as the ratio of volatility-adjusted pre-interest operating cash flow to net interest

Observations

- There was considerable variability in the sector with a large proportion with a CVIC of less than 0.25x as well as better than 4.0x which highlights the weaknesses in operating margin paired with the low debt levels in the sector

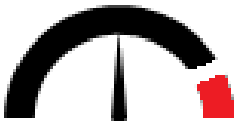
Key Findings

- Income coverage strength in the sector is at least in part attributable to the low debt levels observed in the sector
- Income coverage alone is not the constraining factor in the observed low internal growth and/or the difficulties claimed by some CHPs in obtaining financing; however, lower interest costs will likely improve debt serviceability ratios which may contribute to a further increase in debt capacity
- As such, the sector debt capacity analysis (refer next page) considers a range of quantitative ratios including both financial performance factors, including both operating margin and income coverage, in addition to debt and liquidity factors

2 CHP Sector Viability and Capacity

The shadow ratings model enables sensitivity analysis to show how much additional debt – potentially sourced via a BA bond issuance - could be taken on by the CHP sector without materially impacting CHP sector credit quality.

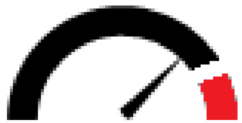
Moderate Risk Debt Headroom



Moderate Risk Profile

$232m

Higher Risk Debt Headroom



Higher Risk Profile

$355m

Methodology

- To determine the debt headroom in the CHP sector, we stress tested the current financial indicators, observing the effect of incremental debt increases on key financial ratios
- To assess the "Moderate" debt headroom we sensitise the debt level such that each "Financial Performance" and "Debt and Liquidity" sub-factor is no worse than "baa"
- To assess "Higher" debt headroom we sensitised the debt level such that each "Financial Performance" and "Debt and Liquidity" sub-factor would be no worse than "ba"

Sustainable Debt Sensitivity Analysis

Broad Factors[27]	Sub-Factors	Sub-Factor Weighting
Financial Performance	Operating Margin	5%
	Social Letting Interest Coverage	10%
	Cash Flow Volatility Interest Coverage	10%
Debt and Liquidity	Debt to Revenue	5%
	Debt to Assets	10%
	Liquidity Coverage	10%

Observations

- Whilst CHPs are unable to internally fund growth through retained earnings, their ability to service an increase in core debt may be utilised to fund a degree of expansion
- Sustainable debt sizing analysis within existing financial metrics highlights that CHP sector debt levels could be increased by approximately $270m - $360m which represents an approximate 25% to 35% increase in debt
- CHP sector appetite for additional debt - and therefore the demand from the CHP sector to sustain a bond issuance – is also examined based on the Survey

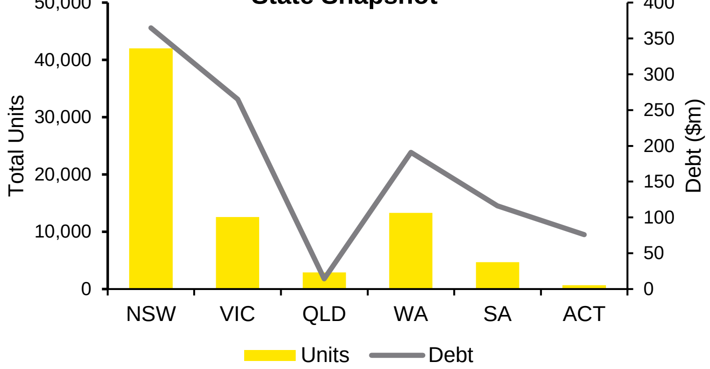
2 CHP Sector Viability and Capacity

Our shadow credit ratings established the sector's existing debt levels and their ability to service debt. A snapshot is detailed below, based on publicly available information.

Debt levels within the CHP sector

- CHPs primarily raise debt to finance construction and refinance existing loans. An analysis of 30 Tier 1 and 18 Tier 2 CHPs reveals that there is approximately **$1.03b worth of debt in the CHP sector**. The majority lies with Tier 1 providers ($880.6m or 86% of total debt). Increased debt levels correspond with increased units under management and development activities therein supporting the increased regulation requirements of the NRSCH at a Tier 1 and Tier 2 level. The registration tiers (as described in further detail at Appendix 1) are important to a potential bond issuance given the importance of adequate regulation to debt capital markets (DCM) investors
- Debt levels are commensurate with CHPs operating in larger markets (e.g. NSW $365m, VIC $265m and WA $191m); however the state snapshot below shows that debt is not concentrated within one region. This means that the BA could potentially benefit providers operating in several states and territories as opposed to a concentrated region

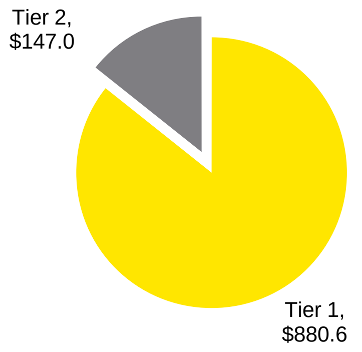
State Snapshot[28]



Minimum market size of $100m

- In order to ensure that the bond issuance is successful and to achieve favourable pricing, the bonds are required to be structured in a way to appeal to target DCM investors and the CHP sector. Wholesale bonds (as opposed to retail bonds) are preferred: the wholesale market is deeper, more liquid, has lower issuing costs and Investor sophistication drives lower disclosure requirements
- Fundamentally, the **prerequisite for a wholesale bond issuance is $100m (inaugural)** with **$30m for re-tap (up-sizing of existing bond issuance)**. These make up the minimum liquidity requirements. Based on prior issuances, the average is approximately $100-$200m for first issue and as low as $30-$50m for subsequent re-tap
- The level of debt in the CHP sector suggests that there is scope for multiple bond issuances; predicated on BA achieving market share of debt

Debt in the CHP Sector ($m)[29]



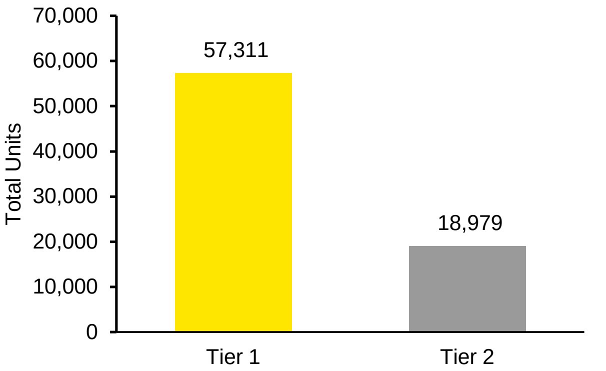
Bond Pre-requisites

Minimum issue size (wholesale)*	$100m (inaugural); $30m re-tap
Minimum issue size (retail)	$50m; no minimum for re-tap
Rating	>Baa
Tenor	>5 years
Structure	Interest-only, bullet

CHP sector highlight

Recently, a Tier 1 QLD CHP (Brisbane Housing Company (BHC)) was awarded the Industry's first AA- Rating by S&P. This is the 4th highest rating; indicating that BHC has very high credit quality and a low risk of credit default.

Units under Management^



** Note: Minimum liquidity requirements: average is approximately $100-$200m for first issue and as low as $30-$50m for subsequent issuances, ^ Figures based on 48 CHP sample size based on latest available data (primarily FY16).*

2 CHP Sector Viability and Capacity

There is sufficient sector debt however the capacity to service debt and borrow on favourable terms is constrained. This impacts growth and capacity building. Key issues regarding the lending environment are detailed below.

Lending Environment

CHPs raise commercial debt for three primary reasons: finance construction, fund turnkey acquisition and refinancing existing loans. Past market soundings and published literature indicate the following issues that are impacting on CHPs:

- Accessing affordable and suitable land for development of stock
- Accessing capital to finance projects given the maturity of the CHP sector and the presence of the funding gap
- Obtaining sufficient tenor of management rights in order to repay external investments
- Bank loan market tenors meet Australian market standards but are short (e.g. three to five years), creating refinancing risk and inefficient mismatch with asset life; loans are predominantly entity-wide lines of credit, rather than specific to a project; and CHPs report that their security assets are under-valued as a result of offering income-related rents[30]

Key Facts: Lending Environment (AHURI 2014)[31]

3-5 year terms

Most commonly offered debt tenor – with three years typically at a higher interest rate. We note that this is in line with Australian bank market conditions.

5-6 months

Transactional time burden for debt facility negotiations

DCR

Instead of Loan to Value Ratio (LVR), Debt Coverage Ratio (DCR) has become the dominant measure in calculating the size of the loan from bank to CHP

Options for growth

There are a range of levers that the Australian Government and the States can utilise to increase the lending capacity of CHPs:

- *Unencumbered stock transfers to CHPs* as opposed to short-term management contracts or vested properties with covenants. This could potentially alleviate the tenor and security issues nominated by CHPs and provide greater comfort to lenders. Furthermore, stock transfers would contribute toward realising the aspirational policy objective set in 2009 by the Housing Ministers for “up to 35%” of all social housing to managed by CHPs by 2014. As at 2015, the CHP share of social housing stood at 18%[32]

Survey feedback

Feedback from the Survey further emphasises the importance of tenor on bank loans. A small sample (18%) also indicated difficulty with securing financing offers from lenders on the basis of “insufficient cash flows” and “lack of knowledge from within the banking sector” resulting in heightened risk and a perceived lack of security. Furthermore, approximately 20% of the sample size noted issues that would constrain debt refinancing with break fees from existing hedging arrangements the primary reason referenced.

In addition to tenor, lower cost and fixed interest rates were the other two areas deemed most important to Survey respondents.

The Survey findings are detailed overleaf.

2 CHP Sector Viability and Capacity

To verify our desktop analysis and hypothesis, we surveyed the sector to gauge actual expected demand over the medium term. 40% of respondents will refinance over half a billion dollars in the next five years.

Key data points

68 responses

QLD (19 responses), NSW (17) and VIC (16) were the best represented States

$546.8 million

Total quantum of debt to be refinanced over the next 5 years (based on 17 CHPs that intend to refinance debt)

22 Tier 1 providers

12 Tier 2 and 16 Tier 3 providers also responded. The remaining did not disclose or are yet to be registered

$1.43 billion

Total estimated future borrowing requirements across 2017, 2018, 2019, 2020 and 2021

Amount of debt to be refinanced (over the next 5 years)[33]

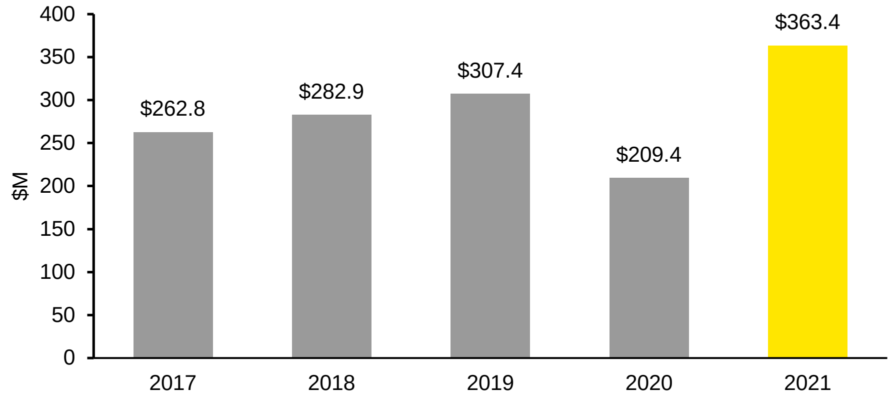
Process

- To supplement the CHP sector level public financial information, the Survey was distributed to provide context to the debt and finance requirements at an individual CHP level and to illicit views on what would make the BA attractive to the market. Further detail is set out in Appendix 2

Key observations

- From 45 responses, 40% intend to refinance existing debt over the next five years. From these 17 entities, the amount of debt to be refinanced over the next five years ($546.8 million) is shown at the below graph on the left. The year by year breakdown is not clear from the survey responses provided
- Five providers are planning on refinancing amounts greater than $50m (over the next five years)*. These providers are all accredited at Tier 1. Based on our shadow credit rating analysis, the CHPs intending to refinance debt are all considered as 'low risk' entities

Estimated future borrowing requirements[34]



* 11 CHPs intend to borrow in 2017; 14 in 2018; 11 in 2019; 7 in 2020 and 6 in 2021.

2 CHP Sector Viability and Capacity

Apart from establishing the quantum of debt the sector expects to refinance over the next five years, we also asked the sector for key issues and lending pressure points to ensure that the BA is aligned to sector requirements and therefore attractive to CHPs.

Key data points

Borrowing Difficulty (18%)

18% of CHPs have experienced difficulty in soliciting financing offers from lenders

Lower cost interest rate

Lower interest costs appears to be the most desirable trait for the BA according to the sample

Variable interest rates

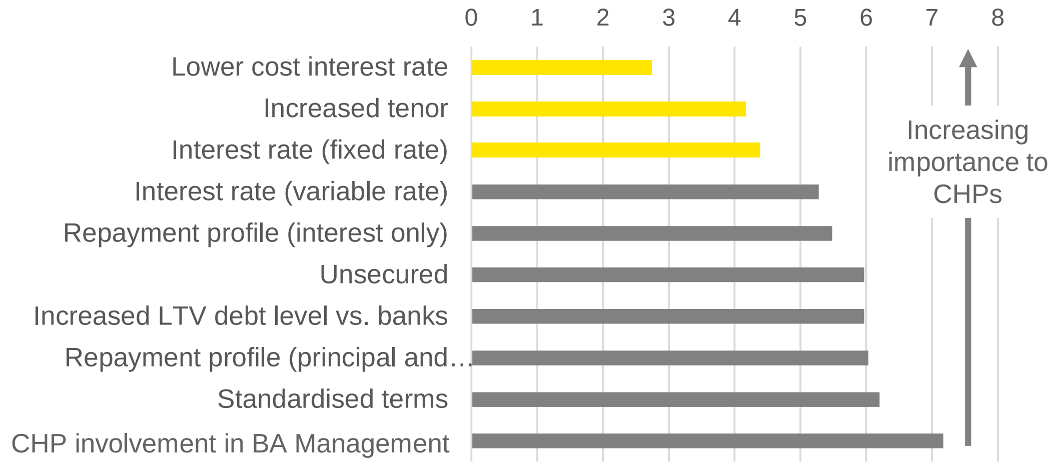
Variable interest rates are more common among current loans in line with cost terms for CHPs and reduced risk appetite for lenders dealing with CHPs

Construction (62%)

From 30 responses, 62% stated that their preferred purpose for borrowing is construction followed by general corporate purposes/other (31%) and refinancing (7%)

CHP priorities

- Survey participants were asked to score a set of BA characteristics on a scale of 1 (high priority) to 10 (low priority) to gain insight into where their priorities lie
- These characteristics are outlined below, in order of most to least important:[35]



Construction finance: the implications

- Provision of specialty construction or development project finance requires a level of complexity beyond that of the preferred model that optimises risk in set up and administration from the Australian Government's perspective, and as such has been excluded. The primary intention for the BA is to offer CHPs more favourable refinancing terms (i.e. cheaper debt over a longer tenor) for general purpose DCM facilities. These are however fully drawn and fungible – the funds can be put to work for any purpose unless limited by loan covenants
- CHP borrowers could direct funds to new developments without the BA taking development risk as the source of repayment is on-going cashflow from existing assets not realisation of development sales/returns

Key observations

- There is sufficient evidence from the shadow credit rating analysis and survey responses that suggests a level of capacity within the CHP sector to sustain issuances under the BA – in line with a minimum of $100m (initial) and $30m for subsequent re-tap
- Lower cost interest rate (fixed) and increased tenor are clearly the most desirable characteristics that the sector want from the BA. Therefore, if the BA can provide more favourable terms than the bank market, the survey results indicate that there will likely be considerable interest from the sector to participate in the BA
- The CHP sector is less interested in standardised terms or being involved in a governance and/or managerial capacity within the NHFIC
- 47% of the sample have a documented debt policy that prefaces limits on targets for maximum debt levels. This number is consistent with the increased accountability requirements prefaced by the relevant tiers of registration and supports the shadow credit rating analysis
- There is natural conflict between achieving the top two CHP priorities, being lower cost interest rate and increased tenor

2 CHP Sector Viability and Capacity

Based on our assessment of the CHP sector debt profile and credit standing, as well as the surveyed future borrowing requirements, we conclude there is sector viability at Tier 1 and 2 levels to support a bond issuance.

There are material benefits if BA issues into the wholesale DCM (see Chapter 4). The below diagram indicates the medium term indicative bond issuance based on CHP sector debt, assumed participation of 30-50% and the potential savings under the BA. Demand and supply drivers are also detailed. These findings are the product of consultation with potential investors; feedback from CHPs through the Survey; and industry knowledge and demonstrated experience as to the type of bonds that are applicable for the BA in the DCM.

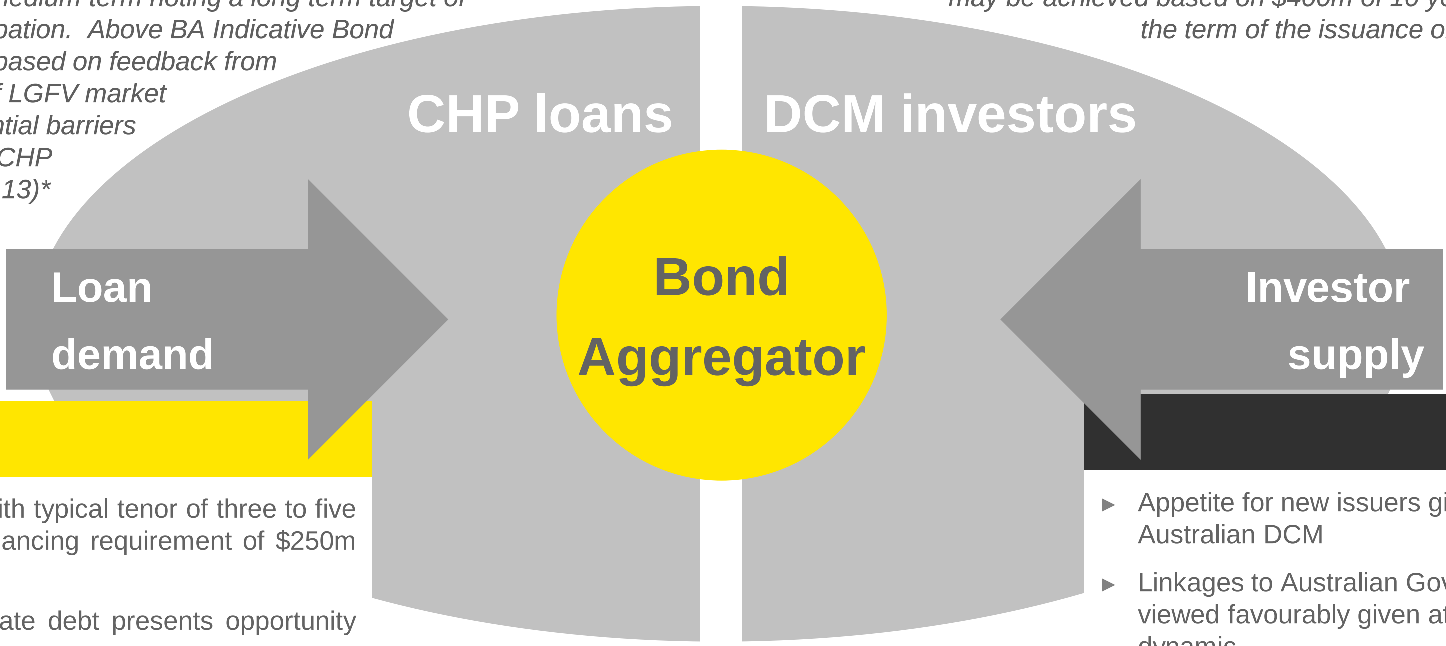
BA Indicative Bond Issuance **$300-500m**

*Based on the BA achieving participation of 30-50% of CHP sector debt over the medium term noting a long term target of 50-100% CHP participation. Above BA Indicative Bond Issuance estimate is based on feedback from THFC and analysis of LGFV market share indicating potential barriers to participation (refer CHP Participation on page 13)**

* Based on commentary from the EWG

Potential Savings **Up to $56m**

Represents the potential savings over the medium term that may be achieved based on $400m of 10 year BA bonds over the term of the issuance on a like for like basis



Demand drivers

- $1.0b CHP debt with typical tenor of three to five years implies refinancing requirement of $250m p.a.
- Existing variable rate debt presents opportunity to refinance early
- Potential capacity to increase debt by 25-35% may increase demand above refinances
- Seeking access to cheaper fixed rate debt and longer tenor

Supply drivers

- Appetite for new issuers given immature Australian DCM
- Linkages to Australian Government should be viewed favourably given attractive risk vs. reward dynamic
- Similar scale to precedent transaction in the Local Government Financing Vehicle (LGFV) for which there is strong demand
- Wholesale DCM prefer longer tenor and are typically cheaper than banks

3

Government assistance

Objectives, parameters and mechanisms of assistance for the BA

3 Government assistance

Overview and key findings.

Overview

This chapter brings together the CHP sector financing gap and impediments which inhibit efficient sector balance sheet utilisation to enhance sector capacity to arrive at a recommended form of Government assistance. It addresses the following components of the services to be provided:

- *Work stream 5: Government Assistance*

Based on the analysis in the previous chapter, we have established that there is sector debt serviceability and appetite for bonds as a source of debt but that the unique regulatory requirements cut across this ability. Importantly, the challenge in determining how Government should assist in establishing the BA is a question of how to handle wrong way risk. Given the reliance on Australian Government funding (income support and CRA) to generate rental streams to meet debt serviceability covenants, the question arises as to what entity is best placed to hold that risk. In addition, the requirement to effect state and national regulatory changes to reduce the lender's risk position also poses the question of who is best placed to retain and resolve these risks.

Methodology

In completing this chapter, we have undertaken the following:

- Identification and assessment of four Government Assistance support options: grant, subsidy, Government ownership and Government guarantee
- Shortlisting of two potentially suitable support options on the basis of alignment with policy objectives – debt aggregation and access to longer term finance into the sector
- Detailed analysis and evaluation of the shortlisted options in light of the complex interplay between CHP preferences, DCM requirements and the Government's risk position to determine a preferred Government assistance support option

Key Findings

- Other than the bank market, the CHP sector lacks the necessary scale to tap financial markets such as the Australian Wholesale DCM
- A bond aggregator is therefore required to bundle sector debt requirements and tap the capital markets for funding
- Subsidies and grants are not effective assistance mechanisms to meet these policy objectives
- Based on international precedents, establishing an aggregator can be a low cost exercise with minimal liquidity requirements or indeed Government assistance. This however has to be balanced by the Australian CHP sector's operating environment which does not enable an off-the-shelf replication of extant international models
- The Australian CHP sector's risk profile is a function of Government policy: concentrated revenues based on Government rent assistance or other Government subsidies and State-based oversight over the use of assets drive solution design to a Government guaranteed BA. Where the regulatory issues can be resolved in a timely manner and/or to the extent that the BA implementation timeframe is extendible, a no guarantee structure may be preferable

Recommendation:

- Government should commence work to establish the BA as part of the NHFIC, noting that CHPs are likely to be the primary agents to maintain and expand the stock of affordable housing

Recommendation:

- The BA should provide borrowers with general corporate debt finance. The longer tenor provides the immediate benefit of addressing the refinancing risk being faced by the sector in the short to medium term

Recommendation:

- To the extent that questions around security over stock and the procedure in the event of default can be resolved ahead of the implementation of the BA, it may be preferable for Government to not guarantee the BA's issuances. Alternatively, an explicit guarantee would provide greater investor confidence and also deliver an enhanced pricing advantage for CHPs

3 Government assistance

Types of Government assistance: there are four broad support options available but only two offer mechanisms that address the financing gap.

	Option	Pros	Cons	Financing Efficiency
Financing Gap Measures	**1 Initial Australian Government ownership & seed funding**	▸ Australian Government ownership provides a credit rating uplift over and above the forecast BA credit rating (see previous Chapter) ▸ Time-bound exposure: potential for short to medium term outlays to establish entity (including lending criteria) under NHFIC ▸ Entity could be privatised or fully outsourced once on a sustainable footing	▸ Requires upfront Budget funding, legislation, policy and process agreements with the States to resolve regulatory issues ▸ BA may not reach level of self-sufficiency and have capacity to repay seed funding/borrower default uses funds ▸ CHP sector reinvestment of additional leverage (and creation of increased capacity) is not a causal outcome	✓
	2 Guarantee: The Australian Government could elect to explicitly guarantee the BA's obligations to bond holders.	▸ Optimal allocation of regulatory risk to the party best able to resolve and manage it ▸ Could be time-bound (to be determined) and limited to specific policy areas or general to the BA	▸ Minimum exposure for the tenor of the last guaranteed bond issued ▸ CHP sector reinvestment of additional leverage (and creation of increased capacity) is not a causal outcome	✓
Funding Gap Measures	**4 Grants: The Australian Government could fund the BA to make grants to eligible borrowers to reduce on-going debt refinance requirements and hence de-leverage borrowers.**	▸ A measurable and direct impact on broader housing policy objectives: payment predicated on reinvestment into new projects with no development risk ▸ Impact on capacity of beneficiaries to reinvest in new projects clearly attributable to the grant's impact on leverage	▸ Outside of policy objectives (no aggregation of debt obligations) and subject to competing sectoral and state claims ▸ Not induce greater commercial rigour into the CHP sector ▸ CHP sector reinvestment of additional leverage (and creation of increased capacity) is not a causal outcome	X
	5 Subsidies: The Australian Government could provide funding to the BA to meet borrower's coupon payments thereby reducing borrowing costs on funds raised through the BA.	▸ Immediate reduction in borrower debt costs could be predicated on reinvestment into new projects (sector capacity enhancement) whilst the BA does not take on project development risk ▸ Increases CHP debt capacity which is also constrained by low margin model	▸ Requires long term Budget funding ▸ Sunk costs and subject to competing sectoral and State claims ▸ Does not achieve debt aggregation nor induce greater commercial rigour into the CHP sector ▸ CHP sector reinvestment of additional leverage (and creation of increased capacity) is not a causal outcome	X

3 Government assistance

Government assistance is a necessary part of the BA in order to address the market gap in the current operating environment.

Overview: The Market Gap

As set out in Chapter 2, there is a market gap caused by a number of factors that are preventing CHPs in achieving the necessary scale to access the DCM. Therefore, Government assistance design features must be targeted to the specific market gap, in order to realise the BA objectives whilst retaining the flexibility to evolve if the drivers of this gap change over time. Assistance measures for the BA should also be considered in the context of the broader supply pipeline for the CHP sector; as complementary reforms that stimulate supply and construction at a State level, should increase the demand to take-up debt financing through the BA.

Analysis in the previous chapters demonstrates that there is sufficient CHP sector debt to support an initial DCM bond issuance and likely generate on-going borrower interest (supply) and DCM investor appetite (demand) at the appropriate risk-reward price points. However, unlike the relatively more developed UK social housing sector, the Australian CHP sector's major players do not – on the basis of their own debt requirements – have the required scale to access the DCM.

Implications for Government assistance: CHP debt requirements

In the first instance, the aim of Australian Government assistance therefore is to efficiently aggregate the collective debt requirements of the CHP sector to facilitate access to the DCM and build a sustainable channel for the CHP sector to access this market. BHC is the only major CHP that has obtained a credit rating – a precondition to accessing the wholesale DCM. S&P rated BHC as 'a+' on a standalone credit rating in December 2016. This was based on low debt levels, 'excellent liquidity coverage', 'a very strong enterprise profile…experienced management' and 'a moderately high likelihood of receiving extraordinary support form its major shareholder, the State of Queensland"[36]. Despite this, S&P notes that BHC is expected to borrow $50m in 2018 and will peak at $70m. Not all of this debt may be term debt that could be financed via the BA – some may be construction finance that could be taken out at a later date. In short, even the "capital markets ready" CHP borrower does not have sufficient debt to support an issuance.

Implications for Government assistance: Financing risks

The second task of Australian Government assistance is to ensure that the BA maximises the efficiency of the financing risk-reward equation for both CHP borrowers (cost) and DCM investors (attractiveness expressed via credit rating). This requires consideration of other market gap drivers as explored in Chapter 2, including regulatory and policy conditions that create actual or perceived risk to investors. Specifically, the States' potential control over assets may limit the ability of CHPs to provide appropriate security which would subsequently detrimentally impact the attractiveness of the bond under a CHP default scenario. Further, due to the reliance on revenue streams which are driven by policy positions at State and/or Federal level, there is uncertainty which could be considered to impact CHP decision making, as well as increase default risk for investors if policy is changed. Current regulations are drafted to protect tenants as well as to protect State-funded assets, and many funding decisions are State based. Therefore, in considering appropriate interventions, the measures must balance the Australian Government's risk (and resultant fiscal exposure) with the intended intervention outcomes.

3 Government assistance

A challenge for the un-guaranteed Government entity is how to provide security to investors when sector regulations add a layer of regulatory complexity to obtaining and then exercising security in EoD. Detailed analysis and consultation with States is required.

Key elements of the national regulatory framework

- The national framework has been implemented in all states but WA and VIC. For the purpose of this analysis, it has been considered that the VIC regulatory environment is largely consistent in intent and application as the national framework
- The regulatory powers that accompany the national structure provide for the regulator to intervene in the operations of a CHP where it detects performance issues. The ultimate sanction under this framework is de-registration of the CHP. CHP's subject to the national system are required to have a "wind-up" clause that allows the regulator to transfer the community housing assets of one CHP to another in the event the regulator commences the process to cancel registration. The clear intent is that the failure of a CHP should not result in social housing tenants losing access to their dwelling
- Defaulting on a finance agreement is considered to be one of the more severe failures of a CHP and would likely result in the appointment of an administrator with a high chance of deregistration if the default is significant. We are not aware of any CHP's being deregistered due to a finance default under a loan agreement as CHP's must provide regular reports to the regulator, including a range of financial performance metrics giving the regulator advance warning over issues with the financial performance of a CHP
- The implication for a significant lender is that there is a risk that a wind-up and transfer process for a CHP debtor may not provide an appropriate opportunity for the lender to enforce their security and liquidate properties owned by the CHP to repay their debt. This risk is exacerbated by the lack of precedent against which lenders can assess the behaviour of individual regulated CHPs

Key State Government restriction

- Jurisdictions have implemented a series of stock transfers that have transferred state owned properties used for social housing to CHPs. These transfers place covenants on the land that require the CHP to use properties on the land for community housing purposes
- This introduces the risk that in a wind-up scenario a lender that has enforced their security cannot effectively maximise asset value where the properties are subject to a State covenant

Implications for the Australian Government

- The BA as primary lender to CHP's would assume this risk. The proposed pooling structure does not alleviate this risk as CHPs are participating on a "several" (each CHPs liability is distinct and separate from the liability of other CHPs) basis. Investors in the BA may be unwilling to accept this risk where the legal due diligence process highlights any uncertainty over the BA's capacity to effectively enforce in the situation a CHP becomes insolvent
- Given difficulty in quantifying and pricing the above risks, DCM investors will likely require a nationally consistent regulatory environment in intent and application which provides comfort regarding the enforceability of security. In the absence of it, a Government guarantee would be an efficient and timely mechanism to address this risk. As the above issues arise primarily from the interactions across the State legal and regulatory regimes, the Australian Government is likely to be the best placed entity to provide such a guarantee. The Australian Government is also best placed to resolve these issues with the States and should seek agreement for transfer of asset and liabilities to another CHP in an EoD. Where regulatory issues can be resolved in a timely manner and/or to the extent that the BA implementation timeframe is extendible, a no guarantee structure may be preferable
- While the BA is effectively open ended, the risk to the Australian Government from such a guarantee is not likely to grow in an uncontrolled fashion as the CHP sector does not have the capacity to rapidly grow their activity profile and resulting debt requirements

3 Government assistance

Government assistance Option 1: an Australian Government-owned BA minus an explicit guarantee.

Support mechanisms – Initial Australian Government ownership provides seed funding, strong credit & speed vs an outsourced solution

Initial Australian Government ownership and seed funding

- Initial Australian Government ownership of the BA (and therefore seed funding of the establishment phase) would deliver a strongly rated counter party with implicit Australian Government support applied to its credit rating. The structural complexity this option entails for lenders to bear in EoD will likely reduce pricing benefits (see below right)
- Initial Australian Government ownership could be used to establish the BA and provide for operational expenses for an interim phase (to be determined) as issuances build to generate fees for services that can fund the operation on a standalone basis
- Seed funding could also be set aside in a debt service reserve account (DSRA) to provide an immediate liquidity buffer to the BA in an EoD to provide sufficient liquidity to resolve borrower default issues and protect the Australian Government's position as an alternative option to obtaining a Liquidity Facility (refer page 57) via a line of credit with a commercial bank or via a facility with Finance. However, a Liquidity Facility is proposed as it offers more efficiently.
- A combination of both is likely required given the upfront costs in establishing the BA and the time required to achieve critical mass (volume and value of issuances) to cover the funds required in reserve
- As the economics of the PoC illustrate, the option of longer term return of seed funding to the Australian Government once the BA is self-sustaining is also possible depending on evolving CHP sector debt appetite and the BA's ability to be a core source of that debt. Further discussion of this scenario is provided in Chapter 5

Benefits of Australian Government ownership

Speed to market, ability influence and affect required changes

The benefit of Australian Government ownership is illustrated by contrast to an outsourced option. If the BA function was fully outsourced to either the private or not-for-profit sector in the first instance, a range of factors will likely determine the BA's standalone credit rating (for example credit policies, management experience and track record). The evolution and development of some of these necessary policies and tools is subject to a complex interplay of State regulations and stakeholder requirements. Short of an explicit Australian Government guarantee provided to an outsourced entity, resolution of these issues could hamper the development of an outsourced solution in a timely manner. In addition to speed, Australian Government ownership also enables Treasury to better manage and control its exposure.

Australian Government ownership challenges

What happens in event of default?

Investors are concerned with how they will be repaid in an EoD. An implicit guarantee is ambiguous and investors may require security over the BA's loans to the CHP sector (they will not have recourse to the BA or NHFIC's assets). The value of the security relative to the loans and the ability to firstly obtain, then secondly exercise, security are also complex given State restrictions on pledging security for transferred stock and the impact of alternate use limitations on the assets (see next page). This structural complexity will likely drive a premium to the explicit guarantee and could undermine the price and tenor benefits for CHPs and also hamper the longer term ability to be self-funding. In the EoD scenario, the Australian Government may also face reputational risk to cover the default and potential claims for support ahead of any event which could increase the Australian Government's exposure. A schematic illustration is provided in Chapter 4.

3 Government assistance

Government assistance Option 2: an Australian Government-owned BA with explicit debt obligations guaranteed.

Australian Government ownership with an explicit guarantee – the fastest route to market

Australian Government ownership and an explicit guarantee

Whilst comparative international experience indicates that the provision of a Government guarantee is not the sole driver of a BA's investment grade credit rating, the relative sophistication and scale of both the Australian CHP sector and DCM, coupled with the regulatory complexity of the Australian Federal system, lead us to conclude that an explicit guarantee is a cost-effective and appropriate method of Australian Government support. The guarantee could operate for as long as the Australian Government deemed appropriate and be affected via the NHFIC Act. In the event of a policy change that abolished the guarantee, any guaranteed issuances would remain afoot for the tenor the DCM provided borrowers. A guarantee based on the Export Finance and Investment Corporation (EFIC) model is a clear and simple statement of the obligation (see wording right). Measures to cost recover from BA borrowers via the provision of the guarantee can be written into the NHFIC Act (as in the case of EFIC) should a price signal be deemed appropriate in the context of the overall support provided. The chosen course of action should be determined in the context of the benefits of the arbitrage between current CHP bank financing costs and tenor and those obtained via the BA (see Chapter 5).

EFIC guarantee wording

"By force of this section, the due payment by EFIC of any money that becomes payable by EFIC to a person other than the Australian Government is guaranteed by the Australian Government."

Export Finance and Insurance Corporation Act 1991, Section 62

Benefits of Australian Government ownership with an explicit guarantee

Reduced structural complexity

Explicit guarantee of the BA's debt obligations reduces structural complexity for bondholders and allocates cross-jurisdictional policy changes to the Australian Government. Given the complex interaction of State regulations on the CHPs, the Australian Government's retention of this risk is appropriate as no other party is as well placed to deal with these issues over the short to medium term. This fact also enhances speed to market and enables the BA and the Australian Government to refine its credit appetite as issues are resolved (see right).

Structural simplicity partially reduces the margin premium bondholders will likely require for the BA's paper by providing a clear path to an Australian Government payment obligation. We have modelled the notional cost savings to borrowers as 1.4% p.a.*

* Further analysis is set out in Chapter 5

Australian Government guarantee issues

How does the Australian Government minimise its risk and protect its position?

The Australian Government's downside risk is that it retains the responsibility for resolving sector-specific issues that limit the ability of an out-sourced BA to achieve the necessary credit profile to obtain an investment grade rating.

The evolution of the policy change process the Australian Government negotiates to protect its position will likely affect the credit polices and risk appetite that the BA will likely need to adopt and evolve. In the BA establishment phase, it is likely that the larger and more sophisticated CHPs participate in the initial market taps. Those credits are strongest but perfecting the Australian Government's security over their assets is onerous and complex and, moreover, the process for managing an orderly transfer of obligations between registered players should be established between the BA, NHFIC and the States to reduce the Australian Government's exposure. Once those issues are dealt with, it may be possible for the BA to flex its credit polices and support lesser credit worthy parties with smaller debt requirements.

3 Government assistance

A comparison of an Australian Government BA guarantee vs. no Australian Government guarantee structure is presented below including pros, cons, considerations and our preferred structure.

Type	Australian Government Guarantee	No Australian Government Guarantee
Description	**The Australian Government elects to explicitly guarantee the BA's obligations to bond holders. This may be included within the NHFIC Act or as a standalone contractual obligation.**	**No Australian Government guarantee is provided for the BA - bond investors benefit from implicit support only associated with Australian Government ownership of the BA.**
Pros	▸ Most suited to meet identified market gap and the BA objectives ▸ Could be time-bound (to be determined) and limited to specific policy areas or general to the BA ▸ Offers the quickest route to market noting that an Australian Government guarantee reduces regulatory complexity for investors ▸ Additional pricing benefit associated with an explicit guarantee should drive further benefits for CHPs vs no Australian Government guarantee structure.	▸ No Australian Government contractual obligations associated with BA liabilities ▸ No change to existing State risk allocation regarding incentive / obligation for States to step-in to prevent and/or resolve a CHP default scenario
Cons	▸ Minimum exposure for the tenor of the last guaranteed bond issued ▸ CHP sector reinvestment of additional leverage (and creation of increased capacity) is not a causal outcome ▸ May result in the Australian Government assuming risks which are currently borne by the States, with potential for change in behaviours of States creating moral hazard due to decreased incentive / obligation for States to step-in to prevent and/or resolve a CHP default scenario	▸ Timing of BA bond issuance is dependent on resolution of regulatory issues, with potential for this to delay or indefinitely prevent implementation of the BA and associated BA bond issuances ▸ No additional pricing benefit associated with Australian Government guarantee vs Australian Government guarantee structure
Considerations	▸ Australian Government's retention of risk should be addressed through credit risk policies and resolution of regulatory issues relating to perfection of security via negotiation with the States (either upfront or over time) ▸ The nature of the guarantee wording and whether it is included within the NHFIC Act legislation or as a standalone contractual obligation should be considered in conjunction with credit rating agency methodology	▸ Investors will prefer a nationally consistent regulatory environment in intent and application which provides comfort regarding the enforceability of security
Preferred Structure	▸ The Australian CHP sector's risk profile is a function of Government policy: concentrated revenues based on Government rent assistance or other Government subsidies and State-based oversight over the use of assets drive solution design to a Government guaranteed BA. Where the regulatory issues can be resolved in a timely manner and/or to the extent that the BA implementation timelines are extendible, a no guarantee structure may be preferable	

4

Entity Structure

Overview of the structure of the BA from a resourcing and operations perspective and consideration of the type of bonds to be issued

4 Entity Structure

Overview and key findings.

Overview

This chapter provides an overview of the proposed structure for the BA and the bonds to be issued. It addresses the following components of the services to be provided:

- *Work stream 2: Structure of an affordable housing bond aggregator; and*
- *Work stream 3: Type of bonds to be issued by the aggregator*

The advice within this chapter relates primarily to the preferred structure for the BA including benefits and shortcomings and an overview of the nature and profile of the bonds to be issued by the BA. We have drawn upon a number of the structural features of both the LGFV model and the THFC model, however variations have been made to ensure efficient market access. Further to Chapter 3, the proposed structure assumes an Australian Government guarantee for the BA.

Methodology

In completing this chapter, we have undertaken the following:

- Assessed the merits of retail vs. wholesale, public vs. private and domestic vs. international bond markets and considered the key characteristics of the investors
- Considered international bond aggregation models with a focus on the nature of operations and specific structural features
- Building on the above and previous work streams, we present our proposed BA structure which draws on international precedents and takes into consideration Australian CHP sector specific characteristics
- Identified the range of stakeholders and third parties that are required to establish and operate the BA including a description of each of the roles and rationale for inclusion
- Provided a detailed overview of the operational mechanics of the BA from the perspective of CHPs including the borrowing process and the cashflow and liquidity management of the BA
- Outlined the proposed BA entity structure and operating model including the governance, management, FTE requirements and the complementary roles to be undertaken by a trust services provider
- Provided a worked example of the implications of a CHP loan default on the BA and the resolution period process prior to the Australian Government guarantee being called

Key Findings

- A low to moderate complexity structure is proposed noting timing, cost and complexity considerations plus flexibility for the BA to evolve over time
- Wholesale bonds issued into the Australian public market are favourable compared to retail bonds, private bonds and/or international bond markets due to lesser disclosure requirements and lower cost
- A pass-through structure provides an alternative debt procurement model to CHPs with attractive financial benefits. Bond issuances are proposed to be 10 year initially (and subject to review depending on market trends and CHP requirements), fixed rate bullet bonds issued from time to time in line with CHP loan demand requirements, with the proceeds on-lent on materially identical terms
- The CHP borrowing process should be simple to ensure no impediments to business as usual CHP borrowing practices with a Warehouse Facility providing debt on an “as needs” basis
- Management of liquidity risk is a key priority for pass-through structures, with a combination of CHP payments scheduled one month prior to bond obligations, a liquidity facility and cash reserves proposed in line with prudent risk management principles
- The BA should be established as a subsidiary of the NHFIC, with the governance model based on either NHFIC Board sub-committee or executive management. BA resourcing requirements are 8-10 FTEs, which are complemented by a trust services provider to minimize costs
- Credit assessment of CHP loans should sit with the BA, in particular noting the Australian Government guarantee

4 Entity Structure

Overview and key findings.

Recommendation:

- The BA should issue wholesale bonds, as opposed to retail bonds, into the Australian DCM. This approach offers cost effectiveness, a deeper market and greater investor demand

Recommendation:

- The optimal structure for the BA is a pass-through model where borrower funding requirements are equally matched to funding sourced from the DCM. Doing this through a standardised product reduces cost and complexity, and enhances transparency. This approach has proven to be effective internationally

Recommendation:

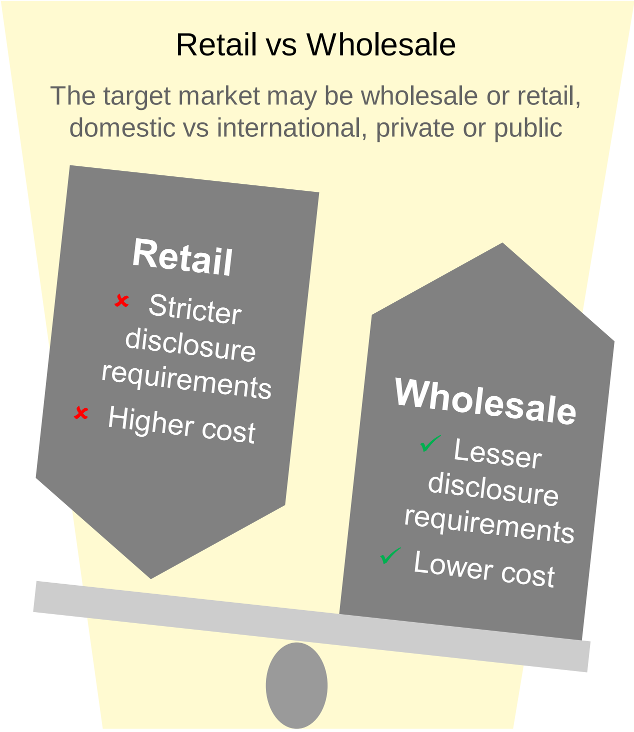
- Government should fund staffing costs and leverage existing expertise in Government to help sustain the BA prior to the entity attaining a critical mass. The BA should develop an investment mandate and credit policies which balance borrower requirements, prudent risk management and regulatory frameworks

4 Entity Structure

The Australian Government guarantee and expected BA credit rating should attract sufficient appetite in the wholesale DCM. As such, the elevated risk and cost associated with a retail issuance is not justified.

Retail vs Wholesale Bonds

- The key consideration in comparing retail to wholesale bonds is determining the optimal target investor market for the proposed issuance; retail bonds technically offer a wider investor pool (in that they are eligible for purchase by both the retail and wholesale market) however this option comes at an issuance cost premium (both monetary and risk due to the disclosure requirements of each bond type)
- As such, the preferred issuance market is the wholesale DCM and the retail DCM is generally only considered if there is an issue with accessing the wholesale market (insufficient wholesale DCM demand)



Retail Bond

- Retail bonds can be issued to both retail and wholesale investors on the basis that the offer document, the prospectus, meets both retail and wholesale disclosure requirements and complies with the Australian Securities and Investments Commission's (ASIC) lodgement requirements
- The retail disclosure requirements of a product disclosure statement (PDS) require significantly more detail than its wholesale counterpart, requiring more resources in its production, increasing the risk exposure in ensuring the accuracy of information provided
- Directors of the issuing company are personally liable for the content of an issued prospectus (with some exceptions)
- In many cases, minimum investment can be as low as $5,000
- Retail bonds trade on the Australian Securities Exchange (ASX) however tend to trade less frequently, especially in regard to corporate bonds

Wholesale Bond

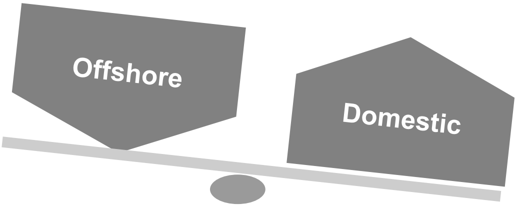
- The wholesale bond offer document, an information memorandum (IM), is less onerous as compared to retail disclosure requirements, which requires less resources to produce and limits the liability exposure from the documents contents
- Furthermore, directors of the issuing company are not personally liable for the content of the IM
- Wholesale bonds, at the time of issues, can only be sold to wholesale investors as the IM does not meet retail disclosure requirements, however, the wholesale bond market in Australia is much larger than the retail market
- In most cases, minimum investment is $500,000
- Wholesale bonds trade in the Over the Counter (OTC) market rather than on an exchange. Access to the OTC market is restricted to specialised dealers or brokers, as securities on the exchange are not publicly traded

Summary

- The more onerous disclosure requirements and personal liability to directors to issue a bond to retail investors generally results in a higher issuance cost and a reluctance for many corporate entities to do so
- Given the higher cost of issuing to retail investors, the preferred method is generally to issue to the wholesale market, unless some prevailing factor warrants the additional cost, such as challenges in liquidity in the wholesale market
- In the current economic climate, an Australian Government guarantee in addition to an investment grade rating the BA issuance is expected to achieve, we do not see any challenges to accessing capital via the wholesale DCM

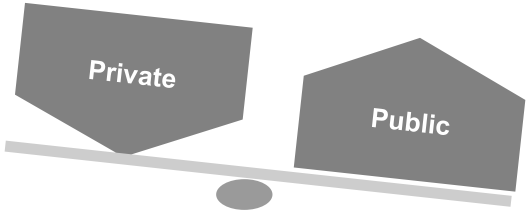
4 Entity Structure

Domestic DCM investors are best placed to understand the background of the issuance (the Australian affordable housing sector) and have a vested interest in its success. A public issuance is expected to facilitate competitive issue terms.



Market of Issuance

The bond may be issued domestically, internationally or both and may be issued in private markets, where they are not freely tradeable, or publicly on an accessible securities exchange



Domestic vs International Markets

A domestic market issuance targets an investor pool most likely to be familiar with the underlying credit metrics of the BA.

International investors are still able to participate (subject to ability to access the Australian DCM) however it is expected that Australian DCM participants (whether domestic or international investors) will be better placed to understand the offer and an issuance in the Australian DCM occurs in AUD, avoiding currency risk.

- Domestic market bond investors (e.g. Australian banks, superannuation funds and international investors focused on the Australian market with appetite for Australian dollars) are expected to be most familiar with the underlying credit profile of the BA and likely recipients (CHPs) which may provide a significant advantage since the underlying CHPs are not proposed to be individually rated (enhanced by Aaa Australian Government guarantee)
- Notwithstanding this, offshore markets such as the US Medium Term Note or Eurobond markets may offer: additional source of liquidity, longer tenors, funding diversity, lower base rates and appetite for lower quality credit
- Furthermore, borrowing in foreign currency is expected to require the purchase of derivatives to swap alternative currencies back into Australian dollars. Other costs may include overseas roadshows and foreign regulatory requirements which adds complexity and the reason we suggest not to pursue
- This may be costly, particularly in instances of early termination where “break costs” are typically significant

Private vs Public

A public issuance is expected to facilitate a competitive tender process which should optimise the BA bond pricing terms.

- A public bond issuance is expected to provide the greatest competitive tension, optimise terms and maximise liquidity
- Issuance in the public market allows multiple investors to bid their best offers in a transparent process based off publicly disclosed offering documentation
- Conversely a private placement is arranged via direct negotiation with one or a select number of investors. Typically, private placements do not require the same regulatory filings and disclosure obligations
- As private issuances are not publicly issued or traded they typically do not require a formal credit rating from Moody’s and/or S&P
- While a public issuance does require a credit rating, along with a greater regulatory and disclosure burden (and subsequent cost), the existence of a secondary market to publicly trade debt securities is expected to maximise initial and ongoing liquidity for issued bonds

4 Entity Structure

A fixed rate, interest only, 10 year bond is proposed based on domestic DCM market dynamics, CHP preferences, risk management principles and cost considerations.

Bond Issuance Format

The bond may be issued as fixed or variable interest rate, interest only or amortising and of various different tenors, with the optimal bond issuance format based on a range of considerations

Fixed vs Floating

A fixed rate bond is the proposed format noting DCM market acceptance, CHP preference and risk management principles

- The domestic DCM offer both fixed and variable coupon bonds, with an assessment of Government, Government-related and other comparable rated finance industry bond issuances over the last 24 months (refer Appendix 5) highlighting:
  - More than half the issuances (approximately 60%) comprised fixed coupons
  - Floating rate bonds represented 35% of issuances
  - There was one zero coupon bond
- Whilst variable rate loans are more common amongst existing CHP bank loans, a number of CHP employ a corresponding interest rate hedge and fixed interest rates were the third most important characteristic of BA loans based on the Survey responses, suggesting a fixed interest profile may be preferred/required
- Fixed rate loans for CHPs represent prudent financial risk management, noting this aligns the asset / liability cashflow profiles – i.e. long term inflation linked cashflows of CHP rental income are aligned to the defined interest obligations of fixed rate debt
- The pricing differential between fixed and variable arises as fixed interest rates represent the financial market's current assumptions regarding future rates, in line with corporate finance principles and efficient market theory (refer adjacent graph and considerations). Whilst there may be a perceived cost differential associated with fixed rate debt vs. variable rate debt, the decision regarding fixed vs variable should also consider risk management policies at an individual CHP level

Repayment profile

An interest only "bullet" bond is market convention

- The domestic DCM market typically does not offer principle and interest amortising bonds
- Whilst bonds may be "callable" (i.e. prepaid early), interest only "bullet bonds" are market convention

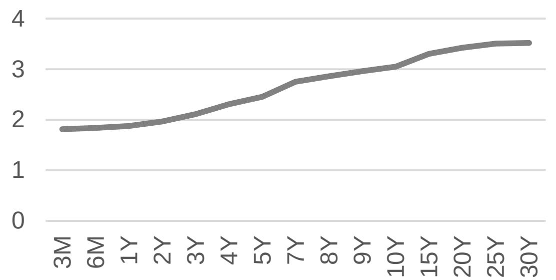
Tenor

A tenor of around 10 years balances DCM market appetite, risk management principles and cost considerations

- The domestic DCM market offers tenors of one to 30 years, however there have been limited issuances of 15+ years and these have largely been Australian Government and various State Government issuances to support further development of the Australian DCM in line with longer dated international bond markets. The average tenor of Government, Government-related and other comparable rated finance industry bond issuances over the last 24 months was 11 years (see Appendix 5)
- An inaugural issuance is likely to be best received by investors in the five to 15 year tenor range given this is in line with market precedent
- Longer dated fixed rate loans for CHPs assist in reducing asset / liability cashflow risk (as noted adjacent) and are in line with the second most important characteristic of BA loans based on Survey responses
- However, pricing and longer tenor are negatively correlated in that longer term debt is more expensive and therefore the objective of providing cheaper debt likely constrains the ability to provide 20-30 year debt (refer misperception of BA pricing benefits on page 13)
- 10 year tenor has been assumed as a reasonable balance between DCM market appetite, risk management principles and cost considerations, however the BA should consider the optimal tenor closer to the time of bond issuance noting that the shape of the yield curve changes over time

The Interest Rate Yield Curve

A normal interest rate yield curve is one in which longer maturity debt / bonds have a higher interest rate compared to shorter-term debt / bonds due to the risks associated with time. The graph depicts the yield curve for Australian AAA rated bonds as shown in the graph:



Source: Bloomberg (BS251 Mid Yield AUD AGENCY KANGAROO AAA BVAL YIELD CURVE as at 7 June 2017)

4 Entity Structure

We considered key DCM investor characteristics and regulatory requirements, the regulatory environment sought by investors, and key characteristics and features of a BA to maximize investor appetite.

The BA should balance the objectives of both CHPs and DCM investors. Key investor characteristics are discussed below:

Investor Preferences

- DCM investors are typically attracted by the prospect of capital preservation, "fixed" income (regular income streams) and diversification
  - **Capital preservation**: regular income stream via coupon payments and return of capital at maturity; bullet repayments at maturity
  - **Fixed Income**: obligation to make regular, fixed interest payments, that are not discretionary. Greater income than other fixed interest securities (e.g. deposits)
  - **Diversification**: fixed income assets may provide diversification to a portfolio of equities and other assets
- Investor demand is expected to be maximised by achievement of critical mass (i.e. >$100m) and tradeability of bonds to increase liquidity

Investor Type

- Purchasers of DCM bonds are largely institutional investors (e.g. Government entities and super funds) who often take a bottom-up approach to investing hence take a "buy and hold" position. Retail investors (e.g. individuals) can access certain products (a limited offering such as retail or hybrid bonds) however the market is smaller and less popular for issuers
- Regulatory obligations are greater for retail issuances (e.g. prospectus issue), with these requirements (and costs) typically incentivising issuers to target the wholesale market exclusively
  - Common investors in relevant Government Business Enterprise (GBE) transactions (e.g. EFIC, Australian Rail Track Corporation (ARTC) and overseas social housing issuances (e.g. THFC) include Vanguard, UBS, Aberdeen, Black Rock and Prudential

DCM Investors

Risk Preferences

- Institutional investors are attracted by issuers of strong credit quality with stable cash flows and sound financial metrics
- Investors are expected to seek:
  - Solid financial track record and conservative financial risk profile
  - Strong economic fundamentals with reliable sources of revenues
  - Appropriate governance, oversight and risk control framework within the vehicle
  - Regulated industry for loan beneficiaries (which will likely result in the CHP regulatory regime being perceived positively)
- Issuances rated between A – AAA are expected to attract demand from investors seeking a substitute to Government bonds. This rating may be achieved via an explicit Australian Government guarantee or a well capitalised vehicle and importantly, highly rated underlying borrowers

Return Preferences

- Many DCM investors have a specific mandate for fixed income investments or requirement for regular income streams making bonds a suitable investment
- High credit quality of investment grade DCM issuers sees returns below that of equity instruments
- A premium above the risk free rate (the minimum return an investor expects for any investment, for which sovereign bond returns are often used as a proxy) is expected to compensate investors for an issuer's credit risk
- Investors are generally attracted by the stable nature and reliability of periodic coupon payments which an issuer is obliged to pay
- Returns are a function of the structure of the DCM instrument, with debt always ranking ahead of equity instruments in insolvency

Recipients of BA funding should exhibit characteristics outlined above to attract investor demand.

4 Entity Structure

The BA incorporates an innovative and unique structure which draws on international precedents and takes into account Australian CHP sector specific characteristics.

Structuring the BA

- EY reviewed a range of international BA models in the social and affordable housing sector and the local Government sector to inform the structuring of the BA that best meets the Australian Government objectives (see Appendix 6). The benchmarking highlighted two key categories of considerations which inform the structuring process as follows:
  1. Nature of operations
  2. Specific structural features
- Importantly, the nature of operations will likely influence the specific structural features outlined below. A low to moderate structure is proposed noting timing, cost and complexity considerations plus flexibility for the BA to evolve over time

Increasing structural complexity / nature of operations

Structural Feature	Low complexity (e.g. LGFV Model, Australia)[37]	Moderate complexity (e.g. THFC Model, UK)[38]	High complexity (e.g. Local Government Funding Agency (LGFA) Model, New Zealand (NZ))[39]
Nature of operations	▸ A BA into a single debt market	▸ A BA into multiple debt markets	▸ A financial institution
Description	▸ A sole pass-through vehicle	▸ A pass-through vehicle with some active operations	▸ A complex operating entity, enabled under local federal legislation
Ownership and guarantee	▸ Owned by Municipal Association of Victoria (MAV) (peak body) ▸ No Government guarantee	▸ Owned by its Board of Directors ▸ No Government guarantee	▸ Owned by major participating councils and the NZ Government ▸ Guaranteed by its council shareholders and borrower and guarantor councils
Credit rating	▸ Aa2 (Moody's)	▸ A (S&P)	▸ AA+ (S&P)
Bonds on issue	▸ A$340m	▸ £5.9b	▸ NZ$7.7b
Asset/Liability matching	▸ Materially matched, loan interest paid three business days in advance of corresponding coupon payment	▸ Materially matched, loan interest paid one month in advance of corresponding coupon payment	▸ Not asset/liability matched, with interest rate and foreign exchange (FX) risk borne by NZ LGFA

4 Entity Structure

The BA incorporates an innovative and unique structure which draws on international precedents and takes into account Australian CHP sector specific characteristics.

Increasing structural complexity / nature of operations

Structural Feature	Low complexity (e.g. LGFV Model Australia)	Moderate complexity (e.g. UK THFC Model)	High complexity (e.g. NZ LGFA Model)
Capital base	▸ Minimal capital base ▸ A$300k reserves (0.1% of bonds)	▸ Low capital base ▸ £28.8m reserves (0.5% of bonds)	▸ Complex capital base with participant buy-in and issuance of derivative securities
Liquidity	▸ Bank facility with a limit equivalent to 12 months of coupon obligations	▸ Reserve buffer account ▸ DSRA	▸ Capital adequacy requirements
Lending activity	▸ Materially matched to corresponding bond issuance terms	▸ Materially matched to corresponding bond issuance terms (but given the volume on issuance, offer more flexibility)	▸ Offer bespoke loans
Governance/ Management	▸ No or limited internal operations	▸ Some internalisation of operations including independent credit assessment	▸ Complex operating entity which classifies as a financial institution
Conclusion	▸ Merit in considering however functionality may restrict accessibility	▸ Capitalisation or other support increases accessibility to a wider variety of participants	▸ Complexity requires significant scale to provide efficient funding due to significant cost base

Implications for BA structure

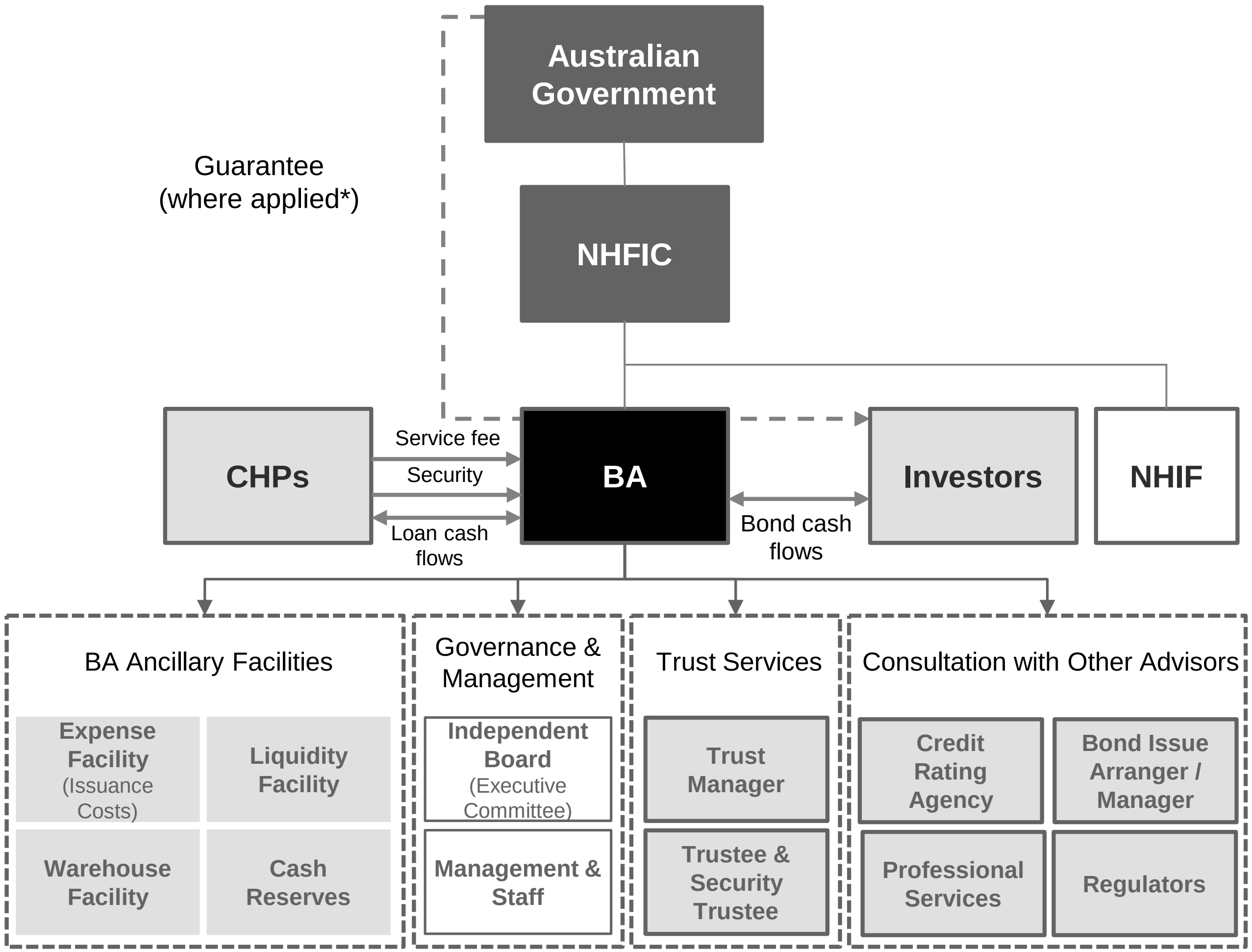
A low complexity structure model is proposed recognising timing, cost and complexity considerations plus flexibility for the BA to evolve over time. In developing the proposed BA structure, we have drawn upon a number of the structural features of both the LGFV model and the THFC model. However, variations have been made to the structures to ensure efficient market access, in particular the inclusion of an Australian Government guarantee as discussed and recommended in the previous chapter.

A BA by definition assumes counterparty credit risk as it borrows from the DCM and and on-lends these funds to the CHPs. The level of capitalisation can protect against any unforeseen defaults and ensure continuity of operations and bond instruments. Given it is recommended that the BA be thinly capitalised, enhancements have been incorporated into the design as follows: CHP loan payments scheduled one month prior to bond obligations, liquidity facility, 12 month resolution period and minimum cash reserves.

4 Entity Structure

The BA is a funding vehicle established to facilitate the aggregation of loans to Australian CHPs to allow sufficient scale to efficiently access the DCM.

The diagram below provides an overview of the BA structural overview, highlighting key stakeholders and interactions with third parties.



*Refer to page 40 for a comparison of the structure with a guarantee vs no guarantee

- The BA incorporates an innovative and unique structure - which draws on international precedents and takes into account Australian CHP sector specific characteristics - to enable the pooling of loans to generate sufficient scale and achieve optimal pricing through a market parcel size attractive to institutional investors
- The BA aims to support the delivery of housing to those on low income through the three core objectives that have informed the design (refer page 22)

A description of the key components of the BA and their alignment to BA objectives is provided on the following pages.

4 Entity Structure

A broad range of stakeholders and third parties are required to establish and operate the BA.

BA roles and rationales – Key Stakeholders

Item	Role Description	Rationale
Australian Government	Responsible for establishing the NHFIC (which the BA is to be a subsidiary of) via passing legislation in parliament. The Australian Government forecast to guarantee the BA's liabilities to investors	The Australian Government is the sponsor of the BA initiative and has the required powers to pass legislation and affect national consistency to protect its position. The Australian Government is best placed to manage the credit risk of the CHPs (via the guarantee) to facilitate institutional investment into the CHP sector
CHPs	Borrows from the BA by entering into a bilateral loan. CHPs are severally liable – i.e. each partner is only liable for their own obligation	CHPs borrow in line with their debt requirements
Investors	Lends to the BA by purchasing bonds	Investments are made in line with its investment mandate based on assessment of risk vs. return

BA roles and rationales – Ancillary Facilities

Item	Role Description	Rationale
Liquidity Facility Provider	Standby line of credit facility sized to cover 12 months bond coupon payments. May be provided by either a bank or the Australian Government/AOFM	Liquidity risk mitigation - provides time to resolve CHP loan default whilst maintaining bond coupon payments
Establishment Expense Facility Provider	Fixed rated principal and interest loan drawn to fund bond issuance costs and repaid from excess margin payable under CHP loans	Cost recovery of establishment costs payable by CHPs over the life of the loans rather than upfront
Warehouse / Interim Facility Provider	Short term bank debt facility (interest only, variable rate) provided to CHPs. May be provided either (i) bi-laterally from bank to CHP; or (ii) from bank to CHP via the BA	Provides financing to CHPs on an "as needs" basis and facilitates aggregation of CHP loans over time in order to achieve wholesale market scale ($100m)
Cash Reserves	Minimum $100,000 cash reserves to be held by the BA per bond issuance	Liquidity risk mitigation - provides liquidity to cover extraordinary expenses

Whilst there may be merit in the Australian Government / AOFM providing some or all of the BA ancillary facilities, this decision should consider competitive neutrality. The ancillary facilities are modestly sized and/or short tenor facilities which are required in order to access the DCM and provide a simple and holistic solution to the CHPs. The provision of these facilities by the Australian Government / AOFM may assist to drive a degree of incremental benefit to CHPs, however this is not a key driver of the BA financing benefit and should it be considered that it presents competitive neutrality issues, then the BA ancillary facilities may be provided by a bank.

4 Entity Structure

A broad range of stakeholders and third parties are required to establish and operate the BA.

BA roles and rationales – Governance & Management

Item	Role Description	Rationale
BA	Pooling the CHP loans to a scale sufficient to access DCM by issuing bonds to investors	To support the delivery of housing to those on low income through the three core objectives
Independent Board and/or Board	Responsibility for key decision making for the BA and setting the strategic direction for operations. A sub-committee of NHFIC Board	In line with prudent governance principles
Executive Management	Management of the BA operations including credit assessment, relationships with CHPs and interaction with and management of other stakeholders / third parties	In line with prudent management principles
Relationship Managers	Responsibility to i) originate loans from the CHP's ii) act as an interface with CHPs and manage ongoing variations that may be required iii) work with credit to submit initial and on-going approvals and iv) ongoing reporting requirements	In line with market practices
Credit Risk Manager	Delegated authority for accepting loans from CHP's where the borrowing conditions meet the BA's credit policy (and in turn ensures credit rating maintenance). Continuously reviews the portfolio and applicability of the credit policy (noting any variations will likely require Independent Board/Board approval). The Credit Risk Manager may be responsible for the relationship with the rating agencies / Australian Government to provide updated information as to the performance of the loan pool	In line with prudent management principles
Treasury Manager	Responsible for the day to day liquidity management of the BA, including co-ordinating drawdowns of the Warehouse Facility and working with arrangers in the issuance of bonds. Potentially undertaken by AOFM in the short term or provided by an external third party	In line with prudent management principles

4 Entity Structure

A broad range of stakeholders and third parties are required to establish and operate the BA.

BA roles and rationales – Trust Services

Item	Role Description	Rationale
Trust Manager	Administrative management of the BA including: servicing and administration of the assets, performing all calculations, reporting and financial and regulatory compliance	The trust services model is primarily utilized to minimize costs noting economies of scale vs. an insourcing model
Trustee	Making payments to investors, advisors and other stakeholders in a fiduciary capacity	Provides oversight and governance to the performance of the duties by the trust manager thereby providing comfort to investors
Security Trustee	Holds assets in trust on behalf of investors	This structure avoids granting security separately to all creditors which would be costly and impractical

BA roles and rationales – Other Advisors

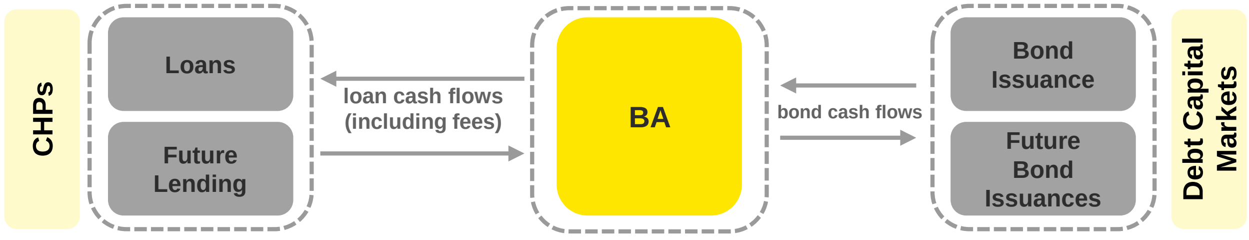
Item	Role Description	Rationale
Credit Rating Agency	Independent assessment of BA creditworthiness with respect to the proposed bond issuance including publishing a credit rating report	A credit rating is a requirement to access the DCM. Investors seek the credit opinion of an internationally recognised credit rating agency prior to investing
Bond Issue Arranger / Manager	The marketing and distribution of the bonds to investors. Typically done by the Big 4 Australian banks	Accessing the DCM requires a network of investors combined with the expertise and financial services licences to offer the bonds for sale to the DCM
Professional Services	To assist with the establishment and operation of the BA and bond issuances including: ▸ Financial advisor: strategic advice and project management of the process ▸ Legal professionals: legal advice and drafting of documentation ▸ Tax professionals: tax advice ▸ Accounting professionals: accounting advice and audit services	In order to access the DCM in line with market practices and to ensure the design and operation of the BA is in accordance with various legal, tax and accounting requirements

4 Entity Structure

The Aggregation Model for the BA facilitates access to DCM by overcoming the scale barrier, providing an alternative debt procurement model to CHPs with attractive financial benefits.

The aggregation model for the BA

- The purpose of the BA is to pool the CHP loans to a scale sufficient to access DCM in line with the three core objectives
- The BA structure is a pooled financing as distinguished from a securitisation – i.e. the CHP general corporate purpose loans are aggregated via the BA rather than the underlying CHP asset cashflows being sold to a third party as would be the case under a securitisation
- The BA borrows directly from the DCM via a bond issuance and on-lends the proceeds on materially similar terms to each individual CHP – i.e. a pass-through structure with BA asset and liability matching
- The CHPs pay interest and principal at maturity on the loans to the BA which are passed through to bondholders as coupon payments and bond redemption at maturity
- The BA has the flexibility to charge CHPs an excess margin (i.e. service fee) above the bond coupon rate to cover a portion of bond establishment costs and/or the ongoing operating costs of the BA



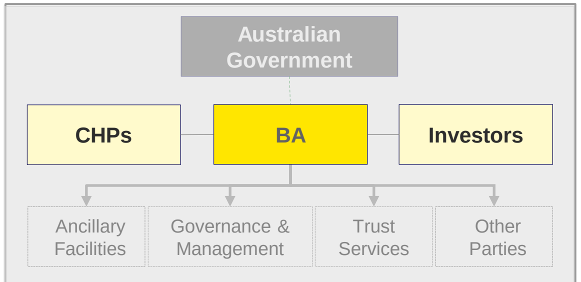
Security over CHP assets

Aggregation of CHP loans provides the scale required to access DCM

Security over BA loans (not securitisation of CHP assets) provided to bond investors, strengthened by Australian Government guarantee

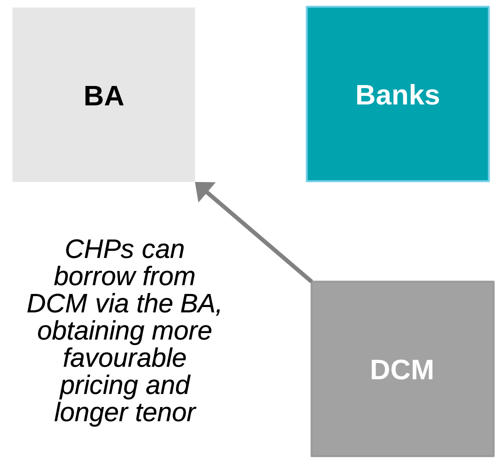
Aggregation Benefits

- The BA has been designed to provide an attractive alternative debt procurement model to CHPs vs. Australian bilateral bank loans. Key direct and indirect benefits of the aggregation model are described overleaf:



This page outlines how the BA facilitates a transaction between CHPs and DCM investors.

The aggregation model for the BA provides access to the DCM, by-passing the bank market who traditionally act as intermediary.



Security over BA loans (not securitisation of CHP assets) provided to bond investors, strengthened by Australian Government guarantee

4 Entity Structure

The aggregation model for the BA facilitates access to DCM by overcoming the scale barrier, providing an alternative debt procurement model to CHPs with attractive financial benefits.

Aggregation Benefits

- The BA has been designed to provide an attractive alternative debt procurement model to CHPs vs. Australian bilateral bank loans. Key direct and indirect benefits of the aggregation model, both quantitative and qualitative include:

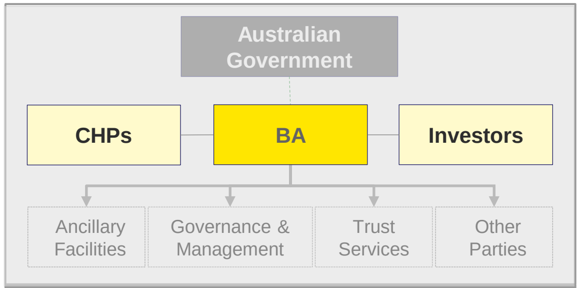
How does the CHP benefit from this structure?

The BA structure is designed to provide the following benefits to the CHP participants:

1. Financial benefits principally in the form of **cheaper funding**. This is captured in Chapter 5
2. Provision of **reduced financing risks**, via:
    a. The **availability of longer tenor** loans of 10 plus years vs current bank lending standards of three years. The longer tenor reduces refinancing risk and is more aligned to corporate financing principles of matching asset and liability tenors. This is expanded on in Chapter 5
    b. Increased **diversification of funding sources** providing CHPs with choice of appropriate funding partners
    c. Addresses current refinancing risks being faced by the sector
3. Efficient fund raising platform. The BA should drive **efficiency in procuring financing and best practice** through standardised documentation and processes
4. Provision of **reduced amortisation requirements**, improving ongoing cash flows and allowing reinvestment into existing or future projects
5. Drives **efficiencies (time and cost) in procuring** financing, and utilisation of best practise through standardised documentation and processes

Other benefits:

- ✓ Improve access to bank funding for developments/construction (project risk profile) given confidence by the bank market given refinance options / certainty of repayment
- ✓ Encourages institutional wholesale investment into the sector. Additional market issuances may enhance the Australian bond market
- ✓ Provides the opportunity to CHPs to increase stock, due to cash flow improvements of lower cost debt (interest savings) and reduction of amortisation requirements
- ✓ Builds an understanding of the CHP sector by various participants (including investors) which may increase investments or drive greater funding advantages
- ✓ Leverages existing Government skill sets and capabilities to create a robust and accountable structure that is streamlined and efficient during set up and operations
- ✓ Leverages existing regulatory environment to optimise attractiveness in the market
- ✓ Leverages experiences of international initiatives, refined for the unique Australian environment
- ✓ Is a flexible model that is scalable and adaptable to changes in future policy priorities



This page outlines how the BA facilitates a transaction between CHPs and DCM investors.

4 Entity Structure

CHP's benefit from a simple BA borrowing process which is comparable to the current process of obtaining debt finance from a bank.

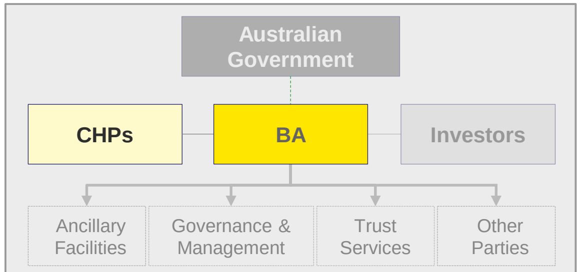
CHP Borrowing Process

- CHPs to follow a simple process to apply for a BA loan, as outlined below:
  1. CHP identifies borrowing requirement (may be a refinance or new borrowing requirement)
  2. CHP submits a borrowing request to the BA
  3. BA reviews the CHP request and eligibility - requesting information from the CHP as necessary such as financial statements - against the BA credit policy and will either approve or decline the CHP's request
  4. Subject to approval, the CHP receives a term sheet, which outlines the key terms of the approved loan similar to that outlined to the below right – since the BA bond coupon will likely not be determined until the time of issuance, the interest rate on the term sheet is indicative only
  5. CHP reviews the term sheet and if deemed acceptable, notify the BA and the formal loan agreement is executed based on standard terms and conditions
  6. Funds available to drawdown following administration and processing of the loan agreement*
  7. As per the terms of the loan agreement, the CHP will likely be required to make its regular interest payments and upon maturity of the loan, repay the principal in full. Note that CHP interest and principal payment are to be scheduled one month prior to bond obligations as the first level of liquidity risk management for non payment (e.g. due to administrative error)

BA vs Bank Process

- As above, the financing process for the CHPs is relatively simple and similar to the process of obtaining debt finance from a bank
- Both banks and the BA will likely require similar information prepared by CHPs in the credit assessment stage hence the administration structure should not be more onerous
- Furthermore, the CHPs may avoid a tender process (approaching multiple banks to obtain a more competitive offer) yet still achieve a competitively priced loan, since the bond issuance process incorporates a wholesale DCM tender that ensures the best market price. This process is managed by the bond arranger on behalf of the BA, and effectively occurs "behind the scenes" from the CHP's perspective
- Also, by engaging in the tender process, CHPs gain insight and a degree of certainty into the loan pricing from banks. Whilst CHPs receive best market price via the BA, there is an element of uncertainty for CHPs given the actual CHP loan pricing is unknown until the day of the bond issuance when the market price is set by the wholesale DCM tender process

* Excess margin to be sized to cover a portion of bond establishment costs and the ongoing operating costs of the BA (refer Appendix 7)
* In the case of a mismatch in timing (between CHP request/drawdown and bond settlement), see page 58 regarding the Warehousing Model



This page outlines the interaction between the CHPs and the BA in order to obtain financing.

The BA Loan Term Sheet: The BA loans are structured similarly to commercial loans offered by banks

Borrower	[Individual CHP]
Lender	[BA]
Amount	$[●]m
Purpose	General corporate purposes
Interest rate	[●]% bond coupon plus [●]% excess margin*
Repayment Structure	Semi-annual interest only. CHP payments scheduled one month prior to bond obligations
Fees	A borrower service margin is charged to cover the BA's issuance costs*
Tenor	[10] years
Covenants	TBD
Security	Registered mortgage(s) and/or General Security Agreement

4 Entity Structure

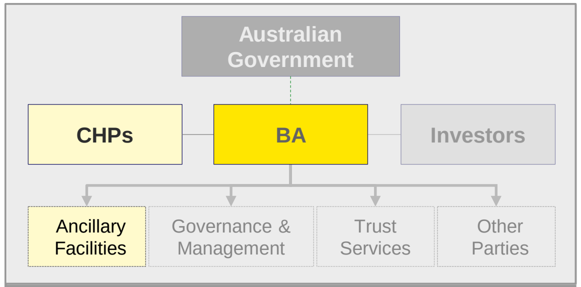
Management of liquidity risk is a key component in the design of a sustainable BA model.

Description

The Liquidity Facility is a revolving credit facility sized to cover 12 months bond coupon payments. The facility is provided to the BA by a financier (e.g. bank or Australian Government/AOFM)

Rationale

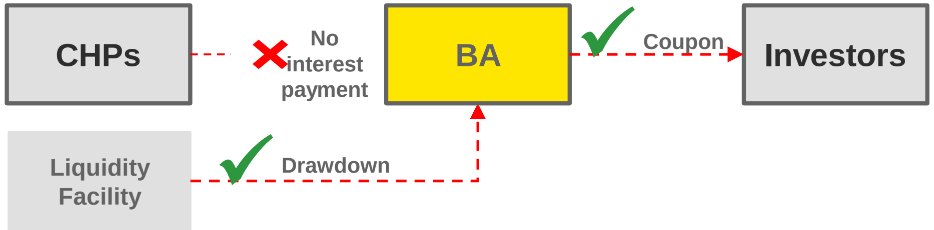
Liquidity risk mitigation - provides time to resolve CHP loan default whilst maintaining bond coupons



This page outlines the operations of the Liquidity Facility.

The Liquidity Facility

- In the absence of a DSRA (refer page 38), the low level of capitalisation (i.e. limited cash reserves) and the pass-through nature of the BA, liquidity management is a key consideration to ensure that the BA is able to service bond coupon payments in the event that a CHP fails to make an interest payment. A Liquidity Facility, which is effectively a standby line of credit, is the structural enhancement proposed to provide such liquidity
- Where a CHP fails to make an interest payment, the BA is able to drawdown on the liquidity facility with the cash proceeds utilised to pay the bond coupon as follows:



- In the event of drawing the liquidity facility, the facility interest costs incurred from drawdown by the BA will likely be passed onto the CHP by way of a higher default interest rate under the terms of the CHP loan
- A separate liquidity facility is to be provided for each series of bonds issued by the BA which is sized to cover 12 months bond coupon payment, thereby providing time to resolve a CHP loan default whilst maintaining bond coupons as follows:

- The Australian Government / AOFM may be best placed to provide the liquidity facility given they are best placed to assess, price and manage the risks associated with CHP loan default and resolution process and provide the lowest cost of finance; however, consideration should be given to the effect (if any) on competitive neutrality in the financial sector

Liquidity Facility Term Sheet:

Borrower	[BA]
Lender	[Australian Government / AOFM]
Amount	$[●]m, sized to cover 12 months bond coupon payments
Purpose	Liquidity support due to CHP loan payment default
Interest Rate	Undrawn commitment fee: [●]% Drawn rate: BBSW + [●]%
Repayment Structure	Revolving. Availability of 12 months from drawdown
Fees	No establishment fees
Tenor	[10] years, in line with the tenor of the bonds
Covenants	TBD
Security	Secured by the CHP Loans (ranks senior to the bonds)

4 Entity Structure

CHP's could benefit from a simple BA borrowing process and access to debt on an "as needs" basis via the Warehouse / Interim Facility.

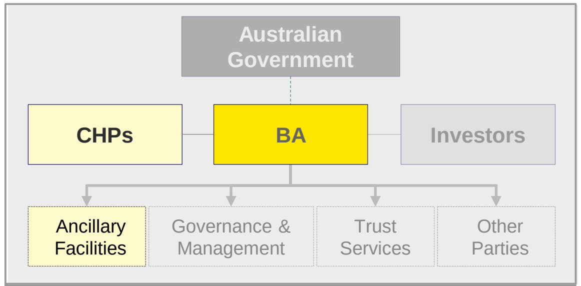
Description

The Warehouse Facility is a short term debt facility (interest only, variable rate) provided to CHPs. It may be provided either:

- **Bi-laterally from a financier (e.g. bank or Australian Government/AOFM/Clean Energy & Finance Corporation (CEFC) to CHP; or**
- **Financier to CHP via the BA**

Rationale

The Warehouse Facility provides financing to CHPs on an "as needs" basis and facilitates aggregation of CHP loans over time in order to achieve wholesale market scale ($100m)

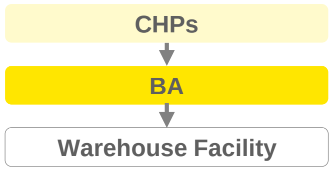


This page outlines the operations of the Warehouse / Interim Facility.

Optional Warehousing Model

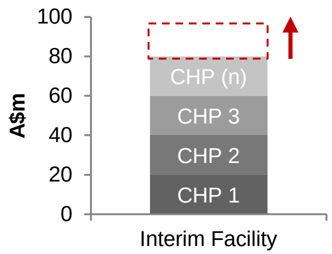
- Following BA credit approval, the CHPs may require interim financing until sufficient scale is achieved and the BA can issue a bond and on-lend the proceeds to CHPs
- While not integral, the Warehouse Facility is useful in providing a simple and holistic solution to the CHPs – within existing relationships – to preserve the interface between the BA and CHPs. It can be arranged to provide bridging finance to the CHPs thereby providing financing on an "as needs" basis, with the Warehouse Facility repaid from the bond issuance proceeds thereby dealing with timing mismatches
- The Warehouse Facility may be outsourced by referral to a third-party financier, such as an Australian bank, or the BA can act as an arranger and manage the facility
- It is proposed that this be arranged by the BA to ensure they have visibility of debt sizing to provide earliest opportunity to issue a bond

- **Step 1:** Join the BA and borrow through the interim facility

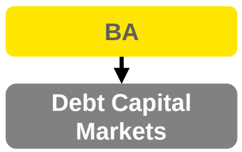


Interim Facility
- **Tenor:** 12 months;
- **Interest Rate:** Variable;
- **Repayment Profile:** Interest only

- **Step 2:** Interim facility builds up to minimum wholesale market parcel ($100m)



- **Step 3:** Bond(s) issued to refinance the interim facility



* Excess margin to be sized to cover a portion of bond establishment costs and the ongoing operating costs of the BA

Warehouse / Interim Facility Term Sheet:	
Borrower	[Individual CHP]
Lender	[Bank or Australian Government/AOFM]
Amount	$[●]m
Purpose	Short term interim financing for general corporate purposes whilst the BA is building wholesale market scale
Interest Rate	[●]%
Repayment Structure	Quarterly interest only
Fees	No establishment or commitment fees
Tenor	[12] months
Covenants	TBD
Security	Registered mortgage(s) and/or General Security Agreement

4 Entity Structure

Cash Reserves are an additional liquidity risk management feature to cover extraordinary expenses. An Establishment Expense Facility provides an optional mechanism for the CHPs to fund establishment costs in line with the self-sustainable objective of the BA.

Cash Reserves

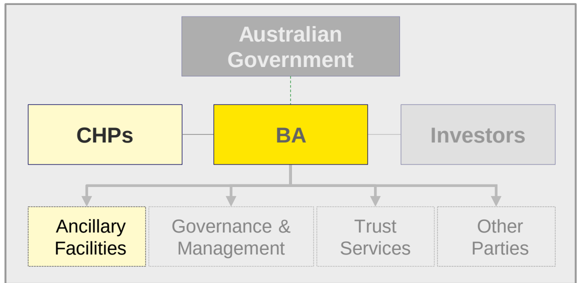
Description	Rationale
The BA should be capitalised with a minimum of $100,000 cash reserves per bond issuance	**Liquidity risk mitigation - provides liquidity to cover extraordinary expenses**

- Given the thin capitalisation (i.e. limited cash reserves) and the pass through nature of the BA, liquidity management is also a consideration to ensure that the BA is able to cover extraordinary expenses
- Minimum cash reserves of $100,000 per bond issuance are in line with precedent transactions (e.g. LGFV) and consistent with the minimum liquidity levels that Moody's typically require when assessing a pooled financing vehicle. The cash reserves may either be funded by the Establishment Expense Facility (refer below) or allocated Budget funding
- Additional cash reserves may be built up over time by the BA through net interest margin – i.e. charging CHPs interest greater than the bond margin plus the excess margin sufficient to cover BA costs (refer below)

Establishment Expense Facility

Description	Rationale
Fixed rated principal and interest loan drawn to fund bond issuance costs and repaid from the excess margin payable under CHP loans	**Cost recovery of establishment costs payable by CHPs over the life of the loans rather than upfront**

- Given the pass through nature of the BA and objective to be self-sustainable, the interest rate charged by the BA for the CHP loans incorporates the bond coupon plus an 'excess margin' (i.e. service fee). The excess margin is determined by three components as follows:
  - Bond Issuance Establishment Costs: an amount which covers the annual principal and interest payments for the Establishment Expense Facility – a loan drawn at bond issuance to fund bond issuance establishment costs
  - Ongoing BA Operating Expenses: an amount which covers the annual operating costs of the BA including ongoing DCM access costs (e.g. credit rating fees) and BA staff wages
  - Net Interest Margin: an amount in addition to the cost recovery components noted above which represents an ongoing source of net operating revenue for the BA
- The excess margin structure (including the Establishment Expense Facility) have been incorporated as a mechanism to address the self-sustainable objective of the BA. The excess margin should be transparently communicated by the BA to CHPs as a cost recovery mechanism. This functionality may be excluded in the early years of the BA to maximise the pricing incentive of the BA vs. alternative bank financing to the extent that allocated Budget funding covers the establishment and ongoing expenses over the life of the initial bond issuances. Additional capitalisation above the minimum Cash Reserves is not proposed at the outset



This page outlines the cash reserve requirements and operations of the Establishment Expense Facility.

Establishment Expense Facility Term Sheet:

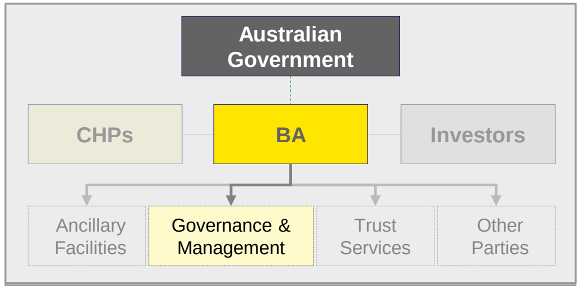
Borrower	[BA]
Lender	[Bank or Australian Government / AOFM]
Amount	$[●]m, in line with the total bond issuance establishment costs
Purpose	To finance the payment bond issuance establishment costs
Interest rate	[●]%
Repayment Structure	Semi-annual principal and interest
Fees	No establishment or commitment fees
Tenor	[10] years
Covenants	TBD
Security	Secured by the CHP Loans (ranks senior to the bonds)

4 Entity Structure

There are several ways the NHFIC and the BA could be established and delivered. The most efficient, effective and economical way to establish and deliver these entities will be determined in accordance with the Commonwealth governance structure policy.

NHFIC Structure Framework

- The NHFIC will likely be a Corporate Commonwealth entity established via an Act in 2018. The NHFIC is proposed to have two functions: management and delivery of the National Housing Infrastructure Facility (NHIF) and the BA. The *Public Governance, Performance and Accountability Act 2013* (PGPA Act) is applicable to the NHFIC. Final design of the governance arrangements for the NHFIC is subject to Ministerial Approval and Cabinet Consideration
- The BA may operate as a subsidiary of the NHFIC and will likely be a Corporate Commonwealth entity under the Corporations Act. The legal form of the entity should abide by relevant legislation including the PGPA Act and Corporations Act



This page outlines the ownership and exposure relationship between the BA and the Australian Government and the subsequent governance and management planning implications.

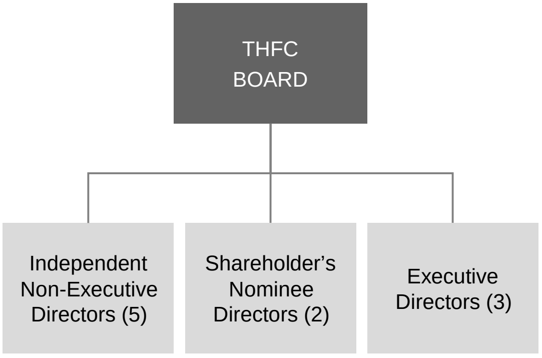
BA Internal Governance

- Two options for oversight and governance controls:
  1. Independent NHFIC Board sub-committee comprising independent members in non-executive roles and BA representatives in executive roles
  2. Executive management comprised of NHFIC and BA representatives plus AOFM, with Treasury and Finance representatives to form risk, credit and overall governance committee
- BA may adopt Model Accountable Authority Instructions (AAIs) for Corporate Commonwealth entities and adhere to PGPA and Finance's resource management guidance (RMGs). Furthermore, it is important that governance principles (as prescribed by Finance) such as clarity of purpose, accountability, transparency and sustainability are maintained

Potential BA support to loan and grant applications for NHIF applications could be considered given complementary skills sets though this may require additional resources to the BA credit function.

THFC Board Structure – for information

- THFC is a non-Government Community Benefit Society. It has close links to Government: S&P notes that the UK Homes and Community Agency (a Government entity) is a shareholder in THFC and at the same time is involved in sector regulation. The board structure (10 members) is shown to the right
- Two governance options are identified below for the BA: Treasury departmental oversight and an independent board. The latter increases costs, but better captures sector insights and issues (therefore improving stakeholder buy-in) and oversight whereas the former minimises costs. The determining factor will likely be the NHFIC's ultimate governance framework



4 Entity Structure

BA resourcing requirements have been estimated considering the scale, structural complexity, outsourcing potential and proposed guarantee. Resources are focused on driving BA loan volumes and prudent lending (relationship management and credit risk).

NHFIC Budget 2017 Funding Profile[40]

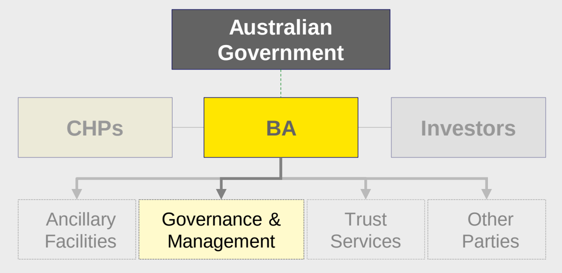
- Budget allocated: $63m/4 years to 2020-21
- $9.6m in 2017-18 ($4.8m in capital costs)
- $1m for office accommodation fit-out in 2017-18 and $400k p.a. in leasing costs

NHFIC Budget 2017 Staffing Profile

Budget allocated:

- 3 FTE from 2017-18
- 32 FTE by 2018-19
- 36 FTE by 2019-20*

* Staffing numbers relates to the total requirement for NHFIC including the BA and NHIF



This page outlines the ownership and exposure relationship between the BA and the Australian Government and the subsequent governance and management planning implications.

Key Credit Policy Principles

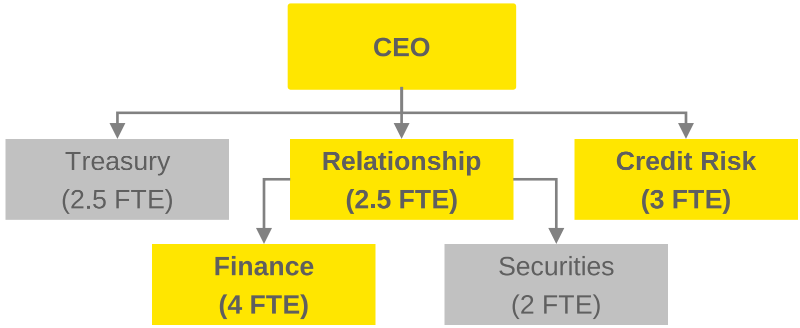
The BA's credit policy must be developed as part of the implementation of the BA. Note that this is a key risk mitigation strategy for the Australian Government given the proposed Government ownership and potential guarantee. At this time it is not intended that there be any housing policy priorities (e.g. geography or cohort) Key principles would be considered to include:

- General corporate purposes for registered Tier 1 and 2 CHPs (Note: may include refinancing, general capital expenditure and construction)
- Serviceability to be assessed is based on CHP cashflows, not proceeds from development settlements
- Eligibility is determined by ability to repay debt and not tied to specific project feasibility or policy outcomes
- Borrower eligibility credit metrics and BA risk appetite, concentration limits/diversification and asset writing strategy to be established
- Security requirements: LVR to be determined through stakeholder engagement and resolution of regulatory issues such as title vesting from Stock transfers and CHP ability to pledge security; and interaction and alignment between State and National regulator metrics for Tiers 1-3 and BA's credit metrics. Consideration to be given to inter-creditor terms and security ranking compared with other lenders

Indicative BA FTE Resourcing Requirement – 8-10 FTE

- Core team of head of bond aggregation, finance director, relationship managers (2), credit risk (2), operations and enterprise risk (2) and administration (2). Compared to THFC, a leaner staffing profile has been proposed based on the scale of likely borrowers noting that the less sophisticated DCM in Australia should benefit from dedicated relationship managers to communicate the mechanics and objectives of the BA to the CHP sector
- Simplicity of core funds flow should reduce the need for large FTE resourcing of Treasury function. To optimise resourcing, corporate functions could be shared within BA and the NHFIC
- The credit policy should ideally be developed prior to operations. Credit risk FTEs to be responsible for assessing financing requests in line with the credit policies
- Outsourcing functions (all loan administration, reporting, compliance, accounting and tax, loan management, liquidity management) to a third party services provider. Note that GB Social Housing (GBSH) and the LGFV use a trust services company as part of their structure and operate lean staffing profiles
- Marketing function to be provided by NHFIC
- Premises and information technology (IT) costs shared with NHFIC

The Core THFC FTE Resourcing* Structure – for comparison



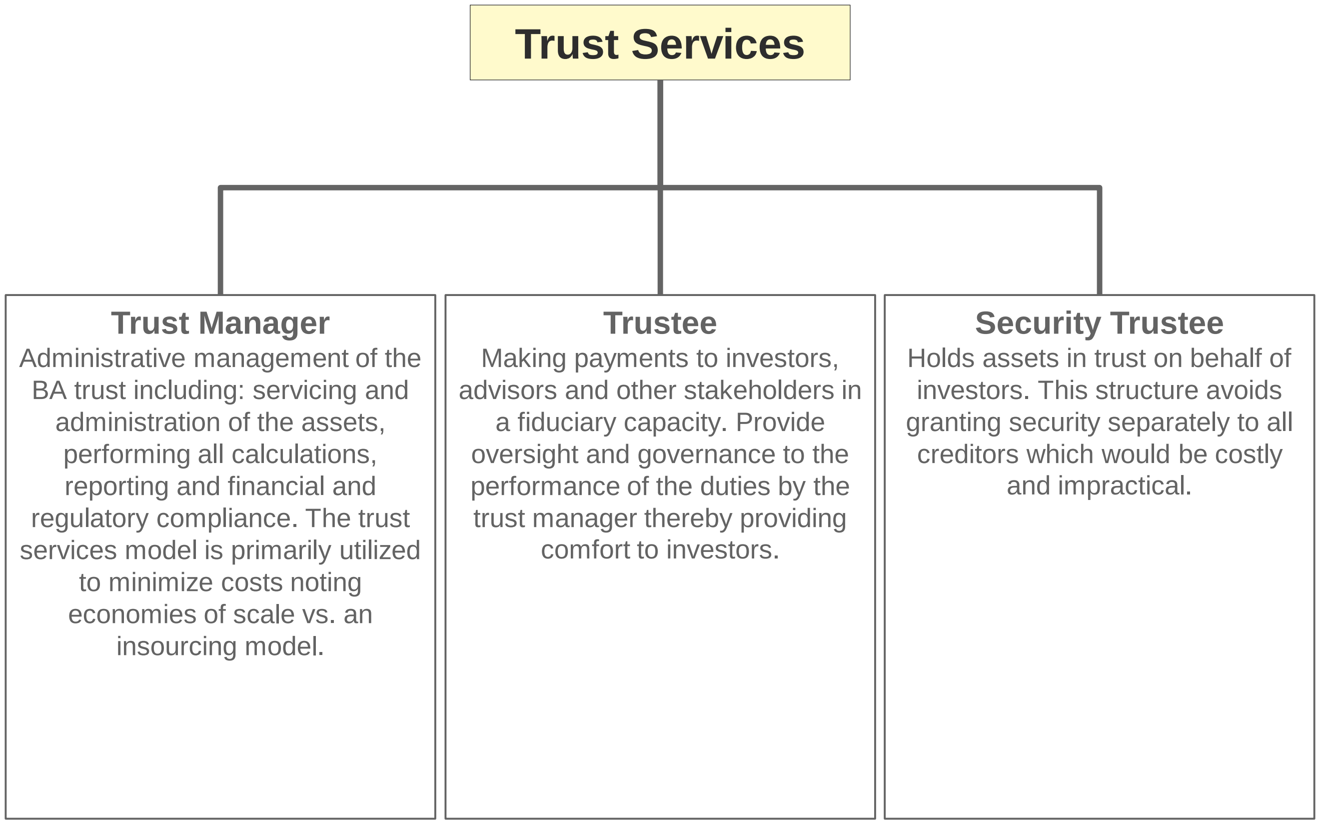
Applicable BA functions, noting that the NHFIC to operate under the direction of one CEO with the BA subsidiary to be led by a CFO or "Head of Bond Aggregation". Excludes marketing (1 FTE) and 2 EAs.

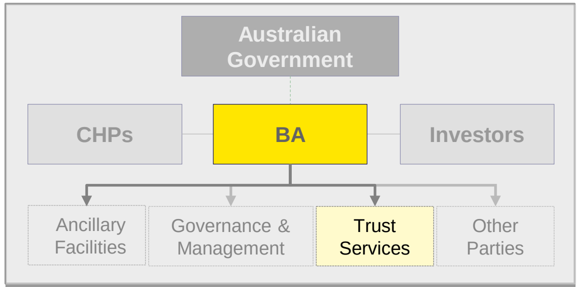
4 Entity Structure

The BA resourcing requirements may be complemented by a trust services provider to undertake administrative management services to minimise costs. Such services may be outsourced and, in some cases, may be internalised.

Trust Services

- From an operational perspective, the BA could delegate administrative management of the BA to third party trust services provider(s) who would be responsible for the day-to-day management
- This may be internal or external to the Australian Government. Key roles are set out below:





This page outlines the BA's transactions with advisors for ongoing Ancillary Debt Facilities, Cash Reserves and Trust Services

Examples

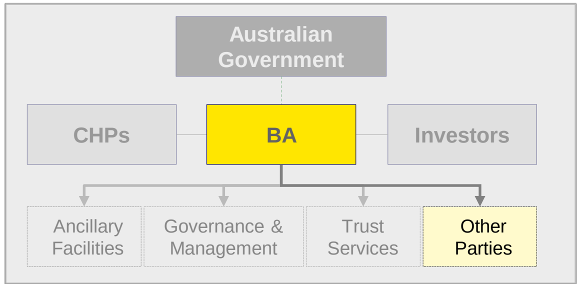
- Trust services are commonly employed in bond aggregation pooled financing vehicles and other structured finance transactions
- Examples of businesses that provide such services include State Trustees, Perpetual and NAB

4 Entity Structure

The BA requires specialised professional services for its establishment and ongoing operations, including a public credit rating by a recognised credit rating agency such as Moody's and a range of legal and financial services.

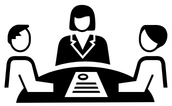
Credit Rating

- Obtaining a credit rating is a key requirement to access the DCM in order to meet investor expectations. Moody's methodology has been used in the work to date to undertake shadow credit ratings for the CHP sector. Moody's has been preferred to S&P on the basis that Moody's provides greater transparency (i.e. for pooled financing) and a "sum-of-all-parts" approach that allows flexibility for out-performance in one area to offset weaker performance in another, resulting in a more balanced outcome
- For the BA, the rating is predicted to incorporate two key components in line with Moody's methodology:
  - CHP Credit Estimates: an unpublished point-in-time opinion of the approximate credit quality of the individual CHPs
  - BA Rating: key steps include provision of information package, management meetings, analysis, rating committee, announcement of public rating
- Indicative timing for obtaining a credit rating is 8-12 weeks subject to timely receipt of information
- Rating reviews to be undertaken on an annual basis, with an updated rating also required for subsequent bond issuances



This page outlines the BA's transactions with professional advisors for ongoing advice and services, including the attainment of a credit rating.

Professional Services and Other Parties

In addition to Trust Services, Ancillary Facilities and a Credit Rating, the BA should engage with a range of professionals for its establishment and ongoing operations:

- **Legal Professionals:** Advice to ensure the legal structure of the BA meets regulatory requirements and legal documents to be prepared and reviewed as required
- **Accounting Professionals:** The BA may be required to prepare financial statements, submit an annual tax return and may require assistance in an audit capacity
- **Tax Professionals:** the BA may require specialist tax advice on its ongoing operations, such as the treatment of goods and services tax (GST) for the services it provides to the CHPs
- **Financial Advisor:** The BA will likely require initial and ongoing advice on the issuance of new bonds, ongoing management of outstanding bonds, and maturity of bonds to ensure that processes are run as smoothly as possible
- **Arranger/Broker:** the issuing and trading of bonds requires an arranger and/or broker to run the book build and manage transactions and settlements with the DCM regulators

4 Entity Structure

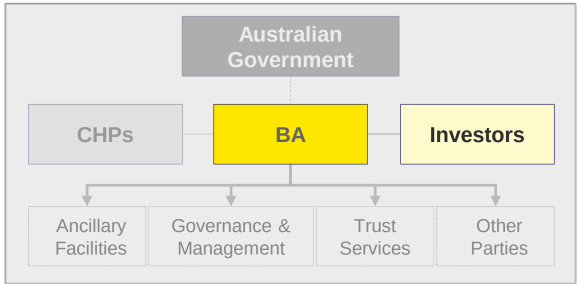
DCM investors are offered the opportunity to invest in debt securities, secured by the BA loan book. Appeal is enhanced with additional income and capital protection in the form of a Government guarantee.

Government guarantee

- An Australian Government guarantee provided to the BA is an undertaking that in the EoD by the BA, the Australian Government assumes the liabilities of BA. It provides assurance to bond investors that principal and interest obligations of the BA are received in the event that the underlying CHP borrower are unable to meet their obligations
- As previously noted, the wording of the guarantee is proposed to be in line with the EFIC guarantee. Should variations on the wording be proposed, it is important to ensure that such changes are acceptable to investors and the credit rating agency
- In order to minimise CHP loan costs it is not proposed that a fee be paid for the provision of the Australian Government guarantee

BA Investor Term Sheet

BA Bond Term Sheet:	
Issuer	[BA]
Investors	Various wholesale fixed income investors
Trust Manager, Trustee & Security Trustee	[Specialised trust services provider]
Issue Rating	Moody's [Aaa] based on Australian Government guarantee
Instrument	Fixed Rate Notes
Amount	$[●]m
Coupon	[●]% fixed rate interest
Repayment Structure	Semi-annual interest only
Tenor	[10] years
Security	Secured against a portfolio of senior secured bullet loan obligations of the CHP borrowers
CHP borrowers and Loan Amounts	Schedule of CHP loans to be attached



This page outlines the transaction between DCM investors in purchasing bonds from the BA.

- The bond issuance terms have been determined by DCM participant criteria and optimised against CHP priorities
- The returns required by investors are reflected in the fixed coupon interest rate and based on prevailing credit market conditions for a given credit rating
- Given the pass-through structure, the regularity of BA bond issuances will likely be driven by the demand of CHPs for loans from the BA
- Underwriting of bonds by the arrangers is not expected to be required given the likely strong demand for the BA bonds
- The liquidity of the bonds in the secondary trading market is likely to be low given the relatively small issuance size vs. Australian Government bonds however this may be improved by obtaining repo eligibility and as bond volumes increase over time

4 Entity Structure

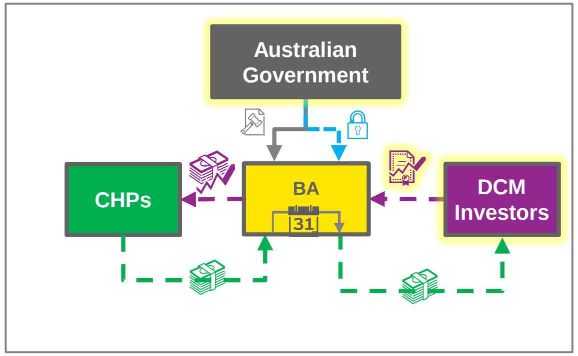
A worked example of the implications of a CHP loan default on the BA and the resolution period process prior to the Australian Government guarantee being called.

Further to the Liquidity Facility drawdown mechanics detailed on page 57, below is a worked example of the implications of a CHP loan default on the BA and the resolution period process prior to the Australian Government guarantee being called

There are risk mitigants which reduce the likelihood of the Australian Government guarantee being called including prudent BA credit policies, oversight and monitoring, and a resolution period where the BA can negotiate with the CHP and the States in the same way as a bank currently would in the event of CHP loan default. However, the Australian Government should resolve the security impediments and interaction with States, and the independent regulator objectives and powers to provide clarity regarding their risk position should a CHP default, given the lack of precedents.

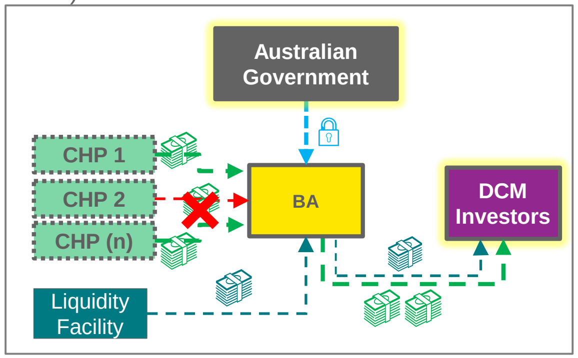
Establishment & Normal Operations

- The Australian Government establishes the NHFIC (which the BA is a subsidiary of) via an Act as a Corporate Commonwealth Entity
- The Australian Government provides the BA with an explicit guarantee as part of the Act. The guarantee may represent a contingent liability with no budgetary impact (subject to technical accounting advice)
- The BA issues a bond that benefits from an explicit Australian Government guarantee
- Bond Issuance funds are advanced to CHPs as loans
- CHPs pay interest on issued loans one month in advance to bond coupon payments falling due



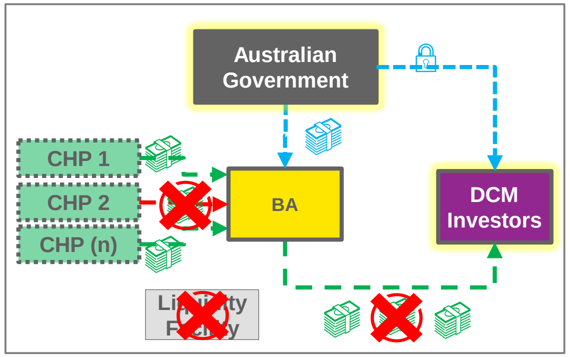
CHP Non-Payment

- Where CHP 2 fails to make an interest payment, the BA has one month to rectify the issue (e.g. through the CHP addressing an administrative error or the CHP sourcing funds internally)
- One month post CHP 2 loan default when the bond coupon is due, the BA draws on the Liquidity Facility to make up the shortfall of bond coupon. This facility is available for 12 months from initial drawing allowing time for the BA (or an appointed loan servicer) to work with CHP 2 and the relevant State to facilitate an orderly resolution
- The CHP loan default triggers penalty default interest rate under CHP loan, with Liquidity Facility drawing costs also passed onto CHP 2 (incentivises CHP to resolve)
- The guarantee may continue to represent a contingent liability with no Budgetary impact noting the BA continues to service the bond (subject to technical accounting advice)



Resolution Period

- The BA as lender will likely be negotiating with the CHP as a secured creditor and be in materially the same position as a bank otherwise would be.
- Australian Government support: In the event that there is no resolution within 12 months, the Australian Government may be incentivised to "cure" prior to default given the political implication of BA default as an Australian Government associated entity or the BA can seek an extension of the liquidity facility.
- Following default on the bond, the DCM investors have legal recourse to the Australian Government. Post default on the bond, the contingent liability crystallises and the shortfall due to the DCM investors represents a liability of the Australian Government (subject to technical accounting advice)



5

Proof of Concept

Implementing the BA: Design and Operational considerations

5 Proof of Concept

Overview and key findings.

Overview

This chapter provides an outline of the design and operation of the BA. It addresses the following components of the services to be provided:

- *Work stream 6: Proof of concept and implementation plan*

The PoC analysis builds on Work streams 1-5 and provides a quantitative assessment of the feasibility of the proposed BA structure to support the hypothesis of the BA driving financial efficiency for the CHP sector. It then provides an implementation plan incorporating key steps, timeline and required legislative changes.

Methodology

In completing this chapter, we have undertaken the following:

- Established the PoC by quantifying the costs and benefits to the sector of the proposed Australian Government guaranteed BA
- To inform our analysis we engaged with CHPs, banks and the AOFM to obtain and seek indicative bank debt and bond market pricing combined with benchmarking analysis based on comparable transactions
- Considered the 2017-18 Budget announcements on the NHFIC to frame the likely processes and timelines required to establish the BA under its auspices
- Identified and outlined the bond issuance preparation steps required in order to access the DCM
- Considered regulatory changes that will likely be required at State and Federal level to be made and how these interact with the BA's credit policy design as well as required BA procurements (e.g. credit analysis tool)

Key Findings

- Based on current market pricing, CHP borrowers may benefit by between 0.9% p.a. and 1.4% p.a. in interest rate margin reductions on a like for like basis
- The BA has the potential to operate on a self-sustainable / full cost recovery basis over the medium term subject to achieving sufficient scale
- Maximising the interest rate benefit to the CHPs to support the establishment and roll out of the BA is contingent on Government covering operating and staff costs for the BA at the outset from Budget allocated funding
- HOTs, Cabinet approval and Parliamentary passage of the NHFIC Act are all required by the end of 1st quarter 2018 to meet the 1 July deadline
- Aiming for a bond issuance in the second half of 2018 (after the NHFIC Act comes into effect) is a reasonable timeframe so long as considerable pre-work on credit policies, lending criteria and market engagement can be undertaken prior to 1 July
- Request for tenders for key service providers such as bank arrangers should be issued in July 2018 to enable a comprehensive BA approach to market
- CHP borrowers should be engaged, prepared and comfortable with the BA's credit policies as the establishment phase unfolds

Recommendation:

- Government should commence work to establish the BA as part of the NHFIC, noting that CHPs are likely to be the primary agents to maintain and expand the stock of affordable housing

Recommendation:

- Government should work with States and Territories to ensure that the regulation of the community housing sector better supports the activities of the bond aggregator, with specific regard for the way in which regulation applies in the event of a default. Given investors value certainty, consideration should be given to standardising the way in which investors are able to obtain security for the finance provided through the BA

Recommendation:

- Government should begin set up activities (such as accounting and legal advice regarding final structure, sector consultation/awareness/education, detail of FTE roles and responsibilities) concurrent with development of BA policies (such as credit policies and approach to sector for expression of interest) to support the proposed July 2018 timetable

5 Proof of Concept

The BA pricing benefits to CHPs of 0.90% p.a. on a BA full cost recovery basis supports the feasibility assessment in our Base Case Structure for an indicative medium term $400m bond issuance.

Bank Loan — 2.4% p.a. (indicative)

The indicative margin CHPs pay to banks on a 10 year fixed rate interest only loan

BA Loan — 1.5% p.a. (indicative)

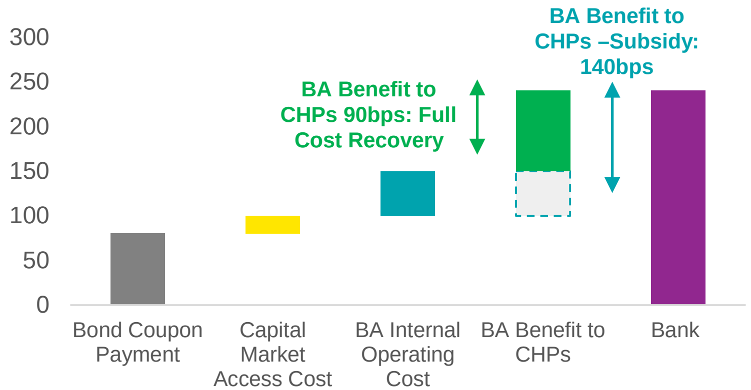
The indicative margin CHPs will likely pay to the BA on a BA full cost recovery basis for the recommended Base Case Structure (BA with an Australian Government guarantee)

BA Benefit to CHPs: Full Cost Recovery — 0.9% p.a. (indicative)

The indicative BA pricing benefit to CHPs on a BA full cost recovery basis for a 10 year fixed rate interest only loan

BA Benefit to CHPs: Op Cost Coverage — 1.4% p.a. (indicative)

The indicative BA pricing benefits to CHPs with the Australian Government covering BA Internal Operating Costs (excluding Capital Markets Access Cost) for a 10 year fixed rate interest only loan



PoC analysis

- Our PoC analysis compares the indicative pricing, i.e. the margin over the 10 year Bank Bill Swap Rate (BBSY), of bank debt vs. the all-in cost of an equivalent BA CHP loan. This assumes full BA cost recovery in line with the self-sustainable objective of the BA
- From our market sounding, we have sought pricing from major Australian banks for a 10 year fixed rate interest only bank loan, with indicative margin of approximately 2.4% p.a. provided
- In assessing the equivalent BA CHP loan pricing we have adopted a building block approach with the all-in margin comprising the following three elements
- See Appendix 7

1. Bond Coupon

- The bond coupon rate as determined by the wholesale DCM markets at the time of the bond issuance
- Indicative bond issuance margins are based on feedback from bank DCM arrangers (refer Appendix 7), AOFM and benchmarking analysis

2. Capital Markets Access Cost: Approximately 0.2% p.a.

- The Capital Markets Access Costs is comprised of:
  - Upfront Costs: legal, credit rating, bond arrangers, financial advisor, Austraclear and minimum cash reserves
  - Ongoing Costs: trust services, accounting, tax, credit rating, Austraclear and liquidity facility fees
  - The additional margin covers both fixed and variable costs, with economies of scale as bond issuance volume increases. The above 0.2% p.a. is based on an issuance size of $400m
- Estimates for the upfront and ongoing costs are based on market feedback and recent comparable transactions (e.g. LGFV)
- The upfront components of Capital Markets Access Costs are funded via the Establishment Expense Facility which are amortised over the life of the CHP loans

3. BA Internal Operating Costs: Approximately 0.5% p.a.

- The BA Internal Operating Costs are comprised of:
  - Upfront costs: office fit-out, IT etc. (assumed to be funded by NHFIC from budget allocations)
  - Ongoing costs: FTE wages based on our resourcing plan
- An Australian Government subsidy for these costs will likely increase the BA Benefit to CHPs

Further details of the PoC methodology, analysis and assumptions can be found in Appendix 7.

5 Proof of Concept

The PoC analysis considers the potential BA pricing benefits to CHPs net of the costs associated with accessing the capital markets for various BA bond issuance sizes and BA resourcing requirement.

Medium Term Indicative Issuance Size — **$300 - $500m**

Based on $400m medium-term issuance and our proposed resourcing requirement, for the recommended Base Case Structure (BA with an Australian Government guarantee)

Indicative BA Benefit to CHPs — **0.9%** (p.a.)

Indicative Additional Benefit — **0.5%** (p.a.)

Based on $400m issuance and the proposed resourcing requirement covered by the Australian Government

PoC analysis

For the BA model to offer an attractive CHP loan product, consideration must be afforded to the relative pricing benefit vs. bank debt which should drive CHP demand for loans. The benefits to CHPs should be considered in conjunction with scale of bond issuances, levers to decrease bond pricing, Australian Government BA cost coverage, optimising BA operational management (i.e. internal vs. outsourced administrative management) and the self-sustainable objective.

The below matrix depicts the potential BA pricing benefits to CHPs net of BA costs, for various issuance sizes and cost levels. We have highlighted the scenario based on a full cost recovery for a $400m issuance and our proposed resourcing requirement (eight FTE / approx. $2m p.a.), where the BA provides a material pricing benefit to CHPs. It can be seen that the receipt of a operational cost coverage from the Australian Government that minimises BA Internal Operating Costs further enhances this benefit.

BA Op Cost Coverage → Full Cost Recovery

	0.00	0.50	1.00	2.00	5.00
100	1.1%	0.6%	0.1%	-0.9%	-3.9%
200	1.3%	1.1%	0.8%	0.3%	-1.2%
300	1.4%	1.2%	1.0%	0.7%	-0.3%
400	**1.4%**	1.3%	1.2%	**0.9%**	0.2%
500	1.4%	1.3%	1.2%	1.0%	0.4%
700	1.4%	1.4%	1.3%	1.2%	0.7%
1,000	1.5%	1.4%	1.4%	1.3%	1.0%
2,000	1.5%	1.5%	1.4%	1.4%	1.2%
5,000	1.5%	1.5%	1.5%	1.5%	1.4%
8,000	1.5%	1.5%	1.5%	1.5%	1.4%
10,000	1.5%	1.5%	1.5%	1.5%	1.5%

The horizontal axis represents cost increments (A$m) above the minimum BA cost

BA medium term indicative bond issuance is $300-$500m

The vertical axis represents the BA issuance size (A$m)

Larger bond issuance sizes drive greater price benefits to CHPs and are able to sustain higher internal costs, given economies of scale. THFC costs have increased from approx. GBP£0.6m p.a. to GBP£4.2m p.a. as total issuance has grown to approx. GBP£5.9bn

The BA Op Cost Coverage column represents the BA Benefit to CHPs absent of BA Internal Operating Costs, as they are paid for by the Government

The red-shaded areas indicate a BA cost model that is not self sustaining for the given issuance volume. Options to rebalance the CHP savings include:

- BA op cost coverage
- Increase BA scale
- Decrease bond pricing (e.g. repo/HQLA status eligibility)

The green-shaded areas indicate a BA cost model that is self sustaining for the given issuance volume, which will likely drive BA scale through CHP demand for cheaper loans

5 Proof of Concept

The CHP pricing benefits support the feasibility assessment based on the three structures presented once scale is achieved. Government cost coverage by way of payment of BA Internal Costs drives further benefits to CHPs.

Low Case Structure (no Australian Government guarantee) – Indicative BA Benefit to CHPs

	0.00	0.50	1.00	2.00	5.00
100	0.5%	0.0%	-0.5%	-1.5%	-4.5%
200	0.7%	0.4%	0.2%	-0.3%	-1.8%
300	0.8%	0.6%	0.4%	0.1%	-0.9%
400	0.8%	0.7%	0.5%	0.3%	-0.5%
500	0.8%	0.7%	0.6%	0.4%	-0.2%
700	0.8%	0.8%	0.7%	0.5%	0.1%
1,000	0.8%	0.8%	0.7%	0.6%	0.3%

- The “Low” Case structure refers to the capital markets benefit achieved from an issuance of an A1 rated BA bond (no Australian Government guarantee)
- The indicative 10 year bond margin is 1.4% p.a. for an A1 rated entity (compared to the base case structure of 0.8% p.a.)

	BA Op Cost Coverage	Full Cost Recovery
BA Loan Margin (indicative)	1.6% per annum	2.1% per annum
BA Benefit to CHPs (indicative)	0.8% per annum	0.3% per annum

Base Case Structure – Indicative BA Benefit to CHPs

	0.00	0.50	1.00	2.00	5.00
100	1.1%	0.6%	0.1%	-0.9%	-3.9%
200	1.3%	1.1%	0.8%	0.3%	-1.2%
300	1.4%	1.2%	1.0%	0.7%	-0.3%
400	1.4%	1.3%	1.2%	0.9%	0.2%
500	1.4%	1.3%	1.2%	1.0%	0.4%
700	1.4%	1.4%	1.3%	1.2%	0.7%
1,000	1.5%	1.4%	1.4%	1.3%	1.0%

- The Base Case Scenario refers to the capital markets benefit achieved for a CHP Bond with Australian Government guarantee
- The indicative BA bond margin is 0.8% p.a.
- We estimate that the addition of an explicit Government guarantee improves pricing by 0.6% p.a.

	BA Op Cost Coverage	Full Cost Recovery
BA Loan Margin (indicative)	1.0% per annum	1.5% per annum
BA Benefit to CHPs (indicative)	1.4% per annum	0.9% per annum

High Case Structure – Indicative BA Benefit to CHPs

	0.00	0.50	1.00	2.00	5.00
100	1.4%	0.9%	0.4%	-0.6%	-3.6%
200	1.6%	1.3%	1.1%	0.6%	-0.9%
300	1.6%	1.5%	1.3%	1.0%	0.0%
400	1.7%	1.5%	1.4%	1.2%	0.4%
500	1.7%	1.6%	1.5%	1.3%	0.7%
700	1.7%	1.6%	1.6%	1.4%	1.0%
1,000	1.7%	1.7%	1.6%	1.5%	1.2%

- The “High” Case Scenario refers to the capital markets benefit achieved for a CHP Bond with Australian Government guarantee plus Repo Eligibility/High Quality Liquid Asset (HQLA) status
- The indicative BA bond margin is 0.55% p.a.
- We estimate that the addition of achieving Repo eligibility/ HQLA status improves pricing by a further 0.25% p.a.

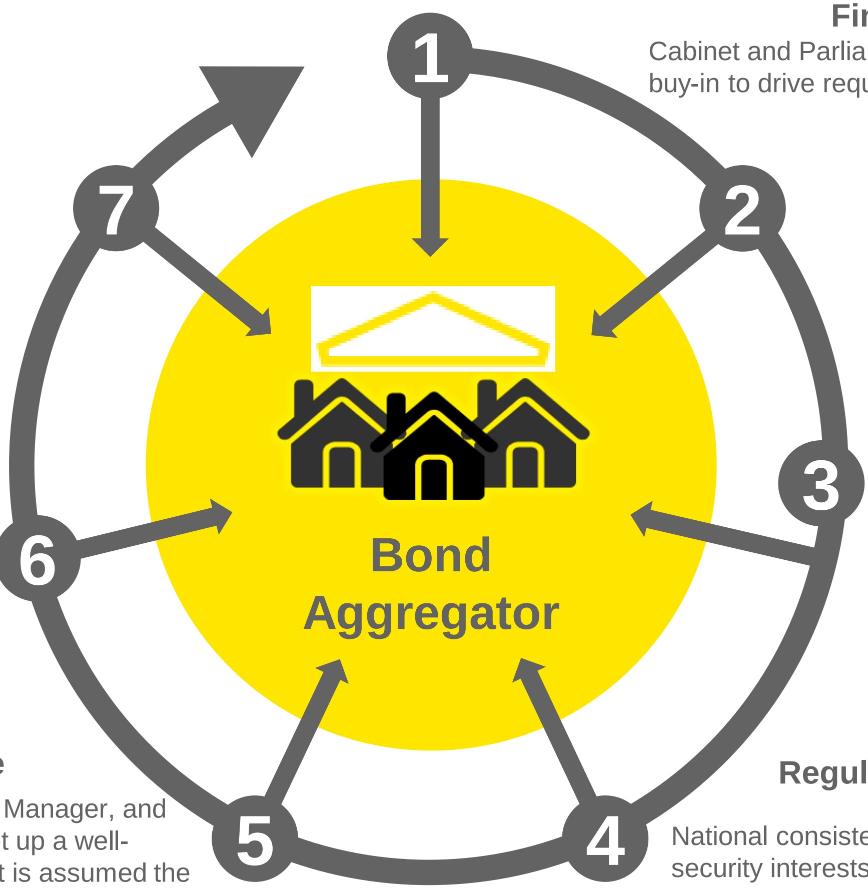
	BA Op Cost Coverage	Full Cost Recovery
BA Loan Margin (indicative)	0.7% per annum	1.2% per annum
BA Benefit to CHPs (indicative)	1.7% per annum	1.2% per annum

5 Proof of Concept

Implementation Timeframe: from concept to issuance. Given the BA is potentially a subsidiary of the NHFIC, the timing of the BA's first issuance is tied to the NHFIC establishment process. Our timeframe and plan has not considered broader NHFIC issues other than required approvals.

BA Establishment and Bond Issuance Preparation

The BA implementation phase incorporates a number of key Work streams relating to entity establishment and subsequent bond issuance preparation. Given the Executive and Parliamentary approvals required - and inter-Governmental considerations - a "deal-ready" BA capable of issuing by 4th quarter 2018 requires significant pre-establishment work to be undertaken. The implementation phase assumes the proposed Base Case Structure (BA with Australian Government guarantee). Where the regulatory issues (as outlined in Recommendation 6) can be resolved in a timely manner and/or to the extent that the BA implementation timeframe is extendible, a no guarantee structure may be preferable. The decision regarding confirmation or otherwise of the Australian Government guarantee is incorporated in step 1 – Finalise BA Structure – with flow on timing issues should this process be delayed.



Finalise BA Structure

Cabinet and Parliamentary approval by March 2018. HOTs buy-in to drive required State-based regulatory changes.

Credit Policies

Developing and evolving the credit policies based on Australian Government risk appetite, the interaction with regulatory frameworks and stakeholder requirements as the BA moves through the approvals process to final establishment.

Credit Rating

Working with credit rating agencies to confirm entity rating via Exposure Draft Legislation and on an on-going basis.

Regulatory harmonisation

National consistency that enables the BA to perfect security interests over assets pledged as security is required.

BA Staffing and Governance

A Head of Bond Aggregation / CFO, a Relationship Manager, and Credit Risk officer are required by 1 July 2018 to set up a well-defined governance and management framework. It is assumed the BA is overseen by the NHFIC Board and Treasury.

Ancillary Services

Refining and procuring the ancillary services that will likely be required for the BA: Lead Arrangers, Liquidity Lines, Legal, tax and Accounting Advisors

Investor Marketing and Bond Issuance

Engaging potential CHP borrowers and the DCM investors on the first issuance

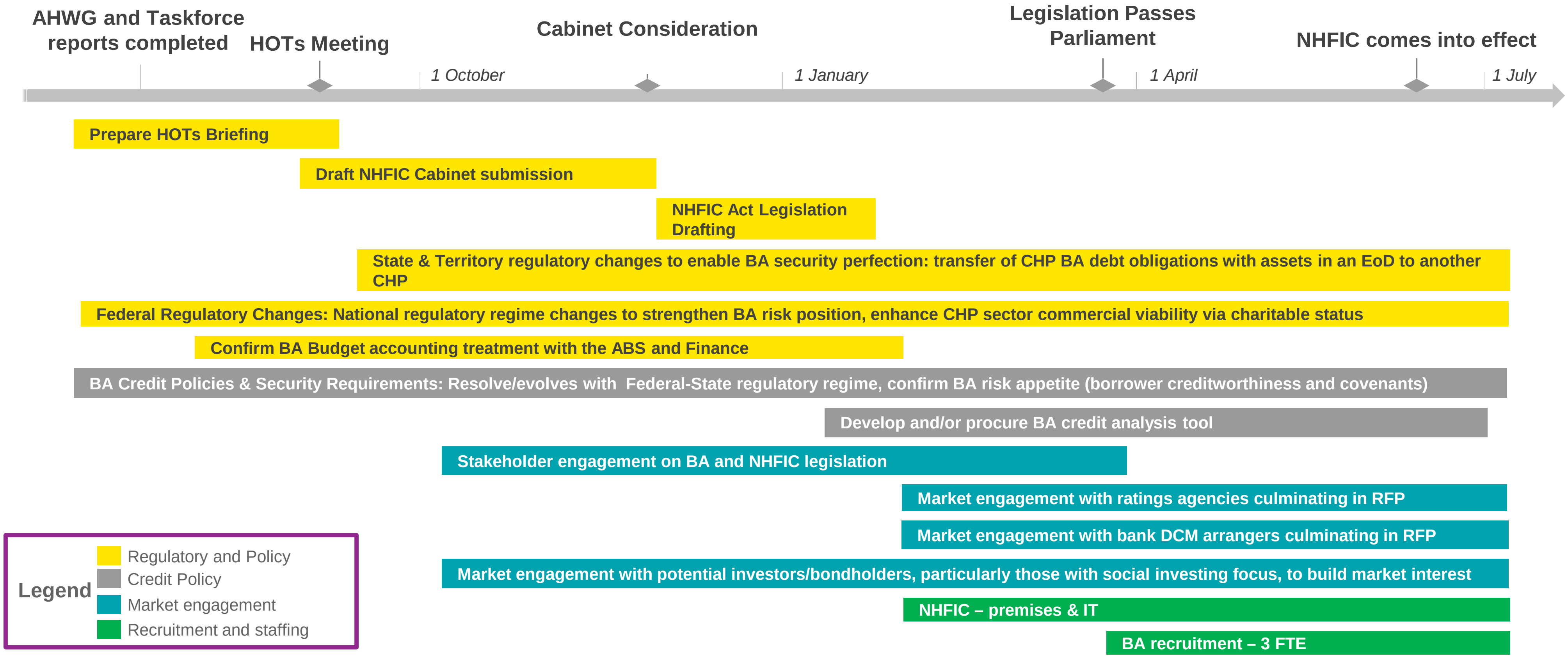
5 Proof of Concept

Implementation Timeframe: Operational activities.

Implementation Timeframe

The indicative timeframe is summarised below. Key considerations for the implementation phase include activities which could commence immediately and concurrently, including:

- **The Market Approach**: Stakeholder management to ensure that the purpose and objective of the BA is communicated to the various stakeholder groups (e.g. CHP sector, banks, investors). Relationship managers have a key role to play in ensuring that the preferences of the stakeholder groups are balanced
- **Entity Structure and Resourcing**: Timely completion of the set-up activities (e.g. corporate functions and governance, Budget accounting treatment, passing of legislation) for the BA and NHFIC from a staffing and legislative perspective
- **Regulatory and Policy**: Interactions across all levels of Government (including at a State level) to ensure that the proposed BA vehicle aligns, supports and works within the current regulatory and policy parameters at a Federal and State level



5 Proof of Concept

Implementation Timeframe: There is a truncated timeframe to establish the BA under NHFIC with the legislation to be enacted three months before operative date. NHFIC's broader governance architecture will likely flow down to BA management and oversight.

Effective risk management of the Australian Government credit risk exposure is contingent on resolving CHP sector regulatory issues. These issues can be dealt with concurrent to the NHFIC and BA establishment phase. Key steps are called out below:

HOTs, Cabinet & Parliament

There are three major milestones in the establishment phase:

- HOTs in September which should frame the requirement for national regulatory consistency to affect the BA (see policy changes)
- Cabinet approval late 2018 and Parliamentary approval in the Autumn 2018 sittings
- All three will likely require significant stakeholder engagement and formal advice to be developed
- BA governance to be set by the Act in the first instance

Registrar Step-in rights

Borrower default will likely trigger Registrar step-in rights to novate assets to replacement CHP

- Such an event is untested in the CHP sector (defaults have not been based on debt defaults)
- Agreement will likely be required to assign the asset and liabilities (debt) to the replacement provider as current regulations and processes do not do so

BA Staffing

Three FTE have been allocated to the NHFIC in FY2017-18

- If allocated to the BA function, the Head of Bond Aggregation, a relationship manager and a credit risk officer should be hired by the end of June 2018
- These FTE should have finance, Government and sector expertise and be engaged on a contract basis
- A governance framework also should be developed

Credit Analysis Tool

The BA will likely require a credit analysis tool or engine to assess borrowers credit standings and manage its overall portfolio risk

- This could be developed in-house but as it is required from the early BA operations phase, an outsourced solution is more practical and efficient
- This could be a bespoke model or an off-the-shelf procurement and ideally be subject to market scoping

Vesting policies

Most States and Territories vest or transfer State stock on a leasehold basis and some prevent CHPs from pledging those assets as security

- The Australian Government should be able to take security over vested assets or, in the case of an un-guaranteed BA, bondholders may
- State policies either must change to full title transfer to allow this or a nationally consistent tripartite agreement that enables the Australian Government to perfect security must be developed

Charitable Status

Enhancing the CHP sector's ability to repay and act more commercially can be encouraged by providing greater clarity on tax status implications from engaging in commercial activities to increase operating margins; noting that not all CHPs are charities

- Treasury could engage with the ATO with the aim of the latter issuing a Law Administration Practice Statement (LAPS) around some examples

BA Credit Policies

The BA's initial credit policies and appetite legislation should inform Cabinet and Parliamentary consideration.

- Many elements are fixed (ICR etc.) but the policy should evolve as regulatory issues are resolved
- Market sounding and engagement with borrowers should also be an important input
- In the absence of a guarantee, potential investors risk appetite also should be gauged

BA Accounting Treatment

Australian Government should establish how it accounts for the BA within or outside of the GGS. Advice on this matter was outside of our scope of works, however:

- This process will likely involve the ABS, Finance and Treasury (as the Portfolio Department)
- This should be largely resolved prior to Cabinet consideration and confirmed once Parliamentary approval is obtained

5 Proof of Concept

Implementation Timeframe: once the BA is established under the NHFIC on 1 July 2018, there are a number of steps that should be undertaken ahead of the first issuance.

Some of these steps may be procurement processes for arrangers, ancillary funding lines and a call for expressions of interest (EOI) from CHP borrowers. To achieve an inaugural issuance by the end of calendar 2018, many of these activities need to be underway before the BA comes into effect on 1 July 2018

Credit Policies

As noted over, development of credit policies and procedural documents including:

- Asset writing strategy, eligibility criteria for CHPs and concentration limits
- Credit approval process and requirements
- Qualitative and quantitative credit scoring tool
- Key terms and conditions
- Covenants and security

Credit Rating

Preparation of an information package which provides an overview of the BA, the CHP sector, the individual CHPs and key risk mitigants.

Obtaining a credit rating for the BA including:

- CHP credit estimates
- Indicative credit rating for the BA
- The final published rating for the BA

CHP Borrower EOI

- Formal engagement with potential borrowers confirming quantum, covenants, credit standings and tenor sought
- Finalise CHP credit estimates
- This will likely be an EOI process with the final issuance terms and conditions subject to market (read investor) interest and market conditions

Professional Services and Other Parties

- Engagement with key market participants (bond arrangers, trust services, legal, accounting, tax)
- Scoping of the roles, evaluation criteria and preparation of RFPs
- Review and evaluation of proposals

Ancillary Funding Lines

- Engagement with key market participants (banks and alternative financiers)
- Preparation of term sheets, evaluation criteria and preparation of RFPs
- Review and evaluation of proposals
- Negotiate terms, structure, pricing and fees

Establishment of BA Bond Program

- Prepare loan documentation in line with Government commercial principles
- Review and negotiation of documentation with bond arrangers and trust services providers

Investor Marketing and Bond Issuance

- Ongoing project management of professional services providers and other parties
- Preparations for investor roadshows including investor presentation materials, IM and investor Q&A

6

Glossary

Glossary of terms and abbreviations used in this Report

6 Glossary

Glossary of Terms.

Abbreviation	Meaning
AAI	Accountable Authority Instructions
ASX	Australian Securities Exchange
"several"	in reference to a several guarantee; each CHPs liability is distinct and separate from the liability of other CHPs
ABS	Australian Bureau of Statistics
ACHP	Aboriginal Community Housing Provider
AHURI	Australian Housing and Urban Research Institute
AHWG	Affordable Housing Working Group
AOFM	The Australian Office of Financial Management
APRA	Australian Prudential Regulation Authority
ARTC	Australian Rail Track Corporation
ASIC	Australian Securities and Investments Commission
Australian Government	Commonwealth Government – Government of Australia
BA	Bond aggregator
BBSY	Bank Bill swap bid rate
BHC	Brisbane Housing Company
BIC / EGW	Swiss Bond Issuing Co-Operative
Big 4 Australian Banks	National Australia Bank (NAB), Commonwealth Bank (CBA), Australia and New Zealand Banking Group (ANZ) and Westpac (WBC)
bps	Basis points for interest rates
Budget	Federal Budget 2017-18
Cabinet	Federal Cabinet
CDC	Term for French body responsible for financing 70% of finance required by social housing companies and HLMs

Abbreviation	Meaning
CEFC	Clean Energy & Finance Corporation
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGLLS	French Mutual Fund for Guarantees of Social Housing
CHFA	Canada Housing Finance Authority
CHP	Community housing provider
CHP Rating	The shadow credit rating of an individual CHP
CISE	Channel Islands Securities Stock Exchange
Corporate Commonwealth Entity	A body corporate established by a law of the Commonwealth and prescribed in an Act or the rules to be a Commonwealth entity
CRA	Commonwealth rent assistance
Credit Estimate	An unpublished point-in-time opinion of the approximate credit quality of the individual CHPs
CVIC	Cash Flow Volatility Interest Coverage
DCM	Debt and capital markets
DCR	Debt coverage ratio
DHHS	Victorian Department of Health and Human Services
DSRA	Debt service reserve account
DSS	Department of Social Services
EBITDA	Earnings before interest, taxation, depreciation and amortisation
EFIC	Export Finance and Insurance Corporation
EIB	European Investment Bank
EoD	Event of default
EOI	Expression of Interest

6 Glossary

Glossary of Terms.

Abbreviation	Meaning
Establishment Expense Facility	Fixed rated principal and interest loan drawn to fund bond issuance costs and repaid from the excess margin payable under CHP loans
EUV	Existing use value
EY	Ernst & Young
FACS	New South Wales Department of Families and Community Services
Finance	Department of Finance
FTE	Full time equivalent staff
FX	Foreign exchange
FY	Financial year
GBE	Government business enterprise
GBSH	GB Social Housing
GFC	Global Financial Crisis
GILTs	UK Government bonds
Government	Refers to the collective Australian and State Governments or an International Government
GRE	Government related entity
GRI	Government related issuer
GST	Goods and Services Tax
HCCB	The Housing Construction Convertible Bond
HFA	Irish Housing Finance Agency
HLMs	“CHPs” in France
HOT	Heads of Treasuries
HPC	Housing Partnership Canada
HQLA	High-Quality Liquid Assets
ICR	Interest coverage ratio

Abbreviation	Meaning
IM	Information memorandum
IT	Information technology
KPIs	Key performance indicators
LAH	Local Authority Housing
LAPS	Law Administration Practice Statement
LGFA	Local Government Funding Agency (NZ)
LGFV	Local Government Funding Vehicle (Australia)
Liquidity Facility	Revolving credit facility sized to cover 12 months bond coupon payments
LVR	Loan to value ratio
MAV	Municipal Association of Victoria
Moody’s	Moody’s rating methodology
MTN	Medium term note
MVST	Market value subject to tenancy
NAHA	National Affordable Housing Agreement
NDIS	National Disability Insurance Scheme
NFP	Not for profit
NHFIC	National Housing Finance and Investment Corporation
NHFIC Act	National Housing Finance and Investment Corporation Act
NHHA	National Housing and Homelessness Agreement
NHIF	National Housing Infrastructure Facility
NRAS	National Rental Affordability Scheme
NRSCH	National Regulatory System for Community Housing
NSWTC	NSW Treasury Corporation
NZ	New Zealand
NZDMO	New Zealand Debt Management Office

6 Glossary

Glossary of Terms.

Abbreviation	Meaning
OTC	Over the counter
Parliament	Federal Parliament
PDS	Product disclosure statement
PGPA Act	Public Governance, Performance and Accountability Act 2013
PoC	Proof of Concept Implementation Plan
PVR	Pooled vehicle shadow rating
QTC	Queensland Treasury Corporation
RBA	Reserve Bank of Australia
Registrar	Housing Registrars from each State / Territory
REITs	Real Estate Investment Trusts
RFP	Request for Proposal
RMG	Resource management guidance set by the Department of Finance
ROA	Return on assets
S&P	Standard & Poor’s ratings methodology
SCP	Standalone credit profile
Semi-Government	Non-Australian Government entities such as States and municipals
"several"	in reference to a several guarantee; each CHPs liability is distinct and separate from the liability of other CHPs
Shadow credit rating	An indicative credit rating determined by a shadow credit rating analysis
SHP	Social Housing Provider, as referred to by Moody’s
SLIC	Social letting interest coverage ratio
SOMIH	State-Owned and Managed Indigenous Housing
SoW	Scope of Works
SPP	Special purpose payment
States	Australian State and Territory Governments

Abbreviation	Meaning
Survey	Debt and Finance Requirement Survey
Taskforce	Affordable Housing Implementation Taskforce
THFC	The Housing Finance Corporation Limited
TIAA	The Internal Audit Association
Treasury	Australian Treasury
UK	United Kingdom
VHBs	Voluntary housing bodies
Warehouse Facility	Provides financing to CHPs on an "as needs" basis and facilitates aggregation of CHP loans over time in order to achieve wholesale market scale ($100m)
WSW	Dutch Guarantee Fund for Social Housing

7

List of Appendices

Appendices

7 List of Appendices

Appendices to be included in the Final Report.

1. CHP Sector overview – Regulatory environment
2. The CHP Debt and Finance Requirement Survey
3. Financial Viability – Moody's and S&P credit rating approaches
4. Financial Viability – Credit Rating and GRI Methodology
5. Summary of recent issuances
6. Entity Structure – International Case Studies
7. Proof of concept pricing process

8

Appendix 1

CHP sector overview – Regulatory environment

Overview	In examining sector viability and the ability to support a bond issuance program, it is necessary to understand how national and State regulatory frameworks govern sector behaviour and financial returns.
Methodology	We considered three primary areas that are detailed in this appendix: 1. Current regulatory environment for CHPs 2. Financial performance and viability requirements 3. Rent setting policies and CRA
Relevance	Considering the regulatory environment is critical to the implementation phase of the BA and has been noted within the CHP sector as a constraint. Growing service delivery capacity is challenged by “regulated” rents set by the States and underwritten by the Australian Government payments. These contribute to low margins and restrain capacity growth

8 Appendix 1

National Regulation: Overview: NRSCH Regulatory Framework Recap.

Objectives

The primary objectives of the NRSCH are as follows:

- Provide a consistent regulatory environment to support the growth and development of the CHP sector and to facilitate a national market – making it easier for CHPs to operate across jurisdictions
- Reduce the regulatory burden for housing providers that operate across multiple jurisdictions
- Provide a "level playing field" for providers seeking to expand and enter new jurisdictions

State based Registrars enforce the NRSCH and the Regulatory Code. The NRSCH Charter **limits Registrar's functions to regulatory activities** to ensure that the State agencies maintain oversight over policy and funding.

Legislation

- The NRSCH has been introduced through a collaborative "applied law scheme" whereby each participating jurisdiction must adopt or mirror the National Law. In 2012, NSW Parliament passed the *Community Housing Providers (Adoption of National Law) Act 2012*, with the Act coming into effect on 1 January 2014. QLD, SA, TAS, ACT and NT followed NSW in adopting the National Law within their jurisdiction
- Prospective providers must meet the Conditions of Registration as per section 15 (2) of the National Law as a precondition for registration under a tier as part of the NRSCH. Conditions of registration include maintaining an accurate asset list (s15(2)(i) of the National Law); a "wind-up clause" in the event

Tier Guidelines

- Tiers are determined with respect to an entity's level of risk arising from the scale and scope of its community housing activities, which informs the intensity of regulatory engagement and oversight
- Tier 1 CHPs are subject to the highest level of performance requirements and regulatory engagement; Tier 2 CHPs are subject to a moderate level of oversight and Tier 3 CHPs are subject to the lowest level of oversight from the Regulator
- Importantly, the guidelines evidence a performance threshold that is commensurate with tiers of registration and the relevant risk and scale of operations managed by CHPs

Evidence and Enforcement Guidelines

- The National Regulatory Code sets out the performance outcomes and requirements that must be met by CHPs. To manage risk, measure performance and ensure compliance with the tiers of registration, evidence guidelines are set under the code for CHPs to follow. The guidelines consider governance, financial viability and asset management et al and are not intended to be prescriptive and seek to minimise unnecessary administrative burdens
- Registrars have powers under the National Law to monitor non-compliance, give binding Instructions, cancel registration and appoint a statutory manager in the EoD or winding up
- Compliance assessments are conducted on an annual basis to monitor performance

8 Appendix 1

National Regulation: NRSCH guidelines – Tiers of Registration for CHPs.

Key points

- The NRSCH sets the tiers of registration for CHPs. Tiers are determined with respect to an entity's level of risk arising from the scale and scope of its community housing activities, which informs the intensity of regulatory engagement and oversight
- The below table[41] differentiates between the three tiers of registration and ties in the financial viability and credit rating analysis undertaken for this engagement. Details of credit rating methodology and analysis is set out in Chapter 2 of the main report and Appendices 3 and 4

Tier 1

Tier 1 CHPs are subject to the highest level of performance requirements and regulatory engagement, on the basis that they:

- Manage higher levels of risk in the sector and the projects they manage
- Operate at a larger scale, meaning that any serious non-compliance has the potential to impact large numbers of tenants and assets, and
- Are involved in ongoing development activities of scale, with any serious non-compliance likely to affect the viability of the provider

Analysis undertaken confirms the hypothesis that Tier 1 CHPs are more bankable with a sample of 30 providers indicating a credit rating range of between A1 to Aa1 based on Moody's ratings methodology

Tier 2

Tier 2 CHPs are subject to a moderate level of performance requirements and regulatory engagement, on the basis that they:

- Operate at a moderate scale, meaning that any serious non-compliance has the potential to impact moderate numbers of tenants and assets, and
- Are involved in ongoing development activities of a small scale, with any serious non-compliance likely to affect the viability of the provider

Analysis undertaken confirms the hypothesis that Tier 2 CHPs have varying debt financing capabilities and requirements with a sample of 18 providers indicating a credit rating range of between Baa1 to Aa2 based on Moody's ratings methodology

Tier 3

Tier 3 CHPs are subject to the lowest level of performance requirements and regulatory engagement, on the basis that they:

- Are involved in activities that means they manage a lower level of risk
- Operate at a small scale, meaning that any serious non-compliance has the potential to impact small numbers of tenants and assets, and
- Are not involved in ongoing development activities or one-off and/or very small scale developments

Analysis undertaken confirms the hypothesis that Tier 3 CHPs have limited debt financing capabilities and requirements in comparison with Tier 1 and Tier 2 providers

8 Appendix 1

NRSCH guidelines – Tiers of Registration for CHPs.

VIC – Housing Registrar Regulatory Framework

- VIC's regulatory requirements are set by the Housing Registrar. The Housing Registrar's approach to regulation and registration is underpinned by the *Housing Act 1983* (the Act)
- VIC is not participating in the NRSCH, but has "contributed strongly to the development of the system and committed to cost effective alignment of the performance and reporting requirements of its current regulatory system with the NRSCH, including the National Regulatory Code"
- CHPs are referred to as Housing Associations or Housing Providers in VIC. Providers are subject to seven performance standards comprising assets, tenants and housing services, governance and financial viability. These standards correlate with the NRSCH requirements with housing associations considered as operating at a higher scale and at a higher risk profile (i.e. Similar to a Tier 1 equivalent CHP under the NRSCH)

Overview of Regulatory Framework (VIC)[42]

WA – Community Housing Regulatory Framework

- The Community Housing Regulatory Framework was introduced in WA in 2016. The new Framework is consistent with the NRSCH
- The Framework is outcomes focused and adopts a risk based approach to monitor and respond to risks that have serious consequences for tenants, funders and investors, community housing assets and the reputation of the sector
- The Framework adopts a number of frameworks and guidelines from the NRSCH including the National Regulatory Code and tier guidelines. The Charter, evidence guidelines and enforcement guidelines from the NRSCH have been adapted to suit the "unique features of the WA sector"
- CHPs are referred to as Growth Providers (Tier 1 equivalent), Preferred Providers (Tier 2 equivalent) and Registered Providers (Tier 3 equivalent)
- The Code Outcomes for WA consider the following as shown to the right:

Regulatory Outcomes for WA CHPs[43]

- ✓ Tenant and housing services
- ✓ Housing assets
- ✓ Community engagement
- ✓ Governance
- ✓ Probity
- ✓ Management
- ✓ Financial viability

8 Appendix 1

NRSCH: Financial performance requirements and evidence sources.

Key points

- The National Regulatory Code sets out the performance outcomes and requirements that must be met by CHPs under the NRSCH. To manage risk, measure performance and ensure compliance with the tiers of registration, evidence guidelines are set under the code for CHPs to follow
- Importantly, the guidelines evidence a performance threshold that is commensurate with tiers of registration and the relevant risk and scale of operations managed by CHPs. The outcomes are summarised below

National Regulatory Code Evidence Guidelines for CHPs: Performance outcomes[44]

Outcome 1: Tenant and housing services

- Aims to ensure that the CHP is “fair, transparent and responsive in delivering housing assistances”
- Evidence sources include tenancy management and rent policies and procedures, survey results and websites

Outcome 2: Housing assets

- Aims to ensure that the CHP manages its housing assets in a responsible and sustainable manner
- Evidence sources include business and asset management plans, annual reports, maintenance data and property condition standards / reports

Outcome 3: Community engagement

- Aims to ensure that the CHP works in partnership with relevant organisations and contributes to community building
- Evidence sources include community engagement policies and formal partnership arrangements

Outcome 4: Governance

- Aims to ensure that the CHP is well governed to support the aims of its business
- Evidence sources include documented governance structure and policies, constitution, charter or equivalent, risk standards and financial reporting

Outcome 5: Probity

- Aims to ensure that the CHP maintains high standards of probity relating to their business activities
- Evidence sources include code of conduct, risk registers and probity policies and procedures

Outcome 6: Management

- Aims to ensure that the CHP manages its resources in a cost-effective manner
- Evidence sources include asset data, financial data, strategic asset management plan and corporate structures and systems

Outcome 7: Financial viability

- Aims to ensure that the CHP is financially viable at all times
- Evidence sources include audited financial reports, financial viability measures and debt financing arrangements and covenants
- The extended requirements for financial viability are shown on the following page

8 Appendix 1

NRSCH: Snapshot on Outcome 7: Financial viability performance thresholds.

Key points

- Financial viability measures are used under the Regulatory Code to assess financial performance and provide a link back to Performance Outcome 7 (Financial Viability). As indicated below, a number of the ratio thresholds are higher for Tier 1 providers (i.e. EBITDA margin) evidencing the heightened risk of their operations and the required financial accountability to manage larger scale portfolios and developments
- The measures seek to provide a transparent level of performance against which results can be assessed. For instance, if a provider is not complying with the performance requirement / financial measure, the Lead Registrar will investigate the cause

Financial viability performance thresholds[45]

Measure	Ratio	Performance Threshold	Data Definition
Operating EBITDA margin	Percentage	Tier 1 (8% to 15%) Tier 2 (3% to 10%) Tier 3 (0% to 5%)	► Operating EBITDA (operating earnings before interest, tax, depreciation and amortisation) / Operating revenue ► Operating revenue excludes capital grants and non-cash income ► Providers with material interest bearing debt would be expected to operate at higher levels
Working capital ratio	Ratio	Tier 1, 2 & 3 >1.5 times	► Current assets less unspent capital grants / Current liabilities less (capital grants received in advance and accommodation bonds)
Amended quick ratio	Ratio	Tier 1, 2 & 3 >1.2 times	► (Cash, short-term investments & unused overdraft facilities) / Current liabilities less (capital grants received in advance and accommodation bonds)
Operating cash adequacy	Percentage	Tier 1 >1.20 times Tier 2 >1.05 times Tier 3 >1.00 times	► Operating cash inflows / Operating cash outflows
Gearing ratio	Ratio	Tier 1, 2 & 3 <30%	► Total repayable debt / Total assets less intangible assets
Interest cover ratio	Ratio	Tier 1, 2 & 3 >1.5 times	► Operating EBITDA / Financing costs ► Financing costs excludes loan establishment costs
Debt serviceability	Ratio	Trend analysis	► Repayable debt / (Operating EBITDA finance costs)
Return on assets (ROA)	Percentage	Trend analysis	► Operating EBITDA / Average total assets ► Dependent on asset level of provider. Less assets would normally result in a higher ROA
Cash Cost of capital	Percentage	Trend analysis	► Total finance costs/ Average total assets ► Related to return on assets: should be at least 1-3% p.a. lower than return on assets. Finance costs should exclude loan establishment costs
Rental bad debt management	Percentage	Tier 1, 2 & 3 <1%	► Bad debts written off during the year may be from current or past year rental debtors

8 Appendix 1

NRSCH: Snapshot on Outcome 7: Financial viability performance thresholds.

National Regulatory Code Evidence Guidelines for CHPs Performance outcomes – Outcome 7: Financial Viability[46]

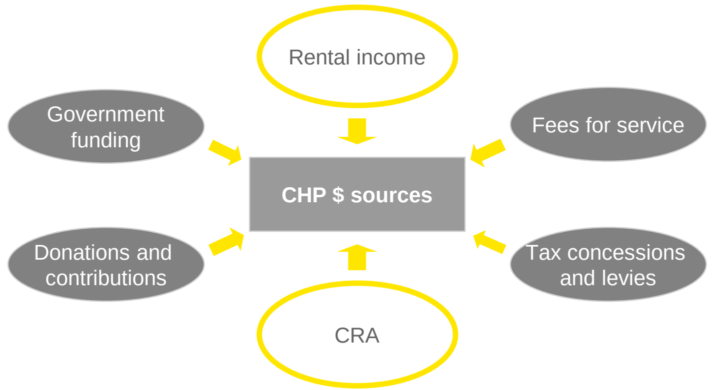
Performance requirements	Performance indicators	Thresholds	Evidence sources to demonstrate capacity	Evidence sources to demonstrate compliance
Ensuring a viable capital structure	The provider monitors and manages its capital structure to achieve its business goals	► Capital adequacy – the provider has sufficient capital resources to be able to absorb unexpected losses and to manage adverse shocks so that it can meet its commitments to investors	Tiers 1, 2 and 3 ► Business plan ► Financial performance report ► Financial viability measures data Tiers 1 and 2 ► Debt financing arrangements and covenants	Tiers 1, 2 and 3 ► Business plan ► Annual Report ► Financial performance report ► Audit management letter for the most recent FY (where they have been issued) ► Financial viability measures data ► Board approved budget and forecast, including financial assumptions Tiers 1 and 2 ► Debt financing arrangements and covenants may be requested ► Sample governing body minutes with relevant operational and financial reports
Maintaining appropriate financial performance	The provider monitors and manages its financial performance to achieve its business goals	► Financial performance is monitored and managed for short, medium and long-term viability ► There are no significant and ongoing or repeated instances of inappropriate financial performance and/or failure to achieve business goals	Tiers 1, 2 and 3 ► Business plan ► Financial performance report ► Financial viability measures data	Tiers 1, 2 and 3 ► Business plan ► Annual report ► Financial performance report ► Audit management letter for the most recent FY (where they have been issued) ► Financial viability measures data ► Board approved budget and forecast, including financial assumptions. Tier 1 and 2 ► Financial planning and scenario testing ► Debt financing arrangements and covenants may be requested ► Sample governing body minutes with relevant operational and financial reports Other sources ► Record of complaints and notifications under the National Law
Managing financial risk exposure	The provider monitors and manages its financial risk exposure to protect its financial interest and the interest of investors	► Potential financial risks are identified and minimised by developing appropriate mitigation strategies ► There are no significant and ongoing or repeated instances of financial risks crystallising ► Any crystallising financial risks are dealt with in a prompt and effective manner	► Tiers 1,2 and 3 ► Business plan ► Financial performance report ► Financial viability measures data Tiers 1 and 2 ► Documented risk management system ► Risk management plan ► Risk register	Tiers 1, 2 and 3 ► Business plan ► Annual report ► Financial performance report ► Board approved budget and forecast, including financial assumptions Tier 1 and 2 ► Financial planning and scenario testing ► Debt financing arrangements and covenants may be requested ► Sample governing body minutes with relevant operational and financial reports ► Governing body consideration and approval of significant financial events and risk management (sample) Other sources ► Record of complaints and notifications under the National Law

8 Appendix 1

Review of rent setting policies in the CHP sector: Overview and key features at a jurisdictional level.

Key points

- The primary sources of income includes rental income, CRA as well as capital and recurrent funding from Government and fees for service
- Rental income represents approximately 25% of eligible tenant income for social / community housing and up to 30% for affordable housing
- Security of funding is an important consideration for the BA as it will be used to repay principle and interest
- Across Australia, there is similarity in rent setting policies* – primarily in relation to a proportion of household income plus inclusion of a CRA entitlement. There is some flexibility afforded to CHPs in rent setting (e.g. VIC, TAS) and this is usually monitored at a Registrar level



NSW

- Rents vary for affordable and are either set as a discount to the market rent or as a percentage of income. Rent set must comply with the *NSW Affordable Housing Guidelines*
- For market rent, discount is usually between 20-25% compared to market. As a proportion of household income, households may be charged between 25-30% of their income before tax
- Rent for NRAS properties must be at least 20% below the prevailing market rent
- CHPs must determine the subsidised rent of all tenancies based on a percentage of the household income plus 100% of the household's entitlement to CRA – subject to the qualification that the subsidised rent including CRA must not exceed market rent
- For ACHPs, rent setting must align with the Build and Grow Policy – charge household rent or property rent (whichever is lower). Tenants are also eligible for CRA payments

VIC

- In practice, rents charged for social housing tenants in community housing are broadly similar to the rest of the country. Providers generally charge rents that equate to 25% of income plus 100% of a tenant's CRA entitlement
- Rents for properties that are owned by CHPs are required to be "affordable for tenants while maintaining financial viability for the agency" (i.e. the provider)
- A net rent requirement caps net rent at 30% of income for lower income households. CHPs have discretion to set their own "affordable rents" for households above the net rent requirement (subject to approval from the Housing Registrar)

QLD

- QLD uses total household's assessable income to calculate the rent subsidy and the rent. Rent is based on either 25% of assessable income or the market rent for the property – whichever is lower
- Rents for community housing tenants are set by QLD Government at 25% of income plus 100% of CRA, or market rent (whichever is lower). This is similar to the Indigenous housing rent policy
- Where CHPs deliver affordable housing, they have greater discretion. Organisations can charge up to 74.9% of market rent, but no more than 30% of income

* **Note**: Data for each State and Territory sourced from publicly available information and State Government websites. The information has not been audited nor have we consulted with any State Government entity or Regulatory body on the data or our interpretation of the data.

8 Appendix 1

Review of rent setting policies in the CHP sector: Overview and key features at a jurisdictional level.

SA

- Tenants in community housing pay rent set at 25% of their income plus 100% of CRA
- In SA, CHPs collect rent from tenants and then calculate and retain certain allowances. For instance, some providers may collect insufficient rent to cover their necessary allowances (e.g. by housing a higher proportion of very low income tenants). In this case, they are able to invoice Housing SA for the difference
- In NRAS properties in SA, rent is generally set at 74.9% of market rent

WA

- Rent is set in accordance with Band A (very low or low incomes) and Band B (low or moderate) tenants who are allocated housing. Providers that accept tenants from the wait list must deliver a 70/30 split between Band A and Band B. Band A tenants are required to pay 25% of gross income while Band B tenants pay 30%
- Community housing rents in WA are capped with reference to market rent
- Further, WA is the only jurisdiction where income limits are segregated by region – either Metro and Country or Northwest / Remote areas

TAS

- Tenant contribution is 25% of household income. This is a flat structure for public housing
- CHPs managing social housing set rent at 25% of assessable income plus 100% of CRA. It is standard practice to cap rent at 25% of income or 74.9% of market rent – whichever is lower. For NRAS properties, there is discretion to charge 30% of income plus CRA
- CHPs often have flexibility to use different rent setting models. For instance, Red Shield Housing usually charges 30% of household income and 30% of CRA (rents capped at $175 / week)
- Sometimes Housing Tasmania will set a special rent (e.g. if the sole tenant has to go to prison or hospital)

ACT

- In the ACT, community housing tenants pay similar rents to public housing tenants. Public housing rents are set at 25% of a household's assessable income. Further, rents in ACT social housing properties cannot exceed the assessed market rent for a property. CHPs in the ACT typically charge tenants 25% of their income plus 100% of CRA (or market rent if lower)
- Community housing is allocated from a common waitlist for both public and community housing. This list is managed by Housing ACT
- Affordable housing is described by the ACT Government as a "type of community housing where… rent is calculated at 74.9% of market rent"

NT

- Given the small size of the CHP sector in the NT, the rent-setting policies in public housing provide a basis for understanding. Public housing tenants pay 23% of their income on rent, with the exceptions of tenants receiving an aged pension who pay at 18% of their income
- There is no articulated Territory-level policy that sets out how NFP providers should set rents. Generally, providers set rent at 25% of a tenant's income plus 100% of CRA
- There is some variance. For instance, organisations could set rent at a proportion of individual income (rather than household) or charge rent according to the number of eligible occupants in a dwelling

* **Note**: Data for each State and Territory sourced from publicly available information and State Government websites. The information has not been audited nor have we consulted with any State Government entity or Regulatory body on the data or our interpretation of the data.

8 Appendix 1

CRA: Overview and key features.

1985

- CRA introduced in 1985
- Some form of assistance has been provided to some social security recipients since 1958

- Since 1986, substantial changes were made to broaden the eligibility and increase the rates of CRA. During 1980s & 1990s there was a move away from direct public housing provision to providing subsidised rents

- 1992: amount of CRA from the Australian Government exceeds payments made to states under the CSHA

2000

- 2000: CRA rates increased as part of the GST compensation package

2009/10

- 2009: Pension review noted price increases had outstripped rate of assistance. Also noted pressure faced by pensioners
- 2010: Henry Tax Review proposed CRA is increased to better align market rents to reflect that growth

2014

- 2014: Commission of Audit recommended changes to the Australian Government's involvement in housing and rental assistance

2015

- 2015: McClure review recommended rents should be phased out in public housing and replaces with CRA over time and the levels of assistance should be reviewed
- 2015: Economics Reference Committee recommended adequacy, indexation and eligibility of CRA is reviewed

Key points[47]

- CRA payments have existed for over 20 years to support the funding gap and reduce housing stress for low income individuals
- Changes to the CRA payments, both in terms of eligibility and the adequacy of levels, have been included in a number of Reviews, including the Commission of Audit and the Henry Tax Review (Australia's Future Tax System)
- The Henry Review concluded that rent caps for CRA were too low and the indexation to CPI meant the assistance was less well targeted over time. It was recommended that the rent maximum be indexed by movements in national rents. Both the McClure Review and the Economics Reference Committee 2015 Report on Housing recommended that the levels and indexation methods of CRA payments should be reviewed to ensure the system provided adequate support. However, unlike the Henry Tax Review, they did not recommend alternate indexation measures
- Recent surveys from the CHP sector suggests that any change or reduction to its structure would significantly impact upon CHPs' ability to operate efficiently and productively. For the purpose of this assessment, it is considered that the long term nature of CRA would be viewed positively by a ratings agency as an indication of Government support

9

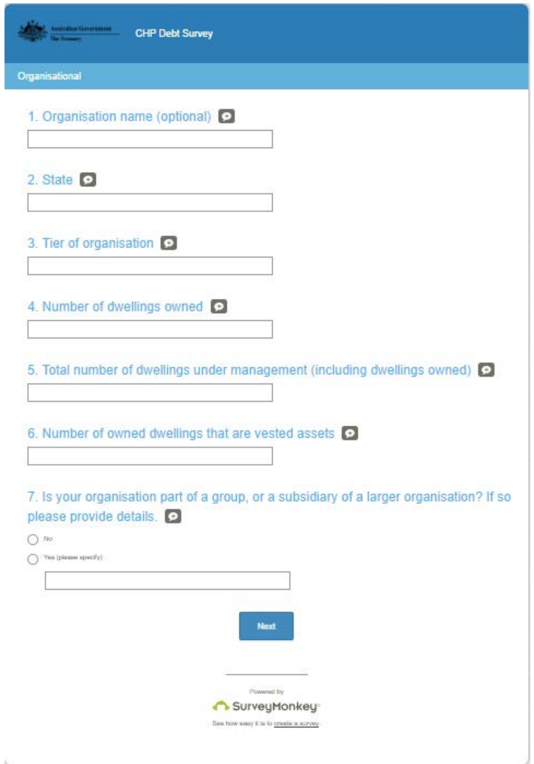
Appendix 2

The CHP Debt and Finance Requirement Survey

Overview	A Survey was sent to CHPs, via industry peak bodies, with the objective to establish their refinancing requirements and debt levels as well as their preferred and existing terms and conditions.
Methodology	The survey questionnaire was developed with Treasury and key stakeholder feedback and was open for 2 weeks following the 2017 Budget announcements.
Relevance	The survey was used to validate the debt requirements and assumptions identified in the desktop shadow credit ratings and cross check lender feedback on existing tenor and pricing.

9 Appendix 2

The Debt and Finance Requirement Survey: Overview and objectives.


CHP Debt Survey

Organisational

1. Organisation name (optional)

2. State

3. Tier of organisation

4. Number of dwellings owned

5. Total number of dwellings under management (including dwellings owned)

6. Number of owned dwellings that are vested assets

7. Is your organisation part of a group, or a subsidiary of a larger organisation? If so please provide details.

No

Yes (please specify)

Next

Powered by SurveyMonkey

See how easy it is to create a survey

The Survey: Purpose and Objectives

- The Survey was prepared for distribution to CHPs nationally to supplement the CHP sector information obtained from publicly available sources such as annual reports, to ascertain sector interest and initial debt re-finance requirements under the BA
- An online survey tool was used to facilitate the process whereby participants accessed the Survey via a web browser and submitted their answers online. The Survey materials were distributed by the Taskforce via email to industry peak bodies for distribution to CHPs and other housing providers in their jurisdiction, including registered Tier 1, 2 and 3 CHPs under the NRSCH as well as other relevant stakeholders
- The Survey went live on 23 May 17 and was open for two weeks. During this time, responses were monitored periodically and updates were provided to the Taskforce

Survey Design

- Measures were taken in the design and structure to maximise participation from the sample, including:
  - Participants were given the option to remain anonymous in case they had reservations about sharing their views or potential privacy concerns
  - The Survey commenced with simple, factual questions and increased in complexity to reflect the varying levels of financial maturity of CHPs
- Mix of pre-filled multi-choice, multi-choice with the option to provide further detail in free form and total free form answers

Survey Questions

- Questions were designed to provide context to the debt and finance requirements for an individual provider and to illicit views on what would make the BA attractive to the market
- The Survey was arranged into four sections and contained questions covering the following:
  - Organisational
  - Assets, liabilities, income and expenses
  - Individual loan details
  - Future borrowing requirements
- The list of questions are detailed overleaf

Observations and Findings

- A total of 68 responses were received comprising Tier 1 CHPs (22 responses), Tier 2 CHPs (12) and Tier 3 CHPs (16). The remaining entities did not disclose their registration or did not register
- The detail of responses varied in their completeness. For instance, only 28 respondents answered every question in the Organisational section of the Survey and 32 respondents answered the “what are the most important characteristics of a new loan product?” question. Six respondents indicated that they have multiple loans on their balance sheets
- The headline findings are included within Chapter 2 of this Report; namely that 40% of respondents will refinance over $500 million in the next five years and that lower cost interest rates and increased loan tenor are the most important features that CHPs covet for the BA

9 Appendix 2

The Debt and Finance Requirement Survey: Questionnaire.

Survey Questions

Organisational

1. Organisation name (optional)
2. State
3. Tier of organisation
4. Number of dwellings owned
5. Total number of dwellings under management (including dwellings owned)
6. Number of owned dwellings that are vested assets
7. Is your organisation part of a group, or a subsidiary of a larger organisation? If so please provide details.

Assets, liabilities, income and expenses

8. Total assets
9. Total liabilities
10. Total income
    - Rent
    - CRA
    - State Government
    - Other (please specify)
11. Total expenses
12. Are you intending to refinance any of your existing debt in 2018, 2019, 2020, 2021, 2022?
    - No
    - Yes (please indicate roughly how much)

Individual loan details

13. Facility limit
14. Drawn debt amount
15. Purpose
    - General corporate purposes
    - Refinance
    - Construction
    - Other (please specify)
16. Repayment profile
    - Principal and interest
    - interest only
17. Nature of interest rate (fixed or variable)
    - Fixed
    - Variable
18. Interest rate:
    - Fixed rate (%)
    - Margin (%) (where variable rate)
19. Establishment fee
20. Loan commencement date
21. Loan maturity date
22. Loan covenants include (please click on multiple answers if applicable)
    - Loan to value ratio (%)
    - Gearing (%)
    - Interest cover (x)
    - Other (please specify)
23. Security includes (please click on multiple answers if applicable):
    - Mortgage over property
    - Fixed and floating charge
    - Other (please specify)
24. Do you have another loan not already detailed? (if yes, you will be directed to a duplicate page to enter details)

Future borrowing requirements

25. Estimate future borrowing requirement (calendar year)
    - 2017
    - 2018
    - 2019
    - 2020
    - 2021
26. Purpose of borrowing:
    - General corporate purposes
    - Refinance
    - Construction
    - Other (please specify)
27. What are the most important characteristics of a new loan product? If a new lending product is issued by the National Housing Finance and Investment Corporation, what characteristics are most important to your organisation? Please rank in order with position 1 being the highest priority, and position 9 being the lowest priority
    - Repayment profile (principal and interest)
    - Repayment profile (interest only)
    - Interest rate (fixed rate)
    - Interest rate (variable rate)
    - Increased tenor
    - Unsecured
    - Lower cost interest rate
    - Standardised terms
    - Increased LTV debt level vs. banks
    - CHP involvement in management of the Bond Aggregator / board level involvement
28. Does your CHP have a debt policy including limits on target / maximum debt levels? Please provide more detail next to your answer
29. Has your CHP ever experienced difficulty in soliciting financing offers or been unable to secure the requested debt amount from a lender(s)? If yes, please provide more detail as to why your CHP experienced this difficulty next to your answer
30. Are there any matters which would constrain your decision to refinance existing debt, for example, hedging, break fees, small amount of debt not worth renegotiating?
31. Other comments – please provide any relevant information that is not elsewhere covered

10

Appendix 3

Financial Viability – Moody’s and S&P credit rating approaches

Overview	A shadow credit rating analysis was utilised to assess sector viability. The shadow credit rating analysis of individual CHPs - as well as the collective shadow credit rating for a standalone BA - was used to assess sector viability to support a BA bond issuance. This further helped inform pricing assumptions and optimal BA structure.
Methodology	Credit ratings methodologies were sourced from two major credit rating agencies, S&P and Moody’s. These two are widely accepted by DCM investors. They were compared to identify the key differences in their approaches to arrive at a suitable methodology for the BA feasibility assessment.
Relevance	Moody’s was selected as the most suitable and was used for the basis of our analysis. The framework is internationally recognised as a robust method for assessing a Borrower’s credit standing.

10 Appendix 3

We have utilised a shadow credit rating analysis as a proxy of financial viability of the sector and the capacity of the CHPs to service the debt obligations. S&P and Moody's were considered, with Moody's methodology selected.

Why Moody's?

Both S&P and Moody's are international market leaders in the provision of credit ratings and offer methodologies to assess the SCP of CHPs with consideration for their Government-related status. Based in a review of the range of credit rating methodologies available, Moody's offer a specific methodology for a pass-through BA, in addition to a non-bank financial institution methodology offered by both ratings agencies. Furthermore, it was assessed that Moody's methodology offers a more adaptable rating process which assists with shadow credit rating analysis in the context of this engagement.

A more detailed comparison can be found on the following page.

Moody's methodology was selected for our shadow credit rating analysis

S&P's Approach

- S&P's approach incorporates a two-step process in assigning a credit rating to CHPs
- The first step is the assessment of a CHP SCP using their *Public And Nonprofit Social Housing Providers: Methodology And Assumptions*[48] methodology. This is followed by an assessment of the impact of extraordinary Government support
- Because CHPs have a public service mission and relationships with Government objectives, S&P assess the potential for a rating uplift using their *Government-Related Entities: Methodology And Assumptions*[49]
- S&P does not offer a specific methodology for pooled financing vehicles with the closest match being the *Rating Finance Companies*[50] methodology, by which THFC, GBSH and LGFA are assessed

Moody's Approach

- Moody's approach also incorporates a two-step process in assessing the individual credit rating of CHPs as they are usually GRIs
- Rating the BA subsequently involves a third step to assess the pooled financing vehicle credit rating
- Firstly, a SCP that represents the opinion of the CHP's standalone credit strength is assigned using the *European Social Housing Providers*[51] methodology
- Secondly, assessment of the probability of the supporting Government providing special measures to prevent the CHP from defaulting on its financial obligations may provide an uplift to the SCP using the *Government-Related Issuers*[52] methodology
- Moody's define public sector pooled financing as "debt obligations secured by loan repayments from a small group of obligors", who are assessed using their *Public Sector Pool Financings*[53] methodology

10 Appendix 3

We compared and contrasted Moody's and S&P across four factors (overview, credit profile, GRI uplift and pooled finance). Ultimately, Moody's was considered more applicable and robust for this engagement.

Factor	Moody's	S&P
Overview of Approach	✓ Incorporates a two-step process for CHPs, to assess both the standalone entity and the impact of extraordinary Government support ✗ There is no precedent Australian CHP rating based on this methodology ✗ The methodology is based on assumptions for the European social housing sector ✓ Offers a specific methodology for evaluating pooled financing vehicles	✓ Incorporates a two-step process for CHPs, to assess both the standalone entity and the impact of extraordinary Government support ✓ There exists an Australian CHP that has been rated based on this methodology ✓ The methodology is based on assumption for social or public housing providers globally ✗ Does not offer a specific methodology for pooled financing vehicles
Standalone Credit Profile (CHP Rating)	✓ The SCP is first assessed on the providers standalone merits, absent of its Government-related status ✓ The 'sum-of-the-parts' approach provides flexibility for out-performance in one area to offset weaker performance in another, thereby offering a more adaptable shadow credit rating process ✗ Whilst specific to social housing providers, the methodology is based on assumptions for the European social housing sector	✓ The SCP is first assessed on the providers standalone merits, absent of its Government-related status ✗ Matrix approach may constrain the ability of out-performance in one area to offset weaker performance in another, thereby offering a less adaptable shadow credit rating process ✓ The methodology is tailored to public and NFP social housing providers globally
GRI Uplift (CHP Rating)	✓ Moody's are considered to be more adaptable in the GRI methodology given the potential for an 'offset effect' of strong performance in one area	✗ S&P are considered less adaptable in their GRI methodology given a matrix approach may constrain the ability of out-performance in one area to offset weaker performance in another
Pooled Financing Vehicle Rating (BA Rating)	✓ Moody's offers a specific methodology for assessing pooled financing vehicles resulting in greater transparency regarding the shadow credit rating assessment	✗ S&P does not offer a specific methodology for assessing pooled financing vehicles, with the most appropriate being the methodology for non-bank financial institutions. This could result in greater subjectivity regarding the application of the methodology for the shadow credit rating assessment

11

Appendix 4

Financial Viability – Credit Rating and GRI Methodology

Overview	A shadow credit rating analysis was utilised to assess sector viability. The shadow credit rating analysis of individual CHPs - as well as the collective shadow credit rating for a standalone BA - was used to assess sector viability to support a BA bond issuance. This further helped inform pricing assumptions and optimal BA structure.
Methodology	The three step process involved: 1. Determining each CHPs' standalone credit profile 2. Determining the GRI uplift to each CHP 3. The pooled vehicle (BA) shadow credit rating
Relevance	The overall financial viability of the CHP sector is sound, as evidence by investment grade CHP credit ratings of A2 to Aa1 and a weighted average BA rating of A1. These rating levels represent medium to high financial viability according to Moody's rating scale.

11 Appendix 4

SCP: Moody's approach to determining a CHP's SCP incorporates analysis of five broad factors mapped to a scorecard.

Moody's CHP Credit Profile Approach – Sub-factor Scoring[54]

- Moody's employs a sum-of-the-parts approach to assessing an entity's standalone credit profile. This incorporates a scorecard rating system that focusses on five broad factors including sub-factors within each
- Each sub-factor is assessed and assigned a rating between ca and aaa in accordance with Moody's Global Long-Term Rating Scale. Each rating corresponds to a numerical score
- The sub-factor scores is weighted based on the relevant significance of the sub-factor in assessing the standalone credit profile

Broad Factors	Sub-Factors	Sub-Factor Weighting	Type
Institutional Framework	Operating Environment	10%	Subjective
	Regulatory Framework	10%	Subjective
Market Position	Units Under Management	10%	Objective
Financial Performance	Operating Margin	5%	Objective
	Social Letting Interest Coverage	10%	Objective
	Cash Flow Volatility Interest Coverage	10%	Objective
Debt and Liquidity	Debt to Revenue	5%	Objective
	Debt to Assets	10%	Objective
	Liquidity Coverage	10%	Objective
Management and Governance	Financial Management	10%	Subjective
	Debt and Investment Strategy	10%	Subjective
Total Scorecard Indicated Outcome		**100%**	

Moody's Scorecard Approach – Standalone Credit Profile

- The weighted sub-factor scores are summed to give a total numerical score, which correlates to a Moody's credit rating, assigned as the standalone credit profile of the entity

Relevance

The overall financial viability of the CHP sector is sound, as evidence by investment grade CHP credit ratings of A2 to Aa1. This incorporates approximately one notch uplift due to due to credit links to their supporting Governments.

Process of analysis

- The objective factors were calculated by EY for each CHP based on their FY16 financial accounts
- The subjective factors were based on assessment of Moody's qualitative factor mapping grid, as provided as part of the methodology
  - Institutional framework was assessed on a sector-wide basis, with uniform scoring being applied to all CHPs
  - Management and governance was assessed based on the accreditation of the CHP as a Tier 1 or a Tier 2 entity

A description of each sub-factor and how these have been assessed in our shadow credit rating analysis outlined in the table including our is provided on the following pages.

11 Appendix 4

SCP: The objective factors were assessed by EY for each CHP based on their FY16 financial accounts, mapped onto the Moody's scorecard and assigned a sub-factor rating accordingly.

Market Position

- *Units Under Management*
  - The size of an SHP is a proxy for a number of aspects of an issuer's market position

Financial Performance

- *Operating Margin*
  - Operating Margin calculated as the ratio between operating surplus and operating revenue
  - A consistently strong operating margin indicates the ability to meet financial obligations, resilience to shocks and usually leads to reserves growth which contributes to overall balance sheet strength and internal funds generation which may reduce the need for debt-funded capital expenditure
- *Social Letting Interest Cover (SLIC)*
  - SLIC represents the ability of profit derived from low-risk social housing letting landlord activity to cover interest obligations
  - A ratio that consistently exceeds 1.0x indicates an ability to cover its annual financing costs from its lowest-risk activities which is consider core in maintaining a solid standalone credit profile
  - SLIC is calculated as the ratio of social rent surplus to net cash interest paid
- *Cash Flow Volatility Interest Coverage (CVIC)*
  - CVIC represents the entities ability to cover its interest obligations from operating cashflows, with consideration for historical volatility in operating margin
  - The ability to demonstrate a consistent ability to meet interest obligations despite historical fluctuations/given low fluctuation indicates a stronger credit profile as compared to an entity that is inconsistent/has high fluctuations
  - CVIC is calculated as the ratio of volatility-adjusted pre-interest operating cash flow to net interest

Debt and Liquidity

- *Debt to revenue*
  - Debt to revenue is calculated as the ratio of total debt to operating revenue
  - It is a proxy for the entity's long-term debt servicing capacity
- *Debt to assets*
  - Debt to assets is calculated as the ratio of total debt to total assets
  - A high gearing level is an indication that the entity may have a limited access to additional funds which may effect financial flexibility and the ability to cope with a sudden change in cash requirements
- *Liquidity coverage*
  - Liquidity coverage is calculated as the ratio of liquidity position to expected two year cash requirements
  - The two-year timeframe is considered to be an appropriate proxy for committed development projects and hence a score of 1.0x implies sufficient liquidity to cover projected cash flow requirements

Factors	Sub-Factors	Above the aaa endpoint*	aaa	aa	a	baa	ba	b	Below the b endpoint^
Market Position	Units Under Management		≥150,000	<150,000 ≥ 60,000	<60,000 ≥ 20,000	<20,000 ≥ 5,000	<5,000 ≥ 1,000	<1,000 ≥ 600	
Financial Performance	Operating Margin	≥ 75%	< 55% ≥ 75%	< 55% ≥ 35%	< 35% ≥ 25%	< 25% ≥ 10%	< 10% ≥ 5%	< 5% ≥ 3%	≤ 3%
	SLIC	≥ 4x	< 3x ≥ 4x	< 3x ≥ 2x	< 2x ≥ 1.5x	< 1.5x ≥ 1x	< 1x ≥ 0.9x	< 0.9x ≥ 0.5x	≤ 0.5x
	CVIC	≥ 5x	< 4x ≥ 5x	< 4x ≥ 3x	< 3x ≥ 2x	< 2x ≥ 1x	< 1x ≥ 0.9x	< 0.9x ≥ 0.25x	≤ 3%
Debt and Liquidity	Debt to Revenue	≤ 0x	> 1x ≤ 0x	>1x ≤ 2x	>2x ≤ 3x	>3x ≤ 4x	>4x ≤ 5x	>5x ≤ 6.5x	≥ 6.5x
	Debt to Assets	≤ 0%	> 10% < 0%	> 10% ≤ 20%	> 20% ≤ 30%	> 30% ≤ 40%	> 40% ≤ 50%	> 50% ≤ 70%	≥ 70%
	Liquidity Coverage	≥ 10x	< 5x ≥ 10x	< 5x ≥ 2x	< 2x ≥ 1x	< 1x ≥ 0.5x	< 0.5x ≥ 0.25x	< 0.25x ≥ 0.15x	≤ 0.15x

* A sub-factor rating above the aaa endpoint is given a numerical score that is better than an "aaa"; ^A sub-factor rating below the b endpoint is given a numerical that is worse than a "b".

11 Appendix 4

SCP: The Institutional framework sub-factors were assessed on a sector-wide basis, with uniform scoring being applied to all CHPs, based on the descriptions provided in the Moody's methodology and mapped accordingly on the scorecard to assign a rating.

Institutional Framework: Operating Environment

For this factor, we have considered the qualitative descriptions provided by Moody's for the institutional framework in the context of the Australian CHP sector. It is a subjective measure, assessed as "a" noting the following against the Moody's description set out in italics.

- *Social housing plays or is expected to play an important role in housing policy and represents a high (over 15%) share of housing*
  - Housing affordability is a key issue in Australia and this is underlined by growing public housing waitlists (with more than 150,000 approved applicants on waiting lists nationwide) and the mismatch between growth in house prices and corresponding growth in average income creating housing stress. Therefore, the increased supply of appropriate, affordable accommodation stock is crucial for the access of low and moderate income households in Australia
  - Social housing represents approximately 4% of total housing in Australia comprising people living in public housing and community housing. Public housing which is owned and managed by the States is a significant subset of social housing with 321,627 public housing dwellings at 30 June 2015 (approx. 80% of social housing dwellings)[55]
  - The CHP role in the sector is also expanding as the sector continues to play a larger role in the provision of not just social but also affordable housing. As at 30 June 2015, there were 72,105 community housing tenancy rental units in Australia, doubling the number recorded in 2006[56]
- *Housing policy is generally stable and changes are made in consultation with key stakeholders, and done with ample notice*
  - While it is acknowledged that there are concerns raised by the sector in regards to long term policy positions , for the purpose of this assessment, it is considered that there are indicators of stable policy positions or interventions at all levels of Government, including transparent housing strategies being published by the States, innovative funding solutions and transactions aligned to policy intent seeking to address demand and supply, one off funding injections (i.e. $5.6 billion investment following the Global Financial Crisis (GFC) by the Australian Government)[57] and long term funding supports such as incremental increases to CRA, the NAHA special purpose payment (SPP) to the States and NRAS. Consultation with the sector is an important lever to implementing effective policy reform; with the consultation process for the AHWG a strong examples of communicating openly with the sector to address market challenges
- *Strong and stable Government capital or support increasing from a low level*
  - Funding provided by Australian Government and the States have remained strong over the last five to 10 years. For instance, the Australian Government will spend approximately $4.5 billion in CRA to support more than 1.3 million households renting at the lower end of the housing market.[58] Strong support is important as a future policy objective, as funding is relied upon by the sector. For instance, a number of prominent providers are subsidised and rely upon Government intervention through non repayable grant or subsidies
- *Government funder has strong financial health and adequate funding of housing budgets*
  - The financial strength of the Australian Government as a supporter of social housing is important to unlocking increased supply. Future funding will ultimately be influenced by the Australian Government's overall financial position. The Australian Government is one of only 12 countries to attain and hold a Aaa credit rating with Moody's. Further, the credit ratings at a State and Territory level are also strong with NSW and VIC maintaining the highest credit rating available

11 Appendix 4

SCP: The Institutional framework sub-factors were assessed on a sector-wide basis, with uniform scoring being applied to all CHPs, based on the descriptions provided in the Moody's methodology and mapped accordingly on the scorecard to assign a rating.

Institutional Framework: Operating Environment (cont.)

For this factor, we assessed the impact of Government policy and funding on the choices and opportunities of CHPs. It is a subjective measure, assessed as "a" noting the following criteria:

- *Providers have moderate revenue flexibility including ability to raise rents without Government consent; ability to engage in ventures outside of their core mission to generate revenue; and a reasonably strong ability to cut costs in times of financial needs*
  - The CHP market is characterised by a diverse mix of organisations that operate with social housing as a core function; however, many organisations draw on multiple revenue streams such as rental receipts, Government operating grants and other revenue to remain financially sustainable. Further, CHPs have flexibility to increase rents (generally subject to an affordability threshold – e.g. 75% of market rent). The policy framework in rent setting in VIC and TAS is conducive to a degree of flexibility and is usually monitored at a Registrar level. Cost flexibility in the market is also present but is mitigated to an extent by a stable revenue base and strong demand for affordable housing. This flexibility is important from a risk mitigation perspective within the sector

Sub-Factors	aaa	aa	a	baa	ba	b
Operating Environment	Social housing plays or is expected to play a critical role in housing policy and represents a significant (over 30%) share of housing. Housing policy is very stable and predictable. Strong and increasing Government capital support. Government funder has very strong financial health and there are no pressures on housing budgets. SHPs have: Very high level of revenue flexibility including ability to raise rents without Government consent and a long history of rent increases. Ability to engage in ventures outside of core mission to generate revenue. Very strong ability to cut costs in times of financial need.	Social housing plays or is expected to play an important role in housing policy and represents a very high (over 20%) share of housing. Housing policy is stable and predictable. Strong and moderately increasingly Government capital support. Government funder has strong financial health and there are no pressures on housing budgets. SHPs have: High level of revenue flexibility including ability to raise rents without Government consent and a history of rent increases. Ability to engage in ventures outside of core mission to generate revenue. Strong ability to cut costs in times of financial need.	Social housing plays or is expected to play an important role in housing policy and represents a high (over 15%) share of housing. Housing policy is generally stable and changes are made in consultation with housing providers and done with ample notice. Strong and stable Government capital support or support increasing from a low level. Government funder has strong financial health and adequate funding of housing budgets. SHPs have: Moderate revenue flexibility including ability to raise rents without Government consent. Ability to engage in ventures outside of core mission to generate revenue. Reasonably strong ability to cut costs in times of financial need.	Social housing plays or is expected to play a role in housing policy and represents a modest (over 5%) share of housing. Housing policy is generally stable and when changes are made they a done with adequate notice. Moderate and generally stable Government capital support. Government funder has adequate financial health and adequate funding of housing budgets. SHPs have: Modest revenue flexibility including ability to raise rents with Government consent and a history of obtaining approval for rent increases. Moderate ability to cut costs in times of financial need.	Social housing plays or is expected to play limited role in housing policy or represents a limited (3- 5%) share of housing. Housing policy is generally stable, but when changes are made it is with limited notice; or policy is evolving, but changes are made with adequate notice. Limited Government capital support or materially declining. Government funder has adequate financial health, but there are pressures on housing budgets. SHPs have: Limited level of revenue flexibility including the ability to raise rents with Government consent and an inconsistent history of receiving approval for rent increases. Limited ability to cut costs in times of financial need.	Social housing plays or is expected to play little or no role in housing policy. Housing policy is evolving and changes are made with limited notice. No projected Government capital support or rapidly declining support. Government funder has generally adequate financial health but there are pressures on housing budgets. SHPs have: Very limited level of revenue flexibility. Raising rents has been or is expected to be difficult. Very limited ability to cut costs in times of financial need.

* SHPs are referred to as Social Housing Providers by Moody's and are considered equivalent to CHPs for the purpose of this analysis

11 Appendix 4

SCP: The Institutional framework sub-factors were assessed on a sector-wide basis, with uniform scoring being applied to all CHPs, based on the descriptions provided in the Moody's methodology and mapped accordingly on the scorecard to assign a rating.

Institutional Framework: Regulatory Framework

For this factor, we assessed the scope and effectiveness of the regulation under which social housing providers operate. Subjective measure, assessed as "aa" noting the following:

- *Active and legislatively mandated public regulator with enumerated powers*
  - Housing Registrar's possess functions under the NRSCH for regulatory activities and compliance and seek to provide a consistent regulatory environment to support the growth and development of the sector. Each participating state and territory has a Registrar to apply the National Law* and regulate providers within its jurisdiction
- *Ability to intervene early in cases of mismanagement or liquidity distress and a track record of timely and effective intervention*
  - The regulator has a degree of oversight and broad powers to intervene in cases of distress. The regulator also possesses a control over registration of providers. This strong governance and oversight role allows for the prevention of provider mismanagement and liquidity issues within the sector
- *Has oversight, including over reporting and certification*
  - Prescribed disclosure requirements that lead to adaptable reporting and regulatory limits on the level of risk taken on by CHPs are also favourable characteristics for scoring this sub-factor. The regulatory framework ensures that stringent reporting requirements are fulfilled by the sector. Metrics and key performance indicators (KPIs) are set to provide benchmarks for the sector as well as triggers for the regulator to intervene if requirements are not met
  - State and Territory housing agencies generally have responsibility for policy and funding decisions that impact upon the sector

Sub-Factors	aaa	aa	a	baa	ba	b
Regulatory Framework	Active and legislatively mandated public regulator with predictable and enumerated powers. Ability to intervene early in cases of suspected mismanagement or liquidity distress and a track record of early and effective intervention. Extremely strong oversight, of financial performance and reporting	Active and legislatively mandated public regulator with enumerated powers. Ability to intervene early in cases of mismanagement or liquidity distress and a track record of timely and effective intervention. Very strong oversight, of financial performance and reporting	Legislatively mandated public regulator with enumerated powers. Ability to intervene in cases of mismanagement or liquidity distress and a track record of effective intervention. Strong oversight, of financial performance and reporting	Legislatively mandated public regulator with limited enumerated powers. Ability to intervene in cases of mismanagement or liquidity distress and a reasonable track record of intervention. Good oversight including of financial performance and reporting	Legislatively mandated public regulator with tools of intervention based in precedent or similar non-codified sources. A precedent for intervention, but limited legal powers or a limited track record of effective intervention. Good oversight including practical limits on debt levels.	Public regulator with weak or changing powers. Where there is a regulator, it has very limited powers and or no history of intervening in cases of struggling social housing providers. Minimal oversight with some visibility of financial performance and reporting

11 Appendix 4

SCP: Management and governance sub-factors were assessed based on the accreditation of the CHP as a Tier 1 or a Tier 2 entity.

Management and Governance: Financial Management

For this factor, we assessed a range of qualitative characteristics including performance reporting and past performance of management's ability to respond to adverse circumstances. Subjective measure, assessed as "aa" for Tier 1 providers and "a" for Tier 2 providers noting the following:

- *Ensuring a viable capital structure, maintaining appropriate financial performance and managing financial risk exposure*
  - These factors are taken into account under the National Regulatory System and are used to assess registration and monitor ongoing performance
  - Comprehensive reporting to the Board including evidence of performance against KPIs and evidence of robust financial policies is an important determinant of viability. Tier 1 and 2 providers are subject to increased reporting requirements relative to Tier 3 providers. An example of this is evidenced through the level of detail required by the regulator of historical and forecast financials for Tier 1 and 2 providers where audited reports and debt financing arrangements are required to demonstrate capacity. In 2015-16, 66 assessments were completed by the Regulator to ensure ongoing compliance
  - Timely responses to adverse financial policies is closely aligned with managing financial risks. Tier 1 and 2 providers are required to supplement financial reports with business plan details, financial planning and scenario testing and may be requested by the regulator to submit risk management reports in accordance with the NRSCH. Furthermore, strong alignment of policies, procedures and practice provides evidence to ratings agencies that shows that a provider can formulate and set financial objectives and maintain financial viability
- The sub-factors are detailed overleaf

11 Appendix 4

SCP: Management and governance sub-factors were assessed based on the accreditation of the CHP as a Tier 1 or a Tier 2 entity.

Sub-Factors	aaa	Aa	a	baa	ba	b
Financial Management	Clear business focus with structured, effective and consistently applied decision making framework. Risk appetite is minimal. Well thought out and defined risk register including remediation activities. Frequent, bespoke and comprehensive reports to the board including key performance indicators. A culture of board challenge. Well communicated, effective and timely response to adverse financial information or events. Extremely conservative financial policies, strong adherence to clear procedures and highly effective internal controls. Simple, clear and well organized group structure. Bespoke, multi-factorial stress testing, including readily achievable mitigation strategies. Compliance with regulatory requirements. Very strong alignment of policies, procedures, and practice.	Clear business focus with effective and consistently applied decision making framework. Risk appetite is limited. Comprehensive risk register including remediation activities. Frequent and comprehensive reports to the board including key performance indicators. A strong track record of board challenge. Effective and timely response to adverse financial information or events. Very conservative financial policies, adherence to clear procedures and effective internal controls. Clear and well organized group structure. Multifactorial stress testing, including easily achievable mitigation strategies. Compliance with regulatory requirements. Strong alignment of policies, procedures, and practice.	Clear business focus with effective decision making framework. Risk appetite is modest. Frequent and comprehensive reports to the Board including key performance indicators. A track record of board challenge. Timely response to adverse financial information or events. Conservative financial policies and procedures. Effective internal controls. Well organized group structure. Stress testing of business plans, including achievable credible mitigation strategies. Compliance with regulatory requirements. Alignment of policies, procedures, and practice.	Defined business focus; when decision making framework is not adhered, to it is explicitly overridden by board. Risk appetite is well managed, but may grow with respect to change in strategy, organization or development risks. Comprehensive reports to the Board including key performance indicators. Track record of board challenge. Generally timely response to adverse financial information or events. Clear and reasonably conservative financial policies. Documented procedures. Effective financial controls. Some complexity in group structure, but agreements and policies provide clarity in operations. Stress testing of business plans, including reasonably achievable mitigation strategies. Compliance with regulatory requirements, but regulator has highlighted some minor weakness. Alignment of policies, procedures, and practice.	Defined business focus with some elements of opportunism and weak adherence to or no decision making framework. Risk appetite is growing with respect to change in strategy, organization or development risks. Key performance indicators are included in Board reporting. Some track record of board challenge. Responsive to adverse financial information or events. Financial policies may have some weakness and/or inconsistent compliance. Documented procedures and adequate financial controls. Some complexity in group structure; agreements and policies generally provide clarity. Group structure in transition adding some change management risks. Limited stress testing of business plans. Mitigation strategies highlight some weaknesses in management response. Compliance with regulatory requirements, but regulator has highlighted significant weaknesses or concern with entity. Limited alignment of policies, procedures, and practice.	Opportunistic approach to managing the business and decision making. Risk management not tailored to the entity and risk appetite introduces challenges which are difficult to manage. Performance metrics lack focus or are not well aligned to business objectives. Limited board challenge. Limited response to adverse financial information or events. Ineffective financial policies and/ or failure to follow policies and procedures. Limited financial controls, or lapses/exceptions highlighted by internal or external audit / review. Complex group structure introducing additional risks. No stress testing of business plans or mitigation ineffective. Regulator is intervening with entity. No alignment of policies, procedures, and practice.

11 Appendix 4

SCP: Management and governance sub-factors were assessed based on the accreditation of the CHP as a Tier 1 or a Tier 2 entity.

Management and Governance: Debt and Investment Strategy

For this factor, a range of considerations are taken into account including sophistication of debt management, tolerance for refinancing and interest rate risk and financial viability ratios that deal with debt indicators. Subjective measure, assessed as “aa” for Tier 1 providers and “a” for Tier 2 providers noting the following:

- Detailed policies and procedures that incorporate conservative liquidity, refinancing and investment guidelines; Evidence of robust liquidity management; and evidence of robust debt financing arrangements and covenants
  - These factors are taken into account under the National Regulatory System and are used to assess registration, monitor ongoing performance and provide assurances that providers are able to take on and manage debt
  - Evidenced through financial capacity ratios including the current ratio, working capital ratio and gearing ratios and embedded within the NRSCH Financial Viability Guidelines. The Regulator sets performance thresholds for these ratios. This includes a <30% performance threshold for the gearing ratio; current ratio greater than 1 and a working capital ratio of greater than 1.5 times
  - Evidenced through financial capacity ratios such as interest cover ratio (ICR) and debt serviceability and embedded within the NRSCH Financial Viability Guidelines. The Regulator monitors trend analysis for debt serviceability and considers an ICR greater than 1.5 times as a benchmark within the industry

Sub-Factors	aaa	aa	a	baa	ba	b
Debt and Investment Strategy	Very strong and detailed annually reviewed treasury policies and procedures that include extremely conservative liquidity and investment guidelines and explicitly incorporate organizational risks. Very simple debt portfolio with either less than 5% variable rate exposure or exceptionally strong mitigants against risks, including cash holdings and unencumbered assets that far exceed potential collateral calls. Very low refinancing risk (typically with no more than 5% of debt due within five years) and unquestioned access to capital markets. Unquestioned headroom against covenants.	Strong and detailed annually reviewed treasury policies and procedures that include very conservative liquidity and investment guidelines and incorporate organizational risks. Simple debt portfolio with either less than 10% variable rate exposure or extremely strong mitigants against risks including cash holdings and unencumbered assets that exceed potential collateral calls. Low refinancing risk (typically with no more than 10% of debt due within five years) and very strong access to capital markets. Very strong headroom against covenants.	Strong annually reviewed treasury policies and procedures that include conservative liquidity and investment guidelines and incorporate organizational risks. Simple debt portfolio with either less than 20% variable rate exposure or very strong mitigants against risks including cash holdings and unencumbered assets that generally exceed potential collateral calls. Moderate refinancing risk (typically with no more than 20% of debt due within five years) and strong access to capital markets. Strong headroom against covenants.	Annually reviewed treasury policies and procedures that include generally conservative liquidity and investment guidelines and incorporate organizational risks. Debt portfolio with some complexity, typically including more than 30% variable rate exposure with strong mitigants against risks including cash holdings and unencumbered assets, which meet potential collateral calls. Modest refinancing risk (typically with no more than 30% of debt due within five years) and good access to capital markets. Sufficient headroom against covenants.	Treasury policies and procedures that include adequate liquidity and investment guidelines and generally incorporate organizational risks. Debt portfolio with complexity, typically more than 50% variable rate exposure or with mitigants against risks including cash holdings and unencumbered assets that are just equal to potential collateral calls. Elevated refinancing risk (typically with no more than 40% of debt due within five years). Historically has comfortably met all covenants, but forecast demonstrates limited headroom.	Treasury policies and procedures that include weak or unclear liquidity and investment guidelines, which are reflective of some organizational risks. Complex debt portfolio, typically with more than 70% variable rate exposure or limited mitigants against risks including cash holdings and unencumbered assets that are less than potential collateral calls. High refinancing risk (typically with 50% or more of debt due within five years). Very limited headroom against covenants on a current or forecast basis.

11 Appendix 4

Government-Related Issuer uplift: Moody's consider that GRIs may be subject to an "uplift" in their standalone creditworthiness due to credit links to their supporting Governments, giving rise to a GRI-adjusted SCP (CHP Rating).

Moody's GRI methodology

- Similarly to the standalone credit profile, Moody's utilises a scorecard rating system that outlines each of the two broad factors for consideration in this GRI methodology:
  - Dependence: this component assesses the degree of default correlation (chance of both defaulting) between the CHP and Government
  - Support: this component assesses the probability of extraordinary support (i.e. the chance that support will actually be provided to the CHP in an EoD or similar situation)

Dependence – Sub-factor Scoring

- Each sub-factor is assessed and assigned a score between Low to Very High
- The Dependence sub-factors are subjective and our assessment was undertaken on a sector-wide basis - with uniform scoring being applied to all CHPs - based on qualitative guidance notes provided as part of the Moody's GRI methodology
- The scorecard then estimates dependence based on the highest level generated by any one of the three factors

Relevance

The impact of "High" *Dependence* and "Moderate" *Support* drive an uplift in the CHP ratings of approximately one notch compared to the CHP stand-alone credit profiles.

Dependence Sub-Factors

- *Operational and Financial Linkages*
  - The operational and financial linkages between the CHP sector and the national Government are high. CRA is indicative of this as it is recouped by the sector as a portion of rental receipts. A 2014 paper prepared by the Community Housing Peaks Policy Network, sampled 24 CHPs and found that CRA made up between 30-39% of most organisation's rental income.[59] Accordingly, income from CRA is critical to CHPs growing their property portfolios using debt financing. Governments grants are also important to the financial standing of a number of individual providers. For instance, BHC revenue base comprised 32% and 19% respectively across 2015 and 2016 for Government grants
- *Reliance on Overlapping Revenue Base*
  - The sector and the Government rely on different but interrelated revenue streams, implying a high level of default dependence. The CHP sector is heavily reliant on rental receipts for revenue. Ultimately, the income attributed to the sector and the supporting Government is primarily derived from within a common economic space
- *Exposure to Common Credit Risks*
  - For the sector and the Government, exposure to common credit risks is moderate and primarily related to shared industry exposure and political event risks. Therefore, the credit profiles of CHPs are more likely to be impacted by the sponsoring Government's credit quality and actions

Dependence	Low	Moderate	High	Very High
(1) Operational and Financial Linkages				
Direct and Indirect Government Transfers as a % of GRI Revenue				
Government Purchases as a % of GRI Revenue			✓	
GRI Payments (Dividends) as a % of Government Revenue				
(2) Reliance on Overlapping Revenue Base				
Percentage of income derived from within the Government's territory			✓	
(3) Exposure to Common Credit Risks				
Shared Industry Exposure		✓		
Political Event Risks				
Overall Guidance Dependence Level			✓	

11 Appendix 4

CHP Rating: We have utilised Moody's GRI methodology to ascertain if/how much of an uplift is applicable to the CHP sector. This uplift is applied as a GRI adjustment to the SCP, to assess the CHP Rating.

Support – Sub-factor Scoring

- The Support scorecard generates an estimate based on six sub-factors (three structural sub-factors and three willingness indication sub-factors), assigning a rating to each between Low and Very High which correlate to a percentage, then assigns a rating based on the average weighting of all sub-factors

Support: Structural Factors

- *Support guarantees*
  - This sub-factor considers explicit guarantees, verbal guarantees and/or comfort letters and special legal status
  - While the Government has historically provided grants and concessional loans to the sector, there is limited evidence of explicit guarantees, comfort letters or special legal status arrangements being provided to the sector
- *Ownership*
  - This sub-factor considers both current ownership level and privatisation plans
  - The vast majority of organisations in the sector are NFPs or privately owned and managed, with a minimal proportion backed by Government ownership (e.g. BHC in QLD). Support is low as a result
- *Barriers to support*
  - There are minimal legal and no policy barriers to prevent the Government from supporting the sector

Support	Low	Mode-rate	Strong	High	Very High
Structural Sub-Factors					
Guarantees	✓				
Ownership	✓				
Barriers to Support				✓	
Willingness Indication Sub-Factors					
Levels of Government Intervention		✓			
Political Linkages		✓			
Economic Importance		✓			
Overall Guidance Support Range		✓			

Support: Willingness Indicators

- *Government intervention*
  - This sub-factor considers the history of state bailouts, the ideological and political inclinations, Government direction of the GRI as well as business planning
  - Historically, the Government has stepped in to support the States in instances of financial distress. For instance, the Government provided stimulus payments to States during the 2008-09 financial crises and temporarily guaranteed State debt. The States also have the capacity to intervene and support the sector from a regulatory perspective via the Housing Registrars. This strong level of oversight has contributed to minimal bailouts at Tier 1 and Tier 2 levels
- *Political linkages*
  - Social housing has traditionally been a State responsibility, both in terms of funding and policy parameters. However, in recent years, the Australian Government has increased its commitment to social and affordable housing as outlined earlier. Therefore, the reputation risk of providers in the sector failing provide an incentive for the Government to support and implies a moderate probability of extraordinary support
- *Economic importance*
  - The sector is responsible for the delivery of social and affordable housing in Australia. This is acknowledged as an essential service and asset base in the country for low to moderate income earning households. However, in the EoD, it is likely that the Government would step in to assuage the accommodation needs of the tenant; rather than managing the financial interests of the provider. Therefore, these factors support a moderate probability of extraordinary support

11 Appendix 4

The BA Rating: Moody's Pooled Financing Methodology was utilised to assign a shadow credit rating to the BA.

The BA is expected to be an enhanced pooled financing vehicle, with the BA shadow credit rating of A1 determined using the Weighted Average Probability of Default Approach.

The BA shadow credit rating improves to Aaa with an Australian Government guarantee.[60]

By force of this section, the due payment of any money that become payable by the BA to a person other than the Australian Government is guaranteed by the Australian Government

Moody's Pooled Financing Methodology

- Following the initial evaluation of the underlying credit quality of the pool participants, the final step focuses on the structural and legal attributes of the pooling vehicle:
  - Ratings for enhanced pool financings which include strong structural elements, such as a dedicated debt service reserve fund (DSRF), will generally be based on the weighted average credit quality of the participants
  - Ratings for un-enhanced pool financings that lack such structural enhancements or contain structural elements that provide limited security will generally be rated based on a "Weak Link Plus" approach
- These two rating approaches make distinctions between a structure that includes additional bondholder security beyond the underlying credit quality of pool participants and those that do not

Moody's Weighted Average Probability of Default Approach

- Vehicles with strong structural elements are rated based on the weighted average credit quality of the pool participants

Moody's Weak Link Plus Approach

- Vehicles that lack such enhancing structural elements are assigned a rating that is the lower of:
  - The weighted average credit quality of the pool participants
  - The rating two notches above the rating associated with the weakest link (lowest individually rated entity) of the pool participants

Explicit Guarantee

- An explicit, legally binding guarantee, covering all debt obligations lifts the GRI's rating to the level of the supporting Government
- As such, the shadow credit rating for the BA improves to Aaa under the recommended Base Case Structure (BA with an Australian Government guarantee)

12

Appendix 5

Summary of recent issuances

Overview	Australian DCM market data was collated on bond issuances over the last two years
Methodology	Desktop research was undertaken sourcing details on bond issuances from Bloomberg comprising Government, Government-related and other comparable rated finance industry participants
Relevance	Key observations informed the proposed features of bonds to be issued by the BA including tenor, interest rate profile and repayment profile

12 Appendix 5

In order to inform the proposed features of bonds to be issued by the BA, market data was collated comprising Government, Government-related and other comparable rated finance industry bond issuances over the last two years.

Tenor

11 years

The average tenor observed over the last 24 months was 11 years

Interest rate profile

Fixed

More than half the issuances (approximately 60%) offered fixed coupons

Repayment Profile

Bullet

Most of the issuances (over 95%) displayed a bullet profile

Market research

- A review of issuance activity within the Australian DCM was undertaken to gain insight into comparable market issuances
- Issuances into the Australian DCM over the last 24 months from the Australian Government, Semi Government (e.g. States), Government GBEs, and Australian financial corporates were reviewed
- An assessment of the tenor, nature of interest rate (coupon) and repayment profile assisted to inform the proposed BA bond characteristics based on the market trends and market conventions

Key Observations

- **Tenor:** the average tenor observed over the last 24 months was 11 years but ranged between one to 30 years, with some bonds being perpetual in nature. The most common tenors were five years and 12 years (approximately 29% and 24% respectively of reported issuances) with only approximately 17% exceeding a 20 year tenor and comprised mostly of Government or Semi-Government issuers, with one exception of a corporate exhibiting a 30 year tenor
- **Interest rate profile:** more than half the issuances (approximately 60%) offered fixed coupons, with 35% floating or variable and just one zero coupon bond in the sample. Of the coupon bonds, the majority of coupons (approximately 60%) pay semi-annually, with approx. 25% paying quarterly and the remainder paying annually
- **Repayment profile:** Most of the issuances (over 95%) displayed a bullet profile, maturing at a set maturity date as opposed to being perpetual in nature (of which there were two) or having an amortising profile (of which there were none). Approximately 29% offered a bullet profile with a call option, meaning that funds could be recalled early in accordance to the terms of the respective issuance
- **Credit rating:** All but five issuances had been assigned a formal credit rating, accredited with an investment grade rating; the unrated issuances appear to have been completed under the 'simple bond' methodology recently introduced. Our analysis excluded this option due to poor pricing outcomes, as evidenced by the relatively high coupons (detailed on the next two pages)

A summary of the issuances can be found over the next two pages

12 Appendix 5

There were 22 Australian Government, Semi-Government and Australian Government GBE issuances over the last 24 months.

The below table outlines all Australian Government, Semi-Government and Australian Government GBE issuances over the last 24 months:

Coupon Type

All Australian Government, Semi-Government and Australian Government GBE issuances over the last 24 months offered a fixed interest rate coupon, with the exception of one issuance which was a zero-coupon bond.

Zero Coupon Bond

A zero coupon bond does not pay any coupon payments to investors; instead, it is issued at a discount to face value hence a return to investors is realised at maturity when the principal is repaid.

Issuer Name	Amount Issued ($m)	Cpn (%p.a.)	Coupon Type	Tenor	Maturity Type	Moody Rating	S&P Rating
Australia Government Bond	8,100	3.00	FIXED	30	AT MATURITY	Aaa	N/A
Australia Government Bond	2,650	1.25	FIXED	25	AT MATURITY	Aaa	N/A
Australia Government Bond	4,000	3.25	FIXED	24	AT MATURITY	Aaa	N/A
Australia Government Bond	6,550	2.75	FIXED	20	AT MATURITY	Aaa	N/A
Australia Government Bond	17,600	2.25	FIXED	12	AT MATURITY	Aaa	N/A
Australia Government Bond	22,300	2.75	FIXED	12	AT MATURITY	Aaa	N/A
Australia Government Bond	14,000	2.75	FIXED	12	AT MATURITY	Aaa	N/A
Australia Government Bond	25,700	1.75	FIXED	6	AT MATURITY	Aaa	N/A
Australia Government Bond	12,800	2.00	FIXED	5	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	3.00	FIXED	30	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	1.25	FIXED	25	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	3.25	FIXED	24	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	2.75	FIXED	20	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	2.25	FIXED	12	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	2.75	FIXED	12	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	2.75	FIXED	12	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	1.75	FIXED	6	AT MATURITY	Aaa	N/A
Exchange Traded Australian Government Bonds	N/A	2.00	FIXED	5	AT MATURITY	Aaa	N/A
Queensland Treasury Corp	1,205	3.25	FIXED	12	AT MATURITY	Aa1	AA+
Treasury Corp of Victoria	100	0	ZERO	20	AT MATURITY	Aaa	AAA
Treasury Corp of Victoria	1,580	3.00	FIXED	13	AT MATURITY	Aaa	AAA
Treasury Corp of Victoria	300	1.75	FIXED	5	AT MATURITY	Aaa	AAA

Source: Bloomberg

30 Year Bonds

There have only been two issuers of 30 year bonds into the Australian DCM over the last 24 months. In fact, the first ever 30 year AUD bond into the Australian DCM was issued by the Australian Government in October 2016[61]

The other issuer was one of the Big 4 Banks, Westpac who issued in USD[62] (see next page).

Repayment profile

The maturity type for all Australian Government, Semi-Government and Australian Government GBE issuances over the last 24 months were “AT MATURITY”, indicating a bullet repayment profile with no call option offered.

12 Appendix 5

There were 35 Australian financial corporates issuances over the last 24 months.

The below table outlines all Australian financial corporates issuances over the last 24 months:

Issuer Name	Amount Issued ($m)	Cpn (%p.a.)	Coupon Type	Tenor	Maturity Type	Moody Rating	S&P Rating
Australia & New Zealand Banking Group Ltd	465	3.75	VARIABLE	12	CALLABLE	Baa1	BBB
Australia & New Zealand Banking Group Ltd	515	4.75	VARIABLE	10	CALLABLE	Baa1	BBB
Australia & New Zealand Banking Group Ltd	1,621	2.05	FIXED	5	AT MATURITY	Aaa	N/A
Australia & New Zealand Banking Group Ltd	1,352	6.75	VARIABLE	N/A	PERP/CALL	Baa2	BB+
Australia & New Zealand Banking Group Ltd	1,352	6.75	VARIABLE	N/A	PERP/CALL	Baa2	BB+
Commonwealth Bank of Australia	1,726	2.00	VARIABLE	12	CALLABLE	Baa1	BBB
Commonwealth Bank of Australia	211	5.15	VARIABLE	10	CALLABLE	Baa1	BBB
Keybridge Capital Ltd	5	7.00	FIXED	5	CALLABLE	N/A	N/A
Mercantile Investment Co Ltd	22	8.00	FIXED	5	AT MATURITY	N/A	N/A
National Australia Bank Ltd	943	3.92	FLOATING	12	CALLABLE	Aa3	AA-
Peet Ltd	100	7.50	FIXED	5	AT MATURITY	N/A	N/A
Scentre Group Trust 1 / Scentre Group Trust 2	774	2.38	FIXED	7	CALLABLE	A1	A
Scentre Group Trust 1 / Scentre Group Trust 2	737	1.38	FIXED	7	CALLABLE	A1	A
US Masters Residential Property Fund	91	7.75	FIXED	5	CALLABLE	N/A	N/A
US Masters Residential Property Fund	175	7.75	FIXED	5	CALLABLE	N/A	N/A
Vicinity Centres	656	3.38	FIXED	10	CALLABLE	A2	A
Westpac Banking Corp	140	5.00	FIXED	30	AT MATURITY	Baa1	BBB
Westpac Banking Corp	350	4.50	VARIABLE	12	CALLABLE	Baa1	BBB
Westpac Banking Corp	175	4.80	VARIABLE	12	CALLABLE	Baa1	BBB
Westpac Banking Corp	314	4.00	VARIABLE	12	CALLABLE	Baa1	BBB
Westpac Banking Corp	425	4.13	FIXED	11	AT MATURITY	Aa3	AA-
Westpac Banking Corp	256	4.85	VARIABLE	10	CALLABLE	Baa1	BBB
Westpac Banking Corp	125	0.76	FIXED	10	AT MATURITY	Baa1	BBB
Westpac Banking Corp	700	4.82	FLOATING	10	CALLABLE	Baa1	BBB
Westpac Banking Corp	175	3.25	FIXED	5	AT MATURITY	Aa3	AA-
Westpac Banking Corp	2,700	2.645	FLOATING	5	AT MATURITY	Aa3	AA-
Westpac Banking Corp	2,100	2.825	FLOATING	5	AT MATURITY	Aa3	AA-
Westpac Banking Corp	200	3.50	FIXED	5	AT MATURITY	Aa3	AA-
Westpac Banking Corp	2,100	2.90	FLOATING	5	AT MATURITY	Aa3	AA-
Westpac Banking Corp	500	3.10	FIXED	5	AT MATURITY	Aa3	AA-
Westpac Banking Corp	2,450	2.65	FLOATING	5	AT MATURITY	Aa3	AA-
Westpac Banking Corp	325	3.25	FIXED	5	AT MATURITY	Aa3	AA-
Westpac Banking Corp	2,350	2.74	FLOATING	3	AT MATURITY	Aa3	AA-
Westpac Banking Corp	1,000	2.15	FLOATING	1	AT MATURITY	Aa3	AA-
Westpac Banking Corp	500	2.15	FLOATING	1	AT MATURITY	Aa3	AA-

Source: Bloomberg

Coupon type

Coupon type observed is a mix of fixed, floating and variable, with no key trend prevailing.

Unrated Issuances

Keybridge Capital

The offer for debt securities was not a public offer or capital raising; bonds were offered to existing shareholders as a form of in specie distribution.

Mercantile Investment Co Ltd

The issuer is a subsidiary of a rated company.

Peet Ltd

This issuance was a simple corporate bond, a type of ASX listed bond that does not require a formal credit rating.

US Masters Residential Property Fund

These issuances were retail offers, not requiring a public credit rating to meet retail investor requirements[64].

Tenor

Australian financial corporates issuances comprised tenors of between one to 12 years, with the exception of a single 30 year bond issuance.

30 Year Tenor

Westpac issued a 30 year subordinated bond in USD into the Australian market[6263]. However, as can be seen, this is not a common trend within the market with Westpac being to only Corporate financial issuer at this tenor, with the other comparators issuing up to 12 year bonds.

Investment Grade Rating

It was observed that issuers who had obtained a public credit rating qualified for an investment grade rating.

13

Appendix 6

Entity Structure - International Case Studies

Overview	To draw on international best practice in the BA's design, we examined a range of International Social Housing financing intermediaries as well as the sole Australian BA
Methodology	Desktop research (including translating French and German websites) was undertaken and focussed on key questions of ownership, levels of Government support, systems of Government, the entities' credit ratings (and how they were derived), and liquidity management processes
Relevance	Crucial to solution design: understanding how these entities are established, supported and then viewed by credit rating agencies drives solution design

13 Appendix 6

Methodology: examining and drawing upon international affordable housing financing intermediaries and the sole functioning Australian Aggregator is crucial to solution design.

EY examined eight international financing structures in the social and affordable housing sector as well as the Australian MAV model and NZ's LGFA model.

The international case studies contain a range of different Government support measures but they are overwhelmingly structured as non-Government entities. Of five of the seven operating structures*, three are NFPs and two private organisations. Only the French and Irish examples are publicly owned corporations.

The level of Sovereign support provided varies from:

- No direct support (GB Social Housing for example)
- Local Governments taking a loss position ahead of the Sovereign
- Loans issued with Sovereign guarantees
- "Credit enhancement by association" (THFC)
- Program-specific guarantees within a broader portfolio (see THFC's detailed example below)

A brief description of each is included over. On the basis of these examples, EY then overlaid our understanding of the Australian Government's assessment criteria (right) on the entity structure to arrive at a preferred structure for the BA.

The wholesale adaptation of an extant International financing model to the Australian context is complicated by a range of factors: the relative size and financial sophistication of the respective community housing sectors, the depth and characteristics of the respective financial markets and the systems of Government (federal vs unitary states and the division of powers via the community hosing sector in the latter).

Based on the criteria to the right, we assessed that THFC and GB Social Housing examples offer the most replicable examples in the context of the Australian Government's requirements, but that the Australian Government's system's division of powers adds a layer of regulatory complexity and risk that needs to be apportioned to the party best placed to handle it. Detailed examples of these two, and the MAV in the Australian context, are provided below.

* The Canadian example is concept only at this stage.

Criteria	Description
Alignment to Government objectives	► Preference is given to a model that optimises contribution to all project objectives, reflecting weighting or priorities where multiple objectives are present.
Complexity in set up and ongoing	► Preference is given to a model that optimises risk in set up and administration from the Australian Government's perspective, giving consideration to time preferences and stand up costs
Learnings and precedents	► Preference is given to a model that leverages the experience of international initiatives and work done by other organisations to date, refined for the current Australian environment
Flexibility in design solution	► Preference is given to a model that is flexible to meet timetable preferences (e.g. through interim solution), and scalable to adapt to future demands or priorities.
Market demand & supply: Investor	► Preference is given to a model that meets investor requirements to optimise attractiveness in the market.
Market demand & supply: Beneficiary	► Preference is given to a model that meets beneficiary requirements regarding volume and process, to address known market failure for them in the current environment. ► Preference is given to a model that aligns with beneficiary capacity and capability during set up and ongoing operations
Governance	► Preference is given to a model that can be structured with robust and efficient governance structure and processes, and where these skill sets are not currently available; able to attract and secure them within the required timetable. *[Note: Independence from Government is not assumed to be a requirement]*

13 Appendix 6

International case studies surveyed: different solutions for different markets but at the core of an Aggregator is credit risk and liquidity management.

Selected international case studies for reference

Project	Country	Description	Key Structural Features
HFA (1982)	Ireland *Source: AHURI 2012; AHURI 2014*	▸ Irish Housing Finance Agency backed by the Irish Government (1982 Local Authority housing (LAHs) / 2012 Voluntary Housing Bodies (VHBs)) ▸ Since 1982, the HFA has raised short term funds on the international capital markets for longer term investments in LAH, related infrastructure and VHBs. The total amount that can be raised by the HFA is capped at €10 billion. In 2011, the HFA loan book was €4.36 billion	▸ Intermediary: Publicly owned corporation ▸ Financial impact: very limited market without a guarantee ▸ Default rate: 0% for LAH

CGLLS (2001)	France
	Source: AHURI 2012; AHURI 2014; CGLLS, http://www.cglls.fr/
		▸ French Mutual Fund for Guarantees of Social Housing (CGLLS), backed by the French Government. Established in December 2000 as replacement to the GCLS. The CGLLS fulfils two main functions:
		  ▸ Guarantees the loans of providers when local authorities cannot (or do not) or when their signature is not agreed by CDC (body responsible for financing 70% of finance required by social housing companies and HLMs) because of their financial situation
		  ▸ Assists providers (or HLMs) to recover when they are in difficulty
		▸ The CGLLS is principally funded by two contributions provided by articles L452-4 and L452-4-11 of the construction and housing code. The CGLLS is both a national body of administrative nature placed under the authority of ministers in charge of finance and the economy as well as a specialised financial institution required to conform to the same requirements as the rest of the banking industry
			▸ Intermediary: Publicly owned corporation
			▸ Financial impact: Market only exists with guarantee
			▸ Default rate: 0% since 2008 (previously been around 0.04%)

WSW (1983)	Netherlands *Source: AHURI 2012; AHURI 2014*	▸ Dutch Guarantee Fund for Social Housing (WSW) backed by the sector, a fund and central and local Dutch Governments ▸ Central Government acts as a second guarantee in the event that the Central Fund for social housing has insufficient capacity. The Government acts as a guarantor of last resort through the WSW with interest-free loans in the event the sector can no longer overcome its financial problems, thereby allowing providers to borrow on favourable terms. At the end of 2011, WSW guaranteed loans totalled around €86.3b. Furthermore, the guarantee fund was able to draw on security reserves to the amount of €481 million in 2012	▸ Intermediary: Private NFP financial intermediary ▸ Financial impact: 1-1.5% below going market rates for similar mortgages ▸ Default rate: 0% ▸ WSW was upgraded to AAA rating in November 2015
EGW (1991)	Switzerland *Source: AHURI 2012; AHURI 2014; EGW/CCL http://www.egw-ccl.ch/fr/*	▸ Swiss Bond Issuing Co-Operative (BIC) for limited profit housing (EGW) backed by the Swiss Federal Government. Swiss NFP co-operatives and associations are financed with commercial bank loans; low-interest loans from a state-funded revolving fund; and loans from bonds issued with Federal guarantee plus a defined percentage of their own or tenants equity ▸ The BIC secures capital from the market by issuing bonds of seven to 10 years term ▸ Members applying for finance are subject to the discretion of an independent board. Approval is non-binding and member accounts are independently audited. Underlying asset must meet EGW requirements	▸ Intermediary: Government-backed, member owned and NFP bond issuing co-operative ▸ Financial impact: Small margin above Government borrowing costs ▸ Default rate: 0% (since 2003)

13 Appendix 6

International case studies surveyed: different solutions for different markets but at the core of an Aggregator is credit risk and liquidity management.

International case studies for reference

Project	Country	Description	Key Structural Features
HCCB	Austria *Source: AHURI 2012; AHURI 2014*	▸ The Housing Construction Convertible Bond (HCCB) is a special purpose private bond that raises low cost funds for the development of affordable rental housing delivered through the for-profit and limited profit sectors ▸ HCCB provide between 40-60% of finance for new or redeveloped affordable rental housing projects – with 20-30 years maturity at either a fixed or variable interest rate	▸ Intermediary: Private organisation ▸ Financial impact: Issued below market rate (1% lower than capital market bonds) ▸ Default rate: 0%
THFC (1987)	United Kingdom *Source: AHURI 2012; AHURI 2014*	▸ Established in 1987, THFC is the leading social housing corporation in England. The THFC funds its operations through the issue of bonds to private investors and bank borrowings ▸ As at March 2009, THFC provided £1.90 billion of loans to 199 housing associations	▸ Intermediary: NFP organisation ▸ Financial impact: Market only exists with guarantee ▸ Default rate: 0% ▸ A+ / Stable rating
GB Social Housing PLC (2010)	Great Britain *Source: GB Social Housing Summary and Loan Termsheet (May 2016)*	▸ GB Social Housing is a finance company with the sole purpose of providing loans to the UK social housing sector. The company is a loan aggregator and raises finance through capital markets notes issuance. Bonds proceeds are on-lent to eligible UK social housing associations on a secured basis ▸ No Government support: credit standing is a function of entity credit policies and liquidity management	▸ Intermediary: Private organisation ▸ Financial impact: flexible financial covenants and long term fixed rate loans at competitive rates ▸ Default rate: 0% ▸ A- / Negative rating
CHFA (2016)	Canada *Source: Feasibility Report regarding a Dedicated Lending Institution for the Canadian Affordable and Social Housing Sectors (MPA, 2016)*	▸ Housing Partnership Canada's (HPC) vision is to create the Canada Housing Finance Authority (CHFA) which will act as a lending institution designed to assist Canadian affordable housing providers finance regeneration and housing projects ▸ This model is currently under consideration – CHFA would raise debt capital in the capital markets and make loans to qualifying housing projects and providers	▸ Intermediary: Private organisation in the form of a finance company incorporated under law ▸ Financial impact: Under consideration ▸ Default rate: N/A

13 Appendix 6

BA Structure Options - the THFC example[65].

Background:

The Housing Finance Corp Ltd (THFC)

The THFC has been funding the UK Community Housing Sector for almost three decades and grew out of Government under the aegis of the Government's Housing Regulator to help meet the sector's funding needs as Government transferred its housing stock to Housing Associations.

It is a not-for-profit loan aggregator that adopts conservative lending practices and has close links to Government and the sector.

According to S&P, THFC accounts for 20% of the new bond issuance by the UK sector in 2016.

Credit Rating

S&P A Rated

S&P rated THFC on a SCP as A in November 2016. It was rated A+ in 2004.
S&P's rating rationale is based primarily on its general creditworthiness which is derived from the conservative lending and funding approach (see below and over).

Apart from an exclusive arrangement with the Government on the Affordable Housing Guarantee Scheme, **there is no direct Government Guarantee of THFC's debt obligations to Bondholders**.

S&P does however currently apply its Government Related Entity (GRE) methodology to THFC through the Affordable Housing Scheme relationship. In 2004, S&P also viewed the Government's nomination of a Board member as an indication of proximity to Government and likelihood of support. The Borrowers are also classified as GREs with "a moderately high likelihood of extraordinary Government support". In simple terms then, S&P's rating is not based on a direct credit uplift because of the direct and sectoral links to Government but on its prudent funding and credit policies which drive the quality of its loan book.

Key Structural Features

Board & Executive

10 Board Members: all from the sector with varying areas of expertise. Three Executive Directors: the CEO, Finance Director and Group Treasurer. Two of the seven non-executive directors are nominated by the Homes and Communities Agency and the National Housing Federation. The remaining five members are all Independent. Members can serve a maximum of three, three year terms.

Funding approach

A conservative, pass through funding structure which minimises interest rate, funding and liquidity risk (see over). 38% of its funding currently comes from the European Investment Bank (EIB), the rest the Capital markets. THFC maintains cash reserves (any annual surpluses are invested into it) as a buffer against default and also requires obligors to make interest payments one month before they fall due. Interest accumulated on these monies fund on-going operations and providing "a small debt service cushion"

Credit Policies

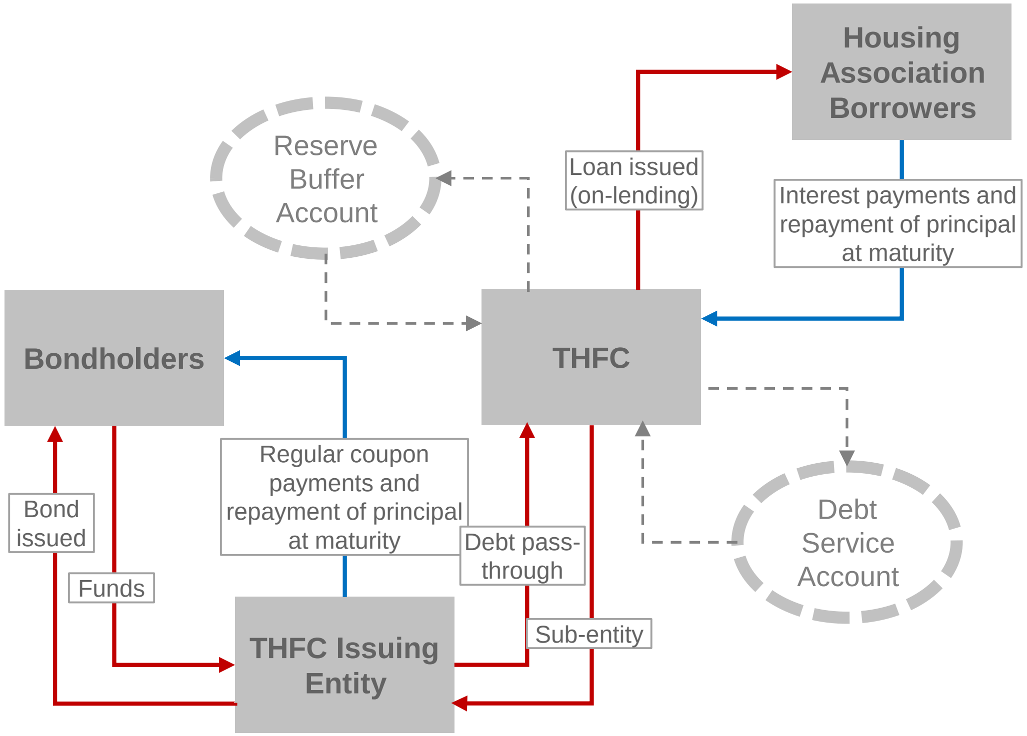
THFC has developed its own credit scoring system for assessing loan applications from Housing Associations. The Board's Credit Committee is charged with managing and assessing applications and credit risks. THFC has a very conservative set of lending covenants: all loans are secured by either fixed or floating charges. In the case of the former set at 150% of market value basis and at 300% for a floating charge over all assets and S&P reports the average portfolio coverage is 233%. THFC also applies annual payment limits for borrowers: the THFC's annual obligor payment exposure cannot exceed THFC's reserves (less any debt service reserve). S&P assess that in the event THFC's largest obligor defaulted it would have sufficient reserves for two years.

13 Appendix 6

BA Structure Options - the THFC's Funding model.

THFC

- The THFC's funding structure is simple and could be adapted to Australian conditions though questions remain as to the maximum tenor could be achieved in the early phases of the entity's evolution.



Key Structural Features

Principal Issuance

- The Bondholders lend funds to THFC via a THFC Issuing Entity, a special purpose entity established for the purpose of issuing bonds (separately constituted legal entities and are entirely owned by THFC)
- THFC and its subsidiaries pledge security to their respective investors in the form of a floating charge over its assets (the social housing loans book), and the reserves of about £15 million (the Reserve Buffer Account)
- Funds are on-lent on a substantially identical maturity, interest and repayment profile by THFC to Housing Association (HA) Borrowers
- All loans are secured with two key loan covenants based on asset coverage and asset-specific income coverage
- Issuance costs are passed on to the HA Borrowers through capitalisation on the principal

Coupon Payments

- HA borrowers are required to make interest payments one month before they fall due, held in the DSRA and attracting interest income from the monthly float before being paid to Bondholders as coupon payments

Track record – No defaults

THFC has yet to record a borrower default in its 30 year history. S&P does note that when "HAs have run into viability problems, the regulator has organised and acquisition or rescue by stronger HA peers"[66]

13 Appendix 6

BA Structure Options - the GB Social Housing example[67].

Background:

GB Social Housing (GBSH)

GBSH is for-profit company registered in the U.K. As a loan aggregator, its purpose is to fund itself via a secured note programme listed on the Channel Islands Securities Stock Exchange (CISE) and on-lend to eligible UK social housing associations on a secured basis. It's first issuance was in February 2013, as an alternative for smaller Housing Association Borrowers to the already established THFC.

GBSH attempts to provide investors flexibility in their borrowing terms by initially offering limited flexibility in the financial covenants and offering the ability to reduce gearing and interest cover over the life of the loan.

Credit Rating

S&P A Rated

S&P rated GB Social Housing on a SCP as A- in August 2013. Previously, it was rated A in Aug 2012. Its £2bn secured program and initial £88.9m proposed issue was also assigned A rating in February 2013. The rating rationale is based primarily on GBSH's conservative underwriting criteria, in that the entities it lends to will have relatively strong credit profiles.

While there is no direct support, S&P considers it a "moderately high" likelihood of extraordinary support[1] for these borrowers from the U.K. Government, and these borrowers considered a GRE.
The lowering of its credit rating is in light of S&P's view that growth of the loan portfolio is slowing and business volumes will remain relatively low in the near to medium term.

Key Structural Features

Board & Executive

GBSH's oversight body is the company's board of directors. In addition, there are three independent non-executive directors who bring expertise in the social housing sector and experience in funding public sector projects.

Funding approach

GBSH's business strategy aims to provide flexible funding arrangements by applying a variable set of asset cover covenant ratios, depending on whether borrowers agree to enter into additional gearing and interest cover covenants. For borrowers willing to commit to stricter gearing and interest covenants, the minimum asset cover required is at relatively lower at 115% on a market value subject to tenancy (MVST) basis, or 105% on an existing use value (EUV) basis. Borrowers who prefer less stringent interest and gearing requirements are subject to relatively higher minimum asset cover, with the top of the range being 150% on an MVST basis or 140% on an EUV basis.

GBSH mitigates liquidity risk by issuing bonds above what it intends to on-lend to maintain a reserve account as a liquidity buffer. This surplus issuance is determined by "the larger of the annual interest payments of the two largest borrowers, or 25% of the annual interest payments on all outstanding loans". Furthermore, GBSH maintains a legal option to extend maturity beyond the intended maturity date by two-years to mitigate refinance risk.

Credit Policies

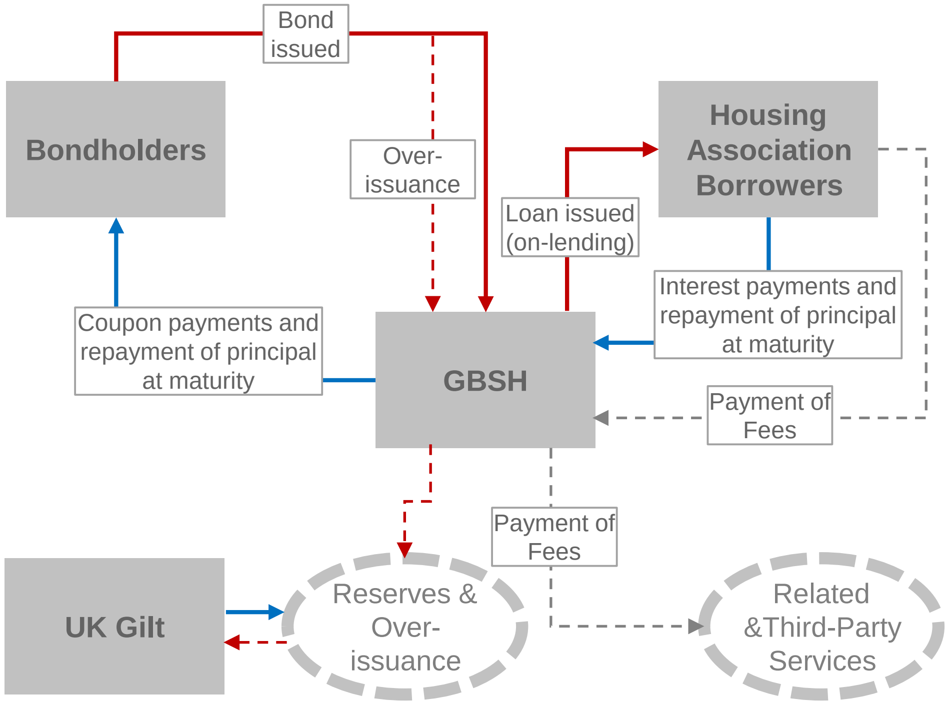
In July 2015, GBSH appointed internal audit firm The Internal Audit Association (TIAA) to conduct annual audits of its loan papers before presenting them to a credit committee.

13 Appendix 6

BA Structure Options - GB Social Housing's Funding model.

GBSH

- The GBSH's funding structure is simple and could be adapted to Australian conditions though questions remain as to the maximum tenor could be achieved in the early phases of the entity's evolution.



Key Structural Features

Principal Issuance

- GBSH issues bonds via a global note programme
- Bondholders are granted a floating charge over GBSH's assets (the HA Borrower loan book)
- The majority of funds are on-lent on a substantially identical maturity, interest and repayment profile by GBSH to Housing Association (HA) Borrowers
- All loans are secured with key loan covenants based on a combination of asset coverage and interest/gearing covenants
- The cash surplus from over-issuance are invested mainly in gilts (UK Government bonds), which will be held until maturity or until any borrower needs liquidity and gilts have to be sold. In simple terms, GB Social Housing raised £89m on its initial issuance in 2013, on-lent £85m and retained £4m to be invested in gilts

Coupon Payments

- Funds are lent to HA Borrowers at the rate at which they were sourced, with an additional administrative fee charged

Risk Mitigation

- Refinancing risk arising at bond (bullet) maturity is mitigated through a two-year grace period until legal maturity

Track record

GBSH is a recent market entrant with a limited trading history. Rating Agency reports do not indicate any borrower defaults at this time.

13 Appendix 6

BA Structure Options – the MAV LGFV example[68].

Background:

Municipal Association of VIC (MAV) Local Government Funding Vehicle (LGFV)

MAV is the legislated peak body for Victoria's 79 councils. MAV has established a pooled borrowing vehicle, LGFV, to provide participating councils access to capital markets. The main objective of LGFV is obtaining more competitively priced funds as compared to bi-lateral bank debt, which was the primary source for debt funding for local councils. The LGFV successfully carried out an A$240m inaugural medium term note (MTN) issuance in November 2014 as part of its MTN program with a further series issuance of $100m in June 2016.

Credit Rating

Moody's Aa2 Rated

Moody's assigned an Aa2 issuer rating to the LGFV set up by MAV in October 2014, which was subsequently reaffirmed in June 2016 with a stable outlook.

The rating rationale is based primarily on Moody's assessment of the strong credit quality of the council participants and the bank facility which offers a liquidity buffer incorporated into the LGFV structure.

The local councils are all located in the State of Victoria, rated Aaa and stable, and supported by a strong institutional framework. When the parliament identifies specific financial risks for a given council, it makes recommendations aimed at improving that council's financial health and appoints an independent expert to oversee the implementation of the recommendations. Furthermore, local councils generally have a solid track record of robust operational surpluses that meet or exceed the original targets and have a relatively low average debt-to-revenue ratio with the ability to absorb increasing debt levels from proposed increases in capital expenditure without impairing its current creditworthiness.

Key Structural Features

Board & Executive

13 Board Members: The Board is elected by members every two years. The president is elected by all members. The other 12 representatives are elected by their region. One CEO: The Board appoints the CEO and monitor his or her performance. Other Parties: There are various committees that offer strategic advice to the Board.

Funding approach

For each issuance, each participating council is only liable to repay its share of borrowings, hence it is not clear what would happen in the event a council(s) default(s). While this may be the case, several factors that mitigate the risk of a council's missed payment which include a liquidity facility to cover 12 months' interest payments as well as an extended cure period of 12 months which would provide time to refinance the loan outside of the LGFV in the case of a capital default.

Credit Policies

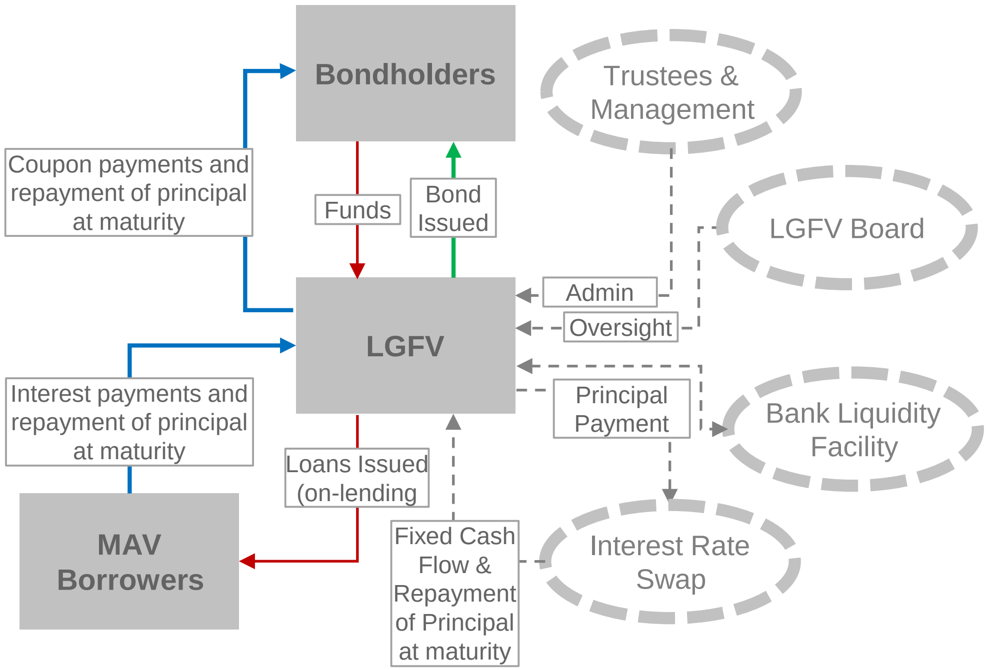
The implicit credit policy that applies is for a participating borrower to be a member of MAV.

13 Appendix 6

BA Structure Options – LGFV's Funding model.

LGFV

- The LGFV's funding structure is simple and could be adapted to apply to the social housing sector, though questions remain as to how the MAV Borrower credit strength could be achieved



Key Structural Features

Principal Issuance

- The LGFV issues bonds to capital market participants, secured over LGFV assets (the MAV Borrowers loan book)
- Tenors vary between five, seven and 10 years (matched to the on-lending demand)
- Funds are on-lent to the MAV Borrowers on a substantially identical maturity profile by the LGFV to MAV Borrowers
- Draw down difference between council loan maturities and bond maturities is covered by the principal repayment under a swap arrangement with a bank
- Each MAV Borrower severally guarantees its debt obligations
- The Bank Liquidity Facility provided to LGFV is used to cover any timing mismatches in respect of loan receipts, with the balance calculated as 12 months of interest payments
- The Trustees and Management are responsible for services including calculations, reporting and compliance, holding assets on behalf of investors, and making payments to investors, service providers and other stakeholders

Coupon Payments

- Funds are lent to MAV Borrowers at the rate at which they were sourced

Risk Mitigation

- Governance, oversight and strong risk control framework provided by LGFV Governance Board
- Strong credit quality of participating councils, with no historical default by a Victorian Council

Track record

No Borrower defaults

13 Appendix 6

BA Structure Options – the NZ LGFA example.

Background:

New Zealand Local Government Funding Agency Ltd (LGFA)

The LGFA is an financing agency specialised in financing the New Zealand (NZ) local Government sector. The LGFA was established in December 2011 following the *Local Government Borrowing Act 2011* to raise debt on behalf of local authorities (Councils) on term more favourable than if they raised them directly. The LGFA is fully owned by the NZ Federal Government (NZ Government) and participating Council borrowers. It currently has approximately NZ$6.2bn[69] bonds (both domestically and internationally, retail and wholesale) outstanding. Initially, issuances were focused on longer-dated bonds (to provide longer tenor loans) however the LGFA has recently issued LGFA Bills to support shorter-term lending.

Credit Rating

S&P AA+ Rated[70]

S&P assigned an AA+ issuer rating to the LGFA in December 2011, which has been subsequently reaffirmed in October 2016 with a stable outlook.

The rating rationale is based primarily on S&P's assessment that there would be an extremely high likelihood of extraordinary support from the New Zealand Government in a distress scenario, reflecting the NZ Government rating of AA+. The LGFA is the main capital funding source for NZ local Government sector and also deepens NZ DCM and provides an additional source of liquidity to NZ banks hence a LGFA default event would have a major impact on the Crown and the economy.

The rating also reflects the LGFA's SCP of aa- which reflects the LGFA's sole focus of on lending to NZ local Governments, its strong market position, exceptional credit quality and increasing borrower base. Offsetting factors include LGFA's reliance on wholesale funding with some maturity concentration and borrower concentration within its loan portfolio.

Key Structural Features

Board & Executive

The LGFA governance structure comprises the LGFA shareholders (20% NZ Government, 80% Councils) , the LGFA Shareholders' Council (five to 10 appointees from the Council Shareholders and the Crown) and the LGFA Board of Directors (four to seven directors, majority of which are independent). LGFA activities are governed by the Local Government Borrowing Act 2011, the Local Government Act 2002, and the Companies Act 1993. In addition, the company is required to comply with 'Foundation Policies' outlined in the Shareholders Agreement. Any change to the Foundation Policies require shareholders' consent[71].

Funding approach

The LGFA was initially established to provide long-dated borrowing, certainty of access to markets and to reduce the borrowing costs to the local Government sector however its strategy has evolved to be able to provide bespoke lending to provide flexibility in maturity dates of borrowing and drawdown dates. In FY16, bespoke lending made up approximately 31% of the long-dated lending over that period.

Credit Policies

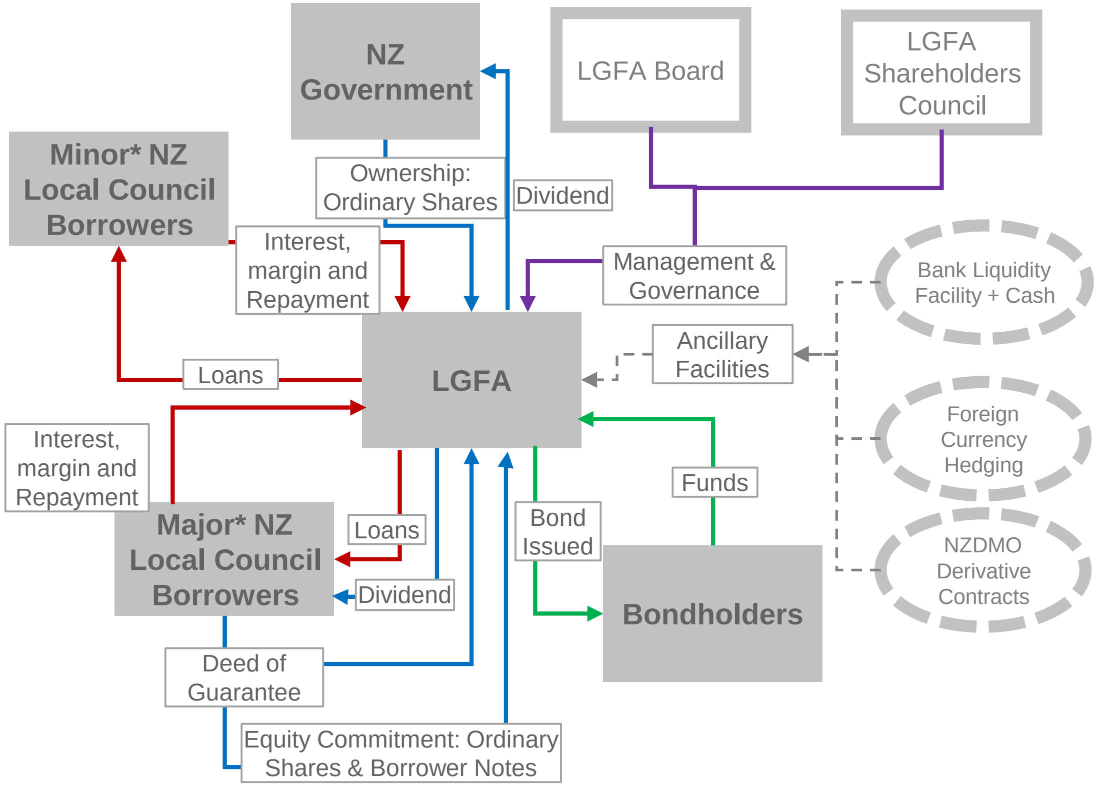
LGFA manages treasury exposures under a Board approved Treasury Policy. The objectives of the Treasury Policy are to: Effectively manage balance sheet and interest rate risk within the interest rate risk control limits to protect LGFA's capital position and Net Interest Margin over time; Fund participating local authorities in the most cost-effective manner and in accordance with the operating principles, values and objectives of the LGFA; Protect LGFA's assets and prevent unauthorised transactions; Promote a professional image of financial and management control to all external parties; Minimise operational risk by maintaining adequate internal controls, systems and staffing competencies; Provide timely reporting to the LGFA Board with meaningful and accurate reporting of interest rate exposures, liquidity, asset and liability maturity, funding, counterparty credit, performance and Policy compliance.

13 Appendix 6

BA Structure Options – the NZ LGFA example.

LGFA

- The LGFV's funding structure is complex, and has increased in complexity as it has evolved over the last ~five years since its establishment



*Major borrowers are those that borrow > NZ$20m, minor borrowers are those that borrow < NZ$20m

Key Structural Features

Principal Issuance

- The inaugural issuance was in February 2012, offering NZ$300m but attracting bids of NZ$1.32b; total issuance in its first year (seven months to 30 June 2012) was NZ$835m[1]
- The majority of funds are on-lent, however loan terms may vary to the corresponding bond issuance, through the offering of a range of maturities and differential pricing, dependant on the borrower Council's level of participation
- The LGFA has also more recently issued LGFA Bills to support short-term funding to Councils
- The LGFA charges a margin (capped at 0.4%) on its on-lending to councils for cost recovery – in its first year this was an average of 0.3%[72]

Coupon Payments

- The funding costs to borrowers include the borrowing margin of the LGFA (to cover coupon payments), a margin to cover operating costs and a price adjustments based on the individual borrower (credit profile, size of borrowing, participation level)

Risk Mitigation

- All local councils are able to borrow from the LGFA but different benefits apply depending on the Council's level of participation (equity participation, participation in the guarantee)
- Treasury Policy dictates on-lending terms, which includes financial covenant compliance and concentration risk measures, with both initial and on-going monitoring and reporting
- The LGFA also maintains one year's worth of operating and funding commitments at call (liquidity facility plus cash)
- Foreign currency exposure is 100% hedged
- Initially, front middle and back office activities were outsourced to the New Zealand Debt Management Office (NZDMO) however this has recently been internalised (July 2015) with NZDMO still managing all derivative contracts

14

Appendix 7

Proof of concept pricing process

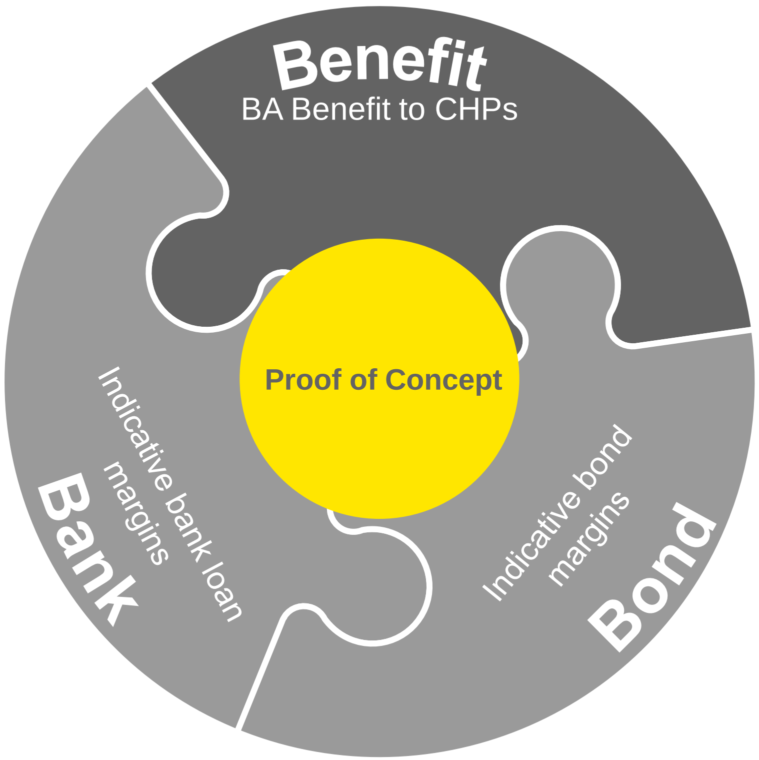
Overview	To quantifying the costs and benefits to the sector of the BA, a financial model was developed to compare the indicative pricing of bank debt vs. the cost of an equivalent BA CHP loan This Appendix outlines the assumptions and calculation methodology of the financial model
Methodology	Indicative bank debt pricing was sought from major Australian banks for a 10 year fixed rate interest only bank loan for CHPs Indicative bond margins for a 10 year fixed rate interest only bond were estimated based on feedback from bank DCM arrangers, AOFM and benchmarking analysis In assessing the equivalent BA CHP loan pricing we adopted a building block approach with the margin comprising three elements: (i) bond coupon; (ii) capital markets access cost; and (iii) BA internal operating costs The analysis has been undertaken on a BA cost recovery basis in line with the self-sustainable objective of the BA and also presented as an alternative scenario where BA FTE wages are assumed to be funded by NHFIC from budget allocations
Relevance	The proof of concept analysis builds on work streams 1-5 and provides a quantitative assessment of the feasibility of the proposed BA structure to support the hypothesis of the BA driving financial efficiency for the CHP sector

14 Appendix 7

Proof of Concept pricing process: Overview.

Overview

- To quantifying the costs and benefits to the sector of the BA, a financial model was developed to compare the indicative pricing of bank debt vs. the cost of an equivalent BA CHP loan
- The Proof of Concept analysis incorporated three key steps as follows:



1. Indicative bank margins

Indicative bank debt pricing was sought from major Australian banks for a 10 year fixed rate interest only bank loan for CHPs

2. Indicative bond margins

Indicative bond margins for a 10 year fixed rate interest only bond were estimated based on feedback from bank DCM arrangers, AOFM and benchmarking analysis

3. BA Benefit to CHPs

In assessing the equivalent BA CHP loan pricing we adopted a building block approach with the margin comprising three elements: (i) bond coupon; (ii) capital markets access cost; and (iii) BA internal operating costs

14 Appendix 7

Proof of Concept pricing process: Indicative bank margins.

1. Indicative bank margins

- Following market sounding interviews with banking officials from major Australian banks, a request for bank pricing for five, seven and 10 year bullet loans email was sent with responses summarised as follows:

Proof of Concept Model Inputs

Bank margin **2.4% p.a.**

Indicative bank debt pricing

Comparative Benchmarks

Item	Banking official A	Banking official B
Margins	► Five years 2.00% - 2.20% p.a. ► Seven years 2.10% -2.35% p.a. ► 10 years 2.20% -2.50% p.a.	Tier 1 (margin) ► Three years – 1.20% to 1.45% p.a. ► Five years - 1.55% to 1.75% p.a. ► Seven years – 1.85% to 2.05% p.a. Tier 2 (all-in fixed rate) ► Three years – 3.15% to 3.35% p.a. ► Five years - 3.65% to 3.85% p.a. ► Seven years – 4.15% to 4.45% p.a.
Commentary	► Indicative rates for a standard community housing transaction based on our experience ► Each transaction would be priced based on a full credit assessment taking into account each applicants structure, capacity, security etc.	► We have provided pricing guidance across three, five and seven year tenors ► There are limited pockets of liquidity available for >seven years, however this is limited and is often situational (e.g. client specific, related to a wider event). In general, the volume of bank financing at 10 years is very limited

- Based on above, the mid-point of Bank A 10 year pricing of 2.35% p.a. has been used as an input for the proof of concept model.

14 Appendix 7

Proof of Concept pricing process: Indicative bond margins.

2. Indicative bond margins

- Indicative bond margins for a 10 year fixed rate interest only bond were estimated based on feedback from bank DCM arrangers, AOFM and benchmarking analysis

Proof of Concept Model Inputs

Low Case — **1.40%** p.a.

Margin above swap achieved from an issuance of an A1 rated CHP bond

Base Case — **0.80%** p.a.

Margin above swap achieved for a CHP Bond with Government Guarantee

High Case — **0.55%** p.a.

Margin above swap achieved for CHP Bond with Government Guarantee plus Repo Eligibility/HQLA status

Market Feedback

Margin above swap rate (% p.a.)	Low Case	Base Case	High Case
Bank 1	1.60 - 1.70	0.80	0.50 – 0.60
Bank 2	1.30 – 1.40	0.80 – 0.85	0.80 – 0.85
AOFM	-	1.00-1.20	0.50
Proof of Concept	**1.40**	**0.80**	**0.55**

Comparative Benchmarks

- The below table outlines the benchmarks, ratings (where applicable), pricing and commentary around the data point

Case	Proxy	Rating	Margin	Commentary
Low Case	Major Banks	N/A	115	▸ Data for bank pricing on a 10 year tenor is limited ▸ Transactional data refers to bespoke placements to foreign borrowers who are well-established
Low Case	Telstra	A2	132	▸ Telstra originated as a Government department but has since been fully privatised
Low Case	LGFV	Aa2	145	▸ Australia's first aggregated funding vehicle for local Government ▸ Benefit from local Government ownership and implicit Australian Government guarantee
Low Case	Suncorp	A1	145	▸ Diversified financial services group, banking and wealth, and insurance products and services across Australia and New Zealand
Low Case	REITs	A	145-160	▸ Real estate investment trusts (REITs) are an investment vehicle that own or finance income-producing real estate on behalf of investors ▸ Whilst REITs and BA operate in the same sector, very different business models
Base Case	NSWTC QTC	AAA AA+	35 53	▸ Both offer financial services to respective state public sector entities, including local Governments ▸ Both are 100% Government-owned and fully guaranteed by their respective state Government but no explicit Australian Government guarantee ▸ Both have a number of outstanding bonds with an Australian Government guarantee (from a grandfathered program) which trade at a premium to Australian Government bonds but inside the un-guaranteed curve
Base Case	ARTC	A1	95	▸ ARTC is an unlisted public incorporated company limited by shares ARTC only has fully paid ordinary shares on issue, all of which are owned by the Australian Government ▸ An Australian Government entity under the PGPA Act1 - there is no separate enabling legislation for ARTC
Base Case	Airservices	AAA	120	▸ Airservices Australia is a Government-owned corporation but does not receive an explicit guarantee ▸ Maintains substantial (costly) liquidity facilities in order to maintain AAA rating
Base Case	Australia Post	AA-	130	▸ Australia Post is a Government-owned business through the Minister for Communications and the Minister for Finance, governed under the *Australian Postal Corporation Act 1989*
High Case	EFIC	NR	50	▸ EFIC is a specialist financier to Australian companies when their bank is not able to help ▸ EFIC is a self-funding statutory corporation wholly owned by the Australian Government and receives explicit Australian Government guarantee

14 Appendix 7

Proof of Concept pricing process: CHP benefits.

3. BA benefit to CHPs

- To quantify the BA benefit to CHPs, the following factors were assessed:
  - The potential pricing benefit of accessing the DCM over the bank market
  - The costs involved with establishing and operating the BA
- The costs involved with establishing and operating the BA are passed onto the CHP via an excess margin in the CHP loans above the bond coupon margin as outlined in Chapters 4 and 5 of the main report
- The analysis has been undertaken to determine the BA costs under two alternative scenarios:
  - BA full cost recovery basis - in line with the self-sustainable objective of the BA
  - BA operating costs coverage – where it is assumed that BA FTE wages are to be funded by NHFIC from budget allocations
- The financial model assumptions and calculation methodology is summarised below. Inputs have been rounded to one decimal place given the indicative nature of the analysis.

(1) BA Benefit to CHPs = Bank Loan – BA Loan

(2) Bank Loan = Indicative bank pricing for a 10 year interest only loan (2.35% p.a. per page 68)

(3) BA Loan = The indicative margin CHPs will pay to the BA calculated as follows:

BA Loan = Bond Coupon + Capital Markets Access Cost + BA Internal Operating Costs

(4) Bond Coupon = Indicative bond issuance margins based on feedback from bank DCM arrangers, AOFM and benchmarking analysis as follows:

$\text{Bond Coupon}_{\text{Low Case}}$ = 1.4% p.a. (per page 128)

$\text{Bond Coupon}_{\text{Base Case}}$ = 0.8% p.a. (per page 128)

$\text{Bond Coupon}_{\text{High Case}}$ = 0.55% p.a. (per page 128)

14 Appendix 7

Proof of Concept pricing process: CHP benefits.

3. BA benefit to CHPs

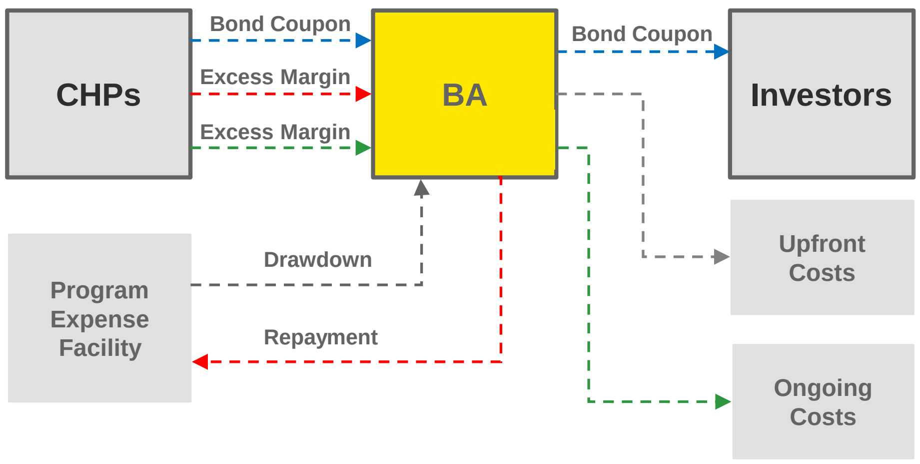
(5) Capital Markets Access Cost = Upfront Costs + Ongoing Costs

Upfront Costs* = Legal + Credit rating + Bond arrangers + Financial advisor + Austraclear + Minimum cash reserves

*Note: The Upfront Costs are a component of the excess margin payable on the CHP Loans as outlined in Chapter 4. Upfront Costs are assumed to funded at financial close via the Establishment Expense Facility and amortised over the life of the CHP loans. As such, the Upfront Costs input into the Proof of Concept calculations is the annual Establishment Expense Facility principal and interest payment expressed as a percentage of the CHP loans. The dollar value of the Upfront Costs are based on market feedback and recent comparable transactions (e.g. LGFV).

Ongoing Costs^ = Trust services + Accounting + Tax + Credit rating + Austraclear + Liquidity facility fees

^Note: The Ongoing Costs are a component of the excess margin payable on the CHP Loans as outlined in Chapter 4. As such, the Ongoing Costs input into the Proof of Concept calculations is the annual Ongoing Cost expressed as a percentage of the CHP loans. The dollar value of the Ongoing Costs are based on market feedback and recent comparable transactions (e.g. LGFV).



14 Appendix 7

Proof of Concept pricing process: CHP benefits.

3. BA benefit to CHPs

(6) BA Internal Operating Costs = Upfront Costs + Ongoing Costs

Upfront Cost** = 0

**Note: costs including office fit-out, IT, etc. are assumed to be funded by NHFIC from budget allocations

Ongoing Costs^^ = FTE wages only (office costs, IT, etc. are assumed to be funded by NHFIC from budget allocations)

^^Note: FTE wages are assumed to be $2m p.a. in line with our resourcing plan as outlined in Chapter 4 in the “BA Benefit to CHPs: Full Cost Recovery” scenarios. In contrast, FTE wages are assumed to be funded by NHFIC from budget allocations in “BA Benefit to CHPs: Op Cost Recovery” scenarios.

15

Endnotes

List of sources used in this Report

15 Endnotes

List of sources.

[1] NRSCH “National Provider Register”, http://www.nrsch.gov.au/national_register, “Chimes Housing Registrar”, https://chimes.force.com/RegisteredHousing?aType=ha, “List of Registered Providers, http://www.dhw.wa.gov.au/investorsandpartners/communityhousingorganisations/registeredproviders/Pages/default.aspx.

[2] Ibid.

[3] Milligan, V., Martin, C., Phillips, R., Liu, E., Pawson, H. and Spinney, A. (2016) Profiling Australia's affordable housing industry, AHURI Final Report No. 268, Australian Housing and Urban Research Institute, Melbourne.

[4] Based on PoC assumptions, outlined in Chapter 5.

[5] The Australian Government.

[6] SCRGSP (Steering Committee for the Review of Government Service Provision) 2016, Report on Government Services 2016, vol. G, Housing and homelessness, Productivity Commission, Canberra

[7] Milligan, V., Martin, C., Phillips, R., Liu, E., Pawson, H. and Spinney, A. (2016) Profiling Australia's affordable housing industry, AHURI Final Report No. 268, Australian Housing and Urban Research Institute, Melbourne.

[8] NRSCH “National Provider Register”, http://www.nrsch.gov.au/national_register, “Chimes Housing Registrar”, https://chimes.force.com/RegisteredHousing?aType=ha, “List of Registered Providers, http://www.dhw.wa.gov.au/investorsandpartners/communityhousingorganisations/registeredproviders/Pages/default.aspx.

[9] Tier 1 equivalent providers consider Housing Associations in VIC (nine providers) and Growth Providers in WA (six providers).

[10] NRSCH “National Provider Register”, http://www.nrsch.gov.au/national_register, “Chimes Housing Registrar”, https://chimes.force.com/RegisteredHousing?aType=ha, “List of Registered Providers, http://www.dhw.wa.gov.au/investorsandpartners/communityhousingorganisations/registeredproviders/Pages/default.aspx.

[11] “NRSCH Sector Snapshot Report 2015-2016”, http://www.nrsch.gov.au/__data/assets/file/0004/410674/DOCUMENT-Report-NRSCH-Sector-snapshot-report-2015-2016_FINAL.pdf.

[12] NRSCH “National Provider Register”, http://www.nrsch.gov.au/national_register, “Chimes Housing Registrar”, https://chimes.force.com/RegisteredHousing?aType=ha, “List of Registered Providers, http://www.dhw.wa.gov.au/investorsandpartners/communityhousingorganisations/registeredproviders/Pages/default.aspx.

[13] “NRSCH Sector Snapshot Report 2015-2016”, http://www.nrsch.gov.au/__data/assets/file/0004/410674/DOCUMENT-Report-NRSCH-Sector-snapshot-report-2015-2016_FINAL.pdf.

[14] NRSCH “National Provider Register”, http://www.nrsch.gov.au/national_register, “Chimes Housing Registrar”, https://chimes.force.com/RegisteredHousing?aType=ha, “List of Registered Providers, http://www.dhw.wa.gov.au/investorsandpartners/communityhousingorganisations/registeredproviders/Pages/default.aspx.

[15] Based on VIC Government and NSW Government data.

[16] Based on publicly available data.

[17] Community Housing Peaks Policy Network, The vital subsidy: Importance of CRA to CHPs (2014).

[18] Milligan, V., Martin, C., Phillips, R., Liu, E., Pawson, H. and Spinney, A. (2016) Profiling Australia's affordable housing industry, AHURI Final Report No. 268, Australian Housing and Urban Research Institute, Melbourne.

[19] Moody’s Investor Services, European Social Housing Providers: Ratings Methodology, July 2016.

[20] Moody’s Investor Services, Government-Related Issuers: Ratings Methodology, October 2014.

[21] Moody’s Investor Services, Pooled Vehicle Shadow Rating.

[22] Moody’s Investor Services, European Social Housing Providers: Ratings Methodology, July 2016.

[23] Moody’s Investor Services, Government-Related Issuers: Ratings Methodology, October 2014.

[24] Ibid.

[25] Moody’s Credit Rating Scale.

[26] Calculations compiled using: Moody’s Investor Services, European Social Housing Providers: Ratings Methodology, July 2016.

15 Endnotes

List of sources.

[27] Ibid.

[28] EY analysis based on publicly available information.

[29] Ibid.

[30] Lawson, J., Berry, M., Hamilton, C. and Pawson, H. (2014) Enhancing affordable rental housing investment via an intermediary and guarantee, AHURI Final Report No.220. Melbourne: Australian Housing and Urban Research Institute.

[31] Ibid.

[32] Milligan, V., Pawson, H., Phillips, R. and Martin, C. with Elton Consulting (2017) Developing the scale and capacity of Australia's affordable housing industry, AHURI Final Report No. 278, Australian Housing and Urban Research Institute Limited, Melbourne.

[33] Findings from the Survey.

[34] Ibid.

[35] Ibid.

[36] S&P Credit Rating Methodology.

[37] LGFV Program Trust Credit Opinion, 16 June 2017.

[38] THFC 2017 Annual Investor Update.

[39] LGFA website http://www.lgfa.co.nz/for-investors/lgfa-bonds.

[40] Budget 2017, Factsheet 1.8, *Reducing Pressure on Housing Affordability: Establishing the National Housing Finance and Investment Corporation*.

[41] NRSCH Operational Guidelines 2014.

[42] VIC Housing Register, *Our Regulatory Framework*, 2016.

[43] Government of WA Housing Authority, *Community Housing Regulatory Framework*, 2016.

[44] NRSCH Evidence Guidelines 2014.

[45] Ibid.

[46] Ibid.

[47] Australian Government.

[48] S&P Public And Nonprofit Social Housing Providers: Methodology And Assumptions, 2014.

[49] S&P Rating Government-Related Entities: Methodology And Assumptions (2015).

[50] S&P Finance Companies: Rating Finance Companies (2004).

[51] Moody's Investor Services, European Social Housing Providers: Ratings Methodology, July 2016.

[52] Moody's Investor Services, Government-Related Issuers: Ratings Methodology, October 2014.

[53] Moody's Public Sector Pool Financings (2012).

[54] Moody's Investor Services, European Social Housing Providers: Ratings Methodology, July 2016; Moody's Investor Services, Government-Related Issuers: Ratings Methodology, October 2014.

15 Endnotes

List of sources.

[55] The Australian Government; SCRGSP (Steering Committee for the Review of Government Service Provision) 2016, Report on Government Services 2016, vol. G, Housing and homelessness, Productivity Commission, Canberra.

[56] Ibid.

[57] Australian Government.

[58] Australian Government.

[59] Community Housing Peaks Policy Network, The vital subsidy: Importance of CRA to CHPs (2014).

[60] Moody's Credit Rating Scale.

[61] Australian Financial Review: Bond market deepening as insurers and funds seek diversification (2016).

[62] Westpac ASX Announcement: Appendix 3B New Issue Announcement (2016).

[63] Westpac ASX Announcement: Appendix 3B New Issue Announcement (2016); Keybridge Capital ASX Announcement: Despatch of CRPN Prospectus (2015); ANZ Publication Simple corporate bonds: an insider's perspective (2016).

[64] URF ASX Announcement: Product Disclosure Statement (2016).

[65] The Housing Finance Corp Ltd, S&P Global Ratings, November 2016.

[66] Ibid.

[67] GB Social Housing PLC, August 2012.

[68] LGFV Program Trust Update to Discussion of Key Credit Factors, Jul 2016.

[69] NZ LGFA 2016 Financial Report (2016).

[70] S&P New Zealand Local Government Funding Agency Ratings Affirmed; Outlook Stable (2016).

[71] NZ LGFA Website.

[72] LGFA 2012 Annual Report (2012).

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.