SGCH

Mr David Murray AO
Chair, Financial System Inquiry
The Treasury
Langton Crescent
PARKES ACT 2600
AUSTRALIA

26 August 2014

Dear Mr Murray

**Financial System Inquiry**
On behalf of SGCH (St George Community Housing Limited), I am pleased to contribute to the Financial System Inquiry second round submissions. As one of Australia's largest and most-awarded community housing providers, owning over 1,400 homes and managing a further 2,800, I wish to draw on our experience to comment on some of the observations raised in the Interim Report.

- Funding: Housing and household leverage

Financial institutions have simplified their product offering in that only the standard home loan is offered to customers. Variations such as shared equity or community land trusts are often avoided.

Consequently entry to the housing market is restricted to wealthier participants. There are economic costs associated with the inability of Australia's young key workers to access the housing market as in the future they will increasingly rely on the Government for benefits such as the Aged Care Pension.

**We recommend:** that banks provide a range of home loan products to encourage shared homeowner programs and other similar schemes.

- Funding: Small and medium-sized enterprises

We have recently agreed a $61m finance facility, which will allow us to start delivery of 285 new properties by 2021. However, this has been a time-consuming and onerous process. Greater access to finance would allow us to realise many long-term plans to increase the supply of affordable housing.

**We support:** any measures that would make it simpler for SMEs to raise private finance, to encourage entrepreneurship and stimulate the economy.

- Funding: Impact investment and social impact bonds

The community housing sector has already demonstrated that it can increase housing supply with increased funding.

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**We support:** any measures that make it simpler or more attractive for organisations to invest in social impact bonds. We also believe that it should be mandatory for superannuation funds to invest in the social sector, and social impact bonds is an ideal route for such an investment.

- Funding: The corporate bond market

Corporate bonds are an ideal funding mechanism for SGCH and other community housing providers given the nature of our assets and steady cash flow. Bonds are already used effectively in community housing sectors overseas, particularly in the UK. The Australian Government's apparent hesitancy to back or guarantee a similar scheme is inhibiting the development of an important potential form of finance for our sector.

**We support:** any measures which puts the development of a corporate bond on the Government's agenda.

- Retirement income: Retirement income products

The number of people who retire without an asset base will increase as home ownership remains unaffordable and out of reach for many. Such a scenario will place a greater strain on the Government.

**We support:** the Government implementing or supporting any measures that increase housing affordability during the accumulation phase.

SGCH is keen to work with Governments and support initiatives to achieve better outcomes, particularly in the housing sector. Housing is a vital form of social infrastructure, and a functional society relies on there being enough housing products at every price point to meet the needs of the population.

The Australian housing continuum no longer has housing products at every price point; many households are in housing stress, where they spend over 30% of their income on housing costs. I note that the inquiry is not considering taxation, and in particular negative gearing. Negative gearing adds to the inequity of the current system by interfering in the operation of normal market mechanisms.

I have expanded on each of the items raised in this letter in Appendix A. I would be pleased to discuss the suggestions in this paper with you at any stage.

Yours sincerely

Trevor Wetmore
Chief Financial Officer
Acting Chief Executive Officer
SGCH

# Appendix A

## 1. Funding: Housing and Household Leveraging

**2.57: What measures can be taken to mitigate the effects of developments in the housing market on the financial system and the economy? How might these measures be implemented and what practical issues would need to be considered?**

This section of the Interim Report does not consider the people who cannot access the home ownership market because the costs involved are too high – largely young employed people who cannot afford the necessary deposit and who cannot access the bank products that are currently available (predominantly home loans). As a consequence, these young people are becoming increasingly marginalised as they are forced to move to the suburbs, where rents are lower, but where they are faced with high transport costs, increased travel time and disruption to family life.

A failure to have different bank loan products to encourage shared homeownership and other similar schemes means that homeownership will remain out of reach of the most economically active portion of our population. Over the longer term these young people will not be able to build the same wealth and asset base as previous generations, which will result in them becoming a burden on Government benefits such as the Aged Pension.

To help alleviate these problems, there needs to be other housing products to fill the gap between private rental and private ownership. We believe that the missing segment is shared homeownership schemes and other similar products. We suggest that the creation of this intermediate product could help reduce the high costs of the housing market currently driven by escalating demand.

As people acquire a share of their own home, they will exit the rental market, while investors who own rental stock will find that it is harder to tenant at current rents and will either moderate the rent or exit the asset class. Creation of this intermediate product will help to increase and diversify the participants in the home ownership market, making it more competitive for all.

The shared homeownership product will require a better understanding of concepts such as "tenants in common" and there will need to be clarity on how each party is protected and managed in such an arrangement.

## 2. Funding: Small and medium-sized enterprises

**2.68: What are the prospects for a market for securitised SME loans developing?**

As a not-for-profit SME, we have encountered significant obstacles to raising finance. Loan covenants are onerous and Directors are understandably risk averse because of the consequences of failure. The creation of a securitised market would help SMEs such as SGCH. Given the nature of our asset and the certainty of our cash flows our business lends itself ideally to such a market.

## 3. Funding: Impact investment and social impact bonds

**2.75: No change to current arrangements.**
We don't support this position.

**2.75: Provide guidance to superannuation and philanthropic trustees on impact investment.**
We believe that it should be mandatory for superfunds to receive guidance on social impact investment bonds. Increasing affordable housing supply is in fact a social impact bond. The current lack of affordable housing supply in Australia has significant economic and social implications, and social impact investment bonds could contribute to alleviating this distress.

Superfunds generally pursue higher returns than our sector of the housing market can provide. They are therefore disinterested in establishing funding facilities in our sector. Given that a home is a fundamental aspect of any well-ordered society, it is a surprising position when considered from a social perspective. In our view it does not seem likely to change without Government intervention.

We believe that superfunds should be compelled to invest in social impact investment bonds. This could be achieved by having a small "charge" levied on them. This "charge" would be an investment rather than a charitable contribution and the superfunds would therefore receive a return on their investment. The Committee may consider the levying of a compulsory investment mandate on superfunds is inappropriate, but it should take into account the fact that Australia already taxes employment via the Payroll tax, has established a levy for NDIS and has made similar interventions in the market.

**2.75: Classify a private ancillary fund as a sophisticated or professional investor for the purposes of the exemptions from the prospectus regime if the sponsor of the fund meets either of these thresholds.**
We support any measures that encourage investment in social impact bonds. It appears that private ancillary funds are indeed professional investors.

**2.75: Simplify and streamline disclosure requirements associated with social impact bonds.**
We support simplification of the disclosure requirements, as we support any measures that simplify the process and encourage investment in social impact bonds.

**2.75: Undertake a more active role in expanding impact investment, such as providing risk capital and establishing social investment banks.**

We think that Government should take a more active role in promoting this form of investment. However, we do not think that this promotion should involve active participation in the manner suggested because a change in Government could result in inconsistent policy application.

## 4. Funding: The corporate bond market

**2.91: No change to current arrangements.**
This is not our preferred position.

**2.91: Allow listed issuers (already subject to continuous disclosure requirements) to issue 'vanilla' bonds directly to retail investors without the need for a prospectus.**
We support this suggestion, as we believe that simplification of the process is to be encouraged.

**2.91: Review the size and scale of corporate 'vanilla' bond offerings that can be made without a prospectus where the offering is limited to 20 people in 12 months up to a value of $2 million, or for offers of up to $10 million with an offer information statement.**
We support this suggestion, as we believe that simplification of the process is to be encouraged.

**2.91: As a greater share of the population enters retirement, would the demand for fixed income products increase in the absence of regulation or other incentives?**
We believe this is unlikely, and that there will therefore need to be some form of regulation and incentive to achieve an increase in demand.

**2.91: Would the development of annuity-style retirement income investment products encourage the growth of fixed income markets?**
We believe that it will.

**2.91: Could alternative credit ratings schemes develop in Australia and would this help improve the appetite for bonds, particularly those of growing medium-sized enterprises? Could alternative standards of creditworthiness develop in Australia? What are the barriers to such developments, and what policy adjustments would assist such developments?**
An alternative credit rating system would result in a higher risk rating and consequently the interest rate levied on alternatively rated products would be higher than traditionally rated products. This could make those products economically unviable.

The Interim Report has made it clear that Australia's bond markets are relatively small, shallow and short term. Banks have traditionally serviced corporate lending needs. Enticed by the strong performance of equities and their preferential tax treatment there is an institutionalised bias against fixed-income securities (Deloitte 2012).

The Australian Housing and Urban Research Institute (AHURI) and other interested parties have been engaging in discussions with Governments to understand their appetite for a housing bond or something similar. The latest AHURI report (2014) focuses upon the superannuation industry as a potential source of funding for large scale affordable housing. The report also considers the mechanism for provisioning a Government guarantee, and points out that Government has and does provide specific guarantees to restore confidence to markets and ensure their sustainability. AHURI argues the position of the Productivity Commission – that "guarantees are inefficient by definition" – is not supportable, either in theory or in policy practice.

Governments point out that any form of guarantee for the sector could negatively impact their credit rating because they may be obliged to list the full amount of the guarantee as a liability. An alternative to a guarantee is a fully funded trust. That would at least cap Governments' position. The issues are complex and require further research and consideration by Governments.

## 5. Retirement income: Policy options for consultation

**4.25: Maintain the status quo with improved provision of financial advice and removal of impediments to product development.**
Financial advice would be helpful to prospective retirees provided it was not product-specific with "trailer commissions" attached.

**4.25: Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.**
Based on the information included in the Interim Report, this is a good option.

**4.25: Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).**
The Financial System Inquiry interim report points out that the longevity risk is poorly managed by the existing practices. It appears a significant portion of Australians rely on their property value at the time of retirement to bolster their financial position. For those who don't own a home at retirement, the Aged Pension will be the fall back solution for many retirees. It would be in the Government's interest to recognise this position during the accumulation phase by doing everything in its power to increase the number of participants in the home ownership market. This would hopefully reduce the number of people who retire without a home and therefore reliance on the Aged Pension would be postponed to later in retirement.

## 6. Retirement income: Retirement income products

**4.33: What, if any, regulations impede the development of products to help retirees access the equity in their homes?**

The development of reverse mortgages further entrenches the position of people who are already participants in the homeownership market. It does nothing to increase the number of participants in this market or the quantity of homes.