Response to Housing Australia — Interest Rate Risk Consultation (Funding Round 3)

Faith Housing Australia (FHA) welcomes Housing Australia's prioritisation of interest rate risk under Funding Round 3 and the opportunity to contribute to the consultation. As a peak body, our response is naturally directed at the sector-wide settings that will most effectively support delivery, rather than any individual transaction or financial situation. It should be read alongside the responses submitted by individual members and by the broader community housing sector, which we support.

Our central observation is one that individual proponents are less able to make on their own. FHA members source and hold capital from materially different places — own balance sheet and reserves, senior bank and AHBA debt, institutional sub-debt and third-party equity, and blended philanthropic or concessional capital. As a result, a member's response to interest rate risk is driven not only by its own board risk appetite but, in many cases equally or more so, by the mandates and hurdle requirements of its third-party investors and financiers. There is no single proponent profile, and any Housing Australia solution needs to accommodate this heterogeneity rather than assume one.

1. Appetite for an IRRM product

There is strong in-principle support across the membership for Housing Australia offering an Interest Rate Risk Management (IRRM) product. The base rate protection available under HAFF1 was an important feature that gave member boards comfort in mitigating long-term base rate risk across the full term. Its removal has materially changed the risk profile that boards and investors are being asked to accept.

Appetite is, however, conditional and differs by capital source:

- For members reliant on third-party sub-debt or equity, a workable IRRM (or a viable market alternative) is effectively a precondition to proceeding. These investors cannot enter projects on an unhedged basis and, critically, cannot progress investment committee approvals until there is certainty on the availability of an IRRM. For these members the question is less, "would you take it up" than "we cannot commit without it." This dependency exposes their projects to significant execution risk.
- For members funding from balance sheet, appetite is governed by internal risk appetite and the cost and complexity trade-off of the solution offered. Whilst this creates additional risk for these proponents, they have considerably more control over the process than those relying on third-party sub-debt capital.

The common thread is certainty and timing. Members need early certainty on the availability of an IRRM (or a defined alternative) to meet the finance approval milestones in their developer contracts. Slippage risks reopening contract negotiations and undermining delivery certainty for the program as a whole.

2. The cost and risk of hedging 15+ years

Where there is a genuine need to hedge base rate risk for 15 years or more, doing so either adds considerable cost upfront or leaves considerable risk on foot — and this is most acute before a project is fully drawn and implemented.

The difficulty is a timing and quantum mismatch. Certainty is required at contract close, but senior debt draws progressively through to completion. Hedging a fully-drawn, long-dated profile from day one over-hedges during construction and exposes the provider to mark-to-market and break costs if the drawdown profile, timeline or scope shifts — all of which are common in construction. Deferring the hedge, on the other hand, leaves base rate exposure open through the period of greatest uncertainty. Neither outcome is efficient at the individual-project level.

The cost is also material and, for the most part, has not been capitalised into projects. Member feedback indicates the cost of 15-year base rate protection is close to 5% of the notional debt amount. For many providers this single item determines whether a project is feasible within Housing Australia's availability payment caps.

Members and their advisors have also questioned the rationale for long-term hedging, and what consideration Housing Australia has given to alternatives — such as shorter-dated hedges that are periodically topped up to reduce duration cost, and the degree of natural hedging embedded in CPI-adjusted cash flows. Entering long-term hedging while interest rates are high can create significant mark-to-market and break-cost risk depending on the nature of the product.

3. Who should hold the risk

FHA questions the rationale for a structure in which the cost and terms of managing this risk are pushed down to individual CHPs, when those terms are necessarily worse than what Housing Australia could obtain itself.

Housing Australia benefits from a government-backed cost of funds, scale, and the ability to aggregate. An individual provider — or its sub-debt investor — accessing market hedging pays a credit-adjusted, sub-scale margin, together with the cost of any security or credit support the bank counterparty requires. The difference between Housing Australia's cost of managing the risk and the provider's cost is value that could instead be directed to offset the increased construction costs flowing through all existing and planned projects. That additional cost is capitalised into projects, impacting member returns and the minimum hurdles required by their investors, and increases pressure on project feasibilities.

4. Security or equity guarantee (approximately 5% of debt)

FHA cautions against requiring members to provide additional security or an equity guarantee to access the IRRM.

- Faith-based providers already extend significant parent-company support and balance sheet capacity across their HAFF portfolios. Further security asks consume limited balance sheet capacity and constrain each member's ability to take on additional projects — again cutting against sector growth objectives, and a matter Housing Australia should weigh at a program level.
- Where security is instead required from members' third-party investors (for example, letters of credit), that cost is passed through to the project and must be tested against the availability payment caps and investors' minimum return hurdles. For some members this will render otherwise viable projects infeasible.
- Should Housing Australia nonetheless require security to access the IRRM, we would encourage that it be structured to scale down as the debt is drawn, and to take account of its interaction with existing lender covenants and security arrangements, so as not to unnecessarily constrain participation by providers with otherwise viable projects. Capital tied up for this purpose carries a real opportunity cost, as it could otherwise support additional housing delivery.

If additional mitigation of interest rate risk is required, we would encourage Housing Australia to consider other levers, such as an increase to the concessional loan or availability payments, rather than adding cost and security into projects.

5. Amortising HAFF senior debt vs holding a reserve

The option to amortise HAFF senior debt during the operating term, rather than holding cash in an amortisation reserve, is broadly supported. Applying notional amortisation as a permanent reduction of senior debt improves project economics by removing the negative carry that arises under the current arrangement — providers pay a higher rate on the notionally amortised debt than they earn on cash held in the reserve account.

The benefit varies by member and structure. It is most valuable where the AHBA loan amortises over the concession term (as is typical for earlier HAFF projects) and less relevant where a member has structured a bullet loan (as some have under HAFF3). We therefore recommend this be offered as an option at member election rather than mandated, preserving flexibility across differing capital structures. We also consider it important for Housing Australia to offer a right to prepay these loans where a member elects to do so — this supports both Housing Australia's objective of crowding in other investors and prudent capital management by members.

From a sector perspective, the option to amortise also has the potential to deliver stronger long-term outcomes. Progressive reduction of debt over the operating term means lower residual debt and increased retained equity at the end of the 25-year term — strengthening member balance sheets, supporting greater long-term ownership of social and affordable housing assets, and improving providers' capacity to reinvest and deliver additional housing over time.

6. Interest rate risk and feasibility within the funding caps

Interest rate risk has been a key consideration for members in framing proposals within the relevant funding caps. The move away from HAFF1 base rate protection introduced both cost and complexity where a market-based solution (such as bank hedging) is required, and that cost bears directly on whether projects fit within the caps.

Recent interest rate volatility and broader macroeconomic uncertainty have heightened this sensitivity, with relatively small rate movements materially affecting outcomes within the caps and obliging members to price in conservative contingency buffers to keep submissions robust under downside scenarios. A reliable IRRM would reduce the need for those buffers — so that interest rate risk ultimately shapes not only individual project feasibility but how many projects can be brought forward, and at what scale, within program settings.

At a sector level, the absence of a consistent Housing Australia solution risks uneven outcomes: providers with deep balance sheets can more readily absorb or self-manage the risk, while smaller and mission-driven providers cannot — working against a level and fair playing field across the program. A simple, standardised and cost-effective IRRM, available on consistent terms, would support comparable outcomes and reduce transaction cost and complexity, particularly for smaller members. The IRRM should reflect Housing Australia's ability to negotiate competitive terms at an industry level for members participating in HAFF rounds, and should also consider incorporating shorter-dated rolling hedges that can be exited if circumstances require. These changes would make such IRRM strategies feasible within the funding cap.

Summary

FHA's position on behalf of the membership is:

- There is strong support for an IRRM, but for members reliant on third-party capital it is a precondition to proceeding, not merely a preference.
- Managing genuine 15+ year base rate risk at the individual-project level is costly and carries live risk during construction; the efficient solution is to manage and aggregate the risk at Housing Australia / wholesale level and pass through the benefit of Housing Australia's superior cost of funds.
- Allocating hedging cost and terms down to providers introduces value leakage that erodes returns, raises the cost of doing business, and reduces deliverable housing — against the program's growth objectives.
- Additional CHP security or equity guarantees should be avoided; a concessional loan uplift or availability payment increase is the preferable lever.
- Amortisation of senior debt should be offered as a member election.
- Beyond negative-carry economics, amortisation strengthens member balance sheets and long-term asset ownership, improving the sector's capacity to reinvest and scale delivery over time.
- A simple, consistent IRRM supports fair outcomes across providers of differing scale and capital structure.
- Any IRRM should reduce, not increase, the risk of locking in long-term rates in a high interest-rate environment, which could expose the sector and Housing Australia's delivery strategy to significant break costs or cash-flow leakage if the trend reverses (in CPI and interest rates).

FHA would welcome the opportunity to work with Housing Australia on the design of any solution, including an aggregated or wholesale approach to interest rate risk, and to convene member input as this work progresses. More broadly, settings that improve certainty, preserve balance sheet capacity and support long-term asset ownership will enhance both the feasibility and the scalability of delivery across Funding Round 3.

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