

Safe as houses

An alternative delivery model for social and affordable housing in Australia



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Over the next 20 years Australia will need to accommodate a further 6.5 million¹ residents. With population growth set to occur almost exclusively in the developing fringe of metropolitan areas and capital cities the pressure on available development sites will continue to force house values up and affordability down to an all time low.

Despite Government initiatives aimed at assisting first home buyers, the growing gap between average earnings and house prices continues to restrict potential homebuyers from getting their foot on the property ladder. Consequently, the demand for social and affordable housing continues to grow, raising the question of how this demand can be met in a low cost and sustainable way.

An opportunity exists for developers and charities to come together, combining their expertise through Property Development Agreements (PDAs) to deliver quality, affordable housing.

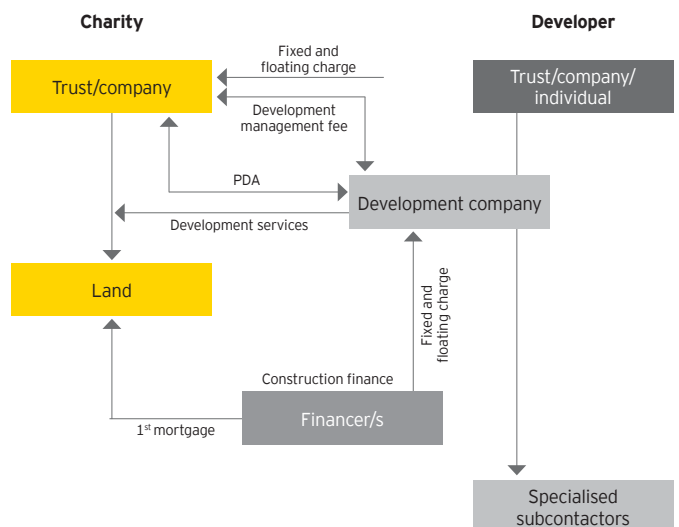
A model for success

PDAs enable developers to provide specialised services to charities that own development sites, for an agreed fee, without having an ownership interest in the project. This type of arrangement reduces the risk from the project from a charity's point of view, while ensuring a secure and consistent income return to the developer. At the same time, the charity benefits from the development, project management and construction services of the developer without losing the available charitable tax benefits that enable the housing to be provided at low cost.

In cases where a portion of the project is sold to market, the developer may enter into a loan agreement with the charity to help finance the project. This means the developer will provide a loan that will be repaid from the "lender's development profit share" – an agreed percentage of any development profit arising from the project².

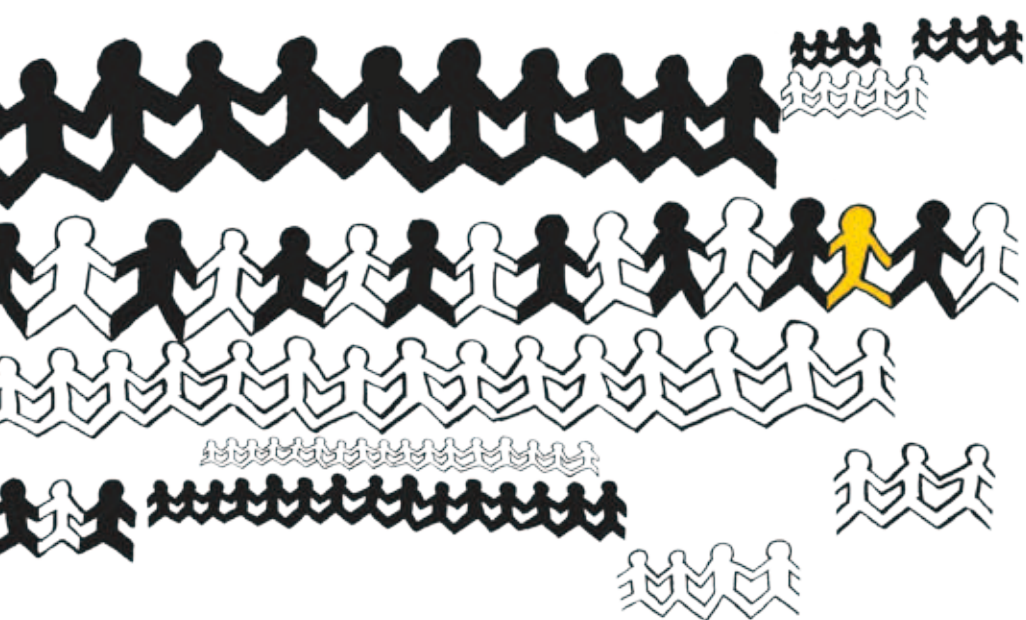
The diagram below illustrates a typical structure of this type of agreement.

Figure 1: Typical project structure



¹ Department of Health Australia, Statistical Local Area population Projections, 2007 to 2027, <http://www.health.gov.au>

² This type of agreement can occur where the charity is selling a portion of the development to the market and resulting in a Development Profit i.e., Retirement Village



Alternative income stream for developers

Developers have historically not participated in the social and affordable housing sector due to the low commercial returns available and the preconceived risk associated with low income and welfare tenants. However some developers, with the aim of expanding their revenue base, have started to offer development and project management services based on a fixed percentage of total revenue or costs.

PDA's with charities for the development of social and affordable housing enable developers to generate a safe "fee for service" income on a relatively low risk project. While the revenue may be less than typically desired from standard commercial projects, the reduced planning, market, settlement and finance risks provide a worthwhile trade-off.

A wealth of expertise for charities

More charitable organisations are beginning to take on responsibility for social and affordable housing development, signalling a shift away from what was once a predominantly government area. However limited funds and a lack of in-house development skills and the experience required to build thousands of new homes, can often present problems. Having a developer on board will of course increase costs, but not dramatically, and the reduced risk means it can be an attractive investment.

Does it all add up?

The table on page 3 models a number of ownership and development structures for the construction of an affordable housing project.

Model 1 – assumes the project is constructed and sold by the private sector. The end cost to the purchaser or tenant is significantly higher due to the profit required to make this project commercially viable for a developer.

Model 2 – assumes the project is constructed, owned and operated by the charity. The end cost to the purchaser or tenant is low but there are likely to be significant delivery risks involved due to the lack of in-house development skills and experience within charitable organisations.

Model 3 – assumes the project is constructed under a PDA structure with the charity retaining ownership of the land and the developer contributing services for an agreed fee. The end cost to the tenant is marginally higher than Model 2 however the skills and experience contributed by a developer substantially reduce the overall project delivery risk.

Table 1: Comparative analysis

Costs and revenues	Model 1 Developer 78 apartments	Model 2 Charity 78 apartments	Model 3 PDA agreement 78 apartments
Revenue			
Gross sales revenue	37,230,000	N/a	N/a
Less selling costs	-961,950	N/a	N/a
Less GST paid	-3,384,545	N/a	N/a
Total revenue (after GST paid)	32,883,505	N/a	N/a
Costs			
Land costs	2,370,000	2,370,000	2,370,000
Land transaction costs Inc. SD	180,220	50,000 ³	50,000
Construction (inc. contingency)	22,124,249	22,477,712	21,565,799
Professional fees	1,112,642	1,180,080	1,200,337
Development/project management fees (6% of costs)	N/a	N/a	1,741,716
Project contingency	N/a	1,123,886	699,225
Land holding costs	128,588	N/a	N/a
Interest expense	1,922,855	1,390,413	1,408,788
Total costs (GST Exclusive)	27,838,554	28,592,091	29,035,865
Value/cost per unit	\$477,308	\$366,565	\$372,161
Average weekly rent @ 6.0% yield	\$551	\$423	\$429
Net development profit	\$5.04m	Nil	Nil
Development margin	17.50%	N/a	N/a

Model 1

- ▶ We have assumed a standard commercial development with the developer required to purchase the site and sell apartments on completion of construction
- ▶ The value of \$37.2m represents the cost to the charity if the properties were purchased on market and the GST Margin Scheme is not applicable

Model assumptions – Options 2 and 3

- ▶ We have assumed the land is purchased/owned outright by the charity and therefore attracts no interest costs. This is generally the case as charities are often gifted the site, have owned the site for many years or have a government grant to purchase the site
- ▶ While the units have the same “value” as Model 1 we have calculated the average rental based on the total cost rather than the end value
- ▶ No transaction costs (Stamp Duty) as the land does not change ownership
- ▶ Higher Construction Contingency and Project Contingency allowances
- ▶ We have assumed rates and land tax are not payable due to the charitable status of the entity
- ▶ We have assumed GST is not payable on revenues as the charity does not intend to sell the property within five years of construction
- ▶ We have assumed GST can be claimed on construction costs due to the charity making a GST free supply of accommodation
- ▶ The charity is required to secure construction finance and may use the site as equity or use their balance sheet to support funding

Model 3

- ▶ The service provider takes a development management⁴ and project management⁵ fee based on gross revenue
- ▶ With the introduction of an experienced Service Provider we have reduced the project contingency to 3.0% and the construction contingency to 5.0%

³ Comprises valuation costs and legal advice

⁴ Development Management services including the design and planning approval process for the Project including but not limited to the preparation, review, recommendation and co-ordination of all work required to deliver a commercially viable planning permit

⁵ Provide appropriate qualified and experienced personnel with the required skill, knowledge and judgement to manage the construction works. Take all reasonable steps to ensure that the works are constructed in accordance with the terms of the deed and consult with and manage the builder.

Building in partnership

The benefits of the PDA model are clear from a financial and risk perspective. However in order for the charity to have access to the tax concessions considered as part of Model 3 it is important for the relationship between developer and charity to be set out appropriately. The two parties must operate independently of one another with no income earned jointly. There are a number of GST, stamp duty and land tax concessions that can apply to charities and which are an essential element to achieving the low costs that have been demonstrated. Tax concessions will vary from project to project depending on the circumstance and the location of the development. It is essential to seek advice on the exemptions available and ensure the PDA is set out in way that will allow the charity to make the necessary cost savings.

Creating homes for the future

As state governments continue to review and re-evaluate their role in the building, managing and maintenance of social and affordable housing, we are seeing an increased need for charities and developers to step up and play a part. PDAs are a beneficial way forward, providing advantages to all parties involved. Charities reap the benefits of having specialist development expertise onboard and developers have access to an alternate asset class creating a new and consistent income stream. However, most importantly, through the collaboration of charities and developers and the increased use of PDAs, more Australian people will have access to affordable homes.

How can we help?

Our Real Estate Advisory Services group has experience working with private developers and not-for-profit organisations focused specifically on the provision of social and affordable housing. Our staff are highly adept in real estate market research, valuation and project feasibility analysis in addition to the structuring of joint venture agreements and the associated financial modelling, specifically for property development projects.

We also possess expertise in conducting industry benchmarking and independent fee certification, having provided extensive advice around the fee arrangements between related parties.

Our taxation professionals possess a high level of knowledge and expertise in relation to the tax issues relevant to property development projects including the impacts of specific partnership development agreements.

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