

Policy, Planning and Financing Options for Affordable Housing in Melbourne

A BACKGROUND REPORT FOR
TRANSFORMING HOUSING
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Cover Image: Kyme Place social housing development in Port Melbourne

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Summary

This paper addresses the question of how to leverage greater investment in affordable housing in the context of investment returns typically too low to attract investors and limited government funding to directly bridge this gap. It contemplates various policy, planning and financing mechanisms to this end. It draws on research carried out by the Transforming Housing team at the University of Melbourne, which has also been used to inform the options paper developed to provide a basis for discussion at an affordable housing summit held at the University in April/May 2015. This paper is intended to be read together with the other background papers prepared by the Transforming Housing team (Whitzman, 2015; Newton et al., 2015).

Semi-structured interviews were conducted with a number of key stakeholders already involved, or with potential to be involved, in the delivery of affordable housing in Melbourne: three community housing organisations, two superannuation funds, a property fund manager, a philanthropic foundation, and a bank. In addition, a number of informal discussions were held with some of these stakeholders, as well as state and local government officers. **Key issues emerging from the interviews include the 'gap' between returns delivered by investment in affordable housing and those expected by most investors, limited government funding available to 'bridge' this gap, and additional costs arising from regulatory inflexibility, and market, planning and development risk.**

Together with a review of literature on mechanisms that could subsidise or otherwise encourage investment in affordable housing, these data have been used to discuss how such mechanisms could potentially relate to a number of development 'scenarios' at different scales, mixes of market-rate and affordable housing, and land in public or private ownership. **This is intended to provide a basis for testing the various mechanisms contemplated in this paper through a series of demonstration projects which may then be scaled up as new models for increasing the supply of affordable housing in Melbourne.**

Introduction

This paper seeks to address the question of what policy and financing mechanisms might be used to increase the quantity of well-located, quality, affordable housing in Melbourne. This paper draws on research conducted by the Transforming Housing team at the University of Melbourne, which has also been used to prepare a discussion paper for an affordable housing summit that was held at the University in April/May 2015. As with all research conducted by this team, it has been situated within a partnership-based action research project focusing on how to facilitate innovation through the building and bolstering of partnerships between key stakeholders. **As such, this paper focuses on a number of key stakeholders – the investors and financiers from which funds are sourced, the developers (including housing associations and providers which act as developers) who use these funds to build housing, and the various levels of government which provide policy frameworks and settings in which this occurs.**

For the purpose of this paper, **affordable housing is defined as housing which costs no more than 30% of gross household income for low and middle moderate households.** By this criterion, a significant number of Australian households do not have access to affordable housing and therefore are in housing stress. In Melbourne, 88% of private renters in the lowest income quintile pay over 30% of their income on housing, and 31% pay over 50%, placing them in severe housing stress (Hulse et al., 2015). In 16 of Melbourne's 31 municipalities, over 95% of appropriately sized dwellings on the private rental market are unaffordable to households reliant on Centrelink (welfare) payments (DHS, 2014). Home ownership is also increasingly unaffordable, with the ratio of median house price to median income in Melbourne being 8.7 respectively, placing it as the 6th least affordable city among 86 included in the Demographia International Housing Affordability Survey (Demographia, 2015). Across the country, there is a shortage of 271,000 affordable and available private rental dwellings for households in the bottom income quintile, and a further shortage of 122,000 such dwellings for those in the second bottom quintile (Hulse et al., 2015).

It is apparent, as has been pointed out by other researchers (e.g. Berry, 2003), that current market failures mean it is not possible for the private market to meet the demand for affordable housing among low income earners and people facing other forms of disadvantage. However, social housing, which is comprised of public housing (managed by state and territory housing agencies) and community housing (managed by non-profit community housing organisations) represents only 3.4% of Victoria's total housing stock (CHFV, 2014). This housing is rented for an amount which is affordable based on tenants' income. The National Rental Affordability Scheme (NRAS) also provided some below market rate housing, through a 10 year ongoing federal government subsidy incentivising private investors to maintain rents at least 20% below the market rate. **However, as rents were based on market rent rather than tenant income, NRAS dwellings were not guaranteed to be affordable, particularly in inner city or well-located areas which are more expensive.** As such, the majority of discussion within this paper refers to community housing which is managed, and in some cases owned, by community housing organisations (CHOs), which in Victoria include larger Housing Associations and smaller Housing Providers.

As much affordable housing is sold or leased to its occupants at a below-market value, a key challenge with regards to funding such housing is, quite unsurprisingly, compensating for the 'gap' between the return generated by such housing as an investment, and the return generated by a

comparable commercial investment. This entails the necessity of a subsidy, generally from some level of government. In terms of public housing, this gap is entirely filled by government expenditure. With other forms of affordable housing, government subsidy is generally combined with other savings, or incentives created by policy settings. For example, housing developed in Victoria under the Social Housing Initiative (SHI) in the past few years was 75% funded by federal government funds administered by the state government with the remainder funded by CHO borrowings and cash flows. Often, direct and indirect subsidies, as well as other cost savings, combined in complex ways to make the provision of this housing viable. In addition, policy instruments such as density bonuses and inclusionary zoning have been used in other jurisdictions to encourage or require the provision of affordable housing.

Hence, a key focus of this paper and this project more broadly is to identify ways to bridge the funding 'gap' required to deliver affordable housing. However, this paper also addresses the needs and capacity of actors involved, or with potential to be involved, in the affordable and social housing sectors. **This is intended to provide an understanding of which sources and recipients of funding may be able to be involved in the development or acquisition of affordable housing at different scales and values, in order to generate discussion on the potential for new or strengthened partnerships to drive increased investment in affordable housing.**

This paper has been informed by interviews with key stakeholders – three community housing organisations, two superannuation funds, a property fund manager, a philanthropic foundation, and a bank – as well as informal conversations with state and local government officers and a review of relevant literature.

Interviews were conducted in a semi-structured style, with a number of broad questions prepared beforehand, with flexibility to discuss other issues as new information emerged. Due to the limited number of interviews conducted and the qualitative approach used, the data gathered are not to be considered representative of the sectors to which they belong. Instead these should be taken as an indication of key issues and challenges around affordable housing, and to test the perceptions of these actors on the feasibility of various policy and financing mechanisms proposed here for application in the Melbourne context.

Key Issues

Insufficient Return on Investment

Perhaps the most important issue identified through discussions with stakeholders on the question of how to leverage greater investment, particularly from private sources, into the affordable housing sector, is that the returns on affordable housing as an investment – in the absence of some form of subsidy – are generally seen as too low to be attractive. In the case of subsidised rental housing, which is the main focus of this paper, there are both capital (e.g. development) and ongoing (e.g. management and maintenance) costs that need to be met. Unsurprisingly, the fact that this housing is provided below market value, often to a significant extent, means that revenues are not high enough to support expenses, even for non-profit CHOs.

In general, there is little institutional investment in residential property, and that which occurs tends to be focused towards high cost, often high rise apartment buildings where dwellings are sold rather than retained as a long term, yield producing asset. This is due to the fact that **the majority of landlords in Australia are small scale investors owning only one or a few properties, underpinned by concessions such as negative gearing.**

Industry expectation of returns from property

(Figures based on recent interviews with Melbourne stakeholders in 2015)

Standard rate of return for social housing:	1-2%
Standard rate of return for market rental housing:	3-4%
Standard rate of return for institutional investors for property:	7-9% (CPI + 5%)
Expected internal rate of return (IRR) for developers – low-medium risk:	20%
Expected IRR for developers – higher risk:	25%

It was suggested by a number of stakeholders that the return from social or subsidised housing may be 1-2% per annum, whereas institutional investors may expect a return of 7-9% across their property portfolio, which tends to focus on retail and commercial property. **Some superannuation funds suggested that they may be willing to accept a lower return on investments such as affordable housing if there were measures to lower risk to the point where this could be considered to be in the infrastructure asset class rather than the property asset class,** the former being associated with lower risk or guaranteed return investments, and therefore lower required returns. However, this was considered to require significant guarantees from government.

An alternative to institutional investment, which would also be likely to require a high development value and scale that may be unfeasible for CHOs to manage, would be to use a vehicle such as a not-for-profit real estate investment trust to pool investment (REIT) from retail investors, particularly those with an emphasis on socially responsible investment. This was currently being investigated by one CHO that was interviewed, but was considered less feasible in the Australian context than in the United States where such a vehicle had previously been used, owing to how such an investment would be taxed.

In essence, even with ways of reducing the cost of affordable housing such as through the possibility of faster planning approval or through the tax concessions available to CHOs, some form of subsidy or concession will be required.

Limited Government Funding

Following from the issue of insufficient return on investment is the fact that there is limited direct or indirect government funding of affordable housing at the current time, nor are government leveraging assets such as land towards the provision of affordable housing. **Funding from all levels of government has decreased over time, with much government expenditure on housing focused on maintenance of its ageing public housing stock.** The notable exception to this was the Nation Building Economic Stimulus Plan, which was a \$42b investment by the Commonwealth Government in response to the Global Financial Crisis (DHS, 2013). Through this stimulus, \$1.26b was made available to Victoria for the construction of new social housing, and a further \$99m for repairs and maintenance. This funding helped deliver 4,663 new dwellings and repairs to a further 9,363 dwellings.

CHOs indicated that this funding was essential to the significant growth in housing stock that was achieved although the fact that the Victorian Government, which administered the funding, only funded 75% of these developments. **As a result, many CHOs now have significant debt and limited capacity to borrow further.**

Another recent and significant source of government subsidy for affordable housing was the National Affordable Rental Scheme (NRAS), similar to the Low Income Housing Tax Credit (LIHTC) program in the US. NRAS provided tax credits (or cash, for charitable organisations) to build dwellings and rent them to means tested tenants at least 20% below market rent. As of December 2014, 24,766 dwellings had been delivered nationally, with 4,958 (20% of the national total) in Victoria. A further 12,757 incentives have been reserved nationally (1,196 in Victoria) for housing that is expected to be delivered by 2017 (DSS, 2014). However, NRAS was discontinued in 2014, with the announcement in the federal budget that the fifth round of the program would not proceed.

Although the SHI and NRAS have delivered affordable housing, there is still a large unmet demand for such housing with no current significant source of subsidy. Some funding is currently available through the Victorian Property Fund (VPF), which is a trust administered by Consumer Affairs Victoria largely funded through license fees and fines paid by estate agents and conveyances. In 2014-15, \$20.7m in grants will be available for “housing assistance for low income or disadvantaged Victorians” (CAV, 2014). In previous years, CHOs such as Common Equity Housing Ltd, Wintringham Housing, and Housing Choices Australia have received grants towards the development of social housing, with grant amounts generally in the order of \$1-2m.

This limited funding is insufficient to meet the need for affordable housing, and the lack of a reliable long-term source of funding is likely to be a barrier to ensuring the involvement of investors and other key stakeholders. Evidence suggests that the LIHTC scheme in the US, although it is criticised for its complexity and high compliance costs, has had successes due to being a reliable subsidy that can survive changes of government (e.g. Dreier, 2006).

In the current political environment, it is perhaps unlikely that major direct subsidy for affordable housing will be made available, let alone one that achieves bipartisan acceptance and continues into the long term. Nevertheless, there are options for governments at the federal and state level (although less so at the local level) to provide indirect subsidies or facilitate other cost savings that would assist development viability, including policies that encourage or mandate the provision of affordable housing, or leverage government owned land assets to that end.

Regulatory Inflexibility

Some cost savings could be achieved with policy changes, largely at the state government level, which could assist in the viability of affordable housing projects. This issue was raised in interviews both with investors and CHOs. **Whilst the potential savings would not be a ‘magic bullet’ that would entirely bridge the gap between returns on affordable housing as an investment and investor needs, they are nevertheless worthwhile to pursue, and would mean that greater returns could be leveraged on any government investment, making this more attractive.** Where such measures privilege affordable housing, or enable innovative models of low-cost models such as accessory or ancillary units (“granny flats”) or laneway housing, as has been explored in places such as Vancouver, they provide an opportunity to provide affordable housing without significant government funding or subsidy.

An important factor representing a development cost is the requirement for car parking within the planning system. While a variation or waiver of the statutory rate of car parking provision can be applied for, this is granted on the discretion of the responsible authority (usually the local council). **In some cases, a lower level of car parking may be justified if the tenant population has a lower rate of car ownership or the site location is conducive to greater use of public transport and active travel.** One CHO that was interviewed gave the example of a middle suburban social housing development where the full statutory car parking rate (one per dwelling) was imposed despite the argument being made that the elderly tenant population would have lower levels of car use. As a result, a large underground carpark was constructed at significant expense (approximately \$3.8 million) and has proven to be underutilised.

Another factor, identified by some CHOs, was the limitation on selling housing transferred to the CHO from the state government or constructed with government funds. The CHOs suggested that relaxation of this limitation would enable them to ‘recycle’ assets that were unsuitable or where capital gains could be made and reinvested to expand their housing stock. One CHO gave an example of a state government owned rooming house it managed, which was ageing and subject to a heritage overlay which limited the potential for redevelopment to better meet tenant needs. This CHO argued for being allowed to sell this property and reinvest proceeds into more appropriate housing would deliver a better outcome, but this was not allowed by the government.

Risks

Risk was identified as a key issue in almost all interviews, increasing the cost of finance and deterring investment. Types of risk that were relevant to affordable housing included development risk, planning risk, and market risk.

Of these, market risk (that is, the risk of losses due to movements in market prices) appears to be the most difficult to mitigate, although this could be addressed by building capability within CHOs to ensure that there is sufficient in-house expertise to deal with this issue to some extent.

Development risk could largely be mitigated through the use of fixed cost contracts with builders, although one CHO believed that risk of contamination and costly rehabilitation was high in ex-industrial urban renewal areas that might otherwise be highly suitable for affordable housing.

Planning risk was cited by both CHOs and investors as both significant and something that could be addressed through policy change in the planning system. The two main elements contributing to this risk were uncertainty around decision timelines for permit applications and the possibility of third party appeals. Both have the potential to delay projects, increase holding costs, and result in additional expenses where appeals are taken to the Victorian Civil and Administrative Tribunal (VCAT). **While third party appeals are a risk factor in any development where such appeals are permitted, they are particularly salient for higher density developments and those involving social housing, as there may be prejudice against social housing tenants.**

A number of interviewees suggested that shortened and guaranteed timeframes for assessment of planning permit applications, as well as limiting third party appeal rights, at least to the extent of reducing the possibility of vexatious objections, could help reduce both risk and cost, making affordable housing development more viable. It is relevant to note that under the SHI funding arrangements, planning permit approvals were fast-tracked and given exemption from third party appeals, although the latter was somewhat controversial.

Summary

Important issues that have emerged through this research include the needs and capabilities of two broad groups: those providing funds (banks and investors), and those receiving funds (CHOs and other providers of affordable housing, including social housing).

The key issues relating to the former group are largely to do with the risk and returns associated with affordable housing projects, and the scales at which they are willing to operate. **Affordable housing at this point in time is generally considered to have too low a return given the risk associated, so measures to encourage investor activity could work towards increasing returns (through subsidy or generation of value) or decreasing risk (through greater policy certainty or mechanisms such as government guarantees).** Another potential barrier is that major institutional investors currently require a large scale of investment – in the order of a \$50m equity stake - to commit funds and this scale may be unsuitable for many forms of affordable housing, such as those delivered by community housing providers, which typically have a development cost in the order of \$20-30m. However, there is the potential to involve smaller scale investors, including philanthropic investors, or to use vehicles such as bonds to enable investment to be used across several projects.

The key issues relating to the latter group are similarly to do with risk and capability, but also relate to the connection between the viability of projects and the social mission of the organisations. In essence, higher needs or lower income tenants were more difficult to house because they generated less income, but organisations did not want to exclusively house higher income tenants as this did not align with their social goals. Furthermore, many CHOs have limited capacity to take on additional debt and may require particular types of dwellings (or other factors, such as location). **This points to**

the importance of consulting with CHOs in the proposed provision of affordable housing, as their needs in terms of price points, availability of cash flow, dwelling design and location must be considered to achieve a successful outcome.

Policy and Financing Mechanisms for Affordable Housing

The following section of this paper will outline a variety of policy and financing mechanisms that might be used to incentivise or enable the provision of affordable housing, before discussing their potential for application in a number of development scenarios involving affordable housing.

Mechanisms

“Business As Usual”

Under a “business as usual” situation where there is limited government subsidy for affordable housing but CHOs do enjoy tax concessions and are able to indirectly leverage federal funding in the form of Commonwealth Rent Assistance through their tenants, there is the potential for larger CHOs to gradually and opportunistically grow their housing stock. One CHO interviewed was confident it would be able to borrow against its significant assets and use in-house capability to develop new housing. The majority of the new dwellings would be sold on the market to subsidise the remainder being retained and rented below market value. **However, there is significant risk involved in this approach, particularly market risk, as the successful cross-subsidy of the social dwellings requires an expected return being achieved on the development.** This would also only result in a very gradual increase in stock whilst occupying a large proportion of the CHOs funds, time and other resources.

An alternative approach would be for CHOs to partner with for-profit developers and enter into an agreement to purchase a small proportion of units within a development below market value, close to or at cost price. This is beneficial to the CHO as it provides the opportunity to help shape the design and development process, thus helping it acquire stock that suits its needs, and also beneficial to the developer as it reduces risk through guaranteeing a proportion of pre-sales required to receive financing.

These approaches are likely to only incrementally increase housing stock and are unlikely to be suitable for any but the CHOs with the largest asset bases and in-house capabilities. Whilst there is some potential for partnership based approaches to help scale up these processes, such as fostering relationships between CHOs, developers and investors, and providing information that could help improve efficiency, the increase in social housing stock resulting under this situation is very unlikely to address the growing need for affordable housing.

Removing Regulatory Obstacles

Governments can provide incentives or remove barriers, effectively reducing the level of subsidy required for affordable housing projects.

For example, as mentioned previously, onerous car parking requirements can increase the cost of development and lessen feasibility. This can also be wasteful if inflexibly imposed statutory rates result in underutilised car parking, as in the example discussed earlier. Planning controls relating to the provision of car parking detail the required rate based on land use but also allow for the consideration of reduction or waiver of this rate. **Particularly where there is evidence that the target population of a development may have lower car ownership or usage rates, such as in the**

case of elderly people, priority could be given to reducing the cost of development through relaxing car parking requirements. As a mechanism to specifically incentivise affordable housing, this approach has been taken in places such as Vancouver.

It may also be possible remove obstacles to smaller scale infill housing programs, such as accessory or ancillary units (e.g. ‘granny flats’) or laneway units. In Victoria, ‘Dependent Persons Units’ are allowed as-of-right (i.e. without the need for a permit) in residential zones but only if the dwellings are removable and the occupant is dependent on the persons living in the main dwelling. These restrictions are not a feature of planning policy in NSW, where ‘secondary dwellings’ can be approved in 10 days if they meet criteria set out in the Affordable Rental Housing State Environmental Planning Policy. The City of Vancouver has also been actively encouraging subdivision of existing single-family homes and development of laneway housing for almost five years, including changes to zoning to enable simple conversions and publishing simple guides for homeowners. About 500 units have been created through these mechanisms since 2009, which have been adapted by several other local governments in the Metro Vancouver area.

A further option would be to provide shortened or guaranteed timeframes for the assessment of planning permit applications for affordable housing developments, as this would reduce both risk and costs. This may include removing or restricting third party appeal rights, as objections and appeals can add greatly to costs due to delays and the need to hire lawyers or specialists for VCAT hearings. **Third party appeal rights were entirely suspended for development funded under the SHI, but some interviewees also suggested that a more moderate approach could be taken, such as tightening avenues for objection to ensure they were made on genuine planning grounds, rather than due to prejudice against social housing.**

Density Bonuses

Density bonuses are used to incentivise public goods like affordable housing in many jurisdictions, including Vancouver and New York (Hodyl, 2015). **Density bonuses allow development proponents to seek approval for additional density beyond pre-defined ‘baseline’ limits in the planning system in return for the provision of affordable housing, additional open space, community infrastructure, and the like.** These baseline limits are generally specified as floor area ratios (ratio of gross floor area to lot area). For example, in Vancouver’s Downtown South the as-of-right maximum building density is 3:1, increasing to 5:1 for the provision of social housing and up to 8:1 for the delivery of a “Community Amenity Contribution” such as community facilities or infrastructure.

Encouraging affordable housing by facilitating additional value through allowing greater densities was identified as an attractive mechanism by interviewees. However, it appears that these ratios must be mandatory rather than discretionary to provide certainty and improve the bargaining position of responsible authorities, such as councils. Otherwise, developers may seek to exceed the discretionary limit without providing a benefit such as affordable housing, and this will also have the effect of increasing land value.

In the Victorian context, height limits are typically used (rather than density limits) and these are often discretionary guidelines, rather than mandatory maximums. Using density limits rather than height limits is perhaps more likely to result in a good outcome as it allows developers to achieve a

specific yield in terms of floorspace area while incentivising the retention of open space and greater building setback.

Inclusionary Zoning

Inclusionary zoning policies typically mandate a certain proportion of dwellings or floor space within a residential development are sold or rented at below-market rates. It has been used widely in a number of countries, using the US, Canada, the UK, and with some limited application in Australia. It may also provide an option to provide a cash payment to be used for affordable housing in lieu of on site provision. It is often used within a suite of policy mechanisms such as density bonuses, and expedited or streamlined planning approval processes, which are discussed previously.

Inclusionary zoning is a somewhat controversial proposal, particularly in jurisdictions that have not yet adopted it. However, while it has its critics in jurisdictions that have adopted it, there is also evidence that it, when used as a suite of tools as part of integrated planning, can achieve acceptance from private sector actors such as developers (e.g. Monk et al, 2005). Critics argue that inclusionary zoning provides a disincentive for developers to operate in jurisdictions that employ it or causes them to pass increased costs onto consumers, thereby reducing overall affordability (e.g. Shuetz, Meltzer & Been, 2011). **However, its proponents argue that, if applied correctly – for example, at a broad metropolitan level, combined with incentives for affordable housing, and with the option of cash in lieu payments – it is an appropriate way of dealing with negative externalities and market failures (e.g. Beer, Kearins & Pieters, 2007).**

Inclusionary zoning has been used in the Ultimo-Pyrmont urban renewal area in inner Sydney, where a relatively modest requirement for 0.8% of residential floor space and 1.1% of commercial floor space to be set aside for affordable housing. **This has yielded 445 affordable housing units** by 2014, approximately 1% of dwellings within the area (Johnston, 2014).

A number of proposals have been made for the application of inclusionary zoning in Melbourne. **These proposals have typically suggested the policy could be implemented as an overlay in the planning scheme, applicable to both residential and non-residential developments, provides a cash-in-lieu option, and is combined with incentives for affordable housing (e.g. SGS, 2007).** Implementation should also be phased in to allow developers to clear their existing pipelines of projects and factor increased cost into future bids for land, in order to avoid increased cost being passed onto purchasers.

Government Funding

There are a number of ways that governments can enter into partnerships to provide indirect subsidies to affordable housing, which have the benefit of leveraging non-government investment through the private and non-profit sectors.

As mentioned previously, the federal government provided tax incentives through NRAS in recent years. This program was modelled on the LIHTC in the US, which has produced more than 2.5m affordable housing units since its inception in 1986, as well as producing 100,000 jobs each year (New York Times, 2012). This program has broad and bipartisan support and has attracted significant private sector investment, although it does attract criticism for its complexity and some lack of efficiency. **In Australia, such a tax credit would need to be implemented at the federal level, which**

is perhaps unlikely given the departure over time of this level of government from housing policy. Similar incentives could include stamp duty or land tax abatements condition on the provision of affordable housing.

A mechanism that is used in Scotland is the establishment of Limited Liability Partnerships (LLP) involving local councils, developers and the Scottish Futures Trust. Councils loan money to LLPs which provide 65-70% of the purchase price of dwellings upfront to developers. Developers contribute the balance as a mixture of loan funding and equity investment. Dwellings are allocated to tenants based on criteria agreed with the council and rents are set at an affordable level for 5-10 years. Income through rent is paid to the council to finance borrowing, pay interest on the loan from the developer and management costs. The federal government provides a guarantee to councils to cover capital and interest payments in case of default.

Social housing bonds can leverage private finance and take advantage of the lower cost of financing from a government-backed bond instrument. Lawson, Milligan and Yates (2012) have examined how the Austrian Housing Construction Convertible Bond could be adapted for use in Australia. **They recommended a solution involving a low risk, low yield, long term instrument with tax incentives structured to be equally attractive to those with high and low tax rates, together with government guarantees to encourage long term investors, particularly institutional investors. Bonds could also be issued by government, including state governments, such as has recently been undertaken in NSW** to fund family support to prevent children requiring foster care (Benevolent Society, 2015). In this instance, the bond delivers performance-based returns to investors, recognising the fact that program success reduces government foster care costs.

Shared equity schemes can help increase access to home ownership for people on low to middle incomes, and have already been used to some extent in Australia, such as the Keystart Home Loans program in WA and HomeStart Finance in SA (Lawson, Berry, Hamilton & Pawson, 2014). In general, the involvement of equity partners such as financial institutions or government backed providers means households pay reduced deposits and mortgage payments. Equity partners recoup their loan and a portion of capital gains when properties are sold. Variants of this model allow households to progressively buy out the equity partner, and for resale values to be limited in order to retain ongoing affordability (a “community equity” model). However, while there is interest from institutional stakeholders and lenders, there is caution around the question of risk, as this is an innovative approach with which many stakeholders are unfamiliar. **State governments could become involved in scaling up community equity models to help preserve affordability in broader housing stock, rather than merely delivering benefits, such as capital gains, to beneficiary households.**

Another potential mechanism is Tax Increment Financing (TIF) which is used or at least enabled by legislation in all but one state in the US. TIF in the US is used generally by local government (which albeit are generally more powerful and well-resourced than local governments in Australia) and enables them to use tax revenues from increases in property values within a designated development area to fund the provision of infrastructure within that area (PwC, 2008). This represents a reallocation of the increased tax (compared to a baseline where no redevelopment occurs), rather than a new tax to property owners. Bonds are issued by the government and used to finance renewal and infrastructure development, and increased property development increases tax

revenue in the area, which is then used to retire debt. Cities such as Portland had used a portion of funds raised through TIF to help fund affordable housing (City of Portland, 2015). In the Australian context, this mechanism could be used by state governments, particularly within urban renewal areas. However, one challenge to the implementation of TIF in Australia is that annual property taxes are about a quarter of those generated by comparable properties in some North American cities, with stamp duties on the sale of homes being the major generator of property-based revenues.

Finally, affordable housing can be produced by the provision of direct subsidy or grants, as was the situation under the SHI. While this generally requires less complexity than arrangements involving tax credits, financial intermediaries and the like, there is little appetite for this kind of capital contribution, particularly at the federal government level, which has the greatest financial capacity in the Australian context. There is limited capacity or willingness to provide this funding at lower levels of government, particularly local government.

Using Government Land

There is potential to repurpose public land for affordable housing or mixed-tenure developments including affordable housing, particularly if the land can be sold or rented at a below market rate. One way that this may occur is for formalised requirements for affordable housing (e.g. covenants or contracts) to 'moderate' the residual land value and therefore its purchase price (Davison et al., 2012). **Land that is currently in public ownership presents unique opportunities for affordable housing, particularly when it is well located with respect to transport and services, or where it contains low-density or no housing.**

Under-utilised land assets owned by local governments might be considered for affordable and mixed tenure housing developments. Local governments typically own land for car parking, libraries, depots, halls and other community facilities. In the case of car parks where it might be desirable to retain the ground level use, development above the car park is possible.

The State Government also has land assets that could be repurposed for affordable housing if under-utilised. Potential sites include hospitals, schools or reservations set aside for road or rail corridors that are no longer required. **In addition, existing public housing estates present an opportunity to contribute to affordable housing supply, particularly those that are well located, relatively low density, contain older housing stock, or stock that is no longer suited to the needs of tenants (e.g. larger dwellings). Where intensification is feasible, there is an opportunity to increase the number of social or affordable dwellings on the site whilst providing additional market housing which can help cross subsidise the former.**

Measures should be taken to ensure that some or all of the land in redeveloped estates remains in public ownership or is bound by other mechanisms to ensure it is being used for broader community benefit. Options here include long-term leasehold arrangements (rather than outright sale) or caveats on land title that require the provision of affordable housing for a fixed period or in perpetuity. An alternative is to use a Community Land Trust, which involves trust entities maintaining ownership over the land and renting or selling dwellings under ground leases. The ground leases include affordability formulae that balance limited equity gain with maintaining perpetual housing affordability. When an owner occupied dwelling is sold, the equity is shared

between the Trust and the seller due to limitations placed on resale prices as set by the Trust. Community Land Trusts are common in the US and the UK, but there are none yet established in Australia.

Social and Philanthropic Investment

An alternative to private investment, which generally requires higher rates of return and scale of development than affordable housing tends to deliver, is social or impact investment. This is currently more prevalent in the US than in Australia, where it has been used for purposes including providing lower cost funding towards affordable housing (e.g. Kelly & Duncan, 2014; New Market Funds, 2014).

An example from the US is the Meyer Memorial Trust, which provides a combination of grants and investments in Portland, Oregon, to strength the affordable housing sector. It helps to fund pilot projects that demonstrate innovation in cost-effectiveness, design and construction. In Vancouver, Canada, Vancity invests according to a social and environmental mission in its 'impact real estate' portfolio which serves moderate income households who may not require deeply subsidised social housing. It also provides bridging funding and supports innovations towards this goal.

Philanthropic funding can be used by both non-profit and for-profit developers or housing organisations towards affordable housing, and it can be combined with private financing. This 'cobbling together' of smaller amounts of funding from multiple sources is more common in the financing of affordable housing in the US and represents opportunities for new funding models in Australia. However, work first must be done by philanthropic or other socially minded organisations in informing philanthropic donors and impact investors of opportunities in affordable housing investment, and the social benefits of such investment, as long term housing (as opposed to homelessness) has not been a major focus for the sector to date in Australia. **There is also an opportunity for government to provide tax concessions or other incentives to stimulate investment from this sector.**

Development Scenarios

This paper has taken the approach of identifying a variety of scenarios for the development of affordable housing to provide a framework for the discussion of the mechanisms for affordable housing outlined above, and what types of stakeholders would be involved.

From interviews with stakeholders, a number of variables for types of development and investment opportunities emerged. It should be noted that the options within the variables below are not comprehensive but represent examples that are considered reasonable for discussion.

- **Ownership of land:** private or public (local, state, or federal government).
- **Proportion of development to be affordable housing:** a modest proportion of total units (5-20%), a roughly equal mix (40-60%), or completely comprised of affordable housing (100%).
- **Scale of development:** relatively small-scale (for example, a 3-4 storey building comprising 20-30 units), somewhat larger (for example, a 6-8 storey building comprising 50-80 units), or at a large or precinct scale (for example, multiple buildings, perhaps over multiple developments or stages in a strategic redevelopment or urban renewal area, yielding in excess of 200 units).

Another relevant variable is tenant mix – relating to tenant income and rent paid – but this will be discussed as an issue within the following scenarios rather than used to generate further permutations of investment scenarios. This is important as a shallower subsidy will be required to provide housing for moderate income ‘key workers’ than for workers on minimum wage (earning about \$33,000 a year), and less so again than for people deriving income entirely from welfare payments (as low as about \$13,000 a year for singles with no dependents receiving the Newstart payment).

Five development scenarios, which are permutations of the three variables listed above, have been selected for discussion in this paper:

1. **Small to medium scale development on privately owned land with a modest proportion of affordable housing**
2. **Small to medium scale development on private owned land with a larger proportion of affordable housing, ranging from an approximately 50:50 mix with private housing to 100% affordable housing, depending on the subsidy available**
3. **Precinct scale development on private land (such as urban renewal) with a modest proportion of affordable housing**
4. **Small to medium scale development on public land, ranging anywhere from a modest proportion of affordable housing to 100% affordable housing, depending on the subsidy available**
5. **Precinct scale development on public land (such as redevelopment of a public housing estate), ranging from a modest proportion of affordable housing to an approximately 50:50 mix with private housing, depending on the subsidy available**

These are shown in the following matrix:

Private Land				Public Land			
	5-20%	40-60%	100%		5-20%	40-60%	100%
Small (20-30 units)	Scenario 1	Scenario 2		Small	Scenario 4		
Medium (50-80 units)				Medium			
Large/Precinct (over 200 units)	Scenario 3			Large/Precinct	Scenario 5		

A number of permutations of the above variables were excluded as it was considered less feasible that a high proportion of affordable housing be delivered across a large scale, particularly on private land. However, this is not to say that such permutations are impossible or have not occurred previously, only that discussion has been confined to which partnerships and mechanisms might be more applicable in the current context.

Table 1: Case Studies Illustrating Five Scenarios

<p><u>Scenario 1: Gipps Street, Abbotsford</u> Organisation: Common Equity Housing Ltd Number of units: 25 affordable housing units, 34 private units Proportion of affordable housing: 42% Land type: Private Total development cost: \$30m (2013)</p>	
<p><u>Scenario 2: Gaffney Street, Pascoe Vale</u> Organisation: Housing Choices Australia Number of units: 28 affordable housing units Proportion of affordable housing: 100% Land type: Private Total development cost: \$7.4m (2012)</p>	
<p><u>Scenario 3: Ultimo-Pyrmont (Sydney)</u> Organisation: City West Housing Number of units: 445 affordable housing units across precinct Proportion of affordable housing: 6-7% Land type: Private</p>	
<p><u>Scenario 4: Kyme Place, Port Melbourne</u> Organisation: Port Phillip Housing Association Number of units: 27 units: Proportion of affordable housing: 100% Land type: Public Total development cost: \$9m (2012)</p>	
<p><u>Scenario 5: Carlton Housing Redevelopment</u> Organisation: Department of Health and Human Services Number of units: 236 public housing units (replacing 192 old units), 800 private units Proportion of affordable housing: 23.5% Land type: Public Total development cost: \$600m (2009)</p>	

Image sources / more information: (1) <http://www.cehl.com.au/index.php?page=gipps-st-abbotsford>
 (2) <http://www.housingchoices.org.au/pages/completed-proje-gaffney-street-pascoe-vale-139.html>
 (3) <http://www.cityofsydney.nsw.gov.au/development/planning-controls/affordable-housing-and-development-contributions> (4) <http://www.ppha.org.au/portfolio/developments/104-completed-projects/144-kyme-place>
 (5) <http://www.housing.vic.gov.au/carlton-redevelopment-reaches-important-milestone>

Discussion

This section will discuss the five development scenarios for affordable housing described earlier, and which of the above policy and financing mechanisms may be most appropriate to encourage investment into affordable housing in each scenario. While these scenarios do not comprehensively cover all possible or feasible types of land and development suitable for affordable housing, they nevertheless provide an indication of how different mechanisms and partnerships may be suitable for different types of development. **They also provide a basis for demonstration projects testing how different scales and types of development may be facilitated through various mechanisms in Melbourne.**

Scenario 1: Small to medium scale development on privately owned land with a modest proportion of affordable housing

Partnerships between CHOs and investors are likely to be useful in this scenario, with a role for government in providing incentives or support through density bonuses, or providing information and guidance to other stakeholders. However, smaller projects are likely to preclude investment from superannuation funds and other institutional investors, which have generally indicated in interviews that their minimum investment threshold is in the order of \$50 million.

Government policy, both in terms of enabling tools and strategic intent relating to development generally, plays a significant role in determining outcomes. Therefore, local governments wishing to partner with others in delivering affordable housing could assist by disseminating information on strategic intent relating to development opportunities and location of affordable housing. A number of CHOs interviewed expressed the view that this kind of information was generally not proactively communicated by local government.

In addition, where planning scheme amendments result in land value increase, such as through rezoning to more permissive zones (e.g. from industrial to residential or Capital City Zone), there is an opportunity to capture some of this value increase, such as through inclusionary zoning. This is another avenue that would require government to partner with stakeholders and announce intent well ahead of time to ensure strategic implementation.

Inclusionary zoning, as well as density bonuses, would require a significant role to be taken by state government, as local government may only act within the framework set by the former. As with inclusionary zoning, density bonuses would require significant action from government, likely at the state level, to set mandatory height or density limits and clearly specify which community benefits, such as affordable housing, would need to be provided to qualify for the bonus. Interviews with investors have suggested that they and other key stakeholders such as developers would be more likely to support density bonuses than inclusionary zoning. **Other measures likely to enjoy broad support among relevant stakeholders include shorter or guaranteed timeframes for permit decisions, reductions in car parking requirements, or reductions in developer contributions, as incentives for providing affordable housing.**

Scenario 2: Provision of a higher proportion of affordable housing within a small to medium scale development on private land

Provision of a higher proportion of affordable housing would be likely to require a deeper subsidy to represent the lower revenues associated with such housing, particularly if a significant proportion of tenants were very low or low income earners, rather than moderate income earners (e.g. “key workers”). This type of housing was developed during the SHI where 75% of the development cost was provided by Commonwealth funds administered by state governments. Despite the heavy subsidy during this program, many CHOs interviewed stated it was difficult even to raise finance for the remainder of the cost given limited cash flows from low-income tenants.

It is unlikely to expect major direct subsidy similar to the SHI to be forthcoming in the short term. **Therefore the required subsidy should be sourced through alternate means, such as “cobbling” together smaller amounts of funding from multiple sources as is common for CHOs and other non-profits in the US. There is potential for involvement from impact investors such as philanthropic organisations, and socially minded lenders and non-profits, as well as leveraging small government grants such as through the Victorian Property Fund.**

As in Scenario 1, there may be opportunity to derive subsidy from mechanisms such as density bonuses, inclusionary zoning, or incentives through the planning system which can reduce cost.

Scenario 3: Provision of a modest proportion of affordable housing in larger or precinct scale development on private land

Government policy and incentives are particularly important to stimulate provision of an affordable housing component across large scale development, such as a strategic redevelopment site or an urban renewal precinct. Particularly in the short term, it is most likely that only a minority of dwellings constructed could be expected to be affordable housing. This is due to the difficulties of providing incentives for or requiring a large number of affordable housing units, as well as limits to the ability of CHOs to acquire large amounts of social housing stock, particularly in a short amount of time.

Again, tools such as density bonuses are likely to be useful, particularly in redevelopment areas where higher densities may be appropriate. **Large renewal precincts where a change of use and therefore rezoning is occurring may also be prime candidates for inclusionary zoning to capture some of the value increase associated with this rezoning.**

In the medium term, it may be possible to use tools such as TIF, given the role of state government agencies such as the Metropolitan Planning Authority in facilitating large scale redevelopments. However, this would be more effective if property taxes represented a more significant source of revenue, as in the US, and as might occur if broad-based property taxes replaced stamp duty in Victoria. Cross-agency partnerships at the state government level, together with developers and CHOs, would be necessary to identify which infrastructural improvements would facilitate broader development activity and investment, where affordable housing would be best located, and how the proportion of the TIF funds to be allocated for investment in affordable housing could be most effectively spent.

Particularly where this type of precinct is a single land holding, such as the major redevelopment of the Amcor paper mills in Alphington, there may be greater potential for involvement of institutional investors such as superannuation funds, due to the large scale of investment required. Tools such as TIF may help increase returns on investment to the point where they are attractive to such investors, while the use of government guarantees for bonds through a TIF or otherwise may reduce risk to investors. **In the case of significant government direction and policy certainty, there is the possibility that risk profiles for such investment may allow for its categorisation within the infrastructure asset class (rather than property) by investors, therefore requiring a lower rate of return.**

Scenario 4: Small to medium scale development on publicly owned land

The utilisation of publicly owned land for social benefit such as affordable housing represents a significant opportunity that has not yet been fully tapped. However, there are a number of issues associated with this opportunity that need be addressed. Firstly, while governments are not explicitly prevented from disposing of land assets for less than market value, they are obliged to consider the land valuation based on highest and best use and justify any discount below this on the basis of community benefit. Discussions with local and state government stakeholders have suggested that they would consider providing such a discount, but not providing land for free. Another issue is that of how to provide land for affordable housing purposes and ensuring that community benefit is retained in perpetuity. Various options to this end, including the use of Community Land Trusts, are discussed in previously in this paper.

Assuming that land is able to be provided at less than full market value, the resultant reduction in cost creates an opportunity to assemble a more attractive investment. However, as discussed in Scenario 1, smaller scales of development may preclude the involvement of institutional investors. In addition, it is vital to involve CHOs as early as possible, in order to ensure that design and other factors meet their needs, as well as feasibility within their ability to borrow or service debt. This appears to have occurred to date in cases where local governments have investigated selling or leasing land such as car parks for development including at least a component of affordable housing. This approach could be scaled up to make use of the larger land holdings of state government and its agencies.

In order to achieve higher proportions of affordable housing, including developments consisting of entirely affordable housing, there is an opportunity to utilise partnerships with the philanthropic sector or impact investors, as they would be likely be more able than institutional investors to fund projects of this scale. **A successful model may include combining small scale government grants such as from the Victorian Property Fund (or from local governments if available, such as in the City of Moreland) and funds from impact investors, who may be willing to accept a smaller financial return in exchange for demonstrable social benefits.** Delivering an entirely affordable housing development may also make it more likely that local governments could provide land at lower cost, due to demonstrable community benefits, and provide other incentives such as reductions in car parking requirements or developer contributions.

Scenario 5: Provision of a higher proportion of affordable housing in larger or precinct scale development on public land

Similar partnerships and mechanisms may be appropriate in this scenario as in Scenario 3, which relates to private land. However, the potential of utilising public land is likely to increase the amount of affordable housing which could be delivered. **Perhaps the largest source of land relevant to this scenario is that which is used for public housing, particularly where this housing is approaching obsolescence and requires redevelopment. However, other significant land holdings, particularly railway related land owned by Victrack, could also be utilised.**

In this scenario, there is potential to create partnerships involving CHOs, developers and investors to both increase the amount of affordable housing stock on such sites, and the quality of housing (both affordable and market-rate). **It is likely that any redevelopment would include a mix of both types of housing, with the latter helping to cross-subsidise the former. This could also help ensure that the affordable housing component includes a significant proportion of housing suitable for very low and low income earners, who require deeper subsidies than moderate income earners.** This model has been used in Melbourne to date, such as in the redevelopment of the Kensington public housing estate, and Port Phillip Housing Association's Ashwood Chadstone Gateway Project.

As with precinct scale development on private land, there is potential to involve institutional investors due to the large scale of investment required, as well as potential to use private-public partnership models to reduce private sector risk and the cost of raising capital. Involving CHOs in any partnership would enable state government to transfer management (whether this is tenancy management or full asset management) of at least some stock, reducing its management burden and delivering social benefits, particularly where CHOs work in partnerships with service providers or have special expertise in dealing with tenants with particular needs.

Any transfer of management could help leverage private investment as has occurred in the UK, where lender confidence in the regulatory framework and ongoing government commitment has enabled a low cost of finance, including a growing bond market (Berry, Whitehead, Williams & Yates, 2004). This has funded about 50-60% of the construction cost of new affordable housing, which is higher than the proportion of private investment leveraged during the SHI in Australia. This model has also employed measures such as shared equity schemes to support lower income people entering home ownership.

One element of such development and partnership that was identified in interviews with CHOs is the barrier posed by excessive inflexibility from state government agencies, such as whether payments to government for land must be made in cash (to be used for affordable housing) or provided in-kind (the provision of social housing by the developer). One CHO that was interviewed argued that the latter would deliver more social housing due to the units being provided at cost price, but that state government would only accept cash payment. This highlights the need for cross-agency collaboration involving both the Department of Health and Human Services, and the Department of Treasury and Finance.

Summary of Discussion

The scenarios discussed here, including potential for stakeholder involvement and use of mechanisms, is summarised on the following page.

Table 2: Summary of development scenarios

Development Scenario	Stakeholder Roles	Key Mechanisms
Scenario 1: Small to medium scale development on privately owned land with a modest proportion of affordable housing	<ul style="list-style-type: none"> • Developers to partner with CHOs • Limited role for institutional investors • Government to play policy development and facilitation role 	<ul style="list-style-type: none"> • Removing Regulatory Obstacles • Streamlined Approvals • Density Bonuses • Cross-subsidisation
Scenario 2: Provision of a higher proportion of affordable housing within a small to medium scale development on private land	<ul style="list-style-type: none"> • Larger CHOs to act as non-profit developers • Governments to provide subsidies where possible • Philanthropic organisations and impact investors to provide lower cost financing 	<ul style="list-style-type: none"> • Removing Regulatory Obstacles • Streamlined Approvals • Density Bonuses • Philanthropic and Social Investment • Direct Government Subsidy
Scenario 3: Provision of a modest proportion of affordable housing in larger or precinct scale development on private land	<ul style="list-style-type: none"> • Government to take key policy development role and consider innovations e.g. Tax Increment Financing • Developers to partner with CHOs • Potential for involvement of institutional investors due to scale of project 	<ul style="list-style-type: none"> • Density Bonuses • Inclusionary Zoning • Indirect Government Subsidy (e.g. bond guarantees, Tax Increment Financing)
Scenario 4: Small to medium scale development on publicly owned land	<ul style="list-style-type: none"> • Government land owners to facilitate redevelopment of land, perhaps provided at below market cost • Developers to partner with CHOs • Larger CHOs to act as non-profit developers 	<ul style="list-style-type: none"> • Removing Regulatory Obstacles • Streamlined Approvals • Philanthropic and Social Investment • Leveraging Publicly Owned Land
Scenario 5: Provision of a higher proportion of affordable housing in larger or precinct scale development on public land	<ul style="list-style-type: none"> • Government land owners to facilitate redevelopment of land, perhaps provided at below market cost • Developers to partner with CHOs • Potential for involvement for institutional investors due to scale of project 	<ul style="list-style-type: none"> • Cross-subsidisation • Indirect Government Subsidy (e.g. bond guarantees, Tax Increment Financing) • Direct Government Subsidy • Leveraging Publicly Owned Land

Implications

For Government Policy

Ideally, there would be strong federal government policy on housing, combined with reliable funding sources and a willingness to participate in measures such as bond guarantees or tax credits that could help leverage greater private investment. However, as the current federal government has signalled its withdrawal from this area, the most relevant levels of government are state and local.

State government could usefully take a proactive role in affordable housing policy even if not in the position to commit significant funds. As the legislative enabler of local governments, including in relation to planning legislation and policy, it has a key role to play in setting targets for social and affordable housing, ensuring local governments have the tools they need to enact mechanisms such as density bonuses, and removing barriers such as excessive inflexibility in terms of car parking requirements, transfer of social housing assets, and availability of government land. It also has the potential to use tools such as social impact bonds, tax concessions and TIF, particularly with regard to major redevelopment and urban renewal areas.

Many local governments have signalled a willingness to become involved in affordable housing and will continue to do so if assisted by state government. Local government policy, particularly around planning, can help provide certainty around issues such as availability of land, strategic intent, permissible densities and developer contributions. **Both state and local governments may be able to leverage public land assets at various scales towards providing a non-cash subsidy for affordable housing.**

For Partnership Building

This paper has highlighted the need of building and strengthening partnerships between all types of stakeholders involved in the provision of affordable housing, particularly in the context of moving away from the central role of government, particularly the federal government, in funding affordable housing, to a situation where investment from a number private and non-profit sources is combined with government incentives and small scale grants.

The complexity of involving a number of actors, particularly in piloting innovative ways of delivering affordable housing, makes strong partnerships and knowledge sharing of vital importance. As highlighted in Getting To Yes, the precursor to this project, there are often significant knowledge gaps around the issue of affordable housing amongst actors and potential actors such as developers, financiers, and investors. Furthermore, there may be insufficient inter-sectoral communication, such as between local government and other stakeholders to signal strategic intent regarding development and affordable housing provision, in order to facilitate the implementation of those governments' affordable housing strategies.

Where there have been successful innovations in affordable housing, including in the context of declining federal government funding or involvement, partnerships and ongoing relationships have been forged between disparate partners in order to share knowledge and opportunities. This has been demonstrated both in Getting To Yes and in current research being undertaken in US and

Canadian cities, which is reported in the paper on partnerships prepared as part of this set of options papers.

For Future Research

This research has focused on identifying the needs of stakeholders providing and receiving investment for affordable housing, and the potential for partnerships to create innovative ways to leverage funding for this purpose. It has intended to provide a basis for discussion, rather than a comprehensive evaluation of how particular mechanisms would operate in the current legal, taxation, policy and political contexts. Future research could provide further detail on these aspects, including demonstrating the cost and potential savings to government of any proposed measures.

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