SPOTLIGHT
Savills Research

Private Money and Affordable Housing

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A new frontier

Equity investment in UK affordable housing is growing fast and could help deliver additional affordable homes

The growth of professional, large scale investment into residential operational real estate in the UK has been one of the foremost trends across the whole real estate asset class since the Global Financial Crisis. Build to Rent (BtR), Purpose Built Student Accommodation and Retirement Living are the sub sectors that have attracted the most attention to date (UK Operational Real Estate: The Sky's The Limit, Savills, 2019) but one of the biggest opportunities is just beginning to gather momentum: affordable housing (Figure 1).

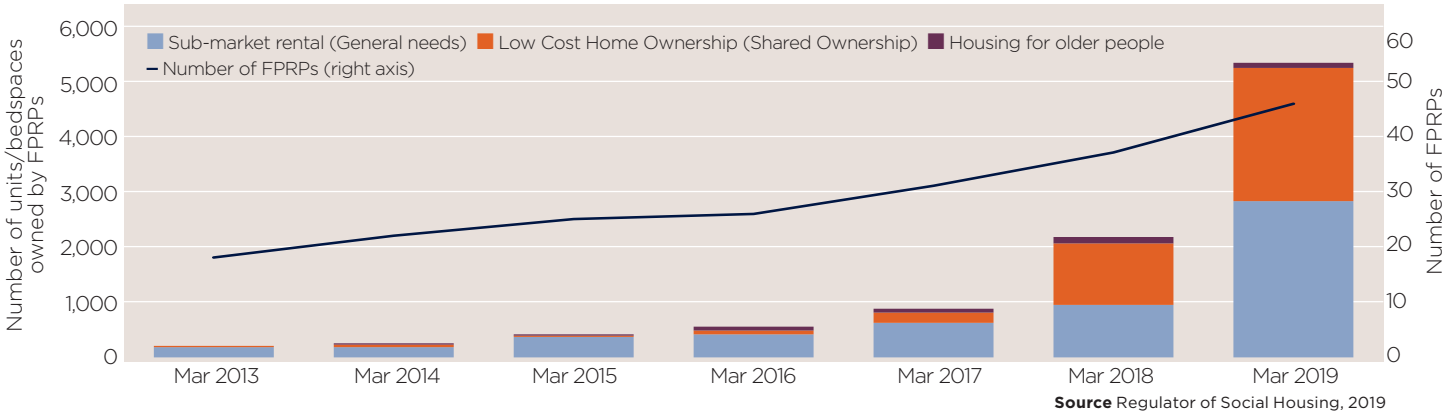
Affordable housing – the opportunity

The affordable housing sector has the same favourable long term structural demand drivers, liability matching return characteristics, potential for growth and insulation from volatility that has drawn investors to other residential sub-sectors. It also offers the best opportunity for social impact and long-term investors are increasingly looking for ethical opportunities.

Private finance has long played a vital role in the sector through debt finance, typically through bank debt and capital market funding from either public or private bond issuances. The bond market activity is financed by private capital for long term financial return and appetite to fund Private Registered Providers (PRPs) has been strong in recent years (Figure 2).

So private money is not new in the sector but it is the recent equity investment activity from For-Profit Registered Providers (FPRPs) that represents a new opportunity and has become a hot topic in the industry and media.

Figure 1 The growth of For-Profit Registered Providers



Source Regulator of Social Housing, 2019

FPRPs were first permitted by the Housing and Regeneration Act 2008 and the first was registered in 2010. In 2019, 46 for FPRPs submitted data to the Regulator of Social Housing.

The need for new money

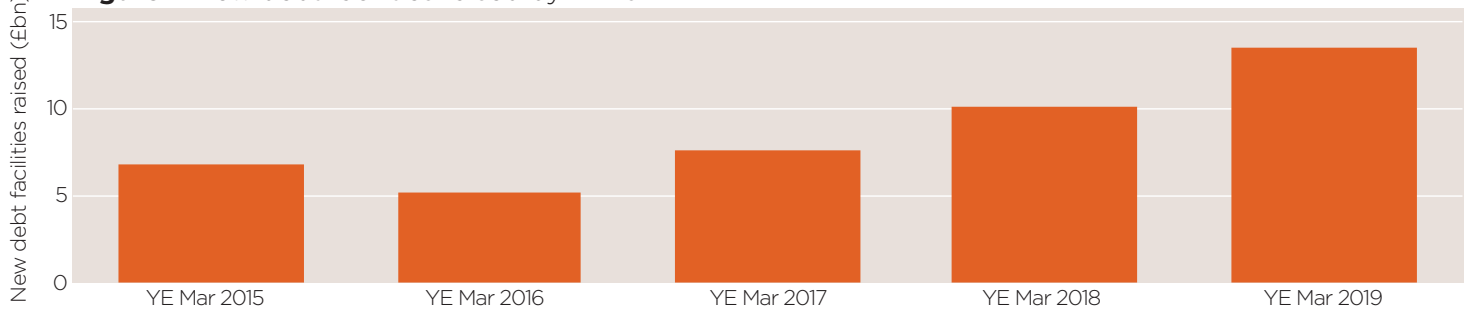
There are compelling arguments that the sector needs new sources of capital and more developers of good quality affordable housing. The UK has been delivering around 46,000 new affordable homes per year since 2013 but this is significantly short of need, particularly in some parts of the country. Our analysis suggests that we need a further 60,000 affordable homes per year, with significant shortfalls in London and the South East (Affordable Housing – Building Through Cycles, Savills, 2018).

Housing associations are still under pressure to deliver new homes. This is in the context of difficult housing market conditions that have reduced the scope for cross-subsidy from market sale.

Further challenges are on the horizon from costs associated with improving existing stock. The cost of building safety improvements as a result of the Hackitt Review, the requirement to decarbonise existing homes and the potential of a 'Decent Homes 2' standard will impact the sector's financial capacity for development.

This will all serve to put pressure on financial capacity in the sector which cannot be stretched indefinitely. This combination of factors represents a clear opportunity for new money to enter the sector. If FPRPs focus on additionality and work alongside existing capital, they can play a valuable role in increasing affordable housing delivery.

Figure 2 New debt facilities raised by PRPs



Source Savills

We need an additional 100,000 affordable homes per year, mostly in London and the South East

What activity have we seen so far?

Direct investment – Shared Ownership

Shared Ownership has seen the most interest to date. It makes up 45% of the homes owned by FPRPs but is less than 1% of the whole sector. It can be acquired as part of the Section 106 affordable housing provision or by bulk purchasing homes from a developer at a discount to Open Market Value and switching to Shared Ownership, typically using grant funding. Homes developed with grant funding can only be acquired by a PRP. Alternatively, investors could acquire the retained equity of existing portfolios.

Table 1 Summary of direct investment activity in Shared Ownership

	Shared Ownership
Current number of homes in sector (PRPs)	180,600 homes
Net initial yield range (assuming 40% initial sale)	Shared Ownership – Section 106 development 3.50% to 4.50% – Reflects development/sales risk and costs. Shared Ownership – retained equity 2.75% - 3.50% – Lower risk as initial equity sale achieved and rent on retained equity set.
Investment considerations	Yields are without subsidy but examples exist of transactions at yields below these levels using internal subsidy to secure the opportunity, resulting in higher price paid. Internal subsidy typically used because organisations are willing to pay a premium for social or strategic reasons.
Likely evolution	150% increase in supply of Shared Ownership needed to meet potential demand after Help to Buy ends (Spotlight on Shared Ownership, Savills, 2019). Possibility of housing associations starting to release capital from existing Shared Ownership portfolios to increase financial capacity for development or investment in existing stock. Possibility of FPRP portfolios being sold on when they have reached scale to achieve a portfolio premium.

Source Regulator of Social Housing, Savills

Direct investment – Social and Affordable Rent

Historically direct private sector equity investment in sub-market rented homes has been low but L&G Affordable Homes, CBRE Gi and Sage are active in purchasing all parts of Section 106 agreements.

To date FPRPs have tended to outsource housing management and maintenance by setting up management agreements with management companies or traditional housing associations.

Table 2 Summary of direct investment activity in Social and Affordable rent

	Social Rent	Affordable Rent
Current number of homes in sector (PRPs)	2.3 million	244,000
Net initial yield range	3.50% - 4.50%	3.50% - 5.0%
Investment considerations	Appeal of huge supply/demand imbalance. 1.2 million on social housing waiting lists so expectation of minimal voids. Underpinned by government benefits. Rents being cut from 2016-20 may have alarmed investors, although debt finance appetite remained strong. Strong social impact from provision of this tenure. Ability to levy service charge on top of rent.	Requires less grant than Social Rent and offers more flexibility for landlord whilst still benefiting from supply/demand imbalance and being part of a regulated sector. Rents typically capped at the lower of 80% of market rent or Local Housing Allowance. No service charge.
Likely evolution	Regulation surrounding the tenure (which is an appeal to some investor types) limits investment opportunities. Large capital subsidy to deliver the new homes inhibits delivery in higher volumes.	Affordable Rent averaged 58% (MHCLG) of all affordable delivery from 2015-16 to 2017-18. Without substantial change to grant funding environment it will be the fastest growing tenure in the sector.

Source Regulator of Social Housing, Savills

Increased appetite for these low risk, long income type investments from the private sector

Lease based investments

Lease based models offer investors exposure to the sector's income and typically see the liability for repair and maintenance of the asset remain with the tenant.

The sector has seen a variety of structures that can broadly be categorised as operating leases, income strips, and sale and leasebacks. Lease based models have received some negative attention because of several poorly constructed examples. Poor capitalisation, unequitable risk sharing and governance failures have been problems.

However, the increased appetite for these low risk, long income type investments from the private sector and the capitalisation they offer for local authorities and housing associations means that if they are well constructed and understood, they can have a valuable role to play.

There is significant interest from major pension funds. The most significant deal to date was L&G's £252m income strip deal with Places for People (PfP). L&G acquired a 50 year lease on 4,000 sub-market properties, with the management retained by PfP.

Table 3 Summary of lease based investment activity (short and long lease structures)

	20-25 year Full Repairing and Insuring (FRI) lease linked to Consumer Price Index (CPI). Either PRP or LA counterparty. Typically operating leases	30-50 year FRI leases linked to either Retail Price Index (RPI) or CPI. Usually LA counterparty but also examples with PRPs. Typically income strip or sale and leaseback
Current number of homes in sector (PRPs and LAs)	4.1 million	4.1 million
Net initial yield range	4.25%-4.75% (with development risk).	2.50%-3.0% for LA backed 40 year revisionary FRI lease linked to RPI. Yields will be higher with a PRP counterparty or if CPI linked.
Investment considerations	Whether investor retains the asset at lease end will be reflected in initial cost of lease and income over its duration. Development risk typically taken (forward fund).	At least 30 year term is required for income strips. Sale & leaseback as low as 20 years. Development risk typically taken (forward fund).
Likely evolution	More equitable lease structures are necessary for this investment type to grow.	Strong appetite from long term, low risk investors. More equitable lease structures are necessary. Previous negative reputation may limit new activity.

Source Regulator of Social Housing, Savills

Will this mean additional affordable housing?

To date the main route to market for FPRPs has been from acquiring homes through Section 106 agreements. This has led to concerns that they are bidding up prices with limited additionality.

Key players have stated the ambition to move toward land-led delivery alongside Section 106. This is where the new money can have a real impact in delivering additional affordable homes. FPRPs can be supportive of traditional housing associations and local authorities and there is widespread appetite for partnerships in the sector (Housing Sector Survey, Savills, 2019).

New capital that is prepared to take development risk can unlock opportunities particularly where the scale and complexity of a project, or market uncertainty, incentivises the sharing of risk and financial commitment. The scope for FPRPs to unlock financial capacity in traditional associations through acquiring portfolios of existing homes, such as Shared Ownership, could also result in the delivery of additional housing.

The FPRP space is evolving rapidly and will continue to be contentious but the additional financial capacity the new entrants can bring to the sector is undoubtedly an opportunity to deliver additional affordable supply.

Savills Research
We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.

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