Private capital in affordable housing

Exponential growth ● Long-term capital ● Policy risk
Doubling down

Private investment into affordable housing is growing fast. In 2015, just 25 for-profit registered providers (FPRPs) owned 395 homes. Five years on, the number of homes FPRPs own had grown by a factor of more than 20. The number of providers hit 53 in 2021.

FPRPs still own a tiny proportion of all affordable housing: they made up less than 0.2% of stock in 2020. But investor appetite for affordable homes is substantial. FPRPs look set to grow their share of low cost home ownership stock from 10% to 25% from development alone by 2026. Sales of established shared ownership portfolios to new entrants will push this number even higher.

We predict FPRPs could commit up to £23 billion for affordable homes by 2026, enough to fund 130,000 new homes for shared ownership and general needs rent.

We’ve based this forecast on interviews with seven of the current largest FPRPs. Conservative estimates from them suggest they’ll have completed around 75,000 affordable homes by 2026 with more in the pipeline.

We estimate total delivery of around 100,000 homes by 2026 accounting for growth from other active FPRPs. We can also expect to see substantial activity from new entrants in the next five years.

What kind of stock do the FPRPs own?

To date, most FPRP appetite has been for low cost home ownership (LCHO) products. They have more than doubled their LCHO stock every year since 2015.

Our survey of the biggest FPRPs shows they owned at least 12,227 LCHO homes as of March 2021, well ahead of the 9,313 reported in last year’s statistical data return.

FPRPs make up a growing share of LCHO supply. They added 2,719 LCHO homes to their stock in 2019-20. That’s 9.9% of the total increase in RP LCHO stock that year.

We expect to see FPRPs taking on more general needs rental stock as they become more established and can benefit from efficiencies of scale.

In 2020 they owned just 0.1% of general needs rental homes, but we expect this proportion to grow.

In total, FPRPs currently own less than 0.2% of all affordable housing. As existing providers mature and more new providers register, we expect to see their overall share of England’s affordable housing grow.
Why is affordable housing so attractive to new investors?

Long-term, inflation-linked income. Demand for investments with strong ESG credentials. Exposure to residential real estate. There are many reasons private investors might be interested in affordable housing, but we think these three explain much of the appeal.

UK private pensions represent £6.1 trillion, according to the 2016-18 Wealth and Assets Survey. A little under half of this wealth, £2.9 trillion, is held in pensions in payment. This means these funds need to generate a secure, long-term, inflation-linked income. Affordable housing has long been seen to offer precisely that.

At the same time, investors are growing more aware of the need to invest in sectors with a demonstrably positive impact. Accounting firm PwC predicts that Environmental, Social and Governance (ESG) funds will make up between 41% and 51% of total mutual fund investments by 2025. Investing in environmentally sustainable homes for low-income households through regulated providers is about as ESG-friendly as you can get.

Finally, we are witnessing a shift in real estate asset allocation. As retail property has fallen out of favour with investors, residential has risen up the agenda. Residential returns’ resilience through the pandemic reinforced the sector’s appeal. As a subsector of residential, affordable housing looks set to benefit.

Same capital, different route

Housing Associations (HAs) have long enjoyed safe haven status from annuity investors. To date, they have lent £87 billion to the sector. We expect that to grow to £130 billion by 2026.

There’s a great deal of overlap between the investors lending to HAs and those funding new FPRPs. Legal & General and M&G have long provided debt to HAs; now they can invest equity and debt in the sector with their FPRPs. This is a story of the same types of capital finding different routes to market. Some of the new lenders in the RP debt market may one day make the jump to equity investment, whether that means creating their own FPRPs or forming a joint FPRP with an HA.

New entrants’ business models will vary. Some will look to hold stock for the very long term, decades or more. Others may establish portfolios for onward sale to another RP, whether non-profit or for-profit. Alternatively, they might sell share capital or sell part of a tenanted portfolio to another RP, no different to portfolio sales between HAs.

Whatever the model, the homes remain owned by a regulated RP.

There are strong opportunities for partnerships between HAs and FPRPs. We are seeing interest in development joint ventures between HAs and new entrant FPRPs, to marry HA development expertise with private capital. This could include setting up a joint venture FPRP, to acquire homes developed by the HA and funded by the FPRP.

This is a marriage of HA development capacity and secure pipeline, with investor partner capital. With management retained by the HA, these investment partnerships can be structured flexibly to meet both partners’ objectives for returns. The outcome is continued delivery of affordable homes, whilst freeing HA capacity to invest in energy efficiency and decarbonisation works.

By 2026 FPRPs will...

- Deliver 75,000 - 130,000 homes
- Have committed up to £23bn

Through multiple models:
- S106 supply
- Grant funded development
- Partnerships with housing associations, local authorities, and developers

Doubling down

£2.9 trillion pension wealth in payment, seeking inflation-linked income
Shared ownership

Long-term security, but policy risks remain

Shared ownership remains attractive to For-Profit Registered Providers (FPRPs). That’s because it provides long-term income streams with lighter touch repairs obligations compared to social and affordable rent. There’s also the potential for house price inflation to boost returns.

Shared ownership, like other affordable tenures, is subject to policy risk. For now, however, it enjoys cross-party support as a way of helping people into home ownership. Recent changes to the shared ownership model had only a limited impact on its attractiveness for private investors.

Direct support

Government wants half the homes built through the 2021-26 Affordable Homes Programme (AHP) to be for affordable home ownership. By contrast, 36% of grant funded starts between 2017-18 and 2019-20 were for shared ownership.

This new funding suggests we’ll see an additional 90,000 grant-funded shared ownership homes built over the next five years, an average of 18,000 per year. This is 73% higher than average grant-funded shared ownership starts over the last three years, 10,382.

The end of Help to Buy

There’s a lot of overlap between people buying through shared ownership and Help to Buy. In our February 2021 survey of London shared ownership applicants, 42% of respondents said they were also considering Help to Buy.

This competition won’t last forever. Help to Buy will end in March 2023. Some households who would have used the scheme could afford to buy without it, possibly buying a slightly smaller home or in a cheaper location.

For many, however, home ownership won’t be affordable without some form of support. We’re already starting to see evidence of demand shifting from Help to Buy to shared ownership. Government introduced new, lower price caps for Help to Buy in most regions from April 2021. Our clients have reported higher sales rates for larger shared ownership properties, which would have exceeded the new price caps.

Government is creating a new affordable home ownership product, First Homes, to help meet this demand. But shared ownership needs a lower deposit and has lower income requirements than First Homes. When Help to Buy ends in 2023, we expect a significant number of people who would have used it to look for shared ownership homes instead.

The chart below compares the income and deposit needed to buy the same home through shared ownership, Help to Buy, and First Homes. Each scheme has different characteristics, which will attract different types of buyers. This suggests there’s space for each of these supported routes to home ownership to coexist.

<table>
<thead>
<tr>
<th>Affordable options</th>
<th>Comparative costs of different routes to home ownership</th>
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<tbody>
<tr>
<td>Property value</td>
<td>Outright ownership</td>
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<td></td>
<td>Deposit</td>
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| Min deposit | £30,000 | £15,000 | £21,000 | £7,500 | £3,750 | £1,500 |
| Min income   | £60,000 | £50,000 | £42,000 | £38,600 | £31,300 | £27,000 |

Source: Savills Research
Challenges ahead
That’s not to say First Homes won’t present challenges. Planning guidance published in May 2021 will require at least 25% of developers’ Section 106 contributions to be First Homes.
This will reduce the supply of LCHO homes through Section 106. Our modelling suggests developer contributions would have delivered 20,071 First Homes over the last three years. But shared ownership delivery would have fallen from 25,297 to 17,929 and Affordable Rent delivery from 36,118 to 25,599.
With less Section 106 stock available, we expect to see an increase in FPRPs seeking grant to develop affordable homes. Strategic Partnership funding is now available to FPRPs for the first time and we expect the sector to take up a larger share of grant funding to deliver their growth objectives. As they deploy more grant, FPRPs’ share of total delivery will grow, made possible by existing strong relationships with volume and SME developers.
Government has also announced changes to the shared ownership model. Homes England and the GLA have both announced new shared ownership homes must be sold on very long leases. That will remove the need for shared ownership to hold steady from FPRPs. There is a risk that all RPs will face much higher costs if homes need more extensive repairs: replacing external cladding, for example. However, with careful due diligence during development and appropriate insurance, providers can mitigate this risk.
Smaller first tranche sales are a double-edged sword. The larger the rented portion, the greater the discount and the greater the impact on development value. On the other hand, this leaves more equity that FPRPs and other private investors could acquire.
These staircasing reforms come with challenges. But agreeing prices through a streamlined valuation mechanism for smaller staircasing steps could help minimise costs. And provisions written into the lease can streamline the legal process of staircasing.
The changes to staircasing will make it more common – it is a lot easier to save up 1% of your property’s value than 10%. A smoother, more predictable stream of staircasing receipts is likely to be more attractive to private investors.

Making leasehold work for residents
Leasehold reform is not a challenge specific to shared ownership, but it is one the sector must face.
Homes England and the GLA have both announced new shared ownership homes must be sold on very long leases. That will remove the need for shared owners to pay for lease extensions.
Service charges will be harder to address. More than half, 54%, of respondents to our shared ownership applicant survey said they’d prefer to buy a home with fewer amenities to minimise their service charge. RPs should look for ways to keep service charges low, so these homes are affordable to the greatest number of people.
Affordable and social rent

General needs rent is the majority of affordable housing, but for-profit ownership is limited for now

General needs rented housing is, by far, the largest category within affordable housing. It made up 84% of all affordable homes and 72% of the homes owned by private registered providers in 2019-20, almost 2.2 million homes. We estimate this stock is worth £270 billion at existing use value. Little wonder then that FPRPs have only scratched the surface here, owning just 0.1% of stock.

The supply-demand fundamentals for general needs housing are strong. Local authority waiting lists provide a ready-made list of potential tenants, keeping occupancy high.

Most FPRPs provide a mix of shared ownership and affordable rented homes. But as more FPRPs register, there will be greater competition for stock. Providers who want to build large, diverse portfolios will have to deliver more affordable and social rent.

Policy risk

In April 2020, the social housing rent cut came to an end. Registered providers were allowed to raise their rents for the first time since 2015-16, following four years of 1% rent falls. Is there a risk we’ll see further rent cuts?

It would not be the first time registered providers have had to face a U-turn on rent policy. In 2013, the Coalition Government announced a ten year rent settlement where social rents would rise at CPI + 1% from 2015-16. Just two years later, the Chancellor announced rents would instead fall by 1% annually for four years. This kind of policy volatility could put private investors off from funding more affordable rent homes.

Slowing growth

Growth in affordable rented stock is likely to slow. We estimate First Homes will cut supply from developer Section 106 contributions by over 3,500 homes per year. The new, larger Affordable Homes Programme (AHP) mitigates this fall. Had both First Homes and the new AHP been in place for the last three years,

We expect housing associations to rationalise their stock to unlock financial capacity for sustainability improvements
Affordable and social rent

The 2021-26 Affordable Homes Programme mitigates First Homes’ impact on affordable delivery

there would have been 2,698 more Affordable Rent starts per year.

Rented homes made up the lion’s share of Section 106 over the last three years. Developers contributed 12,039 affordable rented homes on average each year, 52% of Section 106 delivery. And they delivered a further 3,784 social rented homes.

Government wants First Homes to make up 25% of affordable homes built through Section 106. Social rent supply will be protected. But we expect this policy to reduce the number of affordable rented homes delivered through housebuilder contributions. Had First Homes been in place over the last three years, we would have seen -3,506 fewer affordable rented homes per year.

Between affordable rent, London affordable rent and social rent, rented homes made up 76% of grant-funded housing starts over the last three years. This will change in the next AHP. Government wants half the homes built in the 2021-26 AHP to be home ownership products.

Government plans to fund 180,000 homes through the 2021-26 AHP. With half of these going into ownership tenures, that leaves grant for 90,000 discounted rent homes, an average of 18,000 per year. That’s 43% higher than the 12,602 started on average over the last three years.

The rational choice?

New delivery is not the only way for new entrants to acquire affordable rented homes. We expect to see more housing associations rationalise their portfolios as they seek to contain costs and unlock financial capacity. FPRPs will face stiff competition from housing associations and local authorities for mixed tenure housing.

We expect housing associations to continue to acquire most stabilised mixed tenure and older persons and supported housing portfolios. FPRPs will be the main buyers of stabilised shared ownership housing as they are able to acquire at scale – and housing associations will reserve capital for general needs and specialist portfolios, and development.

Local authorities, itching to use their unlocked housing revenue account borrowing, will also be active in this market. There are already examples of local authorities buying rented stock from a private registered provider, such as East Riding of Yorkshire. These transactions are unlikely to be the last.

Mythbusting

There has been less private investment into social rented homes, both due to lower supply and a perception that affordable rent generates stronger returns with less intensive management.

This perception will change as investors gain familiarity with the sector. There is a common tenant profile across the two rented tenures. And social rent attracts more grant funding per home and/or a greater Section 106 discount. This means social rent will be able to support returns in line with investors’ expectations.

Scale and growth of FPRPs

Number of homes and capital committed

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<tr>
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<th>Past growth</th>
<th>2026 expectations</th>
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<tr>
<td></td>
<td>2015</td>
<td>2020</td>
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<tr>
<td>Total number of FPRPs</td>
<td>25</td>
<td>49</td>
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<tr>
<td>Estimated number of homes owned - surveyed FPRPs*</td>
<td></td>
<td>12,227</td>
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<tr>
<td>Total number of homes owned by all FPRPs</td>
<td>395</td>
<td>9,313</td>
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<tr>
<td>Estimated total capital committed by FPRPs1</td>
<td>£0.07bn</td>
<td>£2.1bn</td>
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* Savills survey of seven of the largest active FPRPs
1 Assuming average cost of £175k per home

Source: Savills Research, Regulator of Social Housing