9 December 2022

SDA Pricing Review Panel
National Disability Insurance Agency
By email: SDAPR@ndis.gov.au

Submission to NDIS – 2023 Pricing Review - Specialist Disability Accommodation

Lighthouse Infrastructure Management Limited (**Lighthouse**) welcomes the opportunity to provide the following submission as part of the pricing review into Specialist Disability Accommodation (SDA).

Introduction

Lighthouse has been an early participant and a supporter of investment in SDA. Lighthouse, on behalf of its institutional investors, has invested over $250 million in a market leading investment portfolio comprising accommodation for up to 400 people with disability across 188 homes and apartments located in Melbourne, Sydney, regional New South Wales, Canberra and Brisbane.

Critical to the success of the SDA program is the development of the market, as envisaged in the 2016 report by the NDIS, and participation by institutional investors in the funding of SDA. It is critical that the market has confidence in the framework underpinning investment in the sector, including related policy stability and intent.

Institutional investors have extensive opportunities to allocate capital across infrastructure sectors throughout Australia and offshore. The 2023 Pricing Review presents an important opportunity for the NDIS to reinforce the investment efficacy and social importance of investment in SDA.

Summer Foundation submissions

Lighthouse has been an active participant in the SDA Price Review Submission, prepared by Dr Phil Pickering on behalf of the Summer Foundation (the Summer Submission). This submission was prepared following consultation and in-person workshops representing key industry participants. Lighthouse supports this work and the conclusions that were reached.

Lighthouse has also supported and participated in the preparation of the Specialist Disability Accommodation Taskforce (SDA) Investor Think Tank report sponsored by the Summer Foundation in June 2021, which contained recommendations to enhance the Scheme. This report was presented in person to the NDIS executive and Minister Reynolds for consideration. Lighthouse is not aware of any response to this report or implementation of the recommendations contained therein.

This submission seeks to amplify several points made in both submissions, and from the perspective of an institutional investment fund manager that has made a significant investment in the SDA market.

Scheme structure and operation

- Scheme structure and ambition
    - The NDIS should be acknowledged as a unique and a globally leading scheme for the provision of accommodation and services to persons with disability.
    - The scheme has been thoughtfully constructed and is innovative and transparent in its objectives and framework.

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  - The architects of the scheme should be recognized for and congratulated on their foresight in establishing a scheme that explicitly sought the participation of institutional investors.
- During the first regulatory price period to date however, the imposition by the NDIA of a series of administrative and policy actions has diminished the confidence of investors in the efficacy of the scheme. We would cite several concerns:
  - Delays in registration of SDA dwellings;
  - Use of Agency staff and lawyers to challenge and delay unnecessarily the approval of SDA in the plans of participants;
  - Ineffectiveness of the NDIA in using the SDA Reference Group;
  - Lack of data collection to provide investors with the signals necessary for the delivery of SDA supply; and
  - Lack of leadership and policy framework concerning Environmental, Social and Governance policy to guide delivery of investment in the industry.
- These actions have contributed to the NDIA being significantly behind its target of achieving 30,000 people with SDA funding by 2025, with only 12,123 receiving SDA payments.

- **Capital costs**

  - Lighthouse confirms that it has witnessed a significant increase in capital costs since it entered the industry in 2017 as outlined in the Summer Submission.
  - We have practical experience which supports the scarcity of suitable vacant land sites for the construction of SDA dwellings. The vast majority of land for SDA must be acquired through the purchase of established properties, the cost of which represents a significant premium over vacant land.
  - Suitable SDA sites take time to acquire at scale and this process and the accompanying risk are reflected in the profit margins required from developers and builders.
  - We support the recommendation in the Summer Submission which advocates the use of established land prices in the SDA Pricing model rather than vacant land prices.
  - The current review of SDA prices comes at a critical time when construction and land costs have increased substantially, rendering many properties commercially unfeasible. The review will provide the opportunity to correct prices, which will flow through to a greater focus on building types, design categories and locations that are otherwise being undersupplied or overlooked by investors.

- **Vacancy**

  - Lighthouse has experienced vacancy rates across its portfolio, which are materially above the 3 to 10 percent allowed in the SDA pricing model.
  - The level of vacancy and consequent risk for investors have been unnecessarily magnified by the actions of the NDIA. The recent focus by the Agency following the changes in personnel and the policy direction of the incoming Federal Government is welcomed and evidences the poor practices of the previous administration.
  - We support the conclusion in the Summer Submission that the cost of finding and replacing tenants has been greatly underestimated.

- **Cost of capital**

  - Lighthouse supports the use of the Capital Asset Pricing Model (CAPM) to calculate the Weighted Average Cost of Capital (WACC) as a key tenet to the establishment of SDA pricing.

- CAPM is applied consistently in Australia and in leading overseas markets for the regulation and pricing of Infrastructure assets, which we consider to be relevant to SDA assets.
- Lighthouse considers such an application of the CAPM to be appropriate to SDA pricing and is widely supported by institutional investors.
- Lighthouse supports the framework outlined in the SDA Pricing Review Consultation Paper published in October 2022 and offers the following comments on the components of the WACC:
  - r_f – The risk free rate. We support the use of market observed and quoted reference points. *F16 Indicative Mid Rates of selected Australian Government Securities* is a widely used and available source. In our experience, the 10-year maturity is most commonly used in WACC calculations for regulated assets. We are comfortable with the continued application of a three month trailing average up to the release of the regulatory pricing outcome, as was adopted in the initial pricing decision in 2016.
  - $\boldsymbol{\beta}$ – Equity beta. Lighthouse contends that a higher equity beta of approximately 1.27 times should be applied assuming leverage of 50 percent (see below). We support the detailed commentary outlined in the Summer Foundation Submission and highlight the following factors:
    - Investment in SDA under the NDIS is still nascent, lacking scale and absent widespread participation by institutional investors, lenders and bondholders that is commonly observed in other regulated markets;
    - The conduct of the Agency in causing prolonged delays in SDA approvals, payments and other administrative uncertainty, during the period since the first Pricing Review in 2016, has elevated the perception of risk by investors;
    - Limited listed market comparables and transactions at scale are observable;
    - The Australian market has a number a listed entities which have investments in aged care and retirement villages, which have a history of observable trading and scale and represent a relevant precedent. The average observed equity betas for this sector from Bloomberg and Axiom ranges between 1.17 to 1.49 at an average of 35 percent gearing.
    - The current SDA pricing review represents the first full review since the inception of the Scheme. The investment market and key stakeholders will closely observe the outcome of the current pricing review and the consistent application of the principles established in 2016 as it informs its assessment of regulatory risk.
  - **MRP** – Market Risk Premium.
    - The 6.8% percent market risk premium applied by the Australian Energy Regulator would represent a suitable assumption to adopt.
  - **DRP** – Debt Risk Premium.
    - We would advocate the application of observable and current reference points in the Australian debt market rather than long term averages.
    - The debt risk premium should reference the cost of debt and include the cost to swap to medium term fixed rate debt, applicable establishment fees, credit margins and commitment fees and other security costs. The Summer Submission outlines this debt risk premium in greater detail.

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- **CPI -** Inflation.
  - We support the use of the Australian CPI index as an input.
  - More widely, investors would gain confidence in the regular application of CPI to pricing applicable to tenants and not lagged to when SDA plans are reviewed as has become common practice.
- **Gearing**
  - The use of a gearing ratio of 60% is not appropriate and does not reflect the leverage available for SDA investments in Australia.
  - Lighthouse recommends the adoption of no more than 50% as appropriate for the assumed level of debt included in WACC calculations.

- **Your Future, Your Super regulations**

  - Lighthouse refers to the review by Commonwealth Treasury (Treasury) contained in the Your Future, Your Super Measures (YFYS) Consultation paper published on 7 September 2022.
  - Lighthouse welcomes the Commonwealth Treasury's review of the YFYS measures, particularly around the performance test as its current settings could have unintended adverse consequences on the cost of capital for the Australian SDA sector;
  - The current benchmark used for the performance test for unlisted infrastructure investments, the MSCI Australia Quarterly Private Infrastructure Fund Index (Unfrozen) is not fit-for-purpose.
  - The high benchmark return and risk profile will deter Australian superannuation funds from investing in SDA assets;
  - The high benchmark return and risk profile could also incentivise superannuation funds to take greater risks to meet the benchmark return, unnecessarily detracting capital away from investment in SDA assets, and acting to the detriment of superannuation members' long-term interests;
  - Over the next decade, superannuation funds will have a significant opportunity and a critical role to play in providing low-cost capital to deliver SDA;
  - Lighthouse recommends that the Commonwealth Treasury excludes SDA investment from the MSCI Index or from any other unlisted infrastructure index that might be developed as an alternative to the MSCI Index which will encourage SDA investments by Australian superannuation funds.

Lighthouse looks forward to working with the NDIS and its stakeholders in supporting the development of an efficient and a predictable Pricing Framework and is available to discuss this paper and the conclusions reached therein.

Yours sincerely,

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