

EXPLANATORY STATEMENT

Issued by authority of the Treasurer

National Housing Finance and Investment Corporation Act 2018

*National Housing Finance and Investment Corporation Investment Mandate
Direction 2018*

The *National Housing Finance and Investment Corporation Act 2018* (the Act) established the National Housing Finance and Investment Corporation (the NHFIC) to improve housing outcomes for Australians by:

- strengthening efforts to increase the supply of housing;
- encouraging investment in housing, in particular in the social or affordable housing sector;
- providing finance, grants or investments that complement, leverage or support Commonwealth, State or Territory activities that relate to housing; and
- contributing to the development of the scale, efficiency and effectiveness of the community housing sector in Australia.

The objectives will be implemented through the NHFIC's administration of the Affordable Housing Bond Aggregator (AHBA) and the \$1 billion National Housing Infrastructure Facility (NHIF), and by undertaking capacity building activities for registered community housing providers (CHPs).

The NHFIC operates independently of the Government and applies commercial discipline in making financing decisions. The NHFIC acts consistently with its objective to improve housing outcomes while balancing the risks of its operations, including risks to the Commonwealth. Under the NHFIC's corporate model of governance, the NHFIC's independent Board will apply the necessary expertise and commercial rigour needed to assess and make sound financing decisions.

This investment mandate is a mechanism for the Government to direct the NHFIC in relation to the performance of the NHFIC's functions. In administering the NHFIC, the Board is subject to the requirements of the Act and the investment mandate.

The investment mandate is made under section 12 of the Act. Under section 13 of the Act, the investment mandate may direct the NHFIC about its operations in a range of areas, including the NHFIC's:

- strategies and policies that the Board must observe;
- decision making criteria;
- limits on financial assistance; and
- risk and return on investments.

However, the Government may not direct the NHFIC in relation to specific investments or projects.

The investment mandate sets out the details of the NHFIC's core functions (being the AHBA, the NHIF and capacity building activities). The inclusion of these details in the investment mandate provides flexibility to allow the NHFIC's operations to respond to the needs of the community housing sector and other recipients of financial assistance.

Details of the investment mandate are outlined in the Attachment.

Consultation

The Government has undertaken extensive consultation on the design and implementation of the NHFIC, including the development of the investment mandate. Consultation has occurred through:

- the Affordable Housing Working Group established in January 2016 and comprised of certain State and Commonwealth officials, and the Affordable Housing Implementation Taskforce, which was subsequently established and designed a proof of concept for a bond aggregator model;
- a Consultation Paper on the design of the NHFIC (including the operation of the NHIF and the AHBA) released in September 2017, which resulted in written feedback from over 50 stakeholders including State and local governments, registered and unregistered CHPs, property developers, financiers, institutional investors and individuals;
- targeted roundtables over September and October 2017 in each capital city with 120 stakeholder groups, including around 30 CHPs;
- release, in January 2018, of exposure draft legislation to establish the NHFIC;
- release, in February 2018, of an exposure draft investment mandate; and
- the parliamentary debate on the legislation establishing the NHFIC, including an inquiry by the Senate Economics Legislation Committee.

Feedback from each consultation process has informed the drafting of the investment mandate.

Details of the National Housing Finance and Investment Corporation Investment Mandate Direction 2018

Part 1 – Preliminary

Section 1 – Name of the investment mandate

Section 1 provides that the title of the investment mandate is the National Housing Finance and Investment Corporation Investment Mandate Direction 2018.

Section 2 – Commencement

Section 2 provides that the investment mandate commences the day after it is registered.

Section 3 – Authority

Section 3 provides that the investment mandate is made under subsection 12(1) of the *National Housing Finance and Investment Corporation Act 2018* (the Act).

Section 4 – Definitions

Section 4 defines terms that give effect to the National Housing Finance and Investment Corporation's (the NHFIC's) activities and obligations under the investment mandate, including "AHBA", "capacity building contract", "Commercial Financier", "financing decision", "financing proposal", "infrastructure loan, investment or grant", "minimum target value", "NHIF", "Permanent Fund", "project proponent", "special purpose vehicle" and "underlying eligible member".

Section 4 also notes that a number of expressions used in the investment mandate are defined in the Act, such as "Board", "NHFIC" and "registered community housing provider".

Section 5 – Purpose of the investment mandate

Section 5 provides that the purpose of the investment mandate is to give directions to the Board in relation to the performance of the NHFIC's functions as set out in section 8 of the Act.

Part 2 – Activities and allocation of funds

Division 1 – The NHFIC's activities

Under sections 6 and 7 of the investment mandate, the NHFIC is required to establish and operate an Affordable Housing Bond Aggregator (AHBA) and the National Housing Infrastructure Facility (NHIF). These activities are intended to improve housing outcomes for Australians. Details are provided in Parts 3 and 4 of the investment mandate.

The AHBA provides finance to registered community housing providers (CHPs) by aggregating their lending requirements and financing them primarily through the issuance of bonds. The ABHA will build the capacity of the sector and encourage investment to improve housing outcomes by providing registered CHPs with a more efficient source of funds, reducing the refinancing risk faced by registered CHPs and reducing their borrowing costs.

The NHIF assists in financing the critical infrastructure that is needed to accelerate new housing supply, particularly the supply of affordable housing.

In addition to these activities, the NHFIC may provide capacity building services to registered CHPs (in accordance with Part 5 of the investment mandate). This service seeks to develop the financial and management capability of registered CHPs.

The NHFIC may not spend money (including making loans or investments or issuing grants) unless doing so is in accordance with its permitted activities (sections 6 to 8 of the investment mandate) or incidental to those activities. The NHFIC may also make an investment in accordance with section 59 of the *Public Governance, Performance and Accountability Act 2013*. That provision places limits on the investments of corporate Commonwealth entities and generally requires entities to invest money in bank deposits, Australian government securities or investments authorised by the Finance Minister.

Paragraph 9(2)(b) of the Act allows the NHFIC to enter into swaps, foreign exchange agreements, forward rate agreements, options or hedge agreements, and similar arrangements. The investment mandate limits this power to circumstances where the purpose of the agreement or instrument is for the purposes of, or incidental to, the NHFIC's permitted activities (sections 6 to 8 of the investment mandate). This ensures that such instruments or agreements are entered into to manage risk and exposure, and not for purposes of speculation or leveraging.

To the extent that doing so does not conflict with another provision of the investment mandate, the NHFIC must apply commercial discipline when making financing decisions, mindful of the broader context of the NHFIC's objective to improve housing outcomes.

Division 2 – Allocation and repayment of funds – AHBA

The NHFIC will borrow from the Commonwealth funds appropriated by Parliament for the purpose of the AHBA reserve. The Board must allocate amounts borrowed for this purpose to the reserve. Up to \$1 billion may be allocated by the Board.

The reserve must be used to fund loans by the NHFIC to registered CHPs unless the Minister and the Minister for Finance approves an allocation to the reserve for a non-lending purpose (such as for liquidity management).

The reserve is primarily intended to be used to provide a warehouse facility that extends bridging financing to registered CHPs until sufficient scale is achieved to enable a bond issuance. The reserve will also assist the NHFIC to offer a range of AHBA loan products as the bond program matures.

The NHFIC must repay amounts borrowed from the Commonwealth (which must be allocated to the AHBA reserve) plus a margin to reflect the Commonwealth's cost of borrowing. The adjustment to cover the Commonwealth's cost of borrowing ensures the Commonwealth recoups the cost of financing the AHBA reserve.

Where amounts are borrowed by the NHFIC for the purposes of financing an AHBA loan, the NHFIC must repay the Commonwealth no later than six months after the time when repayments under the underlying loan are due to be repaid or a later date approved by the Minister. While the Minister may allow repayment at a later date, there is no ability for the Minister to waive the requirement that the NHFIC repay amounts allocated to the AHBA reserve. That is, the risk associated with AHBA lending activities continue to vest with the NHFIC.

For example, the NHFIC allocates \$1 million to the reserve to finance a seven-year \$1 million loan to a registered CHP. The NHFIC must repay the \$1 million (adjusted for the Commonwealth's cost of borrowing at a fixed interest rate equivalent to the seven-year bond yield on the day of drawdown) within seven years and six months.

When the NHFIC makes a repayment to the Commonwealth, the amount allocated to the reserve is adjusted by the amount of the repayment. This ensures that only outstanding amounts borrowed from the Commonwealth are included in the cap on NHFIC liabilities mentioned in section 34.

Where amounts allocated to the AHBA relate to draw-downs for non-lending purposes, such as liquidity management, the NHFIC must also repay those amounts plus a margin to cover the Commonwealth's cost of borrowing. The timing of repayment and any other terms and conditions applicable to that allocation will be determined by the Minister and Minister for Finance.

Over the medium to long term, the NHFIC must reduce the AHBA's reliance on the Commonwealth such that no more than one third of its total liabilities are to the Commonwealth. The remaining two thirds of the AHBA's capital requirements are to be sourced from issuing bonds in the private sector. By 30 June 2019, the NHFIC must develop a business plan to satisfy this funding requirement and provide a copy of the plan to the Minister.

Over the long term, the Board must consider recommending the payment of a dividend to the Government under section 49 of the Act if the AHBA substantially exceeds its benchmark rate of return (see Part 3, section 20).

Division 3 – Allocation and maintenance of funds – NHIF and capacity building

Division 3 directs the NHFIC in relation to the allocation of funding appropriated by the Parliament for the purposes of the NHIF.

The Government has allocated \$1 billion to the NHIF for the NHFIC to make loans, investments and grants to facilitate the construction of housing-enabling critical infrastructure. This funding is provided by appropriations made through the Budget process.

The NHFIC may also undertake capacity building activities for registered CHPs, funded through the allocation for the NHIF.

A cap of \$175 million applies to the total amount of money the NHFIC can provide in the form of grants and capacity building activities. Of the \$175 million, the NHFIC may allocate up to \$1.5 million to capacity building activities.

The NHFIC must establish a permanent fund for the purposes of loans and investments made under the NHIF. The permanent fund includes:

- the value of the NHFIC's current infrastructure loans and investments under the NHIF;
- undrawn amounts allocated to the NHFIC for the purpose of making infrastructure loans and investments through the NHIF, and the operating costs of the NHIF; and
- returns on loans and investments.

Over the medium to long term, the Board must seek to maintain the real value of the amounts allocated to the permanent fund. It does so by maintaining a minimum target value of the fund. The minimum target value at a particular time is the sum of the amounts allocated to the permanent fund adjusted to cover the Commonwealth's cost of borrowing.

The adjustment to cover the Commonwealth's cost of borrowing ensures the permanent fund is maintained in real, rather than nominal, terms. The same approach is taken in respect of the target rate of return in the Investment Mandate for the Northern Australia Infrastructure Facility. The term 'Commonwealth's cost of borrowing' is generally understood to refer to:

- for fixed rate loans — traded yields on Australian Government nominal securities having regard to the average term to maturity of the loan; or
- for floating rate loans — a market benchmark which reflects the Commonwealth's cost of borrowing, such as yields on short-term Australian Government securities or the Reserve Bank of Australia's open market operations repo rate, having regard to the reset frequency of the loan; or
- for other investments — the 10-year yield on an Australian Government nominal security.

Maintaining a minimum target value requires the Board to consider the aggregate return from all NHIF loans and investments, rather than requiring the Board to meet a specific rate of return for all financing decisions. This approach provides the Board with appropriate flexibility in determining the rate of return required for individual financing decisions and the level of concessions provided for particular projects.

The NHFIC is not required to recoup the value of infrastructure grants made under the NHFIC or the value of capacity building activities (although these are subject to the \$175 million and \$1.5 million caps described above).

Part 3 – The Affordable Housing Bond Aggregator

The NHFIC can provide loans through the AHBA only to registered CHPs. CHPs are registered with State and Territory governments and undertake a range of activities, including delivering social or affordable housing and associated services to people on very low, low or moderate incomes. In some cases, CHPs may manage public housing on behalf of governments. CHPs may also own their own stock of housing, which they offer to tenants with modest incomes at below-market rents.

The NHFIC may specify eligibility criteria that registered CHPs (or classes of registered CHPs) must satisfy.

The NHFIC must aim to provide AHBA loans to registered CHPs at the lowest cost and most appropriate tenor, subject to NHFIC recovering operational and financing costs and building capital reserves as required by the Act. A bond aggregator works by sourcing finance in the debt market and on-lending funds to a number of different borrowers for different projects or purposes. Aggregating the funding needs of a number of borrowers into larger debt issuances allows funding to be raised at a lower cost. While the NHFIC seeks to build this new asset class, the Government has provided the NHFIC with the ability to borrow from the Commonwealth to finance some of its lending.

In the case of the AHBA, the NHFIC is supported by a government guarantee (under section 51 of the Act) that further reduces the NHFIC's borrowing costs. Attracting finance through the AHBA in this way will allow registered CHPs to access more affordable finance on more appropriate terms, and will support the expansion of Australia's affordable housing stock.

The aims of the AHBA do not preclude finance being provided to a registered CHP that undertakes 'for profit' activities, provided profits derived ultimately support social and affordable housing outcomes, consistent with State and Territory CHP regulatory requirements. This principle applies in the case of mixed tenure developments – projects involving a combination of affordable housing and other housing. The NHFIC may provide loans to finance mixed tenure developments. However the NHFIC must be satisfied that any profits from the mixed tenure development will be applied to support affordable housing outcomes.

The Board is empowered and encouraged to offer a range of loan products, including construction finance, to meet the varying needs of registered CHP applicants. However, the NHFIC may only provide finance to registered CHPs in the form of secured loans. The NHFIC is required to take an appropriate level of security for its loans, having regard to the potential exposure of the NHFIC and the Commonwealth in the event of a default. The NHFIC will need to consider a range of factors in deciding what security is appropriate on a case by case basis, including the quality and type of any security available from the registered CHP.

In making financing decisions, the NHFIC is required to apply commercial discipline, build and maintain adequate capital reserves, achieve a benchmark rate of return and manage its risks. This supports the NHFIC's functions being performed in an efficient, effective and appropriate manner.

The Board must consider a number of matters when making a financing decision under the AHBA, including in setting the conditions of a loan. These include: the purpose for which the loan is sought and the extent to which that purpose supports affordable housing outcomes; the credit-worthiness of the registered CHP applicant; the extent and likelihood of a return on any loan; and the associated financing cost. In addition, the Board must have regard to: the objects and limits of the Act; the availability and terms of any private sector finance to the registered CHP; the quality of available security; and whether the loan would complement other sources of government finance.

Under section 48 of the Act, the Board must aim to maintain adequate capital reserves over the medium to long term. This needs to be reflected in the benchmark rate of return for AHBA loans; that is, the Board must target an average rate of return that covers its financing and operating costs and allows it to build and maintain an adequate capital reserve. The benchmark rate of return is a minimum target for the purposes of building adequate capital reserves. If the NHFIC's returns substantially exceed the benchmark, the Board may recommend paying a dividend to the Commonwealth.

In targeting the benchmark return, the NHFIC must seek to develop a portfolio that in aggregate has an acceptable but not excessive level of risk, having regard to the objects of the AHBA and the Act. The NHFIC should not assume a greater level of risk than is required for it to carry out its functions and satisfy the requirements of the Act and the investment mandate. In particular, the NHFIC's lending decisions and capital reserve should enable it to adequately manage any risk that the NHFIC will be unable to meet its liabilities, thereby mitigating the risk that the Commonwealth's guarantee under section 51 of the Act might be called on.

Within six months of the commencement of the investment mandate, the Board must agree an investment risk evaluation process to assess the risks associated with the AHBA, and must advise the Minister of this process.

Part 4 – The National Housing Infrastructure Facility

The NHFIC, via the NHIF, may provide finance in the form of loans, equity investments and grants for eligible critical infrastructure projects that support new housing developments. Examples of critical housing-enabling infrastructure include (but are not limited to):

- new or upgraded infrastructure for services such as water, sewerage, electricity, telecommunications, stormwater or transportation; and
- site remediation works including the removal of hazardous waste or contamination.

The NHIF will support critical infrastructure projects linked to new housing supply whether on the site or connecting to or linking to infrastructure. The NHIF will do this by offering innovative financing options such as equity investments and blended finance tailored to the needs of projects. Equity investments involve the NHFIC acquiring an equity interest in a project proponent. Blended finance refers both to the potential for project finance to be provided through any combination of NHIF loans,

grants and investments, and the potential for NHIF financing to be structured to complement funding from a consortium of other government or non-government entities. Applications for grant funding will be preferred if made in conjunction with an application for other NHIF financing.

NHIF financing is not limited to infrastructure that would support new affordable housing. While the impact on the supply and retention of affordable housing is an important consideration that the NHFIC must take into account in deciding whether or not to provide finance for a particular project, projects which would increase the supply of housing generally may also attract NHIF infrastructure finance. This could include funding for infrastructure that supports the construction of mixed housing developments (which offer accommodation for people with a range of income levels).

The NHIF will not finance housing directly nor will it finance community infrastructure such as parks or libraries.

The NHIF may only be used to finance projects that can demonstrate ‘additionality’. Additionality in this context refers to projects that would be unlikely to proceed, or would only proceed at a later time, without NHIF assistance, and the extent to which NHIF assistance would accelerate or increase affordable housing supply. It is anticipated that NHIF finance would not be provided for feasibility, scoping or planning studies that may lead to the later construction of infrastructure, as such studies would be expected to be undertaken before an application is made for NHIF finance, to assist in demonstrating additionality.

The NHFIC may provide NHIF finance to a:

- State or Territory, including a State or Territory agency representing the State or Territory such as a government owned development corporation or utility provider;
- local government body or local government owned investment corporation or utility provider;
- State government owned utility provider that is a constitutional corporation (but not necessarily an emanation of the State);
- Territory government owned utility provider (that is not necessarily an emanation of the Territory); or
- registered CHP.

The NHFIC may also provide finance to a special purpose vehicle (SPV) that has a purpose of undertaking housing-enabling infrastructure projects and has at least one member that is an eligible recipient listed above (the underlying eligible member or members). In this context, an underlying eligible member is an entity that has an ownership or participation interest in the SPV (for example, a shareholder if the SPV is a company or a partner if it is a partnership).

In considering whether to provide finance to an SPV, the NHFIC must consider the extent to which the underlying eligible member or members of the SPV expects to be involved in the proposed project over its duration. In this context, involvement has a

broad meaning. The Board should have regard to the extent of the member's or members' financial involvement, their level of oversight and control, their ability (if any) to appoint directors to the SPV's board, the level of finance they are providing to the project and their role in managing the delivery of the project. None of these types of involvement are determinative, and it is not necessary for the underlying eligible member or members to have financial or management control of the SPV. The NHFIC Board must make financing decisions based on a holistic assessment of all prescribed matters and the proposal.

For example, while it is not necessary for the members to have the ability to control the appointment of directors, the NHFIC Board may consider certain levels of involvement as too low for particular proposals to be approved for NHIF finance. In addition, it is expected that an underlying eligible member of an SPV not sell or otherwise relinquish their interest in the SPV during the life of the project. The Board may address this through the conditions it sets for financing arrangements.

The NHFIC may tailor its concessional loans to suit the needs of project proponents. Tailoring of loans may include (but will not be limited to) a range of concessions, including longer loan tenors and lower interest rates than offered by commercial financiers, and repayment holidays. The NHFIC must limit any concessions provided under the NHIF to the minimum that it considers necessary for an eligible project to proceed or be completed in the proposed timeframe. The NHIF should not provide greater concessions than the NHFIC considers necessary, and this may be reflected in the terms of the contract. The NHFIC will also need to take into account the extent of any public benefit from the housing-enabling infrastructure and the objects of the Act in determining the extent of the concession.

The Board must consider a number of matters in making a financing decision. It must be satisfied that the project proponent and project are eligible under the investment mandate and that the risk of default on a loan does not exceed an acceptable level. The Board must also have regard to matters including: the credit-worthiness of the project proponent; the extent of the concession that is appropriate; the likely effect of a project on the supply and longer term retention of affordable housing; and the quality of the security available from the applicant. In addition, the Board must have regard to the objects and limits of the Act and must consider whether NHIF finance would complement other sources of government finance or activities and whether it would encourage private sector investment in the project.

The NHFIC is required to take appropriate security for its loans, having regard to the potential exposure of the Commonwealth and the NHFIC in the event of a default. State and Territory applicants are not required to provide security. For other applicants, the NHFIC will need to consider a range of factors in deciding what level of security is appropriate, including the quality and type of any security available from the project proponent.

In making financing decisions in relation to the NHIF, the NHFIC is required to apply commercial discipline, achieve a benchmark rate of return and manage its risks.

As described above, the NHFIC must maintain the value of its infrastructure loans and investments over the medium to long term in line with the minimum target value of the NHFIC's permanent fund. The Board has flexibility in determining the expected

rate of return in relation to any particular financing decision; however the Board must ensure that, in aggregate over the medium to long term, the return on NHIF loans and investments is sufficient to cover the NHIF's financing and operating costs, build and maintain adequate capital reserves, and cover the Government's borrowing costs. The Commonwealth's cost of borrowing is described above in the context of the permanent fund.

In targeting the benchmark return for the NHIF, the NHFIC must seek to develop a portfolio that in aggregate has an acceptable but not excessive level of risk, having regard to the objects of the NHIF and the Act. Within six months of the commencement of the investment mandate, the NHFIC Board must agree an investment risk evaluation process to assess the risks associated with the NHIF, and must advise the Minister of this process.

The NHFIC will work in partnership with local, State and Territory governments and registered CHPs to support housing-enabling infrastructure projects under the NHIF.

Part 5 – Capacity building activities

The NHFIC may fund capacity building services for registered CHPs. Through this pilot program, NHFIC can assist registered CHPs to develop their financial and management capability and undertake new developments. A cap of \$1.5 million applies to the amount the NHFIC can spend on capacity building activities.

The NHFIC will fund the provision of any capacity building services. For example, the NHFIC may procure these services from providers such as the Government's AusIndustry service.

The Board may develop guidelines regarding the operation of any capacity building service, including eligibility criteria.

Part 6 – Governance

Section 30 – Reasons for decisions

Section 30 provides that, where it is practicable to do so, the NHFIC should communicate its reasons for making a particular decision to provide finance, or to not provide finance, to the entity that made the related financing proposal.

While this provision does not require the NHFIC to provide such reasons in all circumstances, it nevertheless makes clear the expectation that the NHFIC will, as a matter of good practice, provide applicants with information about its decisions.

Circumstances in which the NHFIC may not provide such reasons include where the information is commercial-in-confidence or places at risk its relationship with third party financiers who have provided commercially sensitive information to the NHFIC.

Section 31 – Good corporate citizenship

Section 31 provides that the NHFIC must have regard to Australian best practice principles of corporate governance relevant to its role. In particular, the Board must develop and annually review policies regarding environmental, social and governance issues.

The NHFIC must also ensure as far as practicable that financing decisions are made in a timely way. This requires the NHFIC to balance its obligations under the Act and the investment mandate to make informed decisions against the costs to the project proponent. The NHFIC should not take longer than is necessary to make financing decisions.

Section 32 – Transparency of NHIF operations

Section 32 provides that the NHFIC must publish guidance on its website to assist potential applicants to lodge AHBA loan applications and NHIF financing proposals and to ensure the NHFIC's decision-making process is transparent.

Section 32 also requires the NHFIC to publish details of each decision to make a grant, loan or investment under the NHIF within six months of the decision. This requirement is subject to the NHFIC's obligation to maintain the confidentiality of commercially sensitive information.

Section 33 – Reputation

Section 33 provides that the NHFIC must not cause damage to the Australian Government's reputation, including its reputation in financial markets both locally and overseas.

Section 34 – Approval required if liabilities will exceed \$2 billion

A cap of \$2 billion applies to the amount of government-guaranteed liabilities that the NHFIC may incur and allocated to the AHBA reserve. The NHFIC may not incur guaranteed liabilities or allocate amounts to the reserve in excess of the cap unless the Minister and the Minister for Finance approve a higher cap.

The cap is an obligation on the NHFIC and does not operate to directly limit the effect of the government guarantee. If the NHFIC breached the cap without ministerial approval, the debt issued in excess of the cap would still be subject to the guarantee.

Section 35 – Five-year restriction on offshore borrowing

The NHFIC may borrow funds from the market, including by way of issuing bonds. Section 35 restricts the NHFIC's borrowing powers to prevent it from issuing bonds in an offshore market until 1 July 2023 as the initial priority of the NHFIC should be to build a new asset class in Australia. From 1 July 2023, the NHFIC may also issue bonds in offshore markets.