FINANCING HOUSING FOR NDIS PARTICIPANTS

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DISCLAIMERS

The Summer Foundation and collaborators have contributed information towards this paper and believe it to be accurate and reliable but neither the Summer Foundation nor any collaborators make any warranty, express or implied, regarding any information, including warranties to the accuracy, validity or completeness of the information.

1. SUMMARY OF CONSULTATION FINDINGS

Addressing the large housing shortage for people with disability in the NDIS will depend on the ability of housing providers to access significant amounts of capital from the private financial market.

The Summer Foundation has been engaging with private financial institutions to determine how different NDIS housing payment structures would impact on a housing provider's ability to access finance to build more units of housing. The key messages from these consultations are that:

- **The design of NDIS housing payments should enable financial institutions to lend against the future stream of income from these payments.** If lenders cannot secure loans against NDIS payments, this will require loans to be secured against property which effectively lowers the amount of finance housing providers can access.
- **NDIS housing payments should be attached to the dwelling and paid regardless of whether a participant is residing in the dwelling.** If this is not possible for all housing payments, a payment guarantee should at least exist for highly modified dwellings funded in the early years of the Scheme. Housing providers have very few tools to manage occupancy risk given that the NDIA determines whether someone is a participant and whether they get a housing payment in their plan. If housing providers bear the full occupancy risk we expect to see either very expensive financing rates or very limited construction of dwellings for young people exiting aged care. If governments want to introduce some element of risk sharing we would recommend that housing providers bear risk for a defined number of weeks after which the NDIA bears the occupancy risk. For example, the housing provider bears the occupancy risk for the first 4 weeks after which the NDIA bears the risk.
- **The length of the NDIS' assignment agreement should be between 20 and 25 years.** Assuming a useful life of a building of approximately 25-30 years it is therefore appropriate for the NDIA to make a funding commitment for the majority of the dwelling's life. Shorter contract terms will limit a housing provider's access to finance and require refinancing, which will raise the cost of delivering NDIS housing.
- **Adaptable design for a range of abilities (alternate use of assets).** Housing that is highly adaptable and suitable for people with disabilities and for the general population is more attractive to potential investors. Highly adaptable apartments or townhouses that are peppered throughout larger developments are much more attractive to potential investors than traditional group homes. We should prioritise creating adaptable housing that is equally attractive to the private market, while recognising that the private market may not fully value the additional cost of creating accessible housing. This gap between market value and cost of construction requires an ongoing funding commitment from the NDIS.

Taken together the Summer Foundation's position on financing NDIS housing would create a stable, predictable and low risk investment. This will enable housing providers to access a larger sum of finance to address the enormous unmet capital needs of young people in residential aged care.

2. BACKGROUND

The Summer Foundation undertook an Expression of Interest (EOI) process on Social Investment for People with Disability in September 2015. The EOI was to both inform the Summer Foundation's decisions on financing its next housing demonstration projects, and to inform and shape government policy and funding related to housing for people with disability.

Three banks and two financial intermediaries responded to the EOI, providing their advice on potential financing models for NDIS housing. The Summer Foundation has synthesised the findings of this EOI to inform the NDIA's decision on how to administer its funding for 'user cost of capital' in the NDIS.

The EOI was based on the Summer Foundation's projected cost of capital for creating contemporary housing and support models for young people in RAC. This has a per person capital cost of around $550,000.

This paper builds on the Summer Foundation's report in September 2015, "Housing Young People in Nursing Homes: A Report from a social finance think tank"[1]. This report explores the development of a model of social finance for the Summer Foundation's Housing Demonstration Projects for young people in nursing homes.

3. OVERVIEW

This paper covers two key questions about NDIS housing payments, summarising the responses financial institutions made to our EOI and providing our view on potential ways forward in each of these areas.

- **Investment term issues:** *What elements of the housing payments scheme are critical to get right to make investment work?*
  - Ability to lend against NDIS housing payments
  - Management of occupancy risk (cash flow risk)
  - Length of housing contracts
  - Adaptable design for a range of abilities (alternate use of assets)
- **Exit strategy and scalability:** *How are we going to move from individual deals to a national scale?*
  - Reputational risk and exit strategy
  - Working towards national scale and a mature market

Our consultations assumed that the cost of housing people with disability is shared between people with disability and the NDIS, and potentially also with other stakeholders in the community. This creates three primary sources of funds to service debt:

- **Disability Support Pension** – The Commonwealth Government provides income support to people with disability who are unable to work through the Disability Support Pension (DSP). Community housing rents usually require around 25% of a person's DSP payment to be paid in rent to the housing provider. This would provide around $5,300 per annum in income.
- **Commonwealth Rent Assistance** – In addition to DSP, the Commonwealth Government also funds Commonwealth Rent Assistance (CRA) to people on DSP in properties with rent above a specified level. Financial models assume this payment would be made to the housing provider. This would provide around $3,600 per year.
- **NDIS payments** – The financial models used to estimate how to finance NDIS housing assume that these payments are the most significant contribution towards the cost of housing. The estimated NDIS contribution required for a $550,000 capital cost ranged from $36,000-$50,000 per annum (based on a 6%-8% return for investors).

CRA combined with 25% of DSP alone is generally sufficient to cover operating costs for housing (tenancy and property management, rates, insurance, owners corporation fees and the sinking fund). This is based on CRA and DSP generating around $8,300 in yearly income to cover the cost of operating expenses ($7,000 p.a.) and contributions to a sinking fund ($1,000 p.a.). There is little left over to materially support principal and interest repayments. Any financial model is unlikely to rely on these amounts to make a substantial contribution to the principal and interest repayments. However, surplus CRA and DSP funds could be captured for upgrade or unforseen capex (e.g. sinking fund).

Importantly, discussions with financial institutions have highlighted the risks that including DSP and CRA pose to projecting the long term financing of housing. All housing models assumed that tenants would contribute to the cost of housing through 25% of DSP and also that CRA was available. Decisions by the Commonwealth to change eligibility, payment rates or indexation of DSP and CRA present a risk to financing housing for this cohort. This risk is especially high when considering a 20-year financing time horizon.

4. INVESTMENT TERM ISSUES

WHAT ELEMENTS OF THE HOUSING PAYMENTS SCHEME ARE CRITICAL TO GET RIGHT TO MAKE INVESTMENT WORK?

This section explores the feedback we received on how the NDIS housing payments can be best designed to generate the most interest from investors and reduce the cost of capital. It looks at what the impact may be of assigning occupancy risk to the NDIA compared with assigning it to a housing provider, and the impact of different lengths in the NDIS agreement for housing funds.

4.1 Ability to lend against NDIS housing payments

The NDIS cash flow of housing payments is an essential part of the financing of NDIS housing. Financial institutions viewed the NDIS housing payments as a stream of revenue that would enable the lending of funds for NDIS housing. If financial institutions had a high level of confidence and certainty in the flow of NDIS housing payments, then loans can be made based on this stream of income, rather than being based on the actual property being purchased. Essentially, this changes the way that financial institutions assess the risk of the loan – it makes the risk assessment based on the flow of income from the NDIA, rather than on the value of the land and buildings being purchased.

This is particularly important in building housing for people with disability. The housing needs of NDIS participants are different to those of the general population and the cost of housing built for NDIS participants may be higher than the standard market value of the property (due to high levels of accessibility that the market does not value). If financial institutions are lending based on the ratio of the loan to the market value of the property, this will increase the gap between the finance available and the equity held by the housing provider. Housing providers will need to hold more equity in properties which will exclude some housing providers from building for NDIS participants and limit the scale of housing that those providers with capital can build.

It will be very advantageous to housing providers if they can access finance through securing loans against the NDIS housing payment, rather than seeking traditional property investment loans.

4.2 Management of occupancy risk (cash flow risk)

One of the most substantial risks in designing the NDIS housing pricing and payments framework is how occupancy risk is managed. Occupancy risk arises when housing has been created for NDIS participants but no participant is living in the dwelling.

In the disability sector, housing has historically been block funded and in the current system it is not unusual to have long vacancies in shared supported accommodation where the housing is highly specialised or house dynamics require careful tenant selection. At present there is not an efficient system that either enables people with disability to find suitable housing or matches people with disability to suitable accessible housing. Community housing providers usually have a vacancy period of less than six weeks and their narrow profit margin cannot tolerate long vacancy periods. Investors/housing providers would bear the occupancy risk if the NDIA housing terms state that the NDIA only makes payments if an approved NDIS participant is living in the property. If instead, the NDIA guaranteed to make payments to the investor/housing provider regardless of whether a participant was living in the dwelling, then the occupancy risk would be born by the NDIA.

Occupancy risk has always been an important issue in housing for people with disability because of the importance of creating the right living environment where people who are well suited to living together are placed together. The severe shortage of housing for people with disability has meant that there is usually high demand for any vacancies. The nature of occupancy risk could change in the NDIS when people with disability are given more choice and control over where they live and who they live with. Depending on the NDIA's decisions, participants could have a much greater role in selecting co-tenants which has the potential to increase occupancy risk. The NDIA has indicated that they expect many participants to continue to live in shared living situations which suggests that there will need to be a clear allocation of roles and responsibilities for selecting tenants for NDIS housing vacancies.

Feedback through the EOI:

The cost of equity capital for NDIS housing will be higher if vacancy risk is borne by investors/housing providers. If investors/housing providers are responsible for managing vacancy risk then investors will require a higher return on their investment in order to adjust for the potential risk that they will receive less funding than that originally projected because of vacancies.

The cost of debt financing is unlikely to be affected by vacancy risk, although it may reduce the debt-to-equity ratio. Debt financing would require repayments from the property owner regardless of the cash flow the owner is receiving from the NDIS. As such, the lender would not be directly affected by a vacancy. However, because the lender would be concerned about the borrower's ability to repay the loan due to higher-than-expected vacancies, lenders may require a higher capital-to-debt ratio to ensure that they are protected against the borrower defaulting on the loan.

Summer Foundation's view:

The NDIA should bear the occupancy risk for highly specialised dwellings, at least in the first few contracting rounds. Over the next 10 years while we are focused on building the market of housing for people with disability, the NDIS housing payments for new housing should be attached to the dwelling rather than the person. This is for two reasons: first, investors are cautious about investing in specialist housing and adding occupancy risk increases the uncertainties, and second, the NDIA is much better placed than investors/owners to mitigate or manage occupancy risk.

Young people in RAC require housing with accessibility features that are beyond the requirement of the general population. In the event that an NDIS participant moves out of the dwelling there are very limited opportunities for the housing provider to find a non-NDIS tenant who will both value the accessibility features in the dwelling and can afford to meet the higher rental/sales price for these dwellings. Investors/housing providers are concerned that if they develop highly accessible housing for NDIS participants that they will not be able to recoup the cost of the housing in any way other than through NDIS payments. Placing occupancy risk with investors is likely to have a particularly detrimental effect on housing for young people in RAC by reducing investor interest in this type of housing and increasing the cost of capital for specialised housing.

It is widely accepted that government procurement should seek to place risk with the party best placed to manage that risk.[2, 3] For example, the Commonwealth Procurement Rules are explicit that where a government agency "is best placed to manage a particular risk, it should not seek to inappropriately transfer that risk to the supplier".[4] Given that the primary market for this housing is NDIS participants, it is unclear how the housing provider can effectively manage occupancy risk. The NDIA is responsible for deciding which participants have an NDIS housing payment in their NDIS Plan, and so the pool of people who could live in the dwelling is restricted by the NDIA. And given that housing providers are likely to be separated from support providers, housing providers will not have existing networks of NDIS participants to promote the availability of a housing unit. The NDIA is therefore better placed to bear the occupancy risk for specialist housing than the housing provider given the NDIA has many more tools at its disposal to fill a vacancy than housing providers.

Finally, the Summer Foundation is particularly concerned about the effects on housing for young people in RAC in regional and rural locations if occupancy risk is borne by housing providers. In small regional communities there may be only a very small number of people who require highly accessible dwellings. Housing providers would therefore be bearing a very significant risk because the absolute number of NDIS participants in that town with an NDIS housing payment is so small that if one or two people leave the town there is no other person in the town with an NDIS housing payment who could live in the dwelling.

To demonstrate the risk faced by housing providers in regional areas, the percentage of the Australian population with an NDIS housing payment is around 0.12%. This means that in a small city such as Hobart, there could be around 270 NDIS participants with a housing payment in their plan. Yet in a small town such as Port Macquarie (NSW) or Bathurst (NSW) this number drops to 55 and 35 respectively; and in very small communities such as Lakes Entrance (Victoria) the number of NDIS housing payments drops to 5 participants. Housing providers bearing occupancy risk in these communities could face extremely high losses if they develop specialised housing and the NDIS participant ceases to live there (because, for example, the participant moves back in with family, enters long term hospital care or passes away). Given this housing is primarily for NDIS participants, it is appropriate for the NDIA to bear the occupancy risk in these situations.

If governments wanted to introduce some element of risk sharing we would recommend that housing providers bear risk for a defined number of weeks after which the NDIA bears the occupancy risk. For example, the housing provider bears the occupancy risk for the first 4 weeks after which the NDIA bears the risk. This would create an incentive for housing providers to actively maintain relationships with potential tenants and make genuine efforts to cover vacancies as they arise. This would also recognise that long term vacancies are unlikely to be driven by a lack of effort on the housing provider's part. The NDIA is better placed to manage vacancy risk through decisions about housing payment eligibility and decisions to make highly modified housing for people with disability available in smaller communities.

4.3 Length of housing contracts

The period of time that the NDIA authorises a housing provider to be able to receive NDIS housing funds is an important factor in the decisions made by investors.

All EOI respondents structured their advice around a 20-25 year assignment period. This is consistent with the view that housing in the NDIS is likely to have a life of 25-30 years. The shorter the period of time that the NDIA authorises the housing provider to receive an NDIS housing payment, the higher the uncertainty is for the resident and for the housing provider about what happens to the property after the housing payment period ends.

The approach of securitizing the cash flow from the NDIA in order to access finance means that as the period of agreement with the NDIA becomes shorter, the smaller the financing envelope available. Requiring housing providers to refinance their property introduces additional transaction costs that would add to the cost of housing provided in the NDIS. Shorter periods of agreement would also place housing providers at higher risk of being unable to re-finance housing. Failure to refinance housing would reduce stability and security of tenure for NDIS participants.

4.4 Adaptable design for a range of abilities (alternate use of assets)

From an impact investor's perspective, new housing for people with disability should not be so specialised that it does not have an alternate use. Highly specialised housing that is segregated is often only worth the value of the land that it sits on because it could not readily be sold on the open market. The housing we create for people with disability should be housing that private buyers and renters also find desirable. We should avoid creating specialist dwellings with institutional features, and instead use design that is adaptable and accommodates a wide range of individual preferences and abilities. Highly adaptable apartments or townhouses that are peppered throughout larger developments are a much more attractive to potential investors than traditional group homes.

Creating adaptable housing that is equally attractive to the private market does not always mean the private market will fully value the additional cost of creating accessible housing. For this reason investors require some certainty in NDIS housing payments because while these properties may be attractive to private buyers on the open market, there may be a gap between the cost of building housing that is highly adaptable and the market value of the dwelling.

5. EXIT STRATEGY AND SCALABILITY

HOW ARE WE GOING TO MOVE FROM INDIVIDUAL DEALS TO A NATIONAL SCALE?

This section explores what a mature market for NDIS housing would look like, in particular how do we lay the foundations now to build a solid market for the future. The section looks at the challenges for investors who lend to a housing provider that defaults, as well as what we can do now to design housing financing models that will be able to grow to scale in a national NDIS implementation.

5.1 Reputational risk and exit strategy

Investors are concerned about the reputational risk involved in lending to NDIS housing projects. It is difficult for investors to respond in the event that a housing provider defaults on their repayments. Investors are aware of the vulnerability of the NDIS participant population and the consequences of repossessing the property.

Relatedly, a barrier to increasing the role of social investors is the lack of an exit strategy. In mainstream financial products there is often a clear exit strategy for the investor who can sell their shares or bonds. The small scale of the social impact investing market means that social investors are often concerned that their funds will be tied up until the expiration of the initiative's term with little opportunity to access funds earlier. This lock in effect deters social investors from participating.

These two issues highlight the need for an exit strategy for investors involved in NDIS housing. It is possible that when the NDIS housing market is sufficiently large, there will be a mature market with numerous investors and appropriate exit strategies.

In the early period of NDIS housing we should be attempting to attract the broadest possible range of investors. This will mean identifying what an exit strategy looks like for these investors – both for financial institutions to address potential default by housing providers, and for social investors who may want flexibility to cease their investment. The development of a well understood and viable exit strategy would help to build the investor base for NDIS housing.

One such strategy is to provide a process that would see the assets and liabilities of special purpose disability housing providers transition to another regulated provider. This reinforces the cashflow centric nature of the borrowing and gives every opportunity to keep residents in situ, in the event of the failure of a housing provider. This is a similar structure to that which exists in some community housing markets (albeit in some markets it is implicit). A caveat on the title could outline the process and link in the respective State or Federal regulatory bodies to manage the process. This model would enable private financing on the cashflow of NDIS housing payments. If, however, NDIS cashflows cannot be securitized then imposing caveats on the property title could pose challenges in accessing finance where the property is used as security.

5.2 Working towards national scale and a mature market

The EOI was concerned with both how we can finance NDIS housing projects in the short term, and what a mature market approach to NDIS housing would look like. The EOI identified two features of a mature NDIS housing market:

1. **Consistency of NDIS funding:** A mature market will be achieved rapidly if the NDIS funding scheme for housing has a well understood model which is consistently applied over time. The lack of historical experience of how housing in the NDIS plays out over time creates uncertainty for investors that is manifested in reduced investor participation and higher perceived risk. Frequent changes in the design and terms of the NDIS housing funds will result in some investors choosing to wait longer to participate until they have seen the results of previous, similar funding rounds.
2. **Replicability of investment models:** When housing investment models are replicated, financial institutions can significantly reduce the transaction costs involved in due diligence on the project. Further, where deals are based on the same financing model it is possible to aggregate these deals together into a package of investments that can be used to raise finance from a larger group of investors (such as through the NAB's Climate Bonds). Attempting to develop financing models that allow housing initiatives to be aggregated together will therefore broaden the base of investors, reduce the cost of capital and allow for an easier exit strategy for investors.

6.CONCLUSION

Young people in residential aged care will benefit most from an NDIS when they have access to housing that meets their needs. Any undersupply of highly accessible housing will severely restrict young people's ability to leave nursing homes because there are so few alternative housing options available in the community.

It is because housing is so critical as an enabler to leave aged care that the Summer Foundation is advocating an NDIS housing payment system that creates a stable, predictable and low risk investment. This will enable housing providers to access a larger sum of finance to address the enormous unmet capital needs of young people in residential aged care. It will also lower the cost of the finance which will benefit the NDIS through lower lifetime costs.

Adopting long term funding commitments and attaching funding to the dwelling appears to involve a trade off between accessing finance and maximising choice and control for participants. Yet if the NDIS housing funds are only short contracts that create high levels of uncertainty (through housing providers bearing occupancy risk) participants' choice and control will be severely undermined because there will be so little new housing created. Finance will be difficult to access creating an undersupply of housing with the most severe impact on highly accessible housing products in thinner markets. Young people in residential aged care would be hit hard by this policy, and particularly in smaller cities and regional locations.

The Summer Foundation's mission is to stop young people living in nursing homes simply because there are no other places for them to live. We believe this mission is shared by Commonwealth and State governments, as well as the NDIA. Over the early years of the NDIS roll out this objective is best met through NDIS housing payments that can be securitised by lenders, provide certainty of payment by being attached to the dwelling and have a 20-25 year agreement period.

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