By ***Nina Hendy***

Innovative developers in Melbourne, Australia, are exploring new funding models to provide quality housing at less than market build prices, with financial institutions ready to follow.

New money mavens

Can architects, developers and would-be homeowners successfully challenge financial institutions to think differently about lending? Less than a decade ago, it's likely the answer would have been a firm "no".

But if you scratch the surface, there are now a handful of innovative and profitable approaches in the market, with many large financial institutions and would-be homebuyers paying close attention.

In Australia, a grassroots movement to explore alternative funding and business models for developments and residential housing is gaining momentum, as an entrepreneurial lens is applied to the increasingly complex problem of housing unaffordability.

Melbourne has become the home of alternative development innovation in Australia, thanks to cheaper land prices (compared to Sydney) allowing more flexibility in the way projects are priced and sold. Three innovative developers – Nightingale Housing, Assemble Communities, and Property Collectives – are leading the way.

Driven by the goal of addressing wealth inequality and housing unaffordability, these developers reject traditional models to bring high quality builds, sustainability and social connection to homeowners, for less.

Offering aesthetically pleasing apartments that consider outlook and design, and creating shared spaces that help establish a sense of community, they are a world away from the low-cost high-rises that were erected for social housing in Melbourne in the 1960s and '70s, and are now largely considered inner-city eyesores.

These developers share a vision far grander than simply putting a roof over someone's head. By looking at new ways to bring homes to market for less, these out-of-the-box thinkers deviate from the well-worn route of home ownership, each forging their own path to help would-be homeowners get a foot in the door.

While their projects are currently small in scale, there is clear potential for these ideas to be embraced more broadly by potential buyers, investors and builders across Australia.

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NIGHTINGALE HOUSING

Nightingale Housing started when a group of Melbourne architects came together in 2014 to create a peer-to-peer lending model, with each architect contributing AU$100,000 towards an AU$3 million equity pool.

Nightingale founder and board member Jeremy McLeod was moved to do something about home unaffordability after grappling with the fact that in Australia – the third richest country in the OECD – more than 116,000 people experience homelessness every night[1].

"It's hard to reconcile how we can live in one of the most developed, privileged, wealthy nations in the world, and yet have such housing disparity," McLeod says. "You would expect a civilised society to take responsibility for housing its people rather than leaving it to the market. Finland[2], for example, has no homeless because the state ensures all of its residents are housed."

Nightingale, he says, set out to tackle the problem by revolutionising the way we live together – and inverting the traditional profit-maximising development model.

Unlike conventional commercial apartment developers, Nightingale entered the market with a 'capped-profit' model – aiming to deliver quality housing for little more than the costs of procurement, design, management and construction, and with no estate agents or marketing firms involved.

So far, it has been a winning concept in the marketplace, with five Nightingale projects completed across Melbourne, and a further 11 under construction across Victoria. Projects in Western Australia, South Australia and New South Wales are also underway. A further 16 communities are in planning.

Placemaking is a key part of each Nightingale project. Community-focused businesses and services such as cafes and small street-facing offices are a feature of every ground floor. Cycling is given priority in every building, with ground floor bike parking and maintenance facilities contributing to the life of the spaces by providing organic opportunities for neighbours to interact. Car spaces, by contrast, are limited.

In a cul de sac between two Nightingale projects in the inner northern suburb of Brunswick, planter boxes and seating offer another place to relax and encourage community interaction. Residents share community rooftop gardens and laundry facilities. For buyers, this approach to residential communities is as appealing as the unique investment and building process.

Establishing Nightingale wasn't easy. Initially, banks didn't want to lend to an architect running a project with a capped-profit model, and without a proven track record or a big balance sheet.

Without directors' guarantees, Nightingale's first project struggled to secure the AU$6 million in funds it needed to build 20 apartments. But they pushed on, and Nightingale delivered the building for nine per cent under market value. All the apartments were sold in a single day via a ballot process.

"The interesting thing about that equity position was that it talked about a capped return. Any upside beyond the 15 per cent was given back to the project, but any downside would be worn solely by the equity investors," McLeod says.

Lessons gained along the way were shared, and Nightingale Housing gained momentum. Before long, some high-net-worth individuals, impact investors and social ventures had thrown their hats in the ring to fund subsequent developments.

Due to high public demand for Nightingale projects, prospective purchasers are required to enter a ballot to secure the right to buy an apartment. The process starts with successful applicants paying an initial Commitment Fee of AU$10,000, which forms part of the deposit and is held in trust.

Every project promises to get buyers in the front door for as little as AU$275,000 for a studio, or AU$400,000 for a one-bedroom apartment in metropolitan Melbourne, or from AU$330,00 in regional Victoria. Two and three-bedroom apartments are also available.

"There's absolutely reduced risk, as you've got 100 per cent guaranteed sales due to the ballot system applied to each build," McLeod says. "We've worked incredibly closely with a couple of key banking partners and impact investors to fine tune the delivery process to reduce risk, increase certainty, and thus reduce the cost of capital and therefore the cost of housing. Our banking partners have been the key to our scale and sustainable growth," he says.

In 2018, the Australian Institute of Architects awarded Nightingale its national awards for housing and for sustainability.

But, as explained later, it hasn't all been smooth sailing for Nightingale, which had to concede in 2021 that its model needed to change to be scalable.

PROPERTY COLLECTIVES

Property Collectives emerged in Melbourne in 2010 with a 'participatory building group' model, pooling the finances of like-minded people to fund group housing developments. Each participant receives a home customised to their individual needs at cost price.

As the development manager, Property Collectives facilitates the development process, with participants avoiding sales, marketing and transaction costs when they buy off the plan. These savings are typically around 15 per cent of the cost of a new home.

Having started out with a network of family and friends, Property Collectives now provides a framework and process for other people wanting to take control of their housing options and create higher quality living spaces at cost price.

Founder and development director Tim Riley first came across the model in 2006 when working in a similar joint venture residential project. "I could see it was quite a good way of doing it because you're sharing the wholesale cost," he says.

After a financial assessment of interested parties, each participant pays a membership fee of less than AU$2000 to fund the first phase for feasibility assessments and architects. So far, 10 Property Collectives projects have been successfully brought to market.

Initial projects in St Kilda, Thornbury and Northcote were hugely successful. Projects in Brunswick, Brunswick West, Eltham, North Melbourne, and West Melbourne are on track to hit targets.

"Typically we start the project with around one third to half of the number of households on board, and then once a site is secured, we fill the project up with a mix of friends, family and connections to the resident group, and people from our database," Riley says.

It is through this approach that members are enabled to internalise development profits and avoid paying sales, marketing and transaction costs.

The financing model, while novel for Australia, is more common in northern Europe, including parts of Germany where the word baugruppen (building group) is used to describe the process of rallying groups of citizens to build in this way.

Riley says it's been "a bit of a journey" trying to get Australian banks involved. "Even in the early stages, it was about finding the right business banker who gets it, and is motivated to fund it, because it is quite different," he says. >

1 https://www.abs.gov.au/statistics/people/housing/census-population-and-housing-estimating-homelessness/2016

2 https://www.theguardian.com/cities/2019/jun/03/its-a-miracle-helsinkis-radical-solution-to-homelessness

> *"Australia needs to build more social, affordable and sustainable housing close to jobs, services and amenities if it wants to foster socially cohesive cities in the future."*
>
> ***National Australia Bank***

He says dwelling costs for recent projects have varied from around AU$1 million to AU$1.3 million, while forecast end values are between AU$1.1 million and AU$1.5 million.

"Because of the scale of the projects and financing model to date, it hasn't been terribly affordable or accessible to most people. However, we are working on that," says Riley. "Our latest project in Eltham is a 20-plus co-housing project and we're aiming to deliver these homes at an average cost of AU$825,000 and average value of AU$950,000. Because of the larger scale of this project, we're able to deliver more affordable homes.

"We run all the projects to try and achieve a 15 per cent saving to the market value of the dwelling, and we do that to ensure that from a finance perspective, by the time we go for our construction finance, the bank is willing to give us the biggest development loan possible, and they're not having to ask the members to put in extra equity," he says.

Riley has close to 3000 potentially interested buyers on his database. "We don't have a wait list as such, as our projects get initiated by a future resident group," he says.

ASSEMBLE COMMUNITIES

Assemble Communities was formed in 2010 when a group of housing industry professionals and experts – frustrated by what they saw as an absence of well-designed housing – pooled their skills with a goal to build well-designed and socially responsible homes.

The team of 45 experts in property, construction, finance, investment, architecture, urban design and community asset operation formed an ambitious plan to help build a better, fairer housing system. The premise was simple: every Australian deserves access to an affordable, well-designed home, and everyone deserves a community to come home to.

They called their initial housing model Assemble Futures – an alternative pathway to home ownership that enabled residents to rent securely for five years, with the option to buy at the end of the lease period. As part of the model, all residents were also provided with free financial coaching.

More than a decade later, after a series of successful developments, the concept continues to evolve and grow. In 2021, Assemble Communities paid AU$30 million for a site in Kensington, in Melbourne's inner west, with plans for a 370-apartment build-to-rent community, including at least 20 per cent of the units dedicated to social housing. The project, at 402 Macaulay Road, represents an ambitious plan to create more affordable housing for low and middle-income households.

GLOBAL INNOVATION

An alternative funding model rated by those interviewed for this story is the peer-to-peer Small Change[3] movement, started by architect and developer Eve Picker.

Small Change describes itself as a real estate investment crowdfunding platform that allows "everyday people to invest in real estate projects that change cities and neighbourhoods for the better". Small Change matches investors with developers raising funds for transformative real estate projects. Developers need to meet the eligibility criteria, and their project must score at least 60 per cent on the 'Small Change Index', which considers qualities such as an area's walk- and bike-ability, public transit access, proximity to green space, availability of commercial and cultural amenities, and other measures of quality of life to gauge the possibilities of a project.

As an intermediary, Small Change doesn't guarantee any particular outcome and doesn't take responsibility for what happens to investments, which are undertaken at the investors' risk.

The site explains: "Our job is to facilitate investments and help ensure that transactions between investors and issuers meet legal requirements."

It allows developers to raise up to GBP5 million from accredited investors annually, while unaccredited investors can invest a percentage of their income or net worth, capped at GBP107,000 per year.

Another UK innovator is Censeo Financial, a specialist affordable housing mortgage provider that works with more than a dozen affordable housing providers, and a range of lenders, to offer a variety of ways for would-be homeowners to enter the market. This includes government backed 'Help To Buy' schemes, shared equity, shared ownership and 'staircasing', a mix of ownership and renting where you work towards owning a 100 per cent share of your home and paying no rent. One of Censeo's housing partners is Pocket Living, which has built more than 1000 homes for eligible first-time buyers in London for at least 20 per cent less than the market value.

In the US, the Incremental Development Alliance[4] has created an alternative approach to helping communities revitalise declining neighbourhoods, putting power in the hands of micro-developers. The website explains: "So much of the real estate industry is extractive, where far-away investors mine the value from properties that line our streets. We are working toward a more generative real estate model, where local people can invest in their own neighbourhoods and in that process, create new life and value that benefits their community. The kind of places we want to live in are built and maintained by people who really love them."

The Incremental Development Alliance offers workshops, tools and mentorships to local would-be developers wanting to make an impact. It's one of a number of small-scale initiatives in the US aimed at encouraging investment that helps build and unite communities[5].

ARE THESE PROJECTS HAVING AN IMPACT?

While the Australian alternative models remain a niche area, there's compelling evidence these projects are making a mark on the property sector nationally. Their wider impact has been supported by the efforts of people behind the projects spending countless hours educating financiers and banks about alternative funding models over the past decade or so.

Riley says: "It's taken a long time to establish those relationships despite the fact our community-led building groups are inherently a much less risky model because the banks have much more visibility of who's involved in the transaction, and more security.

"As our model doesn't neatly fit the typical speculative model boxes, it requires more work from the lender. Being approved often depends on the business banker, what else they've got on, or the credit team and their policies at the time," Riley says.

However, the big banks are now sitting up and taking notice, in some cases even building teams to work directly with alternative housing projects to develop products to get these projects off the ground.

Property Collectives has received funding from Commonwealth Bank, Bank of Melbourne and Bank Australia. ANZ has backed Assemble, and National Australia Bank (NAB) has stuck close to Nightingale. >

3 https://www.smallchange.co

4 https://www.incrementaldevelopment.org

5 https://reasonstobecheerful.world/the-city-owned-by-locals

"The reason (affordable housing developments) don't happen more is not, in essence, about whether they're viable or not. Given the right support, there could be a lot more."

Dr Laurence Troy
Australian Housing and Urban Institute

CBA says it supports other alternative models that make it easier for aspiring buyers to get on the property ladder, including emerging rent-to-buy initiatives.

NAB has set up a Social Impact Team to focus on affordable housing. Between 2020 and 2022, the bank provided AU$1.8 billion in finance for affordable and specialist housing options, including the First Home Loan Deposit Scheme.

A NAB spokesperson said: "Australia needs to build more social, affordable and sustainable housing close to jobs, services and amenities if it wants to foster socially cohesive cities in the future."

ANZ also wants to be innovative and open to alternative housing models that don't fit the strict traditional finance model. The state director of ANZ's Institutional Property Group, John Hudson, says: "We've worked closely with Assemble in building their models and understanding the capital they needed and what was motivating them. Therefore we understand that settlement is the mechanism for the repayment of the development funding.

"From a risk perspective, we were very comfortable with the way Assemble were marketing and identifying the tenants that were ultimately going into these developments."

While the bank has had to invest resources to better understand the motivations of the developers, ultimately its appetite for these alternative models is growing, says Hudson. "It's a bit of a journey because all these new models are coming out and they're working."

He says banks need to keep up with the pace of change when it comes to alternative funding models. "These are different models that require the bank to take a different approach, and if that's what our clients want to do we will continue to work with them to work out how we can keep providing that wisdom. There's not going to be one model of alternative funding here," he says.

Some banks now appear to view alternative housing funding as a vehicle for their internal environmental, sustainability and governance (ESG) targets. NAB, for example, is investing in affordable housing through its social impact mandate.

Bank Australia has been investing resources into understanding the alternative funding models for the residential housing sector for some years. The bank's senior manager of Impact Finance, Emma Spano, says it is her job to use finance to achieve positive impacts, and these alternative financial models for residential housing are a key focus.

"As a member bank, we're driven by what is important to our customers and members, and housing affordability is one of those things. And these projects are chasing affordability by cutting out the development margin and working together. There's more debt available out there, but equity is probably more challenging to come by."

She agrees that working collaboratively with the banks will help affordable housing crusaders formulate better models. "I'm sure there will be new models that emerge over time as others work to overcome the housing affordability issues," she says.

INSTITUTIONAL INVESTORS CIRCLE

While major banks are providing debt finance to alternative housing projects, Australian superannuation funds are now being seen as a major source of long term equity finance, with some having already poured millions into alternative housing projects in recent years.

One major industry fund, HESTA, has invested AU$23.9 million of its members' savings in current Nightingale projects. Australian Super has also joined the push, taking a 25 per cent share in Assemble in June 2020 to "help address housing affordability to create better access to home ownership."

Hudson says: "I think we're seeing the super funds as being there for the long term, permanent, patient capital, and the banks will tend to be the short-term debt funding. You need a lot of capital. And that's where the super funds are perfectly suited."

Backing up this claim is a 2022 Industry Super Australia report suggesting that "if the right model is found there is a substantial capital pool to draw from for affordable housing." Industry Super Australia Deputy Chief Executive Matt Linden said: "With the right financial models and a steady pipeline of projects, industry fund members get a low-risk investment that delivers secure returns even when the economic seas are rough[6]."

CHALLENGES REMAIN

While these alternative approaches to housing affordability have had some success, there are hurdles yet to be crossed. In 2021, Nightingale conceded its current model needed to change in order to be scaled up. The challenge had been a lack of structure in equity investment by small investors, and the risk placed on architects to raise funds and see projects through to the end. Many had openly complained about the huge workload and level of risk involved.

To address the concerns, Nightingale restructured to become a not-for-profit organisation that only raises capital from institutions and sophisticated investors, and that can never be monetised. Every project is now managed in-house to ensure it is delivered on time and on budget, leaving the architects to do what they do best – design great buildings.

Partnering with banks and institutional investors may well help these change-makers perfect their models and increase their chances of playing a greater role in the future of housing.

Dr Laurence Troy, centre director for the Australian Housing and Urban Research Institute, believes not-for-profit development models should become a major component of housing development across Australia. "It's inherently more cost-effective than for-profit development. It just means more of the benefits accrue to occupants rather than speculators," he says.

However, he says a lack of policy support from governments is restraining the sector's growth. Accessing land is also a perennial problem for not-for-profits, including the formal community housing sector, because they usually can't compete on price with commercial developers.

"The reason (affordable housing developments) don't happen more is not, in essence, about whether they're viable or not. Given the right support, there could be a lot more," Troy says. "Done right, more subsidised forms of housing can be underwritten by more market-oriented products through cross-subsidy, but it requires a diverse approach to delivery.

George Bougias, national head of research for residential property funds and real estate services group Oliver Hume, agrees that affordability issues in the housing market provide an opportunity for the uptake of alternative funding models.

"Although COVID-19 disrupted the property market – and we're likely to see increased demand for various greenfield locations in both metropolitan and regional locations as a result – my view is that many of the trends that alternative funding models aspire to capitalise on will continue," he says.

"Demographic changes such as ageing, and structural challenges such as affordability and land supply constraints will continue to shape options, choices and preferences."

He stresses, however, that these models must ultimately make financial sense and meet the needs of the market.

But with banks and institutional investors increasingly keen to invest, the future's looking brighter – both for developers with imagination and vision, and for aspiring homeowners seeking to finally get a foothold in the market. — ●

6 https://www.industrysuper.com/assets/FileDownloadCTA/Super-in-the-Economy-The-investment-opportunity-in-the-Australian-private-marketsNov22

Image Credits

CHAPTER 3
Money talks

New money mavens
01 Tatjana Plitt
02, 05 Tom Ross
03 Peter Clarke
04 Kristian Gehradte, Property Collectives

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