UK Affordable Housing - Summer 2022

SPOTLIGHT
Savills Research

Equity investment in affordable housing

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FPRP survey results ● SWOT analysis ● Evolution of the sector

FPRPs will gain an additional 9,000 affordable homes by 2023

Onwards and upwards

Growth in FPRPs is constrained by the number of opportunities, not investor appetite

Key findings

FPRPs own 20,000 affordable homes, according to our survey

This will grow 7x to 140,000 by 2027, worth £26.8 billion

Institution-backed providers make up the majority of supply

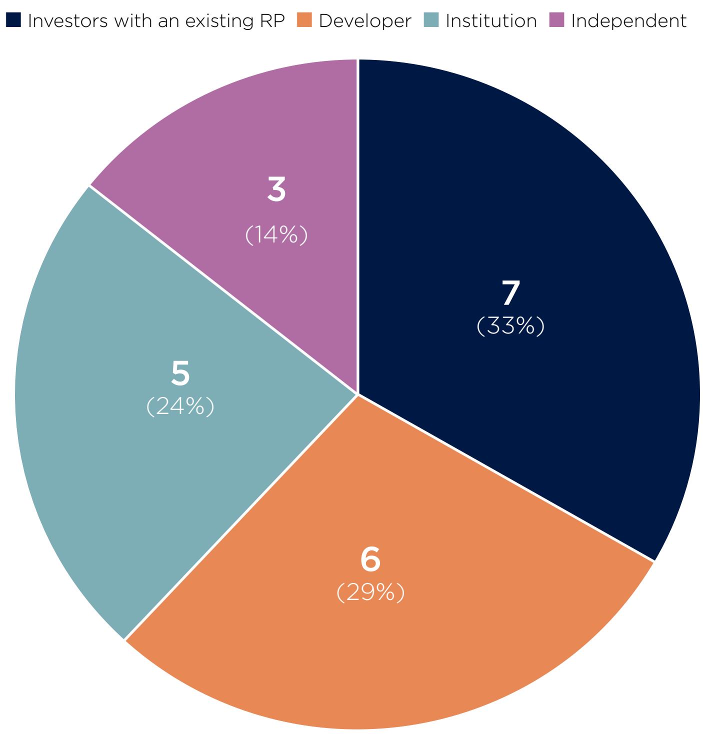
For-profit registered providers (FPRPs) own just under 20,000 affordable homes, according to our latest analysis. That means investors have grown the number of affordable homes they own by 43% since the latest RSH data for 2020-21.

The number of FPRPs has grown too, more than doubling from 31 in 2017 to 64 in 2022. A strong pipeline of applications means it will grow further.

These new FPRPs come from a range of backgrounds. Some have backing from institutional investors looking to build large, long-term portfolios. Others are developers who want to retain control of the Section 106 homes they deliver, so they can sell larger, stabilised portfolios at a premium.

A third of the FPRPs registered since 2019 were from investors with an existing FPRP. This compartmentalisation lets investors hold tenure - or fund-specific portfolios, which carry different risk/return profiles and thus appeal to different types of funders. Some brand new entrants are setting up multiple FPRP entities simultaneously for precisely this reason.

FPRP registrations 2019-22 by type of backer



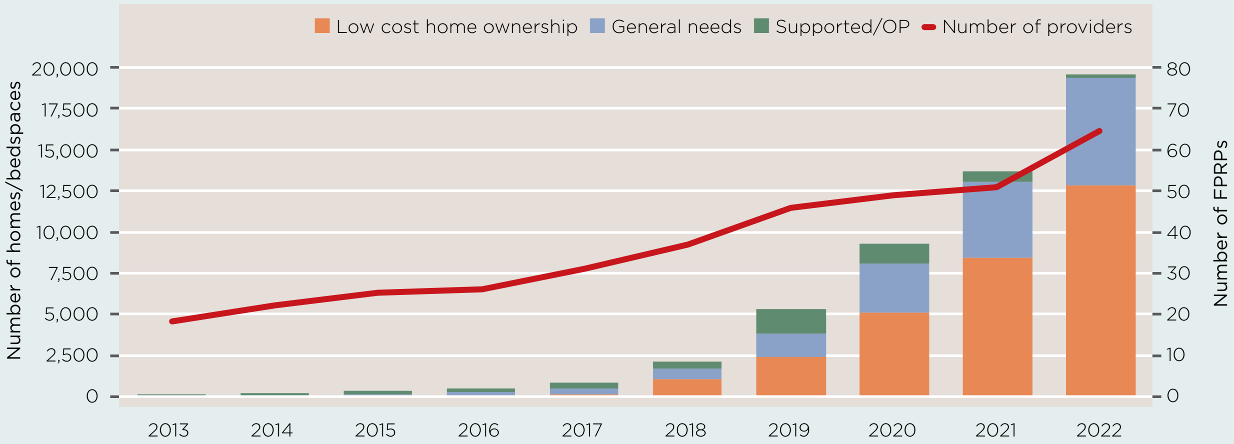
Source: Regulator of Social Housing

Our survey says...

We reached out to the owners of all 64 FPRPs registered as at March 2022 to learn more about their current stock and growth ambitions. Using these results, detailed interviews with select providers, and company accounts data, we've assembled this portrait of the complete FPRP marketplace:

The results suggest we'll continue to see rapid growth: providers predict they'll own more than 29,000 affordable homes next year, rising to just over 110,000 by 2027. Accounting for the arrival of more providers, we estimate there could be more than 140,000 affordable homes in FPRP ownership five years from now, reflecting almost £27bn investment.

Growth in FPRP registrations and stock



Source: Savills Research, Regulator of Social Housing

Scale and growth of FPRPs

	2017	2021	2022	2027		
				Current FPRPs	Additional FPRPs	Total
Number of FPRPs	31	51	64	64	c.25	c.90
Number of homes	873	13,671	19,600	111,400	c.30,000	c.141,000
Capital (£bn)	£0.2	£2.4	£3.7	£21.2	£5.7	£26.8

Source: Savills Research

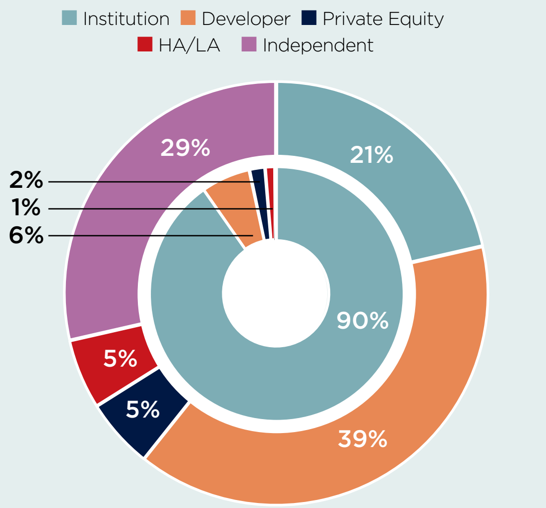
20% of FPRP stock in 2017 was low-cost home ownership... ...**66%** in 2022, and... ...**63%** in 2027 as grant focus shifts back to affordable rent.

Large providers (more than 500 homes) own **91%** of existing stock... ...but those same providers will only own **76%** of stock in 2027 as newer RPs catch up.

3 FPRPs with no complete stock as of 2022 have plans to exceed 1,000 homes in the next five years.

Stock and providers by origin of capital

Inner ring: number of homes | **Outer ring:** number of FPRPs



Source: Savills Research

As HAs grow more comfortable working with new entrants, joint ventures between FPRPs and HAs are an obvious opportunity

SWOTing up

As the weight of capital targeting this sector grows, we've taken a look at its strengths, weaknesses, opportunities and threats to understand how it's likely to evolve in the coming years

Strengths
Access to equity
Barriers to competition
New stock

Weaknesses
Limited track record
Access to debt

Opportunities
FPRP mergers and acquisitions
HA/FPRP group structures

Threats
Inflation
Changing policy

Strengths

Regulation will insulate early movers from competition

We already know there is huge investor appetite for environmentally friendly, regulated assets that provide tangible social benefit. That gives existing FPRPs a deep well of capital to draw on as they grow.

We can see the depth of appetite for FPRP status in the length of the pre-registration queue. There are around 60 applications for for-profit providers sitting with the Regulator as of April 2022.

However, as the FPRP sector grows, the RSH has strengthened its scrutiny of applications to reflect the increased expectations arising from social housing regulation review. We can expect to see more investors and developers submit applications to register FPRPs but the often lengthy process means it will take time for interest to translate into additional competition. That gives the early movers significant competitive advantage.

New entrants don't have legacy stock liabilities (for now)

Acquiring new build homes has been the main route to market for most FPRPs, which lowers their exposure to stock investment costs and risks.

Some may choose to remain focused on building and acquiring new stock. With modern, energy efficient homes, they'll enjoy predictable and lower repairs and maintenance costs and a lower cost of capital as they refinance later.

As FPRPs and their capital partners become more established and familiar with the sector, some, particularly those with experience in other residential sectors, may seek to acquire legacy rented portfolios from HAs.

The result is a win-win. HAs unlock equity to fund the core parts of their business and manage the repairs/decarbonisation costs in their business plans. And FPRPs get to build up scale more quickly, at a lower price that reflects the required retrofit costs.

Weaknesses

Still not a level playing field with HAs (but this is changing)

FPRPs enjoy some benefits over not-for-profit providers, but there are disadvantages too. The framework for taxes and exemptions is, as one FPRP put it, "a dog's dinner".

They must also navigate greater challenges securing access to grant funding. In 2021, Homes England opened the Strategic Partner bidding to FPRPs for the first time, awarding funds to four of them. However, whilst Housing Associations were able to bid for up to £250m in the latest round of grant allocations; FPRPs had a cap of £150m. Our research demonstrates some FPRPs have the appetite to deploy significantly more grant than this.

While the Regulator of Social Housing can fine HAs that don't meet its standards, to date it has avoided this, viewing it as taking away money that could be used to support tenants. Reporting to DLUHC, representatives from the RSH suggested they may choose to use these powers on FPRPs should they fall short of the Regulators' standards.

Debt finance

Development debt is expensive. This is manageable for private developers selling homes on the open market, where the returns justify this cost. It's a greater challenge when building affordable housing for start up FPRPs.

Opportunities

Joint ventures and partnerships

On one hand, you have large HAs with decades of experience building and managing affordable homes, large and capable development teams, but facing growing financial constraints. On the other, you have private investors with plentiful equity, but with limited track records and development experience.

Joint ventures between FPRPs and HAs appear to be an obvious opportunity. A growing number of HAs have asked us to help explore the risks and opportunities presented by partnering with FPRPs and investors. Some HAs are weighing up whether to register FPRPs of their own to unlock investment to fund development; others are considering working with existing FPRPs.

We have advised on a number of sales of Shared Ownership stock from HAs to FPRPs, and expect this market to grow. The appetite of HAs to sell legacy social and affordable rented stock to FPRPs is in its infancy, as is the appetite of FPRPs to buy, but this is also an area we expect to grow.

As FPRPs gather scale and experience, further opportunities will arise for partnerships with local authorities. Here, the flexibility and funding of FPRPs can help unlock council-owned land and fill skill gaps, while helping the authorities tackle their housing lists.

The key to more joint working is mutual trust and understanding. As the FPRP sector matures, and undergoes the In Depth Assessment and Regulatory Judgement processes, HAs and local authorities will grow more comfortable working with new entrants. We expect to see far more of these partnerships emerging.

Threats

Inflation

FPRPs aren't alone in facing the threat of inflation. Rising labour and materials costs could erode margins: materials costs for new dwellings rose 19.5% in the year to March 2022, according to data from BEIS.

HAs with large development programmes may be able to negotiate better terms with contractors because they're operating at scale. The same is true of some of the larger FPRPs with a national footprint and established relationships. But there is no escaping rising cost pressures. Pricing volatility and developer cost uncertainty will be challenging for all investors.

There is a further risk that the Bank of England raises interest rates too quickly in an effort to contain inflation. This would have a negative impact on affordability for Shared Ownership buyers at the point of purchase. Unassisted buyers would face these same barriers, however, which should underpin demand for SO.

Policy risk

Policy changes over the last few years have highlighted how vulnerable the affordable housing sector is to the changing priorities of government. Rewritten rent settlements and changes to the Shared Ownership model lease have presented challenges to HAs and FPRPs alike.

While the sector has been able to weather these changes, new entrants and HAs share a need for stable rent and funding policies to support long-term investment. First Homes risks cannibalising affordable housing supply while discussions around replacing Section 106 with an Infrastructure Levy could disrupt delivery entirely.

A longer-term rent settlement and commitment to a clear, consistent housing strategy would give confidence to providers, lenders and investors, unlocking more affordable housing delivery.

We expect Shared Ownership supply to average 21,000 per year

Evolution of affordable housing

FPRPs want to add to their stock, but where will the new homes they need be built and how will they fund them?

A mixed bag on policy

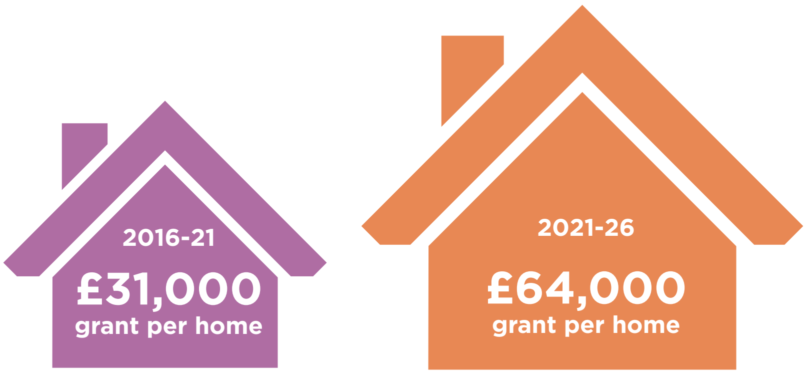
Government has committed £11.5bn in new funding to deliver 180,000 affordable homes between 2021 and 2026. At just under £64,000 per home, this scheme offers more than double the grant per home of the 2016-21 programme. While the previous programme focused primarily on home ownership, funding in the current AHP splits evenly between homes for sale and rent.

That increase in grant funding comes with constraints, however. Unlike before, where there's been a substantial pot available across the whole programme through Continuous Market Engagement (CME), most of the funding in this pot has been allocated to Strategic Partners.

This is great news for those lucky enough to be named Strategic Partners. It's less good news for those who missed the boat this time or prefer the flexibility of the CME model. For newly registered FPRPs, or those in the pipeline, the availability of CME grant is a key risk and consideration. Some wishing to operate at scale may have to wait until the next programme in 2027 for a shot at substantial levels of grant.

Government can help fix this problem. Greater clarity on how it reallocates unspent funds will give FPRPs greater certainty about their options over the next five years. And reopening Strategic Partnership applications or settlements mid-programme would give new entrants the chance to access grant and accelerate affordable housing delivery.

Average grant per home under the Affordable Homes Programme



Source: Homes England, GLA

First Homes

Earlier this year, Government introduced planning changes that require 25% of developer affordable housing contributions to be First Homes: a new discounted home ownership product.

First Homes will cannibalise affordable housing supply. Many local authorities want to preserve delivery of rented tenures, so this policy is likely to have a starker impact on Shared Ownership supply.

Our analysis suggests that First Homes could reduce the supply of Shared Ownership homes through developer contributions by 5,700 homes per year, with a further fall of 700 Affordable Home Ownership homes per year. That reflects 65% of annual supply through developer contributions.

With the increase in grant funding and a refocusing of grant toward rented tenures, we expect Shared Ownership supply to average 21,000 per year.

Off-the-shelf back on the shelf

The current Affordable Homes Programme sets limits on how much grant HAs can spend buying homes that are complete or already under construction. The limit reflects a desire for grant to support additional supply rather than change the tenure of homes that would be built anyway. However, the market is naturally limited by housebuilders' willingness to sell to HAs.

But Help to Buy will end in March 2023. At this point, we would expect to see housebuilders grow far more open to selling stock to registered providers.

Changing this policy now will avoid a gap in housing delivery following the end of Help to Buy. Letting HAs and FPRPs buy housebuilder stock would help create truly sustainable, mixed-tenure communities. It would also increase developers' certainty, allowing them to build more homes at a faster pace than they would in the face of Help to Buy ending.

> "The older generation is among the richest. Homeowners aged 65 and over own 42% of all homeowner equity: £1.9 trillion"

Sources of capital

In our paper last year we noted some overlap between the investors lending to HAs and those funding new FPRPs. But while the types of fund targeting each type of organisation may be similar, the origins of that money may be very different.

HA/FPRP debt is a good fit for annuity investors: it provides stable, quasi-government-backed, inflation-linked returns. It is hardly surprising, then, that so many of the institutions buying HA bonds are domestic pension funds and insurers. But this type of investor is hardly unique to the UK, and there is plentiful appetite from equity funds too.

Evidence from our interviews with FPRPs suggest they are also seeing demand from equity in pension funds, insurers, and endowment funds from North America and Europe. The FPRP phenomenon is broadening the range of types and geographies of investors helping to deliver affordable homes. There are regulatory challenges for UK FPRPs raising funds overseas, which can act as a disincentive for investors. But as FPRPs grow in scale and the size of the opportunity for investors grows, so too does the incentive for them to overcome that regulatory barrier. The snowball has only just started to roll.

Older Persons Shared Ownership

It's no secret that the UK's population is ageing. The population aged over 65 will rise by 4.2 million between now and 2042, according to ONS projections. The older generation is also among the richest: homeowners aged 65 and over own 42% of all homeowner equity: £1.9 trillion.

But that equity is distributed unevenly. Over 1 million households aged over 65 live in social housing and a further 382,000 live in the private rented sector, according to the English Housing Survey.

The scale of need for affordable and intermediate housing options for this group is huge. So too are the barriers to meeting that need. Only 10% of overall grant is available for specialist and supported housing, including Older Persons/retirement housing.

Current grant models for Older Persons Shared Ownership are in need of updating to help open up new markets of supply. The current mainstream SO grant model, with the ability to apply an age restriction, would help this.

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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