IPF Research Programme 2011–2015

MAJOR REPORT

Prospects for Institutional Investment in Social Housing

This research was commissioned by the IPF Research Programme 2011–2015

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This Programme supports the IPF's wider goals of enhancing the understanding and efficiency of property as an investment. The initiative provides the UK property investment market with the ability to deliver substantial, objective and high-quality analysis on a structured basis. It encourages the whole industry to engage with other financial markets, the wider business community and government on a range of complementary issues.

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Foreword

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England and Wales face a crisis in the provision of affordable homes to rent. The situation is particularly acute in the south east of England, where demand for rental accommodation hugely outstrips supply, thus driving market rents to levels that many in work can no longer afford. As a consequence, this has led to a significant demand for social housing.

Institutional interest in this sub-sector of the residential market is growing, attracted by the proposition of an investment profile of potentially long-term, index-linked income to support returns and to match against pension liabilities. To date, however, there have been few examples of institutions investing directly into this segment. Why is this?

The IPF commissioned the following research to consider the strategic options for new investment in the sector, with view to answering questions such as:

What is driving the appetite for investment? What are the attractions to and requirements of investors from a financial and portfolio perspective? What - if anything - is preventing investors from entering the market?

From the social housing providers' side, the IPF has also sought to understand their appetite for new sources of finance and how they manage their investments. If additional funding were to be forthcoming from the institutions, how welcome would it be?

Against a backdrop of welfare and benefits reform, the social housing market may be too politicised for some investors, but, driven by demographic trends, there are long-term structural changes affecting the residential market and there is a huge store of potential investment stock that could provide greater certainty of returns to investors in the years to come.

Ultimately, this research seeks to determine whether a clear case can be made in support of institutional investment in social housing in the UK, and considers how the issues are addressed in continental Europe, Australia and the US. It highlights significant interest in equity investment in the sector from institutional investors, but shows that in the current climate of low interest rates social housing providers have a preference for debt financing. This mismatch of requirements, and the barriers to importing often very different models from other markets, suggests that there are significant hurdles to be overcome if social housing is to become a meaningful part of UK investors' real estate portfolios. This paper should therefore be a useful catalyst to the debate.

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1. EXECUTIVE SUMMARY

This research project was commissioned by the Investment Property Forum (IPF) to investigate how institutional investment might be expanded in the social housing sector in the UK, primarily through the Housing Association (HA) route. The brief was to consider three broad questions:

i. What is driving the appetite for investment? What are the attractions to/requirements of investors from a financial and portfolio perspective? What (if anything) is preventing additional investors entering the market?

ii. What is the appetite for new investment from Housing Associations, by reference to property type, time horizons and other factors, and how do they manage their investments? If additional funding were to be forthcoming, what would be done with it?

iii. Having identified any mismatches between investors and HAs, what solutions exist to overcome these issues and encourage more investment? What are the potential benefits to the respective parties?

The study used a combination of literature review, structured interviews with HAs and investors, round table discussion with representatives of both types of organisation and case studies across Europe in order to address these questions.

The research shows that:

- UK institutional investors currently have very little equity ownership of social housing. Although their total assets exceed £3 trillion and property assets of well over £150 billion, equity investment in social housing accounts for only £0.4 billion, a tiny fraction of the value of social housing in the UK.
- There has been a substantial increase in the use of bond finance for the provision of social housing, and this is widely embraced by HAs. Bonds (notably fixed interest rate bonds) are the primary route by which institutions have provided finance to the sector. Sale and leaseback deals have been the main form of equity investment.
- The credit strength of the sector and lack of any losses to investors through the financial crisis have reinforced views that these assets are as a valuable source of diversification of credit risk. The Regulator (Homes & Communities Agency, HCA), is recognised as having a valuable role in potentially reducing the risk of investing in social housing.
- A low interest rate environment and need to de-risk life and pension fund portfolios have supported a move to alternative low-risk assets. The attractions of index-linked cash flows are an important part of the attraction of equity investment in social housing.
- Equity investment in core social housing property in existing HAs is limited. Investors are keen to expand their sale and leaseback portfolios, as well as many of those that have not yet invested but shown interest in the sector. Barriers to more equity investment, from the investor perspective, include:
  1. Lack of understanding of the sector and the risks involved;
  2. Concerns about reputational risk;
  3. Scale and accessibility/deliverability of investments; and
  4. Due diligence requirements.

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- The advantages of bond finance, compared with bank lending, as viewed by HAs, include overall cost, the term, lower asset cover ratios and less onerous governance requirements.
- HAs do not appear to have significant or substantial appetite for equity investment in their core social housing activities. This is because:
  1. Equity investment is seen as more expensive. Many HAs see the combination of bank and bond financing as meeting all their anticipated requirements;
  2. Asset cover ratios are not so stretched that more equity-style finance is required;
  3. There are other capacity constraints on their expansion (e.g. the availability of land and development capacity), which means that their requirements for funding are unlikely to change rapidly;
  4. For some HAs, there are concerns that less support to the sector from government and lower rates of rental increases will lead to a squeeze on reserves, which, consequently, leads to a cautious approach to expansion;
  5. The focus of some HAs is on the management of existing stock and they have no strong incentive to expand aggressively;
  6. There is a perception that equity investment implies index-linked payments by the HA to the investor and there is a concern that these may become less affordable over time.
- Shared ownership housing and intermediate rental housing are seen by both HAs and institutional investors as areas that are likely to be more suited to greater equity investment than core social housing.
- There is scope to expand equity investment in shared ownership. These assets provide a low-risk route for investment and equity funding in this area and should provide HAs with additional resources for other activities.
- Social Housing Real Estate Investment Trusts were not seen by either HAs or institutional investors as being a useful route for their needs, with the challenges of a sustainable dividend yield, additional costs and the lack of need for liquidity from investing institutions.
- Funding models used in Europe and North America show that equity does not seem to offer obvious models that could be readily implemented in the UK without substantial institutional change. Where such investment is significant, it is supported by a policy environment that includes tax incentives. Development of these types of models in the UK would require substantial changes in housing finance and taxation and the political will to make such changes permanent.
- The potential for more equity investment in social housing will not be realised without providers and investors being more convinced of the mutual benefits of such investment nor without them working to actively realise those benefits.
- More equity investment in social housing may be encouraged by policy changes that include taxation advantages and the promotion of an understanding by investors of the low risk, secure long-term returns. Such policy changes would recognise the wide social and economic benefits of an increase in the supply of affordable housing.

2. INTRODUCTION

This research project was commissioned by the Investment Property Forum (IPF), under its Research Programme 2011–2015, to investigate how institutional investment might be expanded in the social housing sector in the UK, primarily through the Housing Association (HA) route. The brief posed three broad questions:

i. What is driving the appetite for investment? What are the attractions to/requirements of investors from a financial and portfolio perspective? What (if anything) is preventing additional investors entering the market?
ii. What is the appetite for new investment from HAs by reference to property type, time horizons and other factors, and how do they manage their investments? If additional funding were to be forthcoming, what would be done with it?
iii. Having identified any mismatches between investors and HAs, what solutions exist to overcome these issues and encourage more investment? What are the potential benefits to the respective parties?

The research was carried out in four phases. The first stage was a desk-based literature review, focusing on identifying the investment characteristics of social housing as a potential asset and considered institutional investment in social housing in the UK as well as internationally, including Australia, Europe and the United States of America. This review also informed the selection of a sample of HAs and institutional investors in the UK for primary research.

The second stage comprised a series of semi-structured telephone interviews with, firstly, the Finance Directors/Heads of Corporate Finance in selected HAs to explore their funding needs and to ascertain their views on attracting institutional investment. Secondly, interviews with fund managers/consultants explored their experience and interest in investing in the sector. These discussions sought to identify the key characteristics of the existing financial models in use, to explore barriers to investment in the sector and to ascertain the issues to be addressed in any new models.

The third research element, the European case studies, described the extent of institutional investment in the social housing sector in France, Germany and the Netherlands. In each country, social housing providers and institutional investors were interviewed to identify the main factors (e.g. government policies, specific financial models) that help to attract institutional investment in social housing.

The final empirical phase of the study was a half-day round table discussion between HAs and institutional investors on the preliminary findings of the research. Its objective was to address issues on: the mismatched expectations between the two parties, how these could be resolved and new innovative models.

This paper reports the main findings of the research. The detailed literature review and three country reports are included as Appendices. A list of people who assisted the Research Team with the study and to whom they are very grateful appears in the Acknowledgements.

3. CURRENT STATE OF INSTITUTIONAL INVESTMENT IN SOCIAL HOUSING

3.1 Social Housing in the United Kingdom

Social housing is often defined as low-rent housing for people on low incomes. According to the Homes and Communities Agency[1] (HCA, 2013), it includes general needs housing, supported housing (housing with supportive services for particular client groups, such as those with mental health issues, learning or physical disabilities, addiction issues, victims and women at risk of domestic violence, teenage parents or ex-offenders), housing for older people, shared ownership (where the purchaser owns less than 100% of the equity in the property), intermediate rent (a mix of renting and owner occupation, such as keyworker housing), and affordable rent housing. In this research, HCA definitions have been adopted and shared ownership, key worker and affordable rent housing are all treated as intermediate rent housing, whilst homes from general needs and supported housing are defined as conventional social rented housing.

There are approximately four million social housing units in the United Kingdom, which equates to about 18% of total housing stock. These are split between 2.4 million units with registered providers (RPs, HAs or private developers using government grants: 10% of total housing stock) and 1.7 million units that are still retained by local authorities (8% of total stock). Almost half (46%) of HAs' units were once in local authority ownership. Much of the rent in the social rented sector, 62%, is paid by the state in the form of housing benefit (HB) according to the British Property Federation, 2013.

RPs have gross assets with a book value of £95 billion, but estimated open market value of approximately £250 billion. These assets are funded through grant support (£37 billion), debt (£45 billion) and reserves (£16 billion). Debt as measured per unit, is below £20,000. Grants are non-interest bearing, repayable only on the sale of an asset, if not recycled. The rental income generated by the sector is around £9.2 billion per annum, i.e. around £75 per unit per week (British Property Federation, 2013) implying a gross yield of around 3.7%.

Most RPs are HAs, which are non-profit organisations or 'third sector' social housing providers (Pawson and Sosenko, 2012), strongly regulated by government agencies. They can receive capital grants to construct and manage housing for low-income households including those with support needs. Each HA is registered with a non-departmental public body (separate ones exist for England, Scotland, Wales and Northern Ireland) that sponsors and regulates the HA.

The social housing sector has a low void rate (2%). Arrears run at 4.3%, but there is some concern this might grow following the reforms to how HB is paid since April 2013. Most tenants have security of tenure although there is a turnover of tenants of about 4% to 6% per annum (British Property Federation, 2013.

A number of HAs are actively involved in private rented or development for sale initiatives, but the focus of the current study is on investment in social housing (including shared ownership and key worker/affordable rent housing).

3.2 Institutional Investors in UK Social Housing

The main kinds of institutional investor are:

i. Occupational pension funds: categorised as defined benefit, defined contribution and hybrid schemes;

ii. Insurance companies: life, health and non-life insurance products (who also conduct pension business on behalf of companies and individuals);

[1] The HCA is an executive non-departmental public body, sponsored by the Department for Communities and Local Government, regulates social housing providers in England.

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iii. Pooled investment vehicles, such as unit trusts, open-ended investment companies and investment trusts; and

iv. Other financial institutions, such as charities, endowments and educational institutions.

As at the end of 2012, the total assets of insurance companies, pension funds and trusts were valued at £3,284 billion (ONS, 2014). The recent Investment Property Forum (IPF, 2014) report on the size and structure of the UK property market estimated that institutional investment (pension funds, insurance companies, collective investment schemes and traditional estates/charities) accounted for £146 billion of the £364 billion UK commercial property investment universe (42% of the total).

The latest IPF survey of institutional investors' attitudes and investment in residential property (2014) covered 49 respondents (institutions, REITs and property companies) with a total value of investments exceeding £4.8 trillion of which 4.2% (£200 billion) was invested in real estate with only £12.8 billion in residential property. Of this £12.8 billion, the main investments are in private renting (market rent/assured shorthold tenancies) £4.4 billion, student accommodation £2 billion, development land £3.1 billion and ground rents £1.5 billion with only £0.4 billion in social housing. To date, therefore, equity investment in social housing has been limited. However, the survey highlighted significant investment demand for social housing with social housing investment intentions for the next year estimated at £1.5 billion, only just behind investment intentions for the market rented sector.

3.3 Institutional Investment in HA Housing

There are a number of forms of institutional investment in HA housing. These include HA bonds, development partnerships/joint ventures and sale and leaseback agreements. The first involves no sharing or transfer of ownership to the investor and typically sits with fixed income investment teams, whilst joint ventures and sales and leaseback agreements may be seen as more akin to direct property investment.

Bonds issued by HAs have been the main mechanism by which institutions have invested in the social housing sector. The bond structure is well established, investors' awareness of the sector is high and the ability of the sector to withstand the global financial crisis (GFC) of the last six years has enhanced its credit standing. At the same time, historically low gilt yields have made longer-term financing attractive. Investors include UK insurance companies such as Aviva, Legal and General, M & G (Prudential) and Standard Life. Moody's latest figures (2014) show that from 2011/12 to 2013/14, £7.9 billion was raised from the capital markets for the HA sector, equivalent to 63% of total external finance raised by the sector over the period. The financial crisis has restricted banks' willingness to lend and low gilt yields have supported greater use of longer-term finance.

Some institutional investors, particularly pension scheme investors, have recently set up development partnerships/joint ventures that allow them and HAs to work together to develop new homes that can be sold as affordable homes, part sold or rented under management by the HAs. The level of equity involvement from both sides can vary. The pension fund can become the sole equity investor, providing 100% of the capital or there can be a joint equity investment by both. Pension funds potentially benefit from increased returns due to capital gains and also access long-dated inflation-linked cash flows. However, joint ventures are more common to date in the development of new private rental dwellings rather than social rental units.

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Sale and leasebacks have been used by corporations and some universities as a way of diversifying their funding sources and releasing value from existing assets to finance new activity. In the social housing sector, under the most commonly used sale and leaseback agreement, institutional investors buy a number of existing properties and lease them back to the HA for a period of 30 to 50 years but, at the end of the lease, the assets are returned to the HA for a nominal repurchase fee, therefore staying within the HA sector. The institutional investor receives an income (usually index-linked) over the term of the lease, which is not generally directly linked to the rental income the HA receives from the properties. Unlike bond issues, this form of investment is less well established, with Aviva and Legal and General having made investments through this route on behalf of both internal insurance clients and pension fund clients.

To summarise, debt investments are considered to be less risky than equity investments. Equity investments have the potential to deliver higher returns but carry higher risks. Sale and leaseback deals have many of the characteristics of (index-linked) debt, but with the value of the real estate providing time-varying security. The level of risk depends on many different factors, including the type of property being built, the amount of development risk being taken on, the size of the project and the location of the development. To date there has not been significant equity investment through other routes into the sector. More background information about institutional investment in the social housing sector can be found in the Literature Review at Appendix A.

4. FINDINGS FROM HOUSING ASSOCIATION INTERVIEWS

The primary purpose of the HA interviews was to identify the current level of and future intentions to use, institutional investment as a source of funding in new housing development, whilst also seeking solutions to reduce the barriers that prevent institutional investment in social housing.

Thirty-one HAs were invited to participate, of whom nine were interviewed. These were not intended to be nationally representative and were chosen because they represented a range by both scale of stock and location across the UK.

The nine HAs interviewed are included in the organisations listed in the Acknowledgements.

4.1 Profile of HAs Interviewed and Development Activity in the Last Five Years

Table 4.1 shows that four out of the nine HAs interviewed were of medium size, owning 10,000–20,000 social housing units. Only one HA interviewed owned more than 50,000 social housing units, and two owned fewer than 10,000 units. In terms of the locations of the social housing stock, only one HA had stock distributed throughout England, two had stock only in London, one in London and the South East, one in the south of England, one in the Midlands, two in the north of England and one in Scotland.

Table 4.1: Profile of HAs interviewed and new development (2009-2014)

HA	Total no. of social housing stock	Geographical distribution	Sources of funding
A	>50,000	Across England	Bonds, HCA grant and sales of properties
B	<10,000	North of England	Banks and sales and leaseback
C	<10,000	Scotland	Banks and aggregate bonds
D	10,000-20,000	Midlands	HCA grant, banks and bonds
E	10,000-20,000	London and South East	Banks and aggregate bonds
F	20,000-30,000	London	Banks and bonds
G	10,000-20,000	South of England	Banks, bonds and HCA grant
H	10,000-20,000	London	Banks and EIB
I	30,000-40,000	North of England	Banks, HCA grants and own resources

All HAs interviewed had undertaken new development in the last five years. As seen in Table 4.1, HAs funded these activities through a combination of private and public finance. Bank lending continues to be a key funding source, accounting for more than 50% of total financing. Alongside bank lending, institutional investment has been growing in importance as an additional source of funding. All of the respondents, with the exception of one HA in the north of England, had raised funding from institutional investment, usually through bonds, either issued via public issuance or private placement. Only one HA had received funding directly from the European Investment Bank (EIB). Also, one HA used proceeds from the market sale of existing properties to fund new developments. In terms of public subsidy, only four HAs received funding from the Homes and Communities Agency (HCA) grants – the ratio of government grants in the total development cost was less than 25%.

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In cities, such as London and Edinburgh, new-build properties were most likely to be flats, in which the majority have two bedrooms. Outside cities, they were primarily houses, with the majority have three bedrooms. In terms of type of social housing, there was a combination of affordable rented and general needs rented homes, and shared ownership or market sales units. HAs in the North of England tended to produce more general needs rented homes with very few or no shared ownership units. HAs in the south of England, particularly those in London, generally produced more affordable rented than general needs homes. They were also most likely to have a relatively high proportion of new-build units that were shared ownership and for market sales. In Edinburgh, Scotland, half of all new-build units were general needs homes and the balance were affordable rent. Outside Edinburgh, all new-build were general needs homes.

4.2 Recent Institutional Investment

Eight of the nine HAs interviewed had used institutional investment to fund their new developments in the last five years. Bond issuance was, by far, the main form of institutional investment. Bonds were typically structured with fixed coupon rates for 20 to 40 years. Most often, there was no amortisation prior to final maturity date.

Even with such a small sample, the findings from these interviews showed a general pattern of funding for the HA sector from institutions through bonds. Larger HAs, defined as those owning more than 20,000 units or were credit rated, issued ‘own name’ bonds through public issuance. The most common financial covenant was asset cover, in which at least 105% of the value of the bonds is secured on property; however, these sometimes included interest cover ratios. Standard recourse in the event of default was possession of the assets. These larger HAs had well-established practices to facilitate capital raising from institutional investors, including attendance at annual HA road shows, development of specially designed website for investors to give financial information and regular individual meetings with investors. Although it took HAs some time to set up the legal and charging process for public issuance, once the system was established, bond issuance was perceived to be a straightforward process. HAs could easily raise a large amount of money within two or three days. To reduce the holding cost, a number of HAs sold some of the authorised bond issuance into the primary market at the time of issue, then sold further tranches later in the secondary market.

For medium-sized HAs or HAs with no credit rating, bond issuance was through private placement with individual institutional investors in the UK or overseas. Private placement issued bonds had similar covenants and recourse provisions as bonds issued through public placement. The amount of capital raised through private placement could be quite small. One HA raised as little as £10 million through an overseas investor within the last five years.

For smaller HAs (i.e. those owning fewer than 10,000 units) and some medium-sized HAs, bond issuance was usually via an aggregator, such as The Housing Finance Corporation (THFC) or GB Social Housing. One HA obtained institutional investment through the subsidiary of THFC, Affordable Housing Finance, under the government’s Affordable Housing Guarantee Scheme. Aggregated bonds were usually required to meet both asset cover and interest cover covenants (i.e. ratio of net rental income/interest). The minimum property security value had to be 115% of the loan.[2] The standard recourse of aggregated bonds included cross-default provisions, in which HAs would have to share the risk if one of the members in the group collapsed. Most often, the bonds issued were senior debt. One HA received project finance from the EIB through the THFC. The interest rate of the loan was fixed for 25 years, with repayments starting at the 11th year. Specific covenants were attached to the debt, linked to the performance of two groups of assets, a total of 750 properties. The issued bonds were not, in this case, designated senior debt. Although there were significant

[2] At 87%, this still represents an LTV that would be very difficult to obtain for a commercial real estate senior loan through a bank.

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recourse terms, the HA commented that they were very comprehensive but not very aggressive, more like a standard long-term bank loan agreement. However, to be eligible for EIB loans, the project had to meet energy efficiency standards set by the EIB.

Amongst the sample, development partnerships/joint ventures had rarely been used for the development of social rented units. Joint ventures with institutional investors, established by two HAs, were for the development of private rented or properties for sale. One joint venture involved a combination of properties for sale and social rented housing, in which the rented units accounted for 30% of total new-build units. Finance for the joint venture was a combination of loans from both partners in addition to bank lending. The partnership was open-ended and created for three projects. There was a defined exit process for each project. Once the project was completed, the HA sold all properties (including social rented units) to another HA and shared the profits with the investor.

While bond issuance and development partnership/joint venture have been used to fund new development, sale and leaseback arrangements were solely for the acquisition of existing stock. Only one HA interviewed had entered into a sale and leaseback arrangement with an institutional investor in the last five years. The HA used the proceeds to acquire existing stock from another HA. The interview revealed that the HA had a very long term relationship (nearly 20 years) with the investor, established through the HA being a management agent for the investor's market housing, which then set up a sale and leaseback arrangement for the HA's student accommodation. Finally, in 2009, the HA entered into the first social housing sale and leaseback deal with the investor. The transfer value of the stock was based on market valuation at the time of acquisition, which the HA believed was better than the value it would have received from its bank. Lease payments were based on the Retail Price Index (RPI), but the HA will seek to change to Consumer Price Index (CPI) when the annual rate of rent increase changes after 2015/16 to CPI plus 1%. The length of the lease was 50 years, but in effect, 45 years as, for the last five years, rental payments will be notional. At the end of the term, the HA will pay £1 and the ownership of the leased stock will transfer back to the HA. Given the lack of long term/residual ownership of the underlying real estate, this investment route is still bond-like but the index-linked nature of the payments and the transfer of ownership of the underlying assets are the differentiating features from traditional bond investment.

4.3 Future Development and Funding Sources

All HAs interviewed had plans to expand their social housing stock, either through new-build or acquisition of Section 106 stock[3] in the next five years. For those HAs who planned to expand their stock through new construction, planned development would be in the same locations where they had previously developed in the last five years. The majority of the new-build social rented units would be charged at affordable rent. HAs who produced shared ownership units in the last five years planned to increase the proportion of shared ownership in their future output, with the exception of one HA that intended to have fewer shared home ownership units in its pipeline because of the perceived risk of achieving 'sales'. In terms of the type of new-build property, most HAs proposed to continue their patterns of output in order to meet local demand. There was no intention to increase the production of one-bed properties because of the 'bedroom tax'[4]. Some HAs anticipated that the increased demand for one-bed properties would be short-term and commented that more one-bed flats would create management problems (presumed to be due to a higher turnover rate for this type of accommodation).

[3] Section 106 of the Town and Country Planning Act 1990 provides local planning authorities with power s to require developers to contribute toward site-specific infrastructure and provision of affordable housing.

[4] The 'bedroom tax' is an under-occupancy charge, introduced in the Welfare Reform Act 2012, whereby working-age social tenants with rooms deemed to be 'spare' face a reduction in Housing Benefit.

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While HAs in the last five years funded new development through a combination of private and public finance, it was foreseen that bonds would increasingly become the main (or only) source of funding in the next five years. Some HAs assumed there would be no HCA grant available (as a result of the Coalition Government's austerity agenda) when they prepared their development plans. Also, bonds would increasingly replace bank lending as the main source of long-term finance because the banks were no longer able to lend cheaply or for long periods (now typically offering five rather than 20 year terms as had traditionally been the case). Indeed, some HAs that were not credit rated were undergoing or planning to undergo restructuring so as to obtain a rating in order to pursue public issuance of bonds. While there was an increasing appetite for bond finance, HAs continued to have very limited or no interest in using equity finance (joint venture and sale and leaseback arrangements) as a funding source to expand their core social housing stock.

4.4 HA Views on Institutional Investment

All HAs interviewed had positive views on institutional investment in social housing, but were referring primarily to bond finance. All stated that institutional investment had widened their funding base and brought more funding to HAs to support new housing development, acquisition of existing stock or refinancing of debt. In fact, institutional investment was the only source of finance during the GFC, when bank funding effectively ceased. HAs had not had to change their operational models in order to access institutional investment through the bond market. Some HAs, however, commented that they were becoming more commercially focused and paying more attention to performance metrics in order to ensure they remain attractive to institutional investors. In an indirect way, institutional investment had pushed HAs to focus on their performance and become better social landlords.

All HAs agreed that bonds offered many advantages over bank lending, stemming from better loan-to-value ratios, low risk, fewer covenants and minimal governance. Bond issuance allowed HAs to raise money quickly and gave them the flexibility to take advantage when pricing was good. Management of this type of debt is simpler than bank funding. One HA commented that it had raised more capital than needed but was able to afford the short-term carrying costs. The only requirement was to ensure that HAs made the scheduled coupon payments. For medium-sized HAs, with a limited pool of assets and little access to subsidies, bond finance allowed them to expand their assets without increasing social rents and cross-subsidy from other activities. Even in the case of sale and leaseback arrangements, the HA found that the management of the liability was straightforward, namely payment of the rental instalment when it became due.

HAs believed that they would continue to attract more institutional investment as the sector was regulated and government-protected - no defaults had occurred despite the failure of a number of HAs (Ujima in 2008 and Cosmopolitan in 2012). The sector also provide secured cash flow because of the underlying inflation-linked rental income that gave invetsors confidence that HAs would be able to the coupon. In addition, HAs themselves believed that their good management performance and track record in delivering social housing would sustain the attraction of investment in their HAs, particularly those with high credit ratings and property in London.

HAs also believed that, during the last five years, institutional investors had built up knowledge of the HA sector and were now able to differentiate between different types of HAs. According to them, institutional investment in HA housing was based on the perception of a particular HA, not necessarily on the property, and applied differential pricing according to different HAs. Even in the case of sale and leaseback arrangements, a long-term relationship need to be established to develop trust and more assurances than

4. FINDINGS FROM HOUSING ASSOCIATION INTERVIEWS

financial and legal due diligence would supply before any agreement could proceed. This was particularly important for medium- and smaller-sized HAs who were experienced in dealing with banks. HAs had to adapt their language to deal with institutional investors; one HA found that it was daunting to talk to investors who had no knowledge of the HA itself.

Overall, the interviews revealed that there was no barrier to prevent institutional investment in social housing, particularly in the case of bond issuances. In the past, medium- and smaller-sized HAs used to think that institutional investors would not invest in their HAs because of their small size and, hence, smaller amounts of capital required. Today, HAs believe they can access the bond market through many routes, and transaction size is no longer seen as an issue, although some medium- and smaller-sized HAs found that substantial conditions were required to be met in order to issue bonds via an aggregator. Even though they had no problem in issuing bonds, many medium- and smaller-sized HAs still thought that institutional investors needed to understand their distinctness from larger HAs. It was noted that in the past, there were some concerns that institutional investors had negative perceptions of the creditworthiness of HAs in the north of England. However, in the last two to three years, there have been a number of successful bond issuances by HAs in the north, which indicate that this is no longer a major problem.

A number of factors were raised that were seen as potentially affecting perceptions of the sector and the risks associated with investing in it. The introduction of Universal Credit[5] was viewed as a risk, but many HAs commented that they had made reserves to meet increased rent arrears and that this would not affect the value of their assets. HAs also expressed concern about possible changes in regulation – for example, how the HCA would handle the collapse of an HA. The lack of a long-term plan to set rental increases was also noted. At the moment, rental increases are due to be based upon the consumer price index (CPI) plus 1% from 2015, which will provide some certainty of the next 10 years' rental income streams. What might happen after 2025 would create uncertainty that could dampen the interest of institutional investors. In Scotland, the imminence of the independence referendum created an additional uncertainty for HAs, who they felt they had to wait to see what would be the best sources of funding after the poll.

There are barriers for HAs to accept index-linked finance. A number of HAs expressed concerns at potential cash flow problems if rental income failed to keep pace with inflation, either due to policy changes or a growth in arrears or vacancy rates. One HA that had entered into a sale and leaseback stated that it had to cap the extent of such index-linked arrangements at not more than 25% of the HA's whole loan portfolio.

[5] Universal Credit is a welfare benefit, launched in 2013, to replace six means-tested benefits and tax credits: Job Seeker's Allowance, Housing Benefit, Working Tax Credit, Child Tax Credit, Employment and Support Allowance and Income Support.

5. FINDINGS FROM INSTITUTIONAL INVESTOR INTERVIEWS

Concurrent with HA interviews, 11 investors were interviewed to gather their experiences of investment in social housing, whether successful or not. The investor interviewees included consultants that facilitate investment for clients and fund managers from life insurance and pension funds in both the public and private sector. The sample was not intended to provide empirical or representative conclusions for the sector; respondents were selected to obtain a breadth of views amongst 'equity type' property investors, versus those with a bond-only focus – in addition, the small sample lent itself to a deeper discussion of complex issues. The amounts respondents had invested in social housing varied from £25 million to £300 million, often intended to provide liability matching cash flows and/or, where applicable, capital growth – the investment objectives had a natural link with the type of investment made and views expressed by the respondent.

5.1 Experience and Motivation for Investment

The investment experience varied greatly amongst the respondents; all had given social housing some consideration, motivated at least in part by the perceived alignment of social housing investment with the de-risking of portfolios following the GFC. Four investors had successfully invested in either traditional social housing or shared ownership, while a further three had deals in the pipeline. Apart from one small/medium - sized pension fund that was considering investing via a fund, investors were working directly with HAs through equity-type participation in construction projects or sale and leasebacks. Notably, there was little evidence of investor participation in equity-type investment in traditional social housing beyond sale and leasebacks that revert back to HAs. Equity-type investment, with exposure to underlying capital value performance, appears to be restricted to other areas of HA operations, such as shared ownership.

Investor responses indicated that HAs played a key role in managing the number of tenant relationships – some respondents also specified the HA's role in mitigating reputational risk. This supports references in the literature to reputational risk as a deterrent to investing in residential real estate and HAs appear to be the chosen intermediary for many investors to mitigate such risk. Where equity participation in shared ownership was discussed, one of the key areas of equity participation - the role of the occupant as being a part-owner – was highlighted, as it provided an incentive for property maintenance and continuity of rental payments. Thus, shared ownership appeared to be a palatable diversification from commercial real estate, where liability for much of the maintenance is, similarly, the tenant's responsibility. Sharedownership investment was seen as attractive due to the index-linked cash flow and potential capital returns when staircasing (i.e. buying additional shares in the property) occurs.

Sale and leasebacks, which in many ways replicate bond investments (in that, from an investment perspective, these cash flows appear similar to those of a long-term fixed interest corporate bond, but with the added benefit of being secured against existing HA housing stock), are widely used in segments of commercial property but in a social housing context these normally permit the HA to repurchase the assets for a nominal amount at the end of the lease. These investments have been used by investors to secure index-linked cash flows (RPI or CPI) to support defined benefits or pension obligations. However, because many HAs prefer fixed-interest payments, some sale and leaseback investors indicated the possibility of fixed-interest structures as an alternative to inflation-linked payments. Despite leases being related to specific properties, these investors do not have a direct exposure to voids or arrears, as the HA is obliged to make lease rental payments regardless. Lease investors are not exposed, therefore, to full equity risk; the investment performance is not expected to be ultimately affected by the underlying asset value (given the repurchase option) or underlying rental income and they are transacted only with HAs assessed to be strong counterparties, normally medium-

5. FINDINGS FROM INSTITUTIONAL INVESTOR INTERVIEWS

to large -sized entities.[6] Their exposure to default is theoretically minimal and investors highlighted they had no interest in acquiring and running leased properties.

Other investors interviewed are either looking at the sector or have tried and failed to invest. Reasons given for not investing included: internal priorities and resources, the lack of attractive investment opportunities, pricing and generally being unready to invest. In relation to this lack of readiness, a number of respondents mentioned that the sector is new and the route of entry would need to be a simple investment as a first step, such as a straightforward refinancing of existing stock. This highlights that new investors have a hurdle to overcome, before taking more risk and participating further in the sector – successful transactions are required before the sector becomes recognised as a natural area of investment for a number of prospective investors.

5.2 Investment Structures

Sale and leasebacks

About half of the respondents either use or are considering sale and leaseback arrangements. Lease structures range from 30 to 50 years, normally providing index-linked amortising cash flows until the property reverts back to the HA for a nominal transfer value (e.g. £1). Some of these investors indicated a flexibility regarding structuring – e.g. amortisation, debt placement or using fixed uplifts. They are, in general, property-type agnostic, but preference for newer stock and quality threshold standards, such as Decent Homes standards, were highlighted. Responses suggested the type of housing could deviate from being general needs social housing; limited proportions within a transaction could derive from other categories (e.g. retirement homes). Leases were considered to require fewer covenants and security provisions than bonds, an advantage emphasised by the lease investors. A minimum deal size of £10 million highlights a further potential advantage versus bonds, which normally require larger placements. No evidence emerged of construction or development risk being taken on by the respondents to date, but some indicated openness to this in the future.

Transactions with HAs to date had been sourced from both a bidding process and one-on-one discussions. Attractions of leases noted by this investor group included: no need for a valuation (as assessment is based on net income), better asset utilisation (less security required for leases versus bonds), the ability to tranche payments to avoid holding costs (HAs at the round table, described in Section 6, suggested such flexibility with bond financing), being covenant light and lower initial rent on leaseback than the coupon payments for a conventional bond. Respondents declined to comment on the yields they were seeking, but suggested that they were competitive with bonds.

Fund investors in leasebacks are, typically, buy-and-hold investors, as they seek index-linked cash flows to match their clients' liabilities. They are passive investors in the sense that they are not looking to influence the management of the underlying assets, requiring at least annual reports, including such information as a schedule of properties and passing rents. Further direct monitoring, such as by direct meetings, was not normally required, unless connected with prospective transactions. They look for strong counterparties (investment grade) and some investors stressed their focus on HAs that are generally interested in doing deals in the short term – that is, they have little capacity to educate the market and want to focus on those ready and willing to enter into transactions.

[6] Given expectations of rising nominal house prices, the value of the properties as underlying security for the lease should, on average, increase over time.

5. FINDINGS FROM INSTITUTIONAL INVESTOR INTERVIEWS

Shared ownership

Notable equity investments in social housing relate to shared ownership, where investments are made on behalf of life and pension funds, for both building new and acquiring participation in existing properties. Like the typical sale and leaseback structure, these provide index-linked cash flows; however, the tenant has the option to staircase out (reducing the investors' exposure), thus making duration less certain. Unlike typical sale and leaseback leases, however, the investor may benefit from property value appreciation when staircasing occurs. Development does not always appear to be supported by grants. In comparison with the private rented sector or traditional social housing, the equity stake of the tenant provides an incentive for them to take care of the property as they are responsible for repairs and insurance.

By virtue of structuring, with HAs taking responsibility for management and the incentives on the tenant, this type of investment was also suggested to mitigate the reputational risk associated with social housing. One investor emphasised the benefit to developers, as they have an investor that is able to purchase shared ownership properties that are a requirement under Section 106 planning obligations. Some preference was expressed for houses, but there is recognition that the opportunities to acquire shared ownership houses are limited in comparison to flats. Difficulty in securing properties in London was noted, due to pricing. As a result of staircasing, the life of the investment is shorter in duration than for a long-term lease: 25 years was the duration indicated by one investor for a shared ownership fund. If the tenant fails to make repayments, the investor has a claim on the remaining share.

This appears to be a significant niche area of social or affordable housing, which provides index-linked returns with less certainty as to duration in comparison to leases. Nonetheless, it provides an opportunity for 'property' participation in 'social' housing, where appropriate returns may be achieved without grants and reputation risk is more acceptably managed.

Funds and property trusts

Some of the respondents represented funds that allow multiple investors to participate. These funds normally aim to provide investors with index-linked returns. This type of indirect participation was being considered by one respondent, a medium-sized local authority pension fund. A much larger pension fund was considering direct investment, albeit their assessment of the sector was at an early stage. This suggests a possible segmentation of investors in social housing, where larger investors are able to make direct investments, while smaller investors need to pool money or participate in multi-investor funds. For smaller pension funds, the advantages of direct investment may be outweighed by pooling funds to achieve diversification benefits and improve liquidity and resource constraints (smaller pension funds do not have the resources to be experts in all asset classes or have the sourcing capacity). Some respondents indicated that they were in the process of establishing funds for multiple investor participation, which could be a growing route for more institutional investment.

One novel model identified was a property trust to fund the activities of Catalyst for Homes (C4H), a Community Interest Company (CIC). This aims to provide funding for both social and private market housing through a single investment vehicle and to help unlock sites for housing development. The social element would effectively be financed through a bond structure, lending money to an HA, whilst private market element would be equity-funded with the aim of returns above a base level partly feeding into the CIC for the benefit of the local community. The proposed fund, administered through a Jersey Trust, highlights a way

5. FINDINGS FROM INSTITUTIONAL INVESTOR INTERVIEWS

in which institutional investment can be focused on bringing additional development schemes forward by addressing both social and private market housing funding needs[7].

5.3 Interaction between Investors and HAs

Historically, and going forward, investors have sourced deals through direct contact with HAs, typically sized as medium to large, as well as through consultants. For the future, some investors indicated a continued push to raise awareness of their financing products to reduce the knowledge barrier amongst HAs, as discussed in subsequent sections of this report. In some cases, investors have used consultants to bridge their knowledge gap of the sector, notably, for one investor, where the fund was considering making its first investment.

5.4 Attractions of Social Housing

Respondents listed a number of motivations for investing, relating sometimes to specific categories of social housing. These reasons can be categorised into three groups: (1) cash flow and return prospects; (2) ethical and moral preferences of clients; and (3) regulatory environment (including the trend for de-risking investment portfolios) and macroeconomic conditions. Social housing and infrastructure are seen as growth opportunities, driven by underlying demographics and the need for housing. The underlying requirement to deliver returns or predictable cash flows was shared by all investors. Investments, such as index-linked leases, were selected to provide long-term predictable and liability-matching payments. Shared ownership also provide index-linked rental payments; however, the duration of such cash flows is less predictable (which may be mitigated by HAs taking some of the risk). Equity-type participation in shared ownership nonetheless provides the upside of capital growth, potentially boosting returns. In general, it was believed that there were diversification benefits from exposure to social housing relative to other commercial real estate sectors, given the stability of its cash flow over the cycle.

Social housing is seen as an asset that should retain its value and investors were seeking to achieve a blend of income with diversification away from traditional asset types. The current low interest rate environment has also driven down expectations, making social housing more palatable. Removal of certain benchmarks and the setting of total return targets, against which an asset manager may be assessed, were also highlighted by some investors: "When looking at property, social housing has not been expected to meet the peer group benchmark [i.e. based on commercial property]. This has changed when looking at inflation and risk." seeking investors were selective in the areas of social housing in which to invest to meet their return and reputation requirements, excluding the core body of traditional social housing.

5.5 Barriers to Investment

Access, scale and spread of housing stock

Access to stock is a significant issue for a number of investors interviewed. HAs, historically, have been the dominant owners and managers of social housing stock, acting as gatekeepers for investment into much of the existing stock. Investors commented that opportunities presented to them comprise dispersed properties. For one investor this is the biggest barrier as the spread of assets makes due diligence more costly, as the different developments need to be separately assessed on their individual characteristics. Age and quality of stock were also highlighted as a barrier, owing to the greater perceived uncertainties attached to older stock and likely higher maintenance costs. Poor stock may also be presented to investors as such investors are the option of last resort if debt finance is not available.

[7] However, the authors were unable to establish whether this vehicle had launched or attracted investors.

5. FINDINGS FROM INSTITUTIONAL INVESTOR INTERVIEWS

One respondent commented that social housing provision is often part of a wider residential development, which may explain why opportunities may be too few in number for some stock. As the interviews highlighted, the amount of stock is part of a wider building challenge for the UK, as there is a greater shortage of housing that could be addressed by releasing more land for development and by changes in the planning process.

Some regional differences in access to stock were noted by investors. In London and the South East, in particular, the funding pressures have been alleviated in a number of instances through the ability of HAs to raise capital by selling off properties or other operations in the open residential market.

Aversion to index-linking by HAs, treasury advisors of HAs and the HCA

Of particular concern for lease investors interviewed was the aversion of HAs to index-linking, which investors consider to be highly appropriate for the sector. The reasons offered for this phenomenon stem from inertia amongst HAs and how they consider advice and the stance and approval process of the HCA,, as well as the attitude of treasury advisors consulted by HAs.

Inertia originates from the long-running tradition of raising fixed rate borrowing from banks, bond markets and private placements. When given advice, this is perceived to be biased towards fixed rate debt, potentially due to the interests of the advisors chosen and the historical dominance of fixed rate debt. The fixed rate debt market is seen as deeper and there is an evidently large investor participation in fixed income investment. Following the failure of Cosmopolitan Housing Association in 2012, which entered into index-linked leases on non-core activities, the HC Aissued guidance, stressing the importance of the understanding and management of risk in index-linked structures. This is perceived as a deterrent to HAs and has had the trickle-down impact of HAs only turning to leasebacks after bond issuance or private placement options have been exhausted, which are seen to be easier options to raise capital.

The vested interest of some treasury advisors was raised as a concern, as they may gain additional fees for arranging bond issues. In general, advisors may recommend fixed-rate products, owing to the depth of market in comparison to index-linked products. Advisors are thought to promote fixed-rate bonds as a cheaper option; but lease investors counter such arguments due to the greater security requirements for bonds.

Cheap debt and alternative funding sources: reducing HA demand

It is evident that the ability to raise debt cheaply has a significant impact on HA choices. While interest rates remain low, the greater interest in fixed-rate debt is likely to continue.

For stronger HAs in particular, debt financing can be achieved at low interest costs, sometimes lowered even further through government guarantees. As a consequence, returns to equity investors are depressed, as they must offer a competitive alternative to HAs whilst pricing in the risks associated in the investment. Lease investors have also raised the concern that debt is falsely perceived to be cheap, as compared to sale and leaseback transactions, because higher levels of security is required against such borrowing. The higher security requirement in sale and leaseback has the knock-on effect of lowering the assets available for securing further debt; therefore, reducing the HA's assets utilisation potential, particularly in the environment of lower interest rates.

5. FINDINGS FROM INSTITUTIONAL INVESTOR INTERVIEWS

Some lease investors consider themselves as 'property' investors and do not directly benchmark themselves against bonds; rather they consider their investment returns to be competitive with bond rates. Their view is that they offer an alternative, ensuring a diversity of sources of finance that should be important to HAs and, potentially, government.

Given the pressures on social housing and the desire to keep funding costs as low as possible, the options for increasing returns are limited. Many investors are willing to accept lower returns as part of a de-risking strategy and for the benefit of index-linked cash flows. To improve returns for those investors that require better performance, one potential solution proposed is for investors to take more risk, such as construction/ development risk.

Political commitment, regulation and perceived bias against investment types

Even though, in some instances, the protection provided for both tenants and investors was recognised, there was a perceived lack of political support for institutional investment in social housing, as well as for encouraging more building to meet the housing shortage. For investors as a whole, this related to access to more stock and encouraging the development of more housing. For lease investors, requests for HCA policy changes were made, to take into account the diversity of investor preferences. More clarity on HA's rental increase regime would be welcome, to provide a better view of the sustainability of social housing income and RPI- or CPI-linked increases. More interaction with the broader investment community to increase institutional investment, as such investment to date is seen to be confined to a limited number of investors.

For sale and leasebacks, the burden of regulation was seen to be greater than that for debt. Even though these arrangements essentially introduce a liability analogous to debt, they still require tenant consultations for the purpose of compliance, even though there is little difference to, which that does not have such an obligation. The investor raising this issue stated that no other substantive objections from tenants have been raised so far.

Investor and HA familiarity

Concerns were raised by some investors of the time required to understand the HA sector and its regulations; investment in social housing is considered a specialist area of expertise and investors need to understand the regulations and to be sensitive to them. Conversely, HAs were encouraged to become more knowledgeable about investor needs and preferences. The recommendation was to promote open thinking amongst HAs regarding sources of funding, to reduce their reliance on advisors and encourage them to consider non-traditional sources of funding more positively.

Illiquid and time-intensive transactions

Investors appeared generally prepared and willing to accept the illiquid nature of their investments. Nonetheless, some remarked that others may prefer more liquid assets, such as those available in the bond markets. Relating to liquidity, deal-making was seen as resource and time intensive, with it taking three to six months to close some more complex transactions.

5. FINDINGS FROM INSTITUTIONAL INVESTOR INTERVIEWS

Reputational risk

Reputational risk was highlighted as a barrier (e.g. handling of HA default and tenants not paying rent). As noted previously, investors have worked with HAs to manage this risk, as the latter take care of tenant interactions. Additionally, investors appear to have no wish to manage residential property; accordingly, they will look for a good manager/partner in a joint venture.

Development risk

Respondents have mainly invested in stabilised assets, that is existing and recently completed properties. Many highlighted their interest in completed developments, being reluctant to expose themselves to development risk, whereas some respondents are open to participation at the construction stage and indicated a willingness to enter into such arrangements, provided the terms are suitably stuctured. In many instances, investment mandates do not lend themselves to development risk (e.g. mandates focused on stable, long-term index-linked cash flows). The lack of appetite for development risk may also be explained by an initial focus on simpler investments, the lack of required return, and a perception that HAs may not wish to share these higher returns, as well as the issue of scale/fragmented opportunities.

6. FINDINGS FROM ROUND TABLE DISCUSSION

6.1 Introduction

Following the interviews, a round table discussion explored some of the issues raised and to encourage interaction between the providers of social housing, actual and potential investors in social housing and advisors, together with the research team and members of the Project Steering Group. The round table provided a semi-structured forum for the exchange of ideas. Presentation slides provided context, setting out the preliminary findings from HA and investor interviews, as well as examining potential new models for investment and outlining possible lessons from other national markets. These topics were discussed sequentially and summarised in this section of the paper.

Participants included representatives from five HAs and four current investors in social housing. The HAs and institutional investors who attended the round table discussion are noted in the Acknowledgements.

6.2 Views of the HAs

HA representatives confirmed the evidence from the interviews, namely that the large majority of external investment in social housing is via debt funding with, increasingly, bond issuance coming to dominate new capital raising, as banks curtailed conventional lending. Much of this debt is medium- to long-term and typically on a bullet (that is, no amortisation of the principal during the term of the loan), fixed interest rate basis. There appeared to be a good appetite amongst investors to provide debt capital and not all bond structures were standard fixed coupon format, with a growing willingness to provide more flexible terms over drawdown, repayment schedules and amortisation. It was remarked that such lending was increasingly covenant light – as were leaseback arrangements.

There was some recognition that, while bond finance currently dominated inflows, capital markets could be volatile and so some diversification of funding sources might be prudent. However, competitive rates and availability leads most HAs to look initially to the bond markets. Bank lending may provide short-run flexibility (e.g. for bridging or development finance) prior to a switch to a longer-term basis. Alternative sources might include the EIB (through THFC or the Affordable Housing Guarantee Scheme, but possibly direct), as well as retail bonds (seen as new and expensive by HAs). The Affordable Housing Guarantee Scheme was characterised as inflexible but "cheaper than expected".

There was discussion of index-linking and sale and leaseback deals, but these were felt to be more costly relative to bond issuance and, given the supply, availability and favourable terms of the latter, offered little incentive to pursue. Some HAs reported that they had not seen any real appetite for equity involvement (and risk sharing) in the sector: one constraint on equity involvement in new development note was that the costs of delivery could exceed the economic use value, due to rental levels (although others commented that market values or, rather, market values subject to existing leases underpin the security for lending purposes).

Funding innovations and motivations to engage investors beyond debt appeared to be largely in the areas of activity that did conform to a strict 'social housing' definition, but offer the potential to provide cross-subsidies for core HA activities, for example, key worker housing and other below-market rents, shared ownership schemes, private rented subsidiaries. Illustrations of these comprised leaseback deals, joint ventures and equity participation, including capital from sovereign wealth funds and other non-UK investors. To an extent, these supported social housing activity as part of the HA business model, in many cases still representing subsidised housing.

6. FINDINGS FROM ROUND TABLE DISCUSSION

HAs were asked if they thought the lack of apparent equity interest came from the nature of the investors they were talking to and the mediating role of advisors (including, for some, their conflicted role in arranging bond issue a concern raised by some of the investors), which might entrench a fixed interest mentality and product. Most did not agree this was the case: they felt that they were knowledgeable and had access to a breadth of advice. However, those represented in the discussion might be considered to be more sophisticated organisations when compared to the whole of the HA sector.

HAs were also asked the extent to which the current bond dominance reflected a refinancing of existing programmes and back books, leveraged on existing assets, rather than reflecting a more aggressive growth agenda. Could standardised bond debt support growth rather than just act as a substitute for bank debt and what would happen when balance sheets were fully leveraged? HAs indicated that they felt they were far from that point, with one arguing that "the HA's biggest issue is not getting finance; we can raise as much as we can cope with to build". As well as noting the limitation of internal resources (e.g. the capacity of the development team), the issue of the availability of land was raised by HAs, which is a wider problem, creating a bottleneck in the provision of UK housing.

6.3 Views of Investors and Advisors

The interviews with investors demonstrated a wider preference for investment vehicles, with motivations including a need for indexation of rental income and liabilities matching, a wish to diversify investment into alternative sectors and the diversification potential social housing offers. Constraints mentioned included appetite and understanding from the HA sector, the role of advisors and difficulties with the Regulator, which issues were explored by the round table discussions.

The investors discussed their motivations for interest in the social housing sector, much of which echoed the interview findings. Demand for bonds was high and, increasingly, not geographically constrained. It was argued that deals were readily available outside the core London and South East markets, although the HAs suggested that it had not really spread to those providers created after large-scale voluntary transfers. There appeared to be interest in the provision of products other than bonds – leaseback deals were emphasised as being a significant component of lending to the corporate sector, but hard to establish with HAs. There was an argument for leaseback models to be more flexible in respect of cash flow structures and covenants, which could address the security and valuation issues that could constrain further capital raising through the bond markets, by providing a better utilisation of assets for this purpose.

In contrast, HAs argued in response that both leaseback deals and indexation seem more expensive and added an element of risk not present in bond deals (particularly fixed-interest debt where rising income and capital values provided headroom for activities). HAs indicated they were able to achieve flexibility on drawdown with bonds, whilst, at the same time, take advantage of current good rates. They also argued that some early aggressively highly leveraged private equity-style deals had caused reputational damage to the sector and that it was necessary to build a level of trust to develop more creative models of long-term finance.

6. FINDINGS FROM ROUND TABLE DISCUSSION

The degree to which indexation could be reflected in rents over the long term was questioned by one HA, as they currently see comfort in indexation to CPI for the next 10 years. It was also suggested that demand from investors also reflected the positive attributes of investing in social housing as part of a contribution to society and corporate social responsibility. Investors noted that they were in the market to provide sustainable finance, supported by a thorough internal investment committee scrutiny, with no interest in acquiring the security, and they felt that the inability to penetrate the HA sector was constrained by the Regulator and bad publicity surrounding prior failures that were out of context in relation to their proposition.

With respect to regulatory structures, it was argued that the presence of the Regulator provided some of the key investment characteristics of the sector but also created constraints. One investor is quoted as saying "we like the sector because of [the] regulator, but we struggle to deploy capital because of [the] regulator". This was questioned: what was needed to convince the HCA? An investor pointed out that the HCA could be extremely cautious, demanding to know if the HA really understood what they were signing up to, which could cause delays in approvals and inhibit investment.

There was discussion of equity investment in social housing. Some HAs had considered it, particularly if an equity injection might unlock a wider deal. However, the required returns for equity capital were higher than for bonds. HAs emphasised that such higher costs would require risk sharing and exposure of the investors to rental and capital volatility. Without such risk sharing, there was little incentive for HAs to consider equity investment, particularly in the context of relatively freely available capital market debt products at lower cost. For HAs, operationally, bonds and conventional debt seemed to offer the least risk, indexed-linked and leaseback products more risk and equity most risk of all – echoing the hierarchy of risk (and, hence, required return) for investors. This tended to create a mismatch. It was argued that conventional debt funding (for bullet repayment loan structures) did create refinancing risk, HAs suggested that expected growth would offset that. The broad consensus from HAs was that capital availability was much less a constraint than institutional capacity, the size of development team, land availability and planning constraints. They, the HAs, could borrow as much as they needed through the bond markets to grow at reasonable rates, whilst other vehicles or products did not generate such benefits.

An issue that emerged in relation to lower standard capital investment was scale and the need for due diligence. Investors indicated a preference for large, concentrated schemes and/or new development, contrasting this with the costs of analysing a widely dispersed portfolio comprising, for example, single, older units and smaller blocks. The overall scale of the deal was also an issue, given fixed underwriting and due diligence costs.

Turning from conventional rented social housing provision to other areas of HAs' activities it was felt, by both HAs and investors, that there was more scope for innovation. Areas discussed included key worker housing, the use of commercial or near-market rental activity to cross-subsidise social renting, mixed use developments and, in particular, shared ownership schemes, all of which formed a significant component of HA activity, particularly in London and the South East. It was noted that shared ownership could generate the capital component of total returns that made equity investment feasible for institutional investors. An option for joint venture vehicles that could flex housing between subsidised and market rents (such as proposed by the New Economic Foundation[8]) was discussed. While there was some interest, difficulties were noted, including the complexity of modelling risk in a mixed market/social rent structure: what were the required returns/costs and how could incentives be shared?

[8] "Home Group looks to pilot 'flex' tenure scheme on 200-unit site", Social Housing, 2 July 2014.

6. FINDINGS FROM ROUND TABLE DISCUSSION

For their part, the institutions expressed some interest in such unregulated or quasi-regulated vehicles, although it was the regulation that gave the sector many of its attractive investment characteristics. There was discussion of the extent to which HAs would be willing to act as letting and asset managers of privately-held portfolios of residential property on a fee basis. There seemed to be interest, but tempered by a wish to take an equity stake for the HA, as well as for the HA to deliver and manage the property.

There were some constraints to such initiatives because of the charitable status and objectives of many HAs, for example (although many had established organisational structures to accommodate these). However, it was emphasised that projects and schemes must not jeopardise the existing social housing stock, nor bring the sector into disrepute. A number of HAs noted the importance of ensuring the safety of the balance sheet – also an important component of the low cost of bond financing.

6.4 New Investment Models

A number of new investment models for the social housing sector have been advanced. For example, the HCA lists local housing companies, social housing REITs, PFI schemes, equity stakes in HAs and investor-owned partnerships with HAs appear as examples on their website. The Research Team sought to explore whether there was interest in such schemes from investors and HAs.

In general there was, at best, muted interest. One investor described such schemes as "a distraction". There was no enthusiasm for a Social Housing REIT, which seemed to offer few advantages for either investors or HAs, due to the complexity of making it work and issues with achievable dividend yields, given rental levels. Partnerships were seen as more valuable, particularly where there were balance sheet constraints on a development programme. There was some doubt over the likely investment time horizon of such vehicles (contrasted with the long maturity debt instruments seemingly favoured by investors, particularly where amortising structures are in place).

A key question with such vehicles was the required returns and, by implication, the costs of provision from an HA perspective. This links naturally to the question of the distribution of risk. Investors and HAs did not see any geographical constraints to such schemes (two of the investors having done deals in the North and in Scotland, whilst the non-London HAs had been able to secure capital), but struggled to find a clear motivation for them. In terms of implementation of innovative structures or vehicles, there were the same scale issues as previously discussed and the need to defray the costs of underwriting and due diligence over a large, concentrated portfolio, whether pooled or from a single provider.

It was suggested by the researchers that HA resistance to innovative models comes from a lack of familiarity or education. There seemed limited support for this, however – forums and networks already exist where HAs may find out and discuss new initiatives and many HAs have developed more sophisticated expertise. Not all of the investor and advisor participants agreed, however, and noted that there may be many HAs, particularly those small and medium-sized ones, where unfamiliarity and caution could lead to a rejection of new formats and funding models[9].

[9] See Williams et al. (2011) for a discussion of the advantages and disadvantages of such models.

6. FINDINGS FROM ROUND TABLE DISCUSSION

6.5 International Experience

Much of the debate on social housing provision and funding mechanisms remains very parochial. Are there lessons from the models pursued in other countries? Research findings from France, Germany and the Netherlands are detailed in Appendices B-D. These did not seem to offer obvious models that could be readily implemented in the UK without substantial institutional change. Apart from the dominance loan finance in social rental housing, there are other country specifics to be recognised.

In France, for the most part, investment in social housing, through HLM (Habitation à Loyer Modéré), is closed to outside investors, being made through state-regulated funding. Furthermore, intermediate housing (where rents are regulated, but at a level between social and market), is a policy focus. A new fund was launched in 2014, uniting several institutional investors. Its aim is to build up a supply of intermediate rental housing.

In the Netherlands, the policy focus is also on intermediate, middle-priced segment, rental housing. However, here rents are deregulated. Historically, there have been substantial private and institutional holdings in rental housing with a regulated rent. These regulated rents benefit from shifts upwards, but will have to cover a new tax, the landlord levy. As a result, regulated rental dwellings may be moved into the deregulated (middle-priced) segment of the rental market (subject to regulations on physical and locational quality).

The German subsidisation model allows for properties to transfer from social/subsidised to market once the period of subsidy has terminated. The very different institutional and tenure structures and substantial tax differences (for example, on depreciation allowances in Germany) mean that schemes and vehicles are very specific to that setting: the same applies to the United States' tradable tax credit scheme. Development of such models may require substantial changes in housing, finance and taxation in the UK and the political will to make those changes permanent.

6.6 Conclusions

One of the key conclusions from the round table was the need to focus innovative funding and investment models, not on traditional social rented housing, but on the intermediate rental (and shared ownership) components, where the higher rent levels (and possibility of capital return) give more scope for workable schemes. This then raised the question of the core nature of HAs' objectives – does the intermediate and near-market activity meet their charitable objectives, for example? Is it sustainable that intermediate rental and market rental/sale activity provide cross-subsidisation of social housing activity?

For HAs, the important consideration was about risk-return tradeoffs. Investors taking direct equity stakes need to find mechanisms for generating higher returns (on the assumption that they are also taking on more risk, which implies participating in rental growth and, potentially, realising capital gains, e.g. selling properties as they fall vacant, perhaps after a defined period. For such a model to work, there need to be incentives for the HAs, whether they are sharing the equity or acting as specialist managers of the real estate portfolio. This complementary role of specialist provider and investor poses difficult problems in aligning all interests and incentives. For debt funding and hybrid models, risk and return need to be distributed to provide adequate motivation for all parties.

6. FINDINGS FROM ROUND TABLE DISCUSSION

Finally, an important factor in considering and assessing potential models is the recent changes to regulatory practices and welfare arrangements. Examples of these include the substantial changes to HB, not least the ending of the direct payment to landlords of HB (known as 'passporting') and the spare room subsidy (or 'bedroom tax'). As a result, cash flows are less secure than hitherto, which has potential implications for credit ratings (at both HA and scheme levels). The planning and property tax regimes have significant impacts on land availability and scheme viability. Finally, regulatory and market shifts in financial services and the insurance and pensions industry (for example, the secular shift from defined benefit to defined contribution pension schemes) alter the nature of investment demand. These overarching issues all provide a critical context for the potential for new forms of capital investment in social housing.

7. EUROPEAN CASE STUDIES

Three European case studies were chosen to examine the extent of institutional investment in the social housing sector and to identify what measures have been used to attract institutional investment in their social housing. Detailed information for each country can be found in Appendices B to D. Below is a brief summary of the findings from the interviews.

7.1 France

Four French housing experts, listed in Appendix B, were interviewed. All agreed that, because the potential returns that investors can make in the social rented sector are so low, there is no direct institutional investment in the sector. This is also due to the fact that the current regulation of HLM organisations (the social landlords in France) is such that sales of HLM dwellings to institutional investors are not allowed. One housing expert commented that even if institutional investors were to be allowed to enter this sector, it would not be attractive for them because they would not be able to realise an acceptable yield. Dividends are capped at a very low level and profits (including those from the sale of dwellings) have to be reinvested in the social rental sector. As a result, an institutional investor might never get back its initial investment, whereas sales from HLM organisations to institutional investors are not allowed. HLM organisations occasionally buy dwellings from institutional investors in order to transform them into social rental dwellings. This happens particularly in areas in which social rental housing is in limited supply.

There is some debate in France about the desirability of relaxing the regulations that impede the sale of social rental dwellings to institutional investors. The Chief Executive Officer of the Société Nationale Immobilière (SNI) group, one of the largest providers of social and intermediate rental housing in France and also the initiator of the Fonds Logement Intermédiaire (discussed below), is in favour of this. He stated that the sale of older social rental dwellings would result in a large amount of equity which the HLM organisation could subsequently use to build new social rental dwellings. These new social rental dwellings will be of a better quality than the old social rental dwellings that are sold. However, this view is not supported by many social housing organisations nor by the French umbrella organisation for social rental landlords (Union Sociale pour l'Habitat). They fear that such a policy would diminish the availability of cheap rental dwellings. It would also make the management of half sold building complexes rather complicated. Furthermore, they are sceptical about the positive financial effects that such a policy might have. From the economic point of view, high returns could only be reached on a limited scale and in a limited number of areas (principally Paris).

Partnerships between social rental landlords and institutional investors

Institutional investors can be shareholders of the social rental landlords with a commercially-orientated attitude. Usually, there are historic reasons for this, for example because the institutional investor involved want or wanted to provide housing for its employees. Nowadays, allocation rights for social housing are channelled through CIL: Comités Interprofessionnels du Logement (25 organisations throughout France that are related to the employers). However, being a shareholder of such a social rental landlord should not be seen as part of the investment strategy of institutional investors. Given the specific regulations and financial structure of the French social rental sector, this kind of social rental landlord is only allowed to pay a very limited dividend to their shareholders. What do exist are partnerships between social rental landlords (who are usually their own developer) and private developers in new-build projects. These typically are mixed developments, in which a small number of social rented units is included in a market-based project.

7. EUROPEAN CASE STUDIES

Indirect institutional investment in French social housing: housing finance

In July 2014, the EIB signed a partnership agreement with the Caisse des Dépôts, the provider of loans to French social landlords. In the future, this might lead to some form of (very) indirect institutional investment in the sector. However, up to now, the importance of this still seems to be rather marginal.

Institutional investment in the intermediate rental sector

Two important new developments have taken place in the French intermediate rental sector (where rent levels are above the social rental sector but below the market rental sector) that aim to further enhance investment by social rental landlords and institutional investors. Firstly, a new legal and taxation framework that gives the French intermediate sector a more formal position has been introduced. This legal framework gives HLM organisations the opportunity, albeit under strict conditions, to set up a branch organisation that provides intermediate rental housing. Furthermore, the new framework provides some tax advantages to institutional investors that choose to invest in the intermediate rental sector; these investors pay a lower VAT rate (10%) and are exempt from paying local property taxes for a period of 20 years. Secondly, a new initiative has been developed that aims to attract institutional investors to the intermediate rental sector: the Fonds Logement Intermédiaire (FLI).

The FLI, formerly called Argos, has been initiated by the Caisse des Dépôts and its branch Société Nationale Immobilière (SNI). SNI is one of the largest landlords in France, managing more than 185,000 social rental and almost 90,000 intermediate rental dwellings. The FLI was officially launched on 24 July, 2014. Apart from SNI, the fund consists of seven institutional investors, mainly active in the field of insurance and pensions. All these investors already have an affinity with investment in residential property. The aim of the fund is to create 10,000 new intermediate rental dwellings (in 2014) in areas with a tight housing market. The fund will have an investment capacity of €1.7 billion. Half of this amount of money comes from own equity of the fund participants, while special bank loans are available for the financing of the remaining half. The fund expects to have a yearly net rental yield of 3.5% per year, and a total yield (including the future sale of the dwellings) of 7% (IRR). The fund will run for a period of 20 years, after which all dwellings will have been sold. French rent regulation, in which rental contracts have a term of six years, permits this.

The new intermediate rental dwellings will be integrated in so-called mixed projects, with at least 25% social rental housing. The new intermediate rental dwellings will generally have two or three rooms, a floor area averaging 54 square metres and a rental price approximately 15% below market price. The fund takes the form of a Société Civile Immobilière and will be managed by the company Ampere Gestion (HSBC, 2014).

In 2015, the FLI will attempt to attract additional investors, including institutional investors from abroad, including major Dutch pension funds (such as APG and PGGM), as well as with some German institutional investors. In 2015, the FLI plans to construct 8,000 new intermediate rental dwellings. The FLI does not construct these dwellings itself but purchases them from construction companies and project developers. Property developers that want to build dwellings for the FLI can submit their plans to the fund, which selects via a tender process.

As a result of new policy initiatives, investment opportunities in the intermediate rental sector have increased recently. The role that institutional investors could play in increasing the housing supply for middle income groups is now high on the political agenda. In the near future, non-French institutional investors may also enter the intermediate French rental sector.

7. EUROPEAN CASE STUDIES

7.2 Germany

Four German housing experts, listed in Appendix C, contributed to the research. Interviews revealed that institutional investment in the social (or subsidised) rental housing sector (and the private rented sector) occurs only rarely. This is because of the low return and the fact that the scale of the investment required is insufficent to attract investment. However, there are indications that some insurance companies are entering the loan market (not the direct ownership market) at returns of 3.5% to 4%, leveraged at around 20% to 25% of value.

One interviewee indicated that indirect investment in subsidised rental housing by institutional investors hardly exists, because present-day cash returns, of 3.5% at most, are lower than those usually required by commercial institutional investors, of 4% to 5%. Such low returns are the result of restrictions on rent levels and rent increases, which has created a gap between subsidised pre-determined rents and market rents[10]. To obtain a reasonable return requires a period of 15 years (also the normal length of the subsidy period), considered too long given market uncertainties. In addition, further regulations may be introduced that would prevent subsidised rents reaching market rent level within the next three years, which could extend the current period of 15 years to a minimum of 18 years to reach a market return.

Interviews confirmed that, in the past, organisations generally had no subsidised portfolios – unless the dwellings were part of these portfolios, either because of subsidisation or because of a requirement that 20% to 30% of social rented properties be included in any new project. Such portfolios would, however, only be acquired if risk-return profiles were acceptable. There are some exceptions. One interviewee advised that their share of subsidised rental dwellings amounted to 20% or more, being the outcome of a strategy to invest in rental dwellings that deliver a rent-to-income ratio of 25% to 30% in the middle, but better-located market segment. A further strategy mentioned was one whereby subsidised dwellings are acquired at the end of their subsidy period, once future returns become more predictable.

Nevertheless, investment in residential rental property in Germany seems to have become more attractive in recent years. Part of the explanation given is that bank lending has become stricter, thereby leading to a demand for raising capital by alternative means. Another explanation, based on the low alternative returns that has encouraged the exploration of 'new' investment options in the sector, has apparently brought insurance companies into the market as lenders.

Additionally, there has been growing interest from other institutional investors. The relatively low returns achievable on investment in other sectors might also make investment in subsidised rental housing a more attractive alternative than in the recent past, given the strengthening in regulation of (new) rental contracts in existing dwellings and the increased use by city authorities to require subsidised rental elements in new construction projects.

[10] It was also stated that the bricks-and-mortar subsidy system effectively subsidises the developer. Even though the rent and the quality will be acceptable, the additional housing costs (for energy and other services, etc.) will be relatively high for the tenant.

7. EUROPEAN CASE STUDIES

7.3 The Netherlands

Six Dutch housing experts, including two institutional investors, participated in the research. Interviews revealed that HAs, the social landlords in the Netherlands, finance their investment generally through private sector borrowing – e.g. loans from the so-called sector banks, the BNG Bank (profit focussed) and the Dutch Water Board Bank (NWB Bank). Both banks are under the control of different government and/or statutory bodies. Their aim is to provide financing for the public sector and/or for socially beneficial purposes, such as the financing of dwellings provided by social landlords.

A unique feature of the social rental financing system in the Netherlands is that these loans, which, since the 2011 agreement with the European Union, should only be for social stock (that is stock subject to a regulated rent) are guaranteed by the Guarantee Fund for Social Housing (Waarborgfonds Sociale Woningbouw, WSW). In order to secure a loan guarantee, an HA will submit a financial plan for all its intended activities, including refinancing, to the WSW each year. This financial plan will include not only individual projects but also the balance sheet of the organisation. The WSW then determines a maximum guarantee amount for the year in question. A maximum loan-to-value (LTV) of 50% is permitted, while a normal LTV will be about 27%. The maximum loan term for a guaranteed loan is 50 years although, in practice, this period has never been utilised.

The WSW guarantee enables members (i.e. HAs) to raise money in the capital market on the best possible terms as the WSW guarantees that a loan will be serviced throughout its contractual term if the HA is not able to do so. The social landlord members guarantee the finance of other members. The backstop position is assumed by central government and the municipalities, which comprises an irrevocable commitment to make interest-free advances available if WSW's capital falls below a predetermined minimum relative to its total guaranteed capital. Consequently, rating agencies have awarded WSW high (AAA and AA+) ratings, the same as those of government bonds in the Netherlands. The government guarantee backing up the financing of the social rental sector (the non-social stock) makes the sector a relatively attractive investment opportunity for financiers as risks of non-payment are removed. Additional security is provided by the Central Housing Fund (Centraal Fonds voor de Volkshuisvesting, CFV), which is responsible for the financial health of social landlords and their reorganisation should they fall into financial difficulties.

Recently, there has been increased interest from institutional investors in investing in the HA sector. One reason is that WSW has actively sought to stimulate new and, thus, diversified sources of finance. Another is the current low yields on Dutch and German government bonds, which has led institutional investors to consider alternative, more attractive investments. In particular, insurance companies, also from Germany, are discovering social rental housing finance as a way of asset-liability matching in the longer term (preferably loan terms of more than 10 years). From the interviews, it was presumed that pension funds are not similarly-minded, as they are more interested in hedging their inflation liabilities or, as volunteered by another, that pension funds operate large volumes. Conversely, pension funds sometimes provide loans directly to social landlords, even though this activity is understood to be limited.

Another form of institutional investment is through the EIB, with recent negotiations taking place on the first loan that may be provided to one of the social landlords. Ordinarily, the EIB finances projects and not organisations and to projects that match specific EU objectives, such as sustainability goals, while social landlords will search for organisation financing. Last, but not least, the EIB is interested in providing more substantial financing than most individual social landlords require. This may open the way to large-scale

7. EUROPEAN CASE STUDIES

combined borrowing by social landlords. Other social landlords may be interested in pursuing this option, should the first initiative be successful.

For the financing of the non-social stock owned by HAs, initiatives such as seeking credit ratings were explored. However, these ratings take the current guarantee structure into account. Other initiatives that involve the development of financial products specifically for social landlords (e.g. sale and leaseback of land to commercial parties) are also said to depend on the guarantee structure for social rental finance, that might not compare favourably to the present financing options (such as a normal loan).

Currently, prospects for investment in the regulated segment of the rental market look relatively gloomy, given the landlord levy mentioned previously and government emphasis on the middle-price segment of the rental market.

New initiatives to promote growth of the middle segment of the rental market

Generally, it was thought that the Dutch housing market has reached its lowest point for house prices, albeit with regional differences, and it is considered a good point in time to enter the sector, coinciding with low returns on other investment options (government bonds and savings), in contrast to only two or three years ago. Additionally, , Germany is now considered an expensive market, as house prices and rents generally have shown a rising trend over the past few years. However, demand surveys appear to indicate growing demand by consumers for the middle segment of the Dutch rental market and policy is also aimed at the development of that segment.

A new initiative in the Dutch investment market, the Dutch Investment Institute (Nederlandse Investeringsinstelling, NII), was described in the interviews, due to commence operation before the end of 2014. This body unites a number of institutional investors and aims to facilitate the increase in investment in the Dutch economy (possibly including housing) from a point of view of societal responsibilities. However, the risk-return profiles that will be relevant will be commercial ones. In order to create win-win situations, it was suggested that, for projects interfacing between public and private parties, a reliable public policy is needed. Pension funds would like the Dutch government to provide index-linked debt (as government bonds), to allow pension funds to secure index-linked pensions in the future, while government will be able to pay for future index-linked increases through increased income tax revenues from inflation-based rises in income. A further observation about NII was that it unites a number of actors (institutional investors), which can be considered a strong point by providing a broad base, but this raises the challenge of establishing common goals and common win-win situations across the board.

Institutional investment in social (regulated) rental housing

Fundamentally, all institutional investors of any significance have already been investing indirectly in the rental market including the regulated part. However, in the past few years, little investment in new stock with regulated rents has taken place because of the impact of the GFC on the Dutch economy and the housing market, but also because of new (proposed) policies that make investment less attractive and returns uncertain. Rent control was often mentioned as one of the detrimental factor that has discouraged investment in the regulated part of the rental market. The only attraction offered by the regulated rental stock is the longer tenancies than those in the unregulated stock with higher turnover rates. Thus, the average share of the regulated stock in the investors' portfolio is said to be between 20% and 40%.

7. EUROPEAN CASE STUDIES

A direct institutional investment in the social rented sector occuring recently was the largest sale of HA dwellings in Dutch history. The sale of about 5,500 dwellings (around 70% of those dwellings in the regulated segment) to a German fund manager took place when the HA was experiencing financial problems and aimed to sell 30% of its total stock. At the time of writing, the ministry responsible for housing had still to agree to the sale, as had the supervisory board of the social landlord. However, according to one interviewee, discussions were to take place about the principle of whether 'social' stock should be sold off to commercial investors and, if so, under what conditions such sales should take place.

As to the prospect of more portfolio sales by HAs, the general opinion from the interviews was that the future remains uncertain. New policies, such as the landlord levy and proposals about the administrative or legal stock division between social and non-social stock owned by HAs, may or may not cause an increase in sales of stock of HAs.

Future institutional investment in the rental market

In relation to investment in regulated stock more generally, one opinion expressed was that the landlord levy[11] is considered to be an unfair tax on non-social investors in the regulated segment of the rental sector. The interviewee argued that these investors do not receive the same benefits (e.g. guarantee) as HAs. On the other hand, it was argued that non-social investors do not have to contribute if the WSW is to fulfil its guarantee requirements. Nevertheless, the levy has been regarded as an extra cost in the investment decision, implying a lower acquisition price that the investor would be willing to pay. Interviewees also suggested this would result in little new investment in the regulated rental sector in the future. The strategy would be to liberalise rents (after adding value by renovation), if possible, when a new tenant moves in.

New initiative – a mixed housing fund

An alternative financial instrument for housing finance, a mixed housing fund (gemengd woningfonds) was recently introduced by some of key players in the Dutch housing market. At the time of writing, five HAs, two fund managers and a small number of institutional investors are cooperating in a pilot fund. The intention is for HAs to sell some of their non-social stock or potentially "to be deregulated stock" to the fund, partly in exchange for the receipt of participation shares. The equity will be provided equally by the HAs and the institutional investors, whilst the dwellings will be managed by the fund manager. The main objective is to maintain the rental status of the dwellings and not to sell them once tenants move out. However, partners involved voiced some barriers; one of these was the 10% legal maximum for stock in a complex that is allowed to be sold by a social landlord. If a complex contains less than 10% of stock, the non-social sales regime is applicable. In the interviews, it was further explained that the 'social' sales regime allows for profit sharing rules as well as rules for rent increases.

Conclusions

The future of investment in the regulated segment of the rental market looks relatively gloomy, given the landlord levy and the government emphasis on the middle-price segment of the rental market. The sale of regulated rental stock from HAs or investment in new construction may only occur (possibly also via the NII) if satisfactory rates of return can be achieved, taking into account all costs, including the landlord levy. Currently, more proposals have been put forward by the central government to make the deregulated segment of the rental sector more attractive to invest, particularly in the middle segment of the rental market (those dwelling having rents of between €700 and €1,000 per month).

[11] Since 2013, HAs, later broadened to all landlords who own more than 10 dwellings with a regulated rent, are required to pay a landlord levy.

8. NEW MODEL OPTIONS

A number of models have been used or proposed to support additional investment in social and affordable housing and this section considers a number of these.

Model 1: Joint Ventures to Deliver Intermediate and Shared Ownership Housing

Joint ventures (JVs) are an established concept that has been used to increase housing supply. Care needs to be taken in structuring the JV to align incentives and deliver value for all parties. No legislation or regulatory challenges are required to facilitate this option.

Based on common ground between investors and HAs, cooperation would be of most value in the areas of shared ownership and intermediate housing (e.g. non-traditional areas of social housing). In order to separate such developments and to allow multiple stakeholder participation, the investment could be run via a JV with equity participation from the HA and investor. It may also comprise more than one HA or investor, as well as local authority participation. The nature of this structure is discussed previously in this report. The participation of HAs and investors can be beneficial for both parties. HAs may benefit from the investors' ability to raise equity and debt funding, as well as returns from property management fees going forward. Investors gain access to the services of an experienced property management company, which has an equity interest in the JV and a financial interest to manage the properties well. The JV is unlikely to be open-ended, particularly where tenants can staircase. The ownership of the properties at the end of the life of a JV may be consolidated with one of the JV equity holders.

There are a large number of permutations for a JV, which may be determined by negotiations, local conditions and regulation. They may be used as a vehicle to ring fence particular HA operations, so investors may have equity participation in particular operating areas with defined return and risk boundaries. Reputational risk is mitigated though the HA's management and administration of the properties. Ring-fencing also benefits HAs, as they are able to safeguard existing social housing stock from non-traditional areas of operation. Participation in intermediate housing and shared ownership could improve the return prospects for investors, in comparison to traditional social housing.

Model 2: The New Economics Foundation's 'One Million Homes' Model, as Proposed in 2010

This model suggests a number of changes to facilitate increased investment in affordable housing, including a new capital gains tax on land sales and a new housing land fund, as well as significant changes in the planning system. The model highlights the need to encourage new entrants and the use of index-linked funding cash flows, as well as the scope for additional focus on intermediate housing (New Economics Foundation, 2010).

In response to the shortage in affordable housing and funding cuts, the New Economics Foundation proposed a three-pronged strategy for building one million new homes over five years:

- Reducing the cost of land;
- Reducing the cost of capital; and
- Improving operating margins.

8. NEW MODEL OPTIONS

The proposal does not claim to provide a definitive analysis; however, it does present a financial model driven by reasoned assumptions. The model can be applied to mixed developments and to propagate the supply of intermediate housing. The first element of the proposal focuses on the cost of land, an issue echoed in the comments made by HAs and institutional investors regarding the availability of land. To reduce the net cost of land, an 80% rate of capital gains tax on land sales is proposed with the receipts of the tax channelled into a national fund to subsidise social landlord land purchases (or buy land to rent at low prices). The rationale for such a tax stems from land prices being linked to the permission to build, which is created by the planning system and the benefits to developer/land owners. Preferential planning treatment for social landlords and local authorities, as well as improvements on time limits are also suggested.

The model proposes that capital cost reductions can be achieved through issuing index-linked debt with HB payments paid directly to a fund to pay bond holders, as well as the promotion of new entrants (including for-profit participation to improve efficiency) and financial structures. Index-linked bonds are argued to be cheaper and it is suggested that further efficiencies can be gained by pooling to offer diversification benefits. Bonds would be issued in two tranches with a lower-yield tranche, reflecting HB paid directly by government (via a fund), and a higher-yield tranche to be paid by other income.

Operating margins would be improved by higher rents on new properties and cost reductions from lower management costs for new stock. The proposal notes that, at the time, rents on new stock for new housing association tenants are in the order of £76 per week, compared to £113 per week payable by private sector tenants in receipt of the local housing allowance, and that the gap between the two would be financed by the public sector, either through subsidy by HAs or through HB. Hence, higher rents – provided they are below this upper limit – are seen as having little impact on the true underlying public sector cost.

Cheaper land and potentially cheaper credit could make the returns for the equity holder more attractive, which would be a positive driver for investment in the sector. However, the New Economics Foundation report does not address the details of the capital gains proposal and the complexities of when this rate is triggered, its interaction with the Community Infrastructure Levy and Section 106 provision. As noted elsewhere, there are wider issues with the willingness to use index-linked financing, whilst whether index-linked funding is cheaper is dependent on both margins and what happens to inflation. The need for diversified issuance did not emerge from the discussions held by the researchers – given the divisibility of investments, most investors are not particularly in need of an organisation to bundle risks together. Institutional investors could participate in the setting up of new HAs (including for-profit private RPs), allowing them to increase development resources in the sector, which appears to be an issue. However, the legal and policy framework is not particularly supportive for new institutional entrants.

Model 3: Equity Investment in HAs as Proposed by Williams et al. (2011)

This study looked at a range of models for equity investment in affordable housing, including equity investment directly in HAs (with the refinancing of debt by equity) or establishing new HAs, able to develop outside the grant regime with a culture focused on efficiencies in operating costs and the asset base (Williams et al., 2011).

8. NEW MODEL OPTIONS

Some of the challenges identified in that study include:

- Legislation: the report asks if it is possible to buy equity in HAs and proposes the use of profit participating deferred shares (as used by building societies) and joint ventures.
- Insufficient net initial yields: open market rental or sale could be used to boost returns. The study notes that total returns over the long term may be acceptable despite relatively low initial yields.
- Grants: grants are legally unsecured debt. Preferred shareholders are likely to request some subordination of grants.

From investor interviews, there appears to be no desire for this type of equity participation. The scope for improved efficiency is not clearly established. Even though this model would leverage existing stock, potentially to finance the renovation and construction of more stock, the need to change the ownership structure of existing HAs is not clearly established.

Model 4: Grant Capitalisation as Proposed by Williams et al. (2011)

This is another model for introducing direct equity participation in HAs. The ability to convert grants may require significant legislation (Williams et al., 2011).

The model releases the capital tied up as grants through converting it to equity and selling the shares to investors. This would raise cash for the government that can be used elsewhere or re-invested in the sector. The model is not intended to be applied in isolation as it is unlikely to improve HA finances and would be a net drain on cash flows as investors would expect returns (grant at present has no coupon).

The same report discusses the Dutch model, where the grant was written off by Central Government. This is not expected to have an immediate cash flow impact, but could help raise equity as it improves the balance sheet of HAs. As a modification to this model, the grant could also be converted to shares and transferred to a non-governmental entity with a mandate to maximise the use of the sector’s financial assets, and facilitate the mergers of the fragmented sector.

The attractions of this model are similar to switching from debt to equity finance (Model 3). As the grant is being switched to equity this is releasing funds into the public sector that could be used to support new developments. However, equity investors will want to achieve particular levels of return and this is unlikely to help achieve these hurdles in isolation. If the government intends to reinvest the money in the sector, it may be a route to releasing capital for the wider benefit of social housing along with other activities to stimulate additional supply.

9. CONCLUSIONS AND RECOMMENDATIONS

This research project investigated how institutional investment can be expanded in the social housing sector in the UK, primarily through the HA route. It had four elements of analysis: a literature review, structured interviews with both HAs and institutional investors, a round table discussion with representatives of HAs and investors, and case studies across Europe.

Institutional investment in social housing – HA perspectives

The evidence from HAs' interviews show that there has been a substantial increase in bond finance for social housing, and this is widely accepted and used by HAs. Bonds (notably fixed interest rate bonds) are the primary route by which institutions have provided finance to the sector. Investment through sale and leasebacks, joint ventures and equity investment in shared ownership has occurred but to date is small by comparison. It should also be noted that the 'sale and leaseback' model is unlike many commercial property sale and leasebacks as in the model used in social housing the HA takes ownership of the social housing for a nominal figure at the end of the lease.

HAs have positive views on investment by institutional investors based primarily on the bond finance they have obtained. This was seen as having played a crucial role in funding the sector through the GFC. But even as banks have become more willing to lend, bond issuance is seen as having a number of attractions over bank finance. The advantages of bond finance as viewed by HAs include the overall cost, the term, lower asset cover ratios and less onerous governance requirements.

The interviews revealed that there was no barrier to prevent institutional investment in social housing, particularly in the case of bond issuances. But a barrier to index-linked finance is the restriction imposed by the HCA which caps such index-linked financing at not more than 25% of the HA's whole loan portfolio. However, there were some issues that were seen as potentially affecting perceptions of the sector and the risks associated with investing in it, particularly the possible changes of regulation and the lack of a long-term plan to set rental increases.

Institutional investment in social housing – investors' perspectives

The evidence from institutional investors' interviews shows that they are keen to explore and expand investment in social housing. They are attracted by the credit strength of the sector and the Regulator's role in supporting this. However, they face challenges to investing. For those not familiar with the sector, these challenges include building their understanding of the sector, of the risks involved (notably the reputational risk) and of the organisations involved. For those more ready and willing to invest, the barriers are more around scale and due diligence requirements for large-scale existing projects as well as new development.

Mismatch between HAs and institutional investors – fixed-rate coupon versus index-linked equity investment

Findings from the round table discussion show that all the HAs that participated in the discussion do not appear to have significant or substantial demand for equity investment in their core social housing activities. Firstly, for many HAs, they see the combination of bank and bond financing have met all their likely requirements with a very low cost. Secondly, asset cover ratios are not so stretched that more equity style finance is required. Thirdly, there are other capacity constraints on their expansion (e.g. the availability of land

9. CONCLUSIONS AND RECOMMENDATIONS

and development capacity) which means that their requirements for funding are unlikely to change rapidly. Fourthly, they have the concerns that less support to the sector from government and lower rates of rental increases will lead to a squeeze on reserves which consequently leads to a cautious approach to expansion. Finally, the focus of HAs is on the management of existing stock and they have no strong incentive to expand aggressively. Related to these is a perception that equity investment implies index-linked payments by the HA to the investor and there is a concern that these may become less affordable over time. It appears that the current combination of low gilt yields and interest rates and the lack of funding constraints in most HAs are likely to constrain the growth of equity investment in core social housing activities.

For institutional investors, although they are ambitious to expand their investment in the forms of sale and leasebacks and other equity style of investment, they are not interested in the ownership of social housing because they lack the skills and knowledge to manage the social housing and prefer HAs to manage the stock on their behalf.

In terms of moving beyond bond financing, both HAs and institutional investors see shared ownership and intermediate rental housing as areas which are likely to be more suited to more equity style institutional investment. The key positive conclusion from the round table discussion was that both HAs and institutional investors believe that more can be done in this area to expand the sources of finance for HA housing.

New models to attract institutional investment in social housing

A number of alternative financing models were discussed in the round table, but the benefits were minimised by both HAs and institutional investors. Social Housing REITs were not seen by either side as a useful route for their needs, with the challenges of a sustainable dividend yield, additional costs and the lack of need for liquidity from investing institutions all noted.

This study also considered approaches taken in Australia, Europe and the United States[12]. However, they did not seem to offer obvious models that could be readily implemented in the UK without substantial institutional change. Apart from the fact that loan finance dominates in social rental housing in these countries, with the exception of the United States. An interesting development in France has been the launch of a new fund focused on intermediate housing, where rents are regulated, but at a level between social and market rents. In the Netherlands, the policy focus is also on intermediate housing. However, here rents are deregulated. The German subsidisation model allows for properties to transfer from social/subsidised to market renting once the subsidisation period has terminated. The very different institutional and tenure structures and substantial tax differences (e.g. depreciation allowances in Germany) mean that schemes and vehicles are very specific to that setting: the same applies to the United States' tradable tax credit scheme. Development of such models would require substantial changes in housing, finance and taxation in the UK and the political will to make those changes permanent.

[12] For details of the approaches taken in Australia and the United States, see Appendix A: Literature Review.

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Overall Conclusions

The research project concluded that there are no major obstacles to bond financing of social housing; this is reflected in this now being the largest source of external funding for HAs. This structure gives bond investors access to a diversifying source of credit risk, with a premium over government debt and strong creditworthiness. This structure gives HAs low-cost funding that is relatively accessible, understood and easy to manage. There are however obstacles to broadening this to index-linked equity investment with a perception that these are more risky. A better understanding of the risks associated with index-linked funding and encouragement to use this as part of the funding mix would appear to be needed to overcome these obstacles as well as a firm commitment by government that funding of housing should at least keep track with inflation.

Apart from the concerns over indexation, there are some obstacles to the use of sale and leasebacks as a parallel source of funding to bonds. Currently, the uncertainty about the role of HCA and the new rent regime (the use of CPI starting from 2015 for 10 years) means that there is no real driver for HAs (especially for medium-sized and small-sized HAs) to use this route as opposed to conventional bond financing. In addition, for investors, particularly for pension funds, bond financing in the HA sector can provide a stable, low risk and long-term return.

There does appear to be scope to expand equity investment in the forms of joint ventures to invest in intermediate rent housing. This potentially provides institutional investors with an additional income stream and allows HAs to meet a broader housing need and to generate surpluses for cross-subsidy of other activities.

Finally, to encourage more institutional investment in social housing requires government's further commitment. At present, the main focus of the government is on indirect investment through the Affordable Housing Guarantee scheme. Overseas experience highlights the importance of the tax system in attracting and sustaining institutional investment in the sector. The establishment of a new fund with contributions from both social landlords and institutional investors in France together with tax incentives (depreciation allowance) in Germany provide some ideas for attracting investment in intermediate housing in the UK.

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Contributors

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APPENDIX A: LITERATURE REVIEW

The aim of the literature review is to examine the extent of institutional investment in the UK and other developed countries, the models being used in these countries, and the risk and returns in social housing investment. It contains eight sections:

1. Social housing in the United Kingdom
2. New social housing development in England
3. Housing policies that affected investment in English social housing
4. Sources of funding in HA housing – England
5. Risks and returns of social housing investment
6. Barriers of institutional investment in social housing
7. Funding social housing – Australia and the United States
8. Conclusions

1. SOCIAL HOUSING IN THE UNITED KINGDOM

1.1 Social housing in England

HAs in England vary significantly in scale and breadth of operations. In total, there are 1,700, but only 393 with more than 1,000 units. These 393 represent 95% of the stock, and 59 hold more than 10,000 units (44% of stock). There are four HAs that hold more than 50,000 units. Table A1 shows the changes of rental stock between 2001 and 2011. Over the decade, social rented stock was reduced by 255,000 units, with the most reduction seen in those owned by local authorities. The HA stock however grew by 831,000 and by 2011, it accounted for 10% of total English housing stock.

Table A1: Dwelling stock by tenure in England, 2001, 2017 and 2011

Year	Owner-occupation ('000)	Private renting ('000)	Social landlords ('000)	Of which owned by: Housing associations ('000)	Of which owned by: Local authorities ('000)	Total ('000)
2001	14,735 (69%)	2,133 (10%)	4,236 (20%)	1,424 (7%)	2,812 (13%)	21,207
2007	15,093 (68%)	3,182 (14%)	3,938 (18%)	1,951 (9%)	1,987 (9%)	22,288
2011	14,827 (65%)	4,105 (18%)	3,981 (17%)	2,255 (10%)	1,726 (8%)	22,976
Change 2001-11	+92 (1%)	+1,972 (92%)	-255 (-6%)	+831 (58%)	-1,086 (-39%)	+1,769 (8%)

Source: DCLG Live Table 104 – Dwelling stock: by tenure, England (historical series).

As at 31 March 2013, HAs owned a total of 2,634,917 units/bedspaces, a 2% increase on the total for 2012. A total of 284 HAs owned affordable rent stock, with a total of 39,594 affordable rent units. Of these 37,755 were general needs units. The remaining 1,839 were supported housing/housing for older people affordable rent units (HCA, 2013). Shared ownership has been offered by HAs for over 25 years with over 130,000 such homes currently existing. However, the number of new-built shared ownership units has dropped as a component of HA development plans (Heywood, 2013).

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The Homes and Communities Agency (HCA) is the regulator of HAs in England which replaced the Tenant Services Authority that was abolished on 31 March 2012 by the Localism Act 2011. This legislation transferred the responsibility for social housing regulation to the HCA from 1 April 2012. The Localism Act limits the HCA to a reactive role, only intervening in cases of serious detriment that have caused, or are likely to cause, harm to the HA sector.

1.2 Social Housing in Scotland

The latest statistics report that Scotland has approximately 1.5 million owner-occupied homes, 290,000 privately rented homes, 275,000 homes rented from HAs and 320,000 homes rented from local authorities. There are 167 HAs operating in Scotland. Scottish HAs tend to be smaller on average (with the exception of Glasgow) than English HAs. Scotland has its own regulator, the Scottish Housing Regulator, which undertakes a similar role to that of the HCA. Although HAs are generally self-financing, many receive capital funding to build new homes. Since the 1970s, when new council house building declined, capital funds were diverted to HAs to replace the provision of new homes. Initially funding 100% of the costs of new homes, funding has gradually decreased over time to around 30% of the capital cost with the HA borrowing from banks and other financial institutions to provide the remaining 70% (Unison Scotland, 2013). Even though grant levels in Scotland remain higher than in England, Scottish HAs have attracted over £3 billion of private finance by 2012. The Scottish Government has also promoted new development models such as the National Housing Trust, which encourages HAs and local authorities to build homes for affordable rent that can later be sold to the private market (Heywood, 2013).

1.3 Social Housing in Wales

In Wales, the number of social rented housing units, including bedsits and bedspaces, was 226,221 at the end of March 2014. On average, there were 17 social rented housing units available per 100 households across Wales. HAs owned 61% of all social rented housing stock and owned all social housing in half of the authorities across Wales (Statistics for Wales, 2014). The Welsh HA regulator is the Welsh Assembly Government. A new and improved regulatory framework has been introduced following some previous criticism from lenders and others about the quality of regulation in Wales. HAs have a modest development programme, which completed 992 homes in 2010/11 and 829 in 2011/12. Welsh local authorities have not completed any new homes in these two years (Heywood, 2013).

2. NEW SOCIAL HOUSING DEVELOPMENT IN ENGLAND

The vast majority of new social housing produced in England over the past two decades has been provided by HAs. Figure A1 shows that HA annual housing output reached the highest level of over 30,000 in the period between 1993/1994 and 1995/1996, but fell below 14,000 in 2002/2003 and 2003/2004. But prompted by the ‘Barker Review’ of housing supply (Barker, 2004), the central government has been actively encouraging the increase in the supply of social homes. Even during the recession, the vast majority of government spending on the National Affordable Housing Programme budget went to HAs (TSA, 2010). Such stimulus spending pushed HA production to over 26,000 in 2008/09 and 2009/10, and in 2012/13, it exceeded 22,000.

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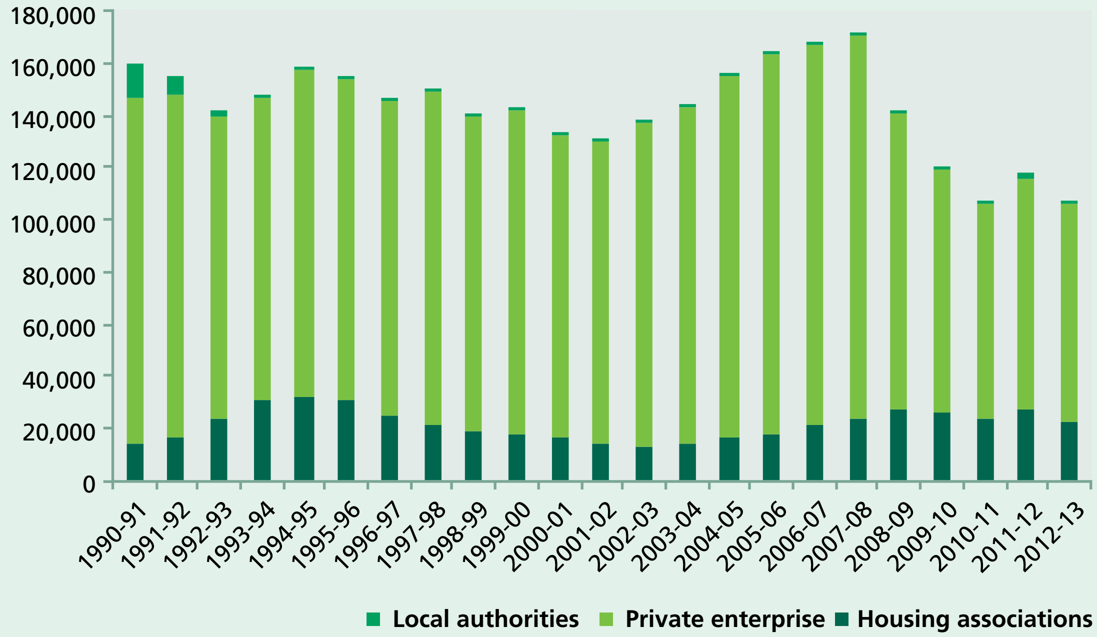
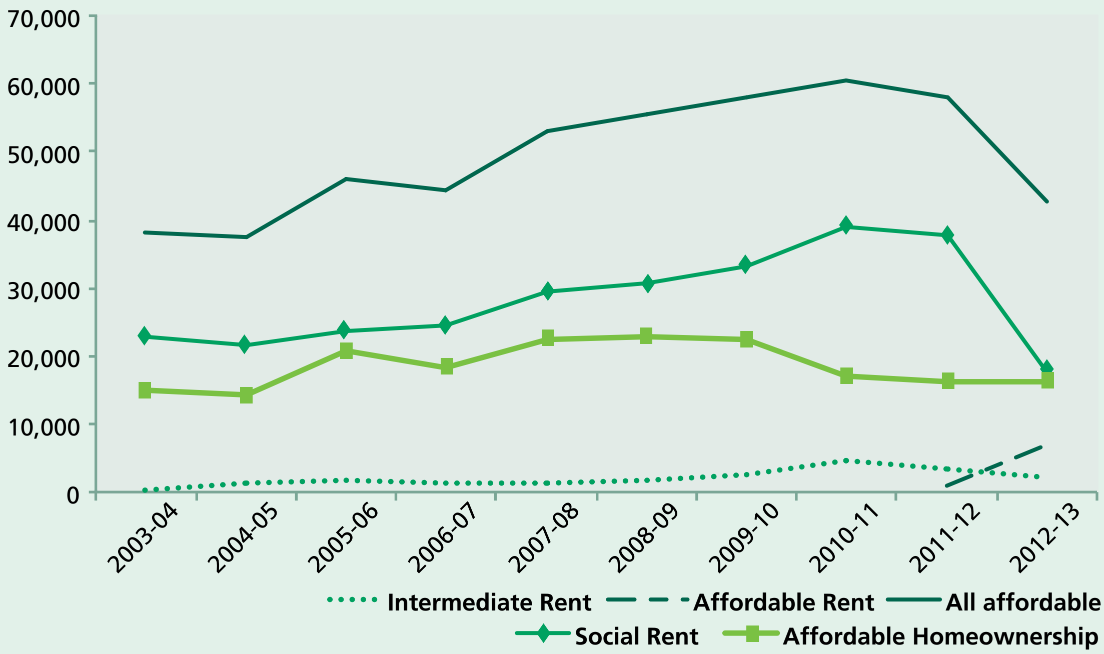
Figure A1: Permanent dwelling completed by tenure, England, 1990/1991 to 2012/2013



Source: DCLG Live Table 209.

Figure A2: Trends in the gross supply of affordable housing, England, 2003/2004 to 2012/2013



Source: DCLG (2013a) Fig. 1.

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Figure A2 provides a breakdown of the supply of different types of social housing in England. In 2012/13, a total of 24,550 social rented homes, including social and affordable rented homes, were provided, a decrease of 36% from 38,610 in 2011/12. A total of 18,290 new homes were delivered through intermediate housing schemes, including intermediate rent and affordable home ownership, in 2012/13, a 6% decrease from the preceding year.

3. HOUSING POLICIES THAT AFFECTED INVESTMENT IN ENGLISH SOCIAL HOUSING

Table A2 sets out the major housing policy changes that have impacted on the investment in social housing in England since the 1970s. The most notable one is the 1988 Housing Act through which HAs took over most of the social housing activities of local authorities and became the main social landlords providing housing for low-income households (Malpass, 2000). The 1988 Act also introduced a mixed funding regime (public grant plus private finance) which laid the foundations for the influx of private finance into the HA sector and facilitated the expansion of Large Scale Voluntary Transfer, by which council housing stock was transferred from local authorities to (usually) newly created HAs.

Table A2: Government policies affecting funding of social housing in England

Period	Government policies
1970s	1972 Housing Finance Act: Fair Rent was introduced in the social rented sector and the introduction of rent rebates to council tenants; 1974 Housing Act: HAs were allowed to access substantial public funding; 1975 Housing Rents and Subsidies Act: removal of Fair Rent in council houses
1980s	1980 Housing Act: Right to Buy; 1983: HB system; 1985 Housing Act: Secure Tenancies for council tenants; 1988 Housing Act: mixed funding regime for HAs; 1989 Local Government and Housing Act: large-scale voluntary transfer
1990s	1990 Town and Country Planning Act: introduced Section 106 to provide affordable housing; 1996: Housing Corporation introduced restriction of HA annual rent increase
2000s	2000 Housing Green Paper: rent restructuring in the social rented sector and RPI was used as an index to set the annual rent increase, Decent Home Standard was introduced; 2005 Pre-Budget Report: introduced REITs
2010s	2010 Welfare reform: 2011 Localism Act: Affordable Rent regime in the social rented sector and local authorities resumed the ability to build new council housing; October 2013: Universal Credit; 2015: CPI will replace RPI as an index to set rent increase

The Housing Act 1988 allowed HAs to increase their rents substantially. However, the increases in HA rents led to a concomitant increase in HB which prompted the Housing Corporation (the regulator of HAs at that time) in 1996 to embark on a 'rent-influencing' strategy to restrict the annual rent increase. In 2000, the Retail Price Index (RPI) was officially used as the index to set rent increases, linking the rental stream to inflation. However, from 2015, RPI will be replaced by the Consumer Price Index (CPI) for 10 years.

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The 2000 Green Paper introduced the Decent Homes Standard and required all social landlords to bring general needs social housing stock up to the standard by 2010. Meeting this standard has involved very substantial investment by HAs, usually in the form of private finance. At 31 March 2012, 1.9% of social rental stock owned by HAs did not meet the Decent Homes Standard (HCA, 2012). The Green Paper also introduced the rent restructuring policy with the aim to 'harmonise' rents of similar dwellings in the local authority and HA sectors locally, and move towards a consistent, integrated method for setting rents across all social housing stock within 10 years (Tang, 2008).

In 2011, the Localism Act introduced a new 'affordable' housing model with a minimum security of tenure of two years. The affordable rent regime allowed social landlords the flexibility to convert vacant social rent properties to an affordable rent at up to 80% of market rent from April 2012 onwards. The affordable rent tenancies will not be subject to rent restructuring, but the maximum rental increase will be based on the RPI plus 0.5%. The 2011 Localism Act also ended the provision of direct grant for social housing in England and modified the funding for local authority housing in order to make such housing self-financing and resumed local authorities' ability to build social housing.

The Welfare Reform Act (passed in March 2012) introduced a new Universal Credit regime to replace working tax credits, child tax credits, HB, income support, and the income-related jobseeker's allowance, and employment and support allowance. This will directly affect social tenants who are on HB and those who are under-occupying. For social housing providers, there may be an increase in operating costs to deal with the increase of rent arrears, internal transfer from large to small units, and so on.

4. SOURCES OF FUNDING IN HA HOUSING – ENGLAND

Prior to the 2008 GFC, the 'traditional' source of funding for HAs was a mixture of government grants from the HCA and bank debt.

4.1 HCA Grant

The HCA is the government agency with overall responsibility for social housing investment except in London, where this role has been given to the Greater London Authority. Figure A3 shows the falling rates of grant starting from 1993/1994 up to 2003/2004 after the 'Barker Review' of housing supply (Barker, 2004) and the increasing grant rates from 2003/2004 up to 2007/2008. Since 2008/2009, the HCA grant has been significantly reduced. The proportion of HCA grants in HA gross investment expenditure was around 40% throughout the period from 2008/2009 to 2011/2012 (Fig. A3). Between 2011 and 2015, the HCA will invest £4.5 billion in affordable housing through the Affordable Homes Programme (HCA, 2011). Despite that, the amount of public funding available for the construction of new social homes has been cut by 60% as a result of the Coalition Government's austerity agenda[13].

[13] "European Investment Bank to fund UK social housing", Financial Times, 18 July 2014.

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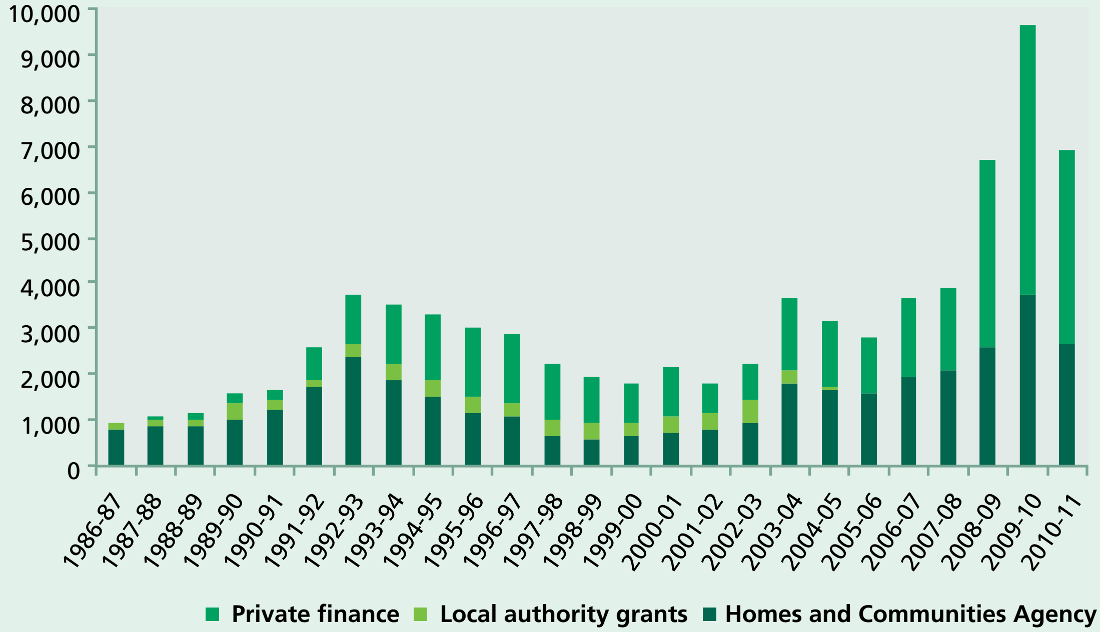
Figure A3: HA gross investment expenditure, including use of private finance, in England (£m)



Source: Pawson and Wilcox (2013). UK Housing Review, Table 59.

4.2 Bank Lending

HAs have traditionally been able to borrow long term at very low margins from banks. As of March 2014, 78% of the HA sector's debt was attributable to bank loans, reflecting the historical significance of bank finance to the sector (Moody's, 2014). This borrowing was supported by HCA grants to allow the sustainability of low-cost housing construction. However, since the GFC, banks have no longer able been to lend cheaply or for long periods, now typically set at five years (rather than the traditionally offered 20 years), after the new Basel III regime, which forces them to hold extra capital for long-term debts (Milligan et al., 2013). It was only in 2014 that banks started to re-enter the market. For example, L&Q has secured a £75 million finance package from HSBC Corporate Banking Real Estate to develop and purchase new property across London and the South East[14]. Also, Danske Bank, currently the biggest lender to the HA sector in Northern Ireland, plans to begin lending to English social landlords this autumn, as the economic climate has improved[15]. Nevertheless, HAs have begun to shift towards capital market bond financing.

4.3 Bond Issuance

Although HAs have accessed the capital markets since 1996, it is only since the 2008 GFC that the process has accelerated. HAs can raise funds with retail and wholesale bonds with 'own name' issues or bonds issued by an aggregator, such as The Housing Finance Corporation. Figure A4 shows that from 2011/2012 to 2013/2014, £7.9 billion was raised from the capital markets, equivalent to 63% of total external finance raised over the period.

[14] "HSBC re-engages with social housing sector through £75m L&Q loan", Social Housing, 16 April 2014.
[15] "Exclusive: Danish bank to enter sector as cost of borrowing falls", Inside Housing, 14 August 2014.

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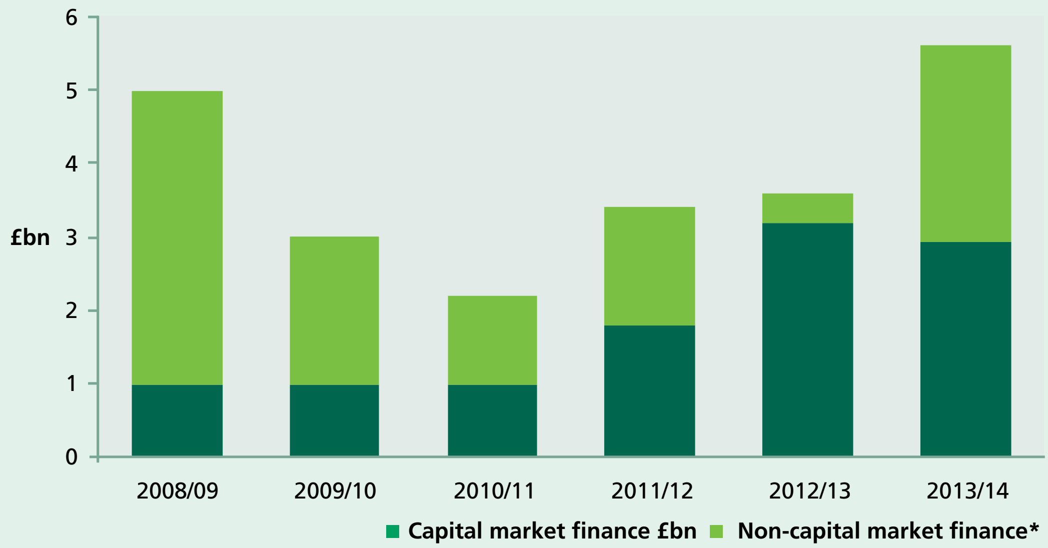
Figure A4: The sources of new finance in HA housing, 2008 to 2014



Note: *Non-capital market finance mainly consists of bank loans with 'other' sources accounting for less than 3% annually (approx.).
Source: Moody's (2014) Exhibit 1.

Typically, bonds are issued with long-term maturities in excess of 30 years and command a premium of around 2% to gilt yields (the price of government debt), with decent credit ratings of between AAA and A. HAs have issued long-dated fixed rate or inflation-linked debt which institutional investors (especially insurance and pension funds) can use for liability matching. This debt can be secured against the HA's property portfolio.

Usually, bonds are issued in a public offering, in which the issuer publicises the upcoming bond issue, provides the timeframe and platform for which bids will be accepted, and provides any additional guidelines or details related to the bond issue. For example, Sanctuary issued an 'own-name' bond in 2012 – a £300 million 35-year bond issue – which attracted more than 20 investors and was priced at a spread over gilts of 172 basis points (1.72%)[16].

Recently, however, private placements have played an increasing role. Private placement provides funding through direct negotiation with one or a select number of private financial institutions. The private financial institution is effectively providing a loan to the issuer that must be repaid over time. In general, private placements do not require many of the disclosure requirements found in public offerings and may be more tailored to the cash flow needs of the HA. As such, private placement bonds are not publicly issued or publicly traded and typically do not require a rating from a credit rating agency. In September 2013, Knightstone HA, which manages 11,000 homes in the South West, secured £100 million through a bond issue and became the first social landlord to do so without having to secure a credit rating. Rather than issue a public bond, it opted for private placement, which gave it added flexibility and allowed it to defer accessing the proceeds – saving £3.6 million in the process.[17] Nevertheless, a run of seven private placements over the last three months up to August 2014, which raised a total of £250 million, has reduced institutional investors' appetite for cheaper publicly listed bond issuances. This may push up the costs of private placements in which the seven deals were priced between 140 and 175 basis points over gilts (the spread), compared with publicly listed bonds, which have been priced at 120 to 130 basis points up to August 2014[18].

[16] "Housing association in biggest bond issue of 2012", Inside Housing, 20 April 2012.
[17] "A perfect match", Inside Housing, 14 November 2013.
[18] "Warning that private deals are pushing up costs", Inside Housing, 14 August 2014.

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HAs have also targeted retail investors by issuing retail bonds. Places for People, owning 82,000 social housing units, was the first HA in the UK to issue a retail bond on the London Stock Exchange's Order book for Retail Bonds platform. They raised £140 million when it launched in January 2012, providing investors with a 5% fixed rate coupon. Additionally, HAs' bond finance issuance is not limited in the UK.[19] Places for People was also the first UK HA to issue a 10-year bond in Euros with a €40 million (around £33 million) deal with two European investors, priced at 3.11%[20].

Moody's (2014), which provides ratings to 26 HAs, predicts that bonds will become cheaper over the next two years as the HA sector becomes more attractive to institutional investors. Moody's expects over half of the approximately £3.4 billion to be raised in external finance for the financial year 2014/2015 to be raised via the capital markets. Moody's expects the HA sector's total debt to increase as HAs continue to undertake development programs in the pursuit of growth. Though the sector's total debt is equivalent to around 3.7% of UK GDP, refinancing needs are limited over the next two years, with just 3% of total debt (£1.8 billion) due to be repaid. It is noted that HAs have ample available cash and undrawn facilities to pay this debt. However, maturing historic debt means there could be a greater, though still limited, refinancing need over the medium term, with £7.7 billion (13% of drawn debt) due to repaid between three and five years.

4.3.1 The Housing Finance Corporation (TFHC) Bonds

Although the larger HAs have been able to issue bonds, the smaller associations lack the financial standing and size to raise capital at a reasonable cost. However, The Housing Finance Corporation (THFC) enables smaller associations to access finance by aggregating funding as an A+ rated institution and lending on funds to HAs on the same terms as it borrows.

Established in 1987 through a joint initiative of the government, the Housing Corporation (the regulator of HAs from 1964 to 2008) and the National Housing Federation, THFC obtains fund from bond issues (public issuance and private placements) and bank loans including funding from the EIB. THFC administers bonds usually for medium and smaller HAs. The first TFHC bond was issued in 1987 for £30.75 million for six HAs. THFC's bonds are typically bought by institutional investors such as life companies and pension funds. Up to 2012, it has raised £3.7 billion across a range of issues for a significant number of HAs in England, Scotland, Wales and Northern Ireland (SFHA, 2012). As a group vehicle, it has enabled even very small associations to raise private finance (loans of less than £1 million in some cases).

4.3.2 European Investment Bank (EIB) Funding

The EIB is the European Union's long-term lending bank and is owned by the member nations of the European Community (the UK Government is one of the four equal largest shareholders with a 14% holding). It can be considered as a typical intermediary between the financial market and the financing of activities of general interest that the market does not finance or finances only partially. The EIB has directly invested in UK house building and aims to lend £1 billion a year to tackle the lack of affordable housing[21].

The most recent EIB investment in UK social housing include:

- A £350 million loan to Sanctuary in the years 2012 to 2017 for retrofit and new construction of social housing and associated infrastructure facilities throughout England and Scotland[22].

[19] "Housing association launches 4.75% retail bond", Interactive Investor, 3 October 2013.
[20] "Association issued first Euro bond with €40 million deal", Inside Housing, 9 April 2014.
[21] "European Investment Bank to fund UK social housing", Financial Times, 18 July 2014.
[22] http://www.eib.org/projects/pipeline/2013/20130270.htm.

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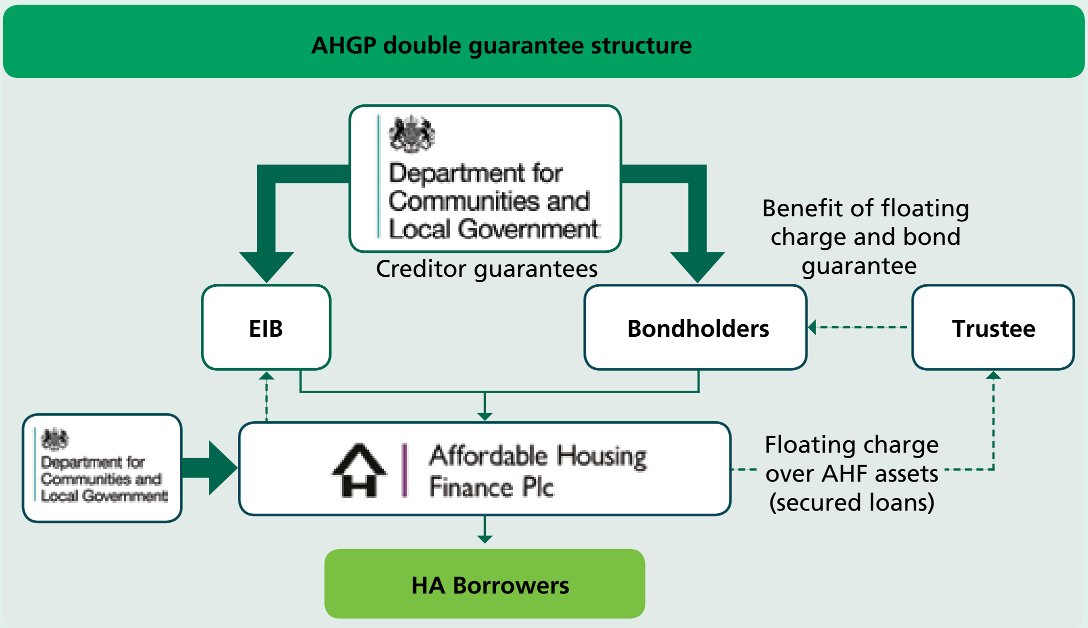
- A 30-year £500 million loan to Affordable Housing Finance, a subsidiary established by THFC for on-lending to HAs investing in the social housing and urban regeneration sector throughout the UK under the UK government guarantee, the Affordable Housing Guarantee scheme (see below)[23].

4.3.3 Government-Guaranteed Bond for Affordable Housing

Generally speaking, government guarantees aim to reduce perceived risk and, thus, required yields, in order to improve the borrowing conditions of third parties such as social housing providers and institutional investors. In September 2012, the Affordable Housing Guarantee scheme was launched whereby the Department for Communities and Local Government (DCLG) will provide a guarantee to support debt raised by borrowers (HAs and other private RPs) to develop additional new affordable homes. The guarantee scheme (£3.5 billion initially, with £3.0 billion held in reserve) is complemented in England by grant funding, although the guarantees themselves are UK wide (DCLG, 2013b). On 20 June 2013, DCLG appointed the THFC through a newly formed subsidiary, Affordable Housing Finance, as the delivery partner for the Affordable Housing Guarantee scheme.

In May 2014, under the Affordable Housing Guarantee scheme (Figure A5), 13 HAs secured £208.4 million of funding through AAA-rated 28-year bonds, which is believed to be the HA sector's cheapest ever bond finance after being priced at 37 bps over gilts and an all-in cost of 3.76%. The 13 HAs include one Scottish and two Welsh borrowers. The largest participant was the 55,000-unit Home Group whilst the smallest was the Surrey-based 1,200-unit Mount Green HA. It is estimated the guaranteed-bond will support the delivery of 5,800 additional homes, with over 4,100 homes to be delivered outside London[24].

Figure A5: The structure of the Affordable Housing Guarantee scheme



Source: "AHF £200 m bond issues at 37 bps in sector's cheapest deal", Social Housing, June.

[23] THFC Affordable Housing Finance http://www.eib.org/projects/pipeline/2013/20130244.htm.

[24] "Government-backed bond prices at 37 bps to mark sector's 'cheapest issuance'", Social Housing, 22 May 2014.

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4.3.4 GB Social Housing Bond

GB Social Housing plc (GBSH) is a public limited company registered in the U.K. It provides long-dated loans to the social housing sector and funds itself in the capital markets. GBSH aims to offer HAs an alternative to THFC. Unlike THFC, GBSH requires associations to meet gearing conditions (which measure debt to equity) and interest cover (profits divided by interest payments). However, it asks for a lower level of assets, 105%, as security than its rival THFC, which requires 150% of the loan in asset cover[25].The most recent deal was £48 million with two Scottish HAs, Hillcrest and Caledonia, with the bond maturing in February 2038[26].

4.3.5 The Extent of Bond Investment in Social Housing

Pension funds

The UK pension fund sector is the third largest in the world (after the US and Japan), with a total of £1.7 trillion assets under management at the end of 2012 – equivalent to 112% of UK GDP. UK pension funds invest in a variety of assets, both in the UK and in global markets. Just under half of UK pension fund assets are held in equities and just over a third in bonds (City of London, 2014). Currently, many pension funds in the UK are seeking to increase their direct exposure to property investment, which include rental housing.

In September 2012, Pension Insurance Corporation (PIC), which manages £10 billion of assets, directly funded Raglan HA as the sole buyer of a £50 million bond issue. The funds are to be used by Raglan to build new houses across the country. Raglan HA owns and manages 12,320 homes in 95 local authority areas across the South East, South West, Midlands and East of England[27]. Since then, PIC has invested more than £150 million in bonds to support three social housing projects in Greater Manchester and Leeds, and has another £180 million earmarked for similar investment over the next 12 months[28].

Local authority pension funds

Local authority pension funds (LAPFs) can be a source of institutional investment. LAPFs are for employees working for local government as well as a whole range of other organisations, including Parish Councils, educational establishments, charities and other public bodies. There are 99 UK local authority pension funds, with total assets under management of £148 billion as of March 2013 (City of London, 2014).

A group of London boroughs (Camden, Enfield, Hackney, Harrow, Newham, Tower Hamlets and Waltham Forest councils) is considering investing hundreds of millions of pounds from their pension funds into HAs to fund new development. Although discussions are said to be at an early stage, an initial fund of £500 million was cited as a possible investment. Currently, LAPFs in Manchester, Sheffield and Leeds have invested in development of market rented housing, but not social rented housing[29].

Investment funds

For investment funds, the attractiveness of social housing investment is highly dependent on the investment objectives, as well as the ethical and social credentials that a fund may seek. In August 2013, Regenda HA raised £55 million in a private placement with M&G Investments, of which £25 million is for its development programme (1,000 additional homes) and £30 million for refinancing existing bank debt. The deal, for terms

[25] "New bond player promises flexibility", Inside Housing, 4 March 2011.

[26] "£48m deal for GB Social Housing", Inside Housing, 16 April 2014.

[27] "Pension Insurance Corporation directly invests £50 million in social housing association", News & media, 18 September 2012, https://www.pensioncorporation.com/news-media/press/pension-insurance-corporation-directly-invest.

[28] "Affordable housing projects draw big investors", Financial Times, 23 February 2014.

[29] "Pension funds may invest in providers", Inside Housing, 26 April 2013.

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between 30 and 40 years, was priced at 150 basis points (1.5%) above gilts. This gave an average coupon rate (the market interest rate at the time of the first issue of the gilt) of 4.99%[30].

M&G Investments has also struck a club bond deal with the Welsh government to provide loans worth £153 million to a group of 17 HAs in the country. The six largest HA participants include Wales & West HA, Gwalia Group, Pennaf, Seren Group, Coastal HA and United Welsh HA. The funding will be used to build around 1,000 social and affordable houses across Wales, with the loan structured to allow the HAs access to flexible long-term finance. Some £98 million worth of funding will be provided through the Welsh Housing Finance Grant, with the remaining £55 million lent to HAs. The HAs involved in the club bond in Wales opted for M7G bond above an alternative THFC offer, which was government guaranteed. Despite the slightly higher rate of interest (around 5%), it required less stock as security[31].

[30] "Landlord makes £55 m deal with M&G Investments", Inside Housing, 20 June 2014.

[31] "Welsh RSL club secures £130 million from capital markets", Social Housing, October 2013, p.3.

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4.4 Equity Investment

4.4.1 Development Partnership/Joint Venture

Development partnership/joint ventures are increasingly common in the social housing sector. Joint ventures are often formed for the purpose of a single project, e.g. the development and on-sale of housing, such as affordable homes or shared ownership units. These may be Local Asset Backed Vehicles where the local authority contributes land or another tangible asset into the vehicle (Grace and Ludiman, 2008). They can happen in two ways:

a. Full Development Partnership – institutional investor provides development capital from the outset of the project.

b. Forward Sale – institutional investor enters an agreement with HA to provide equity investment once the development has completed.

Usually, a Special Purpose Vehicle (SPV) would be set up to allow the institutional investor and HA (and in some cases the local authority) to work together in a structure that ring-fences the project and limits liability to both parties. The level of equity involvement from both sides can vary. The institutional investor can become the sole equity investor, providing 100% of the capital or there can be a joint equity investment by both sides. This will depend on the ability of the HA to provide equity capital. Under this SPV arrangement, the HA would fully manage all aspects of the properties while the institutional investor becomes a 'silent investor', providing capital and participating in the risk and returns.

There are many risks associated with an investment of this type. Principally, they revolve around the ability of the HA to plan, build and deliver a large number of finished homes within a limited budget and timescale. Following this, the HA needs to be able to fill the properties and then manage them ensuring that rental voids and maintenance costs are kept at an acceptable level. Before partnering with an HA, the institutional investors will need to perform a thorough due diligence of the HA's development and management track record and convince themselves that the HA will continue to be able to deliver this into the future (Redington, 2011).

Finance raised in this way is generally more expensive than bond issuance because it is not secured against the assets of the HA but against the revenues to be generated by the project. In this way, the HA's balance sheet is protected. Under the accounting rules, this is more than likely to be on balance sheet, which affects the HA's gearing. For institutional investors, they potentially benefit from increased returns due to capital gains and access to long-dated inflation-linked cash flows. There are usually some forms of lease arrangements such that after the funding period, which might be 40 years for example, the ownership of the property reverts to the HA. In these instances, funders may require the HA to take the inflation risk for the duration of the lease.

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4.4.2 Sale and Leaseback

The sale and leaseback arrangement involves an investor (e.g. a pension fund) granting an HA a long-term lease (30 to 50 years) on the properties it sells to the fund, paying an annual rent to the lender who now owns the properties. At the end of the lease, freehold reverts to HA at term for nominal fee, i.e. the asset amortises to zero over time. Essentially, it is a loan taken against the security of properties, and sale and leaseback agreements count as a financial liability on an HA's balance sheet. This model is therefore potentially not suitable for HAs that have limited capacity to add further borrowing to their balance sheet. Also, the upfront cost of setting the sale and leaseback agreement is large, with legal fees of £50,000[32].

Derwent Living is the first HA to sign up with a pension fund in a deal worth £40–45 million with Aviva. Aviva will give Derwent a 50-year lease over the properties it sells to the fund, in exchange for which Derwent pays Aviva 4% of the gross purchase cost per year, increasing annually at the rate of RPI. The freehold will revert to the landlord at the end of the term for a nominal re-purchase price of £1, meaning that effectively the asset amortises to zero over time[33].This structure provides 20 to 30-year income streams with indexation and highly secures cash flows to pension fund trustees.

In April 2014, Legal and General's £252 million investment in 4,000 homes owned by Places for People marked the HA sector's largest ever leaseback deal (Table A3).

Table A3: Recent sale and leaseback activity in England

	Sale and leaseback			Lease and leaseback		
	Derwent Living	Derwent Living	Places for People	GreenSquare		
Date	07/11	11/12	04/14	02/13	06/13	04/14
Deal size	£45m	£25m	£252m	£19m	£13m	£19m
Lease term	50 years	50 years	50 years	48 years	48 years	48 years
No. of properties	839	411	4,000	212	129	189
Freehold	Aviva Investors	Aviva Investors	Legal & General	GSCH*	GSCH*	GSCH*
Leaseholder	Derwent Living	Derwent Living	Places for People	Aviva Investors	Aviva Investors	Aviva Investors
Purpose	Purchase of 839 units from Home Group	Refinancing	7,000 mixed tenure new-build over 7 years	Generate 212 new-build units	Generate 129 new-build units	Purchase of 189 units from Guinness

Note: GSCH = GreenSquare Community Homes (group subsidiary). When deal was signed, immediately became the sub-leaseholder from Aviva.
Source: "What does the future hold for the leaseback?" Social Housing, May 2014, p. 6.

[32] "Examining sale and leaseback", Inside Housing, 11 July 2014.
[33] "Derwent Living pioneers re-introduction of sale-and-leaseback with £45m Aviva deal", Social Housing, July 2011, p. 3.

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JLL (2014) published a research report outlining the views of 20 fund managers considering investment in affordable housing in the form of sale-and-leaseback financing structure. The main findings are:

- The average target yield is 4%;
- The optimum deal size is around £30 to £50 million;
- The ideal portfolio size is £100 to £200 million;
- Either CPI or RPI is accepted as an inflation measure and there is a general acceptance that indexing should be capped (i.e. CPI or 3.5% maximum);
- The preferred length of the deal is 40 years;
- Investment in HAs is determined by their financial strength, long-term partnership and rent cover (i.e. ability to service rent); and
- The role of the Regulator is crucial to reduce the risk of the investment as the Regulator will step in when HAs become vulnerable.

However, HCA has urged HAs to exercise caution when entering into sale and leaseback deals because linking debt to the RPI over 30 years or longer can cause problems when the rent regime, which is currently also RPI-linked, will change after 2015/2016 to CPI plus 1% each year for the following 10 years (Wilson, 2014)[34]. Also, there are possibilities that there will be further changes on rent regimes for the next 15, 25 or 30 years. Despite that, HCA have given approval for eight proposed sale and leaseback deals[35] since the start of the 2012/2013 financial year[36].

In Scotland, the Scottish Housing Regulator has suggested that a ballot of tenants be required where the leaseback proposal includes existing stock, to cover the technical change of landlord. This creates a further barrier to make sale and leaseback available without the high cost and possible risk of failure of a tenant ballot (SFHA, 2012).

4.4.3. Real Estate Investment Trusts (REITs)

REITs are property companies that escape corporation tax as long as they pay 90% of their income to shareholders. Participating landlords would be expected to transfer some homes into the REIT before it was floated on the stock market. REITs are closed-ended companies or trusts that hold, manage and maintain real estate for investment purposes. Equity REITs own a portfolio of property assets and the income that these generate (i.e. the rental yield) is passed on to shareholders in the form of dividends.

REITs are already a feature of a number of mature economies such as the US and Australia, but have only been permitted to operate in the UK since 1 January 2007. In the US, where residential REITs are known to have been established successfully, REITs have predominantly invested in communities of 200 or more small apartments in urban areas, as well as student accommodation and sheltered housing for older people (Jones, 2007). In the UK, REITs are mainly involved in commercial and retail investment, although a small number also invest in rental accommodation. However, there are no REITs involved solely in residential property. In

[34] "Ten associations withdraw from first REIT plans", Inside Housing, 26 January 2007.
[35] "Affordable housing projects draw big investors", Financial Times, 23 February 2014.
[36] "Affinity and Circle issuance signals new era for RSL bond investors, covenants and pricing", Social Housing, December 2008.

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2007, a consortium of over 20 HAs (including large HAs such as Affinity Sutton, Genesis and Peabody Trust) attempted to establish the first residential REIT in the UK, which was to be known as the 'HA REIT'. The consortium pledged £250 million worth of properties to the 'HA REIT', and it was envisaged that other HAs would be able to sell properties to the REIT or manage properties on behalf of the REIT. It was estimated that the initial start-up costs associated with the REIT would run into millions of pounds, and the consortium was said to have started negotiations with a major investment bank to secure the necessary finance. However, around 10 HAs were reported to have withdrawn from the REIT consortium and no HA REIT was formed[37].

Since 2007, UK-REIT legislation has undergone a number of reforms to help remove barriers to entry to, and investment in, the REIT regime, and to reduce administrative burdens for new and existing UK-REITs (HM Government and DCLG, 2012). The 2012 Finance Bill introduced legal changes, which included a number of measures that improved the prospect of developing a successful REIT. In particular, it abolished the 2% conversion charges for companies joining the REIT regime and relaxed regulation on listing requirements. To date, only one social housing REIT – Houses4Homes REIT – has been launched (in August 2012) after securing £30 million investment from pensions providers and would raise another £700 million to invest in social homes. Overall, there is general scepticism about establishing social housing REITs and no indication of strong demand for this type of REIT.

5. RISKS AND RETURNS OF SOCIAL HOUSING INVESTMENT

Many HAs have high ratings, which attract investment from institutional investors, for example Aviva, Canada Life, Legal & General Investment, M & G, and PIC[38]. Moody's publicly rate 26 HAs in the UK (see a selection of names in Table A4). The ratings range between Aa2 and A1 suggesting that in the "unlikely event of a HA facing acute liquidity stress, the UK government will very likely provide extraordinary support". The rating also reflects the fact that the social housing stock itself serves as collateral in the event of a default as the houses would be sold and the proceeds would go to the creditors. For example, the Affinity Sutton and Circle Anglia bonds do not have amortising profiles and rely on a bullet re-financing in 30 years' time. The bonds are secured by assets owned by Affinity Sutton and Circle Anglia, but they are not structured and instead rely on the corporate credit rating of each HA[39]. Also, the majority of the association's rental income comes from very robust rent collection rates (NAPF, 2013). The rental incomes are also very secure because the critical shortage in social housing supply means there is low turnover and vacancies in properties.

[37] "Ten associations withdraw from first REIT plans", Inside Housing, 26 January 2007.
[38] "Affordable housing projects draw big investors", Financial Times, 23 February 2014.
[39] "Affinity and Circle issuance signals new era for RSL bond investors, covenants and pricing", Social Housing, December 2008.

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Table A4: Moody's rating of selected Housing Associations

Housing Association	Moody's rating
Family Mosaic	Aa2
Peabody Trust	Aa2
Radian Group	Aa2
AmicusHorizon	Aa3
Notting Hill Housing Group	Aa3
Together Housing Group	Aa3
Genesis Housing Association	A1
B3 Living	A1

Source: NAPF (2013), Table 1.

The HA sector is a very heavily regulated sector. HCA oversees the sector and has the power to move in when it sees something that could be of detriment to the sector. Out of the 1,700 HAs, only two have collapsed.

In broad terms, the basic requirements for institutional investors to provide finance for social rental housing are not particularly different from those required by banks. These include: a reassurance of adequate cash flows to pay interest (and, ultimately, principal); and the presence of risk-mitigating features (e.g. those provided with collateral, guarantees, insurance, and sound evidence of effective regulation and financial management).

However, investing in social housing, like investment in other types of residential properties, presents several risks: capital risk on property value, rental yield risks and political risk associated with changing policies (Berry and Hall, 2005). Comparatively speaking, investing in HAs' rental housing is less risky than investing in build-to-let properties and student accommodation, even though all these types of investment deliver a similar net yield (Table A5).

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Table A5: Comparison of risks in different types of investment in residential sector

Sub-sector characteristics		Liquidity	Income security	Net yield	Capital growth prospects	Operational risks	Construction and maintenance risks
Benchmark							
	IPD based existing portfolio	◀▶	◀▶	◀▶	◀▶	◀▶	◀▶
Alternatives							
	Build-to-let portfolio £200m	◀▶	◀▶	▲	◀▶	▼	▼
	Housing association let portfolio	▼	▲	▲	▼	▲	◀▶
	Development and sale	▲	▼▼	▼▼	▲	◀▶	▼
	Mezzanine development finance	▼	▲	▲	▼	▲	▼▼
	Student accommodation fund	▼	◀▶	▲	▼	▼▼	▼

Legend	Benchmark	Better	Weaker	Much Weaker
	◀▶	▲	▼	▼▼

Source: British Property Federation (2013), Table 3.

5.1 Potential risk – Welfare Reform

HAs have historically been able to obtain long-term private finance cheaply and with high investor confidence because rental incomes (and therefore the ability to repay loans) have been underwritten by the government in the form of HB. Changes to HB since 1 April 2013 (reduction of HB to under-occupied social tenants and caps on the maximum HB available) and the introduction of universal credit in which HAs will no longer receive direct HB payments, will probably exacerbate the reliability of steady rental incomes. This will threaten HAs' low-risk credit profile and increase the risk to private finance when investing in social housing.

5.2 Returns to Social Housing Investment

Most institutional property investment has been focused on office, retail and industrial properties let on fully repairing and insuring leases. Long-term target returns are typically 2% to 3% over gilts. Table A6 shows that secured property income funds are currently targeting minimum net returns of 3% to 4% real (i.e. above inflation), compared with the minimum 5% real typically required by core commercial property investors, or the 5% to 7% real targeted by residential investors. The target return for secured property investors corresponds to sale and leaseback deals for properties with RPI-linked leases at an initial yield of say 4.5% (Williams, et al., 2011). NAPF (2013) states that social housing bonds could potentially return 1.5% to 2.5% extra return for investors. Better ratings however may lead to lower New Issue Spread. In general, the bigger the HA or deal is, the tighter the New Issue Spread.

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Table A6: Comparison of returns in different types of investment

Category	Target net return
Bonds of HAs	1% over gilts
UK Commercial property	2-3% over gilts
Secured property funds	3-4% real
Core property investors	Minimum 5% real
Residential property	5-7% real
Sale and leaseback with RPI indexing	4.5% initial yield

To provide transparent and measurable data in order to more easily attract institutional investors, Investment Property Databank (IPD) is working to launch a HA sector-wide index to measure the performance of social housing as an asset class. IPD will measure the property portfolios of the largest 200 HAs, covering around two million homes with an estimated capital value of between £150 and £200 billion. Currently, HAs including Genesis, Helena Partnerships, Liverpool Mutual Homes and Spectrum Housing Group have taken part in a feasibility study, aiming to produce an index that can reflect the increasingly commercial landscape of social housing in the face of reduced government funding. It is modelled on methodologies traditionally used in Europe, in countries such as the Netherlands, where private finance plays a much bigger role in financing social housing than in the UK[40].

Rather than looking solely at financial return, Legal & General (pension fund) has called for a new system to measure objectively the social benefits of investing in affordable/social housing[41].

6. BARRIERS TO INSTITUTIONAL INVESTMENT IN SOCIAL HOUSING

6.1 Credit Rating Availability for Smaller HAs

Large HAs are most likely already credit rated. Few institutional investors are willing to do credit rating work on smaller HAs, which may lead to smaller HAs struggling to obtain finance due to the lack of credit ratings. Aviva Investors, for example, only deals with the top 30 to 50 of the approximately 1,700 RPs in the UK[42].

6.2 Inflation-Linked Return

Some big institutional investors have concern over the low returns and reputational risks in investing social housing. For example, Lothian Pension Fund's investment in social housing has been impeded by concern over the level of inflation-linked returns offered by the asset class. The fund is looking for around 3% return and social housing cannot deliver this[43].

[40] "Social housing index to launch", Inside Housing, 6 March 2014.
[41] "Fund manager seeks measure for social value", Inside Housing, 13 February 2013.
[42] "As safe as houses", Investments & Pensions Europe, October 2012.
[43] "Lothian: Social housing returns too low to invest", Pensions Expert, 7 March 2013.

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7. FUNDING SOCIAL HOUSING – AUSTRALIA AND THE UNITED STATES

7.1 Australia

Social housing in Australia provided directly by the state has become marginalised and residualised. It is very small, consisting of fewer than 390,000 dwellings, of which approximately 60,000 are managed by more than 900 Community Housing Providers (like HAs in the UK). Nationally, fewer than 30 providers manage more than 1,000 tenancies with the largest provider managing less than 4,000 tenancies[44].

Australia started to attract institutional finance for social housing in the early 2000s. With the election of a centre-left government in late 2007, at a time of declining housing affordability and a severe shortage of rental housing, an innovative tax credit policy was introduced. The National Rental Affordability Scheme (NRAS) aimed to build 50,000 new affordable units over five years, followed by a further 50,000, subject to demand. While not explicitly modelled on the US approach, the LIHTC has been frequently cited as a source of inspiration (Blessing and Gilmour, 2011).

Like the United States' LIHTC (described later), the Australian NRAS scheme targets institutions, and, in particular, pension funds, which, as at March 2011, managed funds of A$1.36 trillion, up from A$200 billion in the mid-1990s. NRAS incentives have been offered in four rounds, with round three raising the minimum application size from 20 to 1,000 incentives and explicitly targeting 'large institutional investors'. Successful round three applicants were made public in Parliament during August 2011. Of the 14 recipient organisations, four were traditional not-for-profits, three were universities and public agencies, one was a finance company, two were not-for-profit investment vehicles, and four were for-profit investment/development vehicles. Therefore, although Australia is witnessing the emergence of US-style intermediaries, there is little evidence of significant institutional investment, which was the key policy goal. Unlike in the US, there is no 'stick' to promote this type of investment, just financial 'carrots', which have turned out to be attractive to individuals paying higher-rate tax. Furthermore, institutional investors in Australia generally have a poor regard for the returns they would otherwise get from social housing (Berry and Hall, 2005). There is also less tradition of institutional investment in Australian residential development compared to the US, with most property investors being families owning and renting a second home (Blessing and Gilmour, 2011).

7.2 United States

In the United States, it is not an institution but a programme, the Low-Income Housing Tax Credit (LIHTC), that is seen as a successful policy for the development of subsidised rental housing through institutional investment. The LIHTC is by far the nation's largest subsidy programme for the development of low-income rental housing. It is often used in conjunction with other federal and state housing programmes, including tax-exempt bonds, block grants, and the HOPE VI programme for the redevelopment of distressed public housing (Schwartz, 2011).

Established by the Tax Reform Act of 1986, the LIHTC provides investors with a dollar-for-dollar reduction in their federal income taxes. Figure A6 provides an overview of the LIHTC. The system is complicated, involving multiple actors, and as a result took over a decade to be accepted and work efficiently. Once a developer has identified a scheme and been allocated tax credits, they are 'sold' via a syndicator to investors to raise capital. Investors do not necessarily pay the syndicator the full price for tax credits, and in the early years of the LIHTC only 42 cents of each tax dollar went into social housing. As the programme matured, and as investors came

[44] "Big pond", Inside Housing, 30 July 2014.

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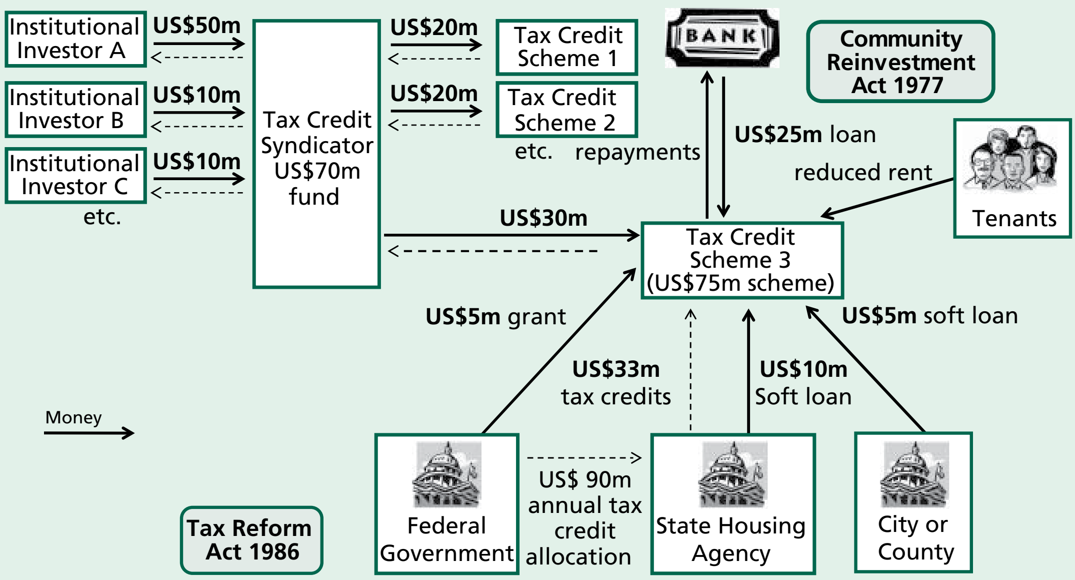
to believe that this was a very safe investment, investors were willing to accept lower rates of return and the value of the credits increased. By 1996, the figure had reached 65 cents, and at its peak in 2006 a full dollar was received, and by the mid-2000s, developers received upwards of 95 cents or more for each tax credit dollar[45] (see Figure A7). As a result of the programmes increasing efficiency, developers required less "gap subsidy" to make up the difference between the tax credit equity, the mortgage and the total development costs (Schwartz, 2010).

LIHTC explicitly targets institutional investors, typically large and well-capitalised organisations with access to wholesale funding. In the US, restrictions on claiming depreciation allowances, together with onerous application procedures, shifted the investment market for LIHTCs from individuals to institutions from the late 1980s. LIHTC investment by individuals rather than institutions fell from a high of 98% in 1988 to below 5% since 2002. The rise of intermediaries that began to actively market the credits to large institutional investors also helped engineer this shift. However, it was the ability of financial institutions to use LIHTC investment to comply with the Community Reinvestment Act rules, which created the largest investor class, particularly from the mid-1990s when banks overtook a broader range of corporate investors. In 2006, an estimated 85% of LIHTC assets were purchased by financial institutions (Blessing and Gilmour, 2011).

Figure A6: An overview of the LIHTC



In this hypothetical example, a tax credit syndicator creates a US$70m fund from a number of institutional investors. The fund invests in several tax credit transactions: this diagram relates in detail to Tax Credit Scheme 3. The scheme builds multi-unit housing costing US$75m. The State allocates to the developer US$33m of its US$90m annual tax credit allocation from the Federal Government. These tax credits encourage investment of US$30m equity by the tax credit syndicator. Other funding comes from bank loans (US$25m), state/city soft loans (US$15m) and grants (US$5m).

Source: Blessing and Gilmour (2011) Figure 1.

[45] The amount that investors will pay for tax credits is determined by the yield they desire from their investment (discount rate). The higher the yield, or discount rate, the less investors will pay. For example, if investors demanded a yield of 20%, they would pay US$4.2 million for a project that generated US$1 million annually in tax credits for 10 years; but they would pay US$7.7 million for the same amount of tax credits if they required a yield of 5%.

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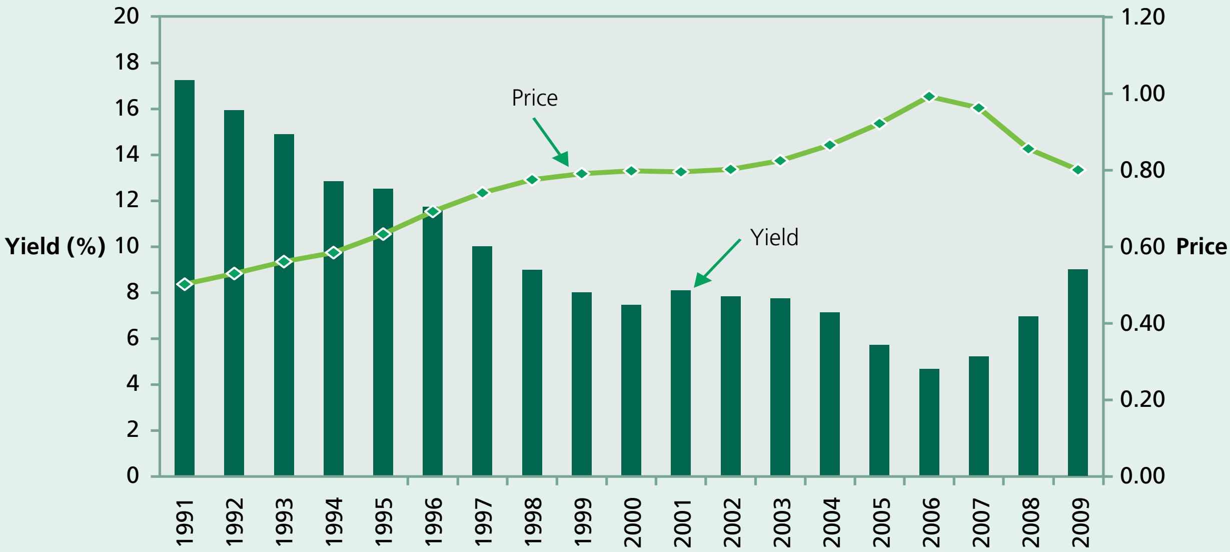
Figure A7: Low-income housing tax credit in United States: yield and price, 1991-2009



Source: Schwartz (2011, Fig. 1).

The GFC sharply diminished the market's appetite for LIHTCs and for tax-exempt housing bonds. Corporate entities with little or no taxable income no longer benefited from tax credits, and a number of major investors failed (Schwartz, 2011). Weak demand for tax credits caused their price to fall sharply in 2008/2009, creating gaps in the financing of properties that had already received allocations, as shown in Figure A7. However, this in turn encouraged the return of syndicators and re-activated the market, stimulating interest from new classes of direct investors (e.g. Google and Verizon) and the return of investors, such as insurance companies, multi-investor funds and corporate investors. As a result of this renewed activity, by 2010 investment levels were reported to be near those achieved before the crisis and competition for credits was considered to be robust in most markets. Nevertheless, wider economic conditions and anticipated policy and fiscal reform on a number of fronts in the United States have continued to add to market uncertainty (Milligan, et al., 2013).

In sum, the LITHC has facilitated the development of 2.4 million units of affordable housing in the period 1986 to 2012. The annual cost (or, more accurately, loss of tax income) totals roughly US$5 billion for the Federal Government (Milligan, et al., 2013).

8. Conclusions

Bond issues are the predominant form of institutional investment in the United Kingdom, and there is an increasing trend of bond issuance as the alternative source of funding for the HA sector. Even though with higher yields but higher risks, HAs shy away from sale and lease arrangements with investors. Only the United States has a higher degree of institutional investment in the social housing sector. Even though Australia has introduced a specific programme to attract institutional investment, it was unsuccessful.

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APPENDIX A: LITERATURE REVIEW

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APPENDIX B: COUNTRY REPORT – FRANCE

In this report,[46] the prospects for institutional investment in social and intermediate rental housing (defined as housing with a regulated rent) are discussed. The report is based on a literature review as well as on information that has been provided by four relevant French housing experts that were contacted by both phone and email.

This report covers the following topics:

1. A description and definition of social, intermediate and market rental housing in France;
2. Institutional investment in the social rental sector;
3. Institutional investment in the intermediate rental sector;
4. Institutional investment in the market rental sector;
5. Summary and conclusions.

1. Social, Intermediate and Market Rental Housing in France

Social rental housing in France

French social rental dwellings are dwellings with a rent level below the market rent. The target group of these consists of households with a lower and lower-middle income.

The providers of social rental dwellings in France are Habitations à Loyer Modéré organisations (HLMs). In 1894, the first HLMs were created on a private "not for profit" basis. These organisations are now called Entreprises sociales pour l'habitat (ESH). They are allowed to pay a very limited dividend, referring to a very low capital, to their shareholders (Amzallag and Taffin, 2003, p.21). The initiators of these organisations were often companies that wanted to provide housing for their own employees (for example the French railway company SNCF; Bougrain, 2004). Others are subsidiaries of financial institutions (savings banks, insurance companies; Driant, 2011, p.122). Social rental landlords with a private character (ESH) usually operate under the supervision of shareholders from both the private and public sector (representatives from local authorities are members of their management board).

Since 1912, there are also HLM organisations with a predominantly public character. These public HLMs are now (since 2008) known as Offices Publics de l'Habitat: OPH. They are controlled by the local authorities (municipalities, groups of municipalities or departments; CECODHAS, 2007). Although the OPH are under strong influence from the local authorities, they are mainly financially independent from them.

In the literature, and also in this report, all French social rental landlords, whether they have a public (OPH) or a private character (ESH), are often simply referred to as HLMs. In 2005, the total HLM stock consisted of 54% public (270 OPH managing 2.2 million dwellings) HLMs and 46% private HLMs (265 ESH managing 2 million dwellings; Haffner et al., 2009, p.105). Both types of HLM organisations are subject to the same government regulation.

HLM organisations have a long-term commitment to build and manage social rental housing under specific rules: level of rents and rent increases, income ceilings for tenants, reduced VAT rate for building, exemption of local property tax (for 25 years) and off-market loans for new construction (1% below market interest rate and 40 years duration). Furthermore, potential returns that HLM organisations are required to be reinvested in the social rental sector. The rules and facilities for HLM organisations make are guaranteed through a commitment between the central state and the social rental landlords. In practice, this commitment

[46] A significant part of this text has been taken from Hoekstra and Cornette (2014).

APPENDIX B: COUNTRY REPORT – FRANCE

(conventionnement) is of an indefinite nature. This is a major difference with the German system where the "social" qualification disappears with the extinguishment of the subsidised loan. (This last paragraph is based on information that has been provided by Jean-Pierre Schaefer.)

Intermediate rental housing in France

The French intermediate rental sector occupies a middle position between the social rental sector and the private rental sector. As shown in Table B1, rent levels are higher than in the social rental sector, but lower than in the unregulated market rental sector. Just as in the social rental sector, tenants who wish to live in the intermediate rental sector generally have to meet certain income criteria. However, the income limits that apply are higher than those in the social rental sector. Finally, the rent regulation and tenant protection in the intermediate rental sector is less strict than in the social rental sector but stricter than in the market rental sector.

Table B1: Maximum rent levels in the intermediate rental sector in the different French regions in 2014

Monthly rent in €/m²	Paris	Paris region	Large metropolitan areas	Middle-sized metropolitan areas	Other territories
	Zone A bis	Zone A	Zone B1	Zone B2	Zone C
Maximum rent for private investor with fiscal deduction "Duflot"	16,72	12,42	10,00	8,69	none
PLI	18,38	15,32	10,65	10,65	7,67

Source: www. anil.org.

The idea behind the French intermediate rental sector is that it fills the gap between the social rental sector and the unregulated market rental sector, by offering a good alternative to tenants from both these sectors. For tenants in the social rented sector with a slightly higher income, the intermediate sector might offer an affordable rent option and the prospect of lifelong renting. Tenants in the private rental sector, as well as newcomers on the housing market with a slightly higher income who are not entitled to enter the social rental sector, will be attracted by the relatively good price-quality relationships in the intermediate rental sector. Intermediate rental dwellings are especially needed in regions with a relatively tight housing market, in which there are large price differences between relatively 'cheap' social rental dwellings and the relatively expensive market rental dwellings (Hoekstra and Cornette, 2014).

French intermediate rental dwellings are mainly provided by individual private rental landlords. Many of these individual landlords make use of the various tax incentives that are provided by the French government. These incentives assure that in exchange for the financial support of the government, landlords have to meet certain criteria with regard to the rent level and the income of the tenants (see Hoekstra, 2013, for a detailed description of these tax incentives; see Table B1 for the maximum rent levels of the Duflot tax incentive). The financial arrangements between government and individual rental landlords in the intermediate rental sector apply for a fixed medium-term period, typically more than seven years. When this time period has passed, the dwellings concerned are again part of the free rental market. In this respect, the French intermediate rental sector has many similarities with the German social rental sector.

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Market rental sector

The market rental sector involves dwellings for which there are no rules and regulations with regard to the initial rent setting and the income of the tenant that is housed in the dwelling. These dwellings are generally not subsidised, although in the past tax incentives have been available for individual private rental landlords that provide them. The annual rent increase of market rental dwellings is tied to an inflation-based index (Haffner et al., 2009).

2. Institutional Investment in the Social Rental Sector

Direct institutional investment: institutional investors buying HLM dwellings

In France, there is no direct institutional investment in the HLM sector. The current regulation of HLM organisations (conventionnement) does not allow sales of HLM dwellings to institutional investors. Moreover, the restrictions on financial transfer from HLMs and reinvestment requirement would not allow institutional investors to extract sufficient profits to realise an acceptable yield (information provided by Jean-Pierre Schaefer). Dividends are capped at a very low level and profits (including those from the sale of dwellings) have to be reinvested in the social rental sector, thus the institutional investor in the sector would never get back its investment (information provided by Vincent Mahe).

If they get permission from the state or the local authorities, HLM organisations may sell dwellings to sitting tenants or, in case of vacancy, to other interested households. In 2013, 7,319 social rental dwellings were sold to tenants throughout France. Given the fact that there are about 4.5 million social rental dwellings in France, this is a small fraction of stock.

HLM dwellings may also be transferred from one HLM organisation to another. Whereas sales from HLM organisations to institutional investors are not allowed, HLM organisations occasionally buy stock from institutional investors in order to transform them into social rental dwellings. This particularly happens in areas in which social rental housing is in limited supply (information provided by Jean-Pierre Schaefer).

There is some debate in France about the desirability of lifting the regulations that impede the sale of social rental dwellings to institutional investors. The CEO of the SNI group, one of the largest providers of social and intermediate rental housing in France and also the initiator of the Fonds Logement Intermédiaire (see Section 4) is in favour of this. He stated that the sale of older social rental dwellings would result in a large amount of equity that the housing associations could subsequently use to build new social rental dwellings. These new social rental dwellings will be of a better quality than the old social rental dwellings that are sold. However, this view is not supported by many social housing organisations and by the French umbrella group for social rental landlords (Union Sociale pour l'Habitat). They fear that such a policy would diminish the availability of cheap rental dwellings. It would also make the management of half-sold building complexes rather complicated (especially the management of allocation rights). Furthermore, they are sceptical about the positive financial effects that such a policy might have. From the market point of view, high returns could only be reached on a limited scale and in a limited number of areas (information provided by Jean-Pierre Schaefer).

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Partnerships between social rental landlords and institutional investors

Institutional investors can be shareholders of the social rental landlords with a private character. Usually, there are historic reasons for this, for example because the institutional investor involved wants or wanted to provide housing for its employees. Nowadays, allocation rights for social housing are channeled through CIL: Comités Interprofessionnels du Logement (25 organisations throughout France that are related to the employers). However, being a shareholder of a social rental landlord with a private character should not be seen as part of the investment strategy of institutional investors. After all, given the specific regulations and financial structure of the French social rental sector, social rental landlords with a private character are only allowed to pay a very limited dividend to their shareholders. What do exist are partnerships between social rental landlords (who are usually their own developer) and private developers in new-building projects. This typically concerns mixed programmes in which a small number of social rented units is included in a market-driven programme (information provided by Christian Tutin).

Indirect institutional investment in French social housing: housing finance

French social rental landlords are financially supported through an unusual system in which household demand savings[47] (accumulated in any bank) are used to provide long-term loans to landlords that build social rental housing. These savings are deposited tax-free saving accounts for households such as the Livret A scheme or similar schemes (with a ceiling of €22.9 thousand per account; Amzallag and Taffin, 2003). The interest rate for the Livret A savings scheme is the mean of the Euribor and Eonia interest and inflation rates. The interest rate on the loans for landlords is linked to this Livret A interest rate (0.6%), which is generally below the market interest rate. Table B2 shows the specific conditions of the various loans that are available.

[47] The saving accounts do not charge any fees for deposit nor for getting the money back. Furthermore, there are no management fees and saving money can be withdrawn without prior notice.

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Table B2: Main characteristics of the four most important loans for rental landlords, France

	PLA-I	PLUS	PLS	PLI
Target group	Social rental landlords	Social rental landlords	All investors	All investors
Interest rate TLA rate 1% August 2014	Livret A – 0.2% (0.8% in 2014)	Livret A + 0.6% (1.60% in 2014)	Depends on credit provider and type of landlord, usually around Livret A + 1.1%	Depends on credit provider and type of landlord, usually around Livret A + 1.4%
VAT rate	Low (5%)	Low (5%)	Low (5%)	Normal[48] (20%)
Exemption of land and property taxes	Yes (25 years)	Yes (25 years)	Yes (25 years)	No
Maximum term of the loan	40 years (50 years for the value of the land)	40 years (50 years for the value of the land)	30 years (50 years for the value of the land)	30 years (50 years for the value of the land)
Amount of the loan	Variable, maximum 100% of investment costs	Variable, maximum 100% of investment costs	> 50% of investment costs	Variable
Duration of contract with state	Long term	Long term	Term of the loan, minimum 15 years (longer term for social rental landlords)	Term of the loan, minimum 9 years (longer term for social rental landlords)
Maximum amount of direct subsidy[49]	25%	Depends on type of investment, usually between 5 and 10%	No subsidy	No subsidy
Maximum rent level in the most expensive region (Paris) 2014 Maximum rent level in the cheapest region 2014	€5.94/m^2 €4.53/m^2	€6.26/m^2 €5.11/m^2	€13/m^2 €7.67/m^2	€18.38/m^2 €7.67/m^2
Maximum income level (based on taxable income: revenu imposable)	Depending on region and household size, <60% of the income ceiling of PLUS dwellings	Depending on region and household size	Depending on region and household size, maximum 130% of the income level of PLUS dwellings	Depending on region and household size, maximum 140-180% of the income level of PLUS dwellings
Number of dwellings financed in 2013	29,700 loans €2.03 billion	54,700 loans €5.9 billion	32,500 loans €760 million	2,800 loans €45 million

Source: Hoekstra and Cornette (2014) and Ministère du Logement (2014).

[48] However, for renovation work, the low VAT applies.
[49] In the case of relatively high land costs, part of these costs may be subsidised by the government as well.

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The above loan system is coordinated by the Caisse des Dépôts. Caisse des Dépôts, which is state-owned financial institution, has a €243 billions deposit (Livret A and others). In 2013, they granted €16 billion of loans for social housing (Rapport Annuel du Fonds d'Epargne 2013).

This system limits the amount of state subsidisation required for social rental housing (although direct state subsidies for social rental housing still exist, see also Table B2). The repayment of the Caisse des Dépôts loans is guaranteed by the municipalities or the guarantee fund for the social rental sector: the Caisse de Garantie du Logement Locatif Social (CGLLS). Table B2 gives an overview of the four most important Caisse des Dépôts loans for rental landlords.

The Caisse des Dépôts loans are allocated following an analysis of the operations and financial health of the social rental landlords concerned. The Caisse des Depôts (the manager of the fund) can refuse to provide loans if the relevant criteria are not met. It is also responsible for the financial supervision of social rental landlords.

Central government still has a significant influence on the allocation of the loans of the Caisse des Dépôts. It defines housing needs at the national and regional level, and decides on the level of the subsidy given to social housing. Nevertheless, local authorities are playing a growing role: they also supervise social landlords, co-finance social housing programmes and are in charge of urban planning. Since 2004, the Second Decentralisation Law has allowed groups of local authorities to take responsibility for distributing subsidies for social housing (Lévy-Vroelant and Tutin, 2007).

About 71% of the investments of social rental landlords are financed by the loans provided by Caisse des Dépôts. An additional 15% comes from government grants and subsidies, mostly from local authorities. Furthermore, about 10% is financed by equity capital from the HLM body itself. The remaining 4% comes from the 1% logement scheme (Action Logement). Any private company employing more than 19 people has to put money into this scheme, which is designed to express social solidarity between employers and employees as well as the wider society. The rate, initially set at 1% of the total gross wage bill of private companies, has been set at 0.95% since 1992. The largest proportion of this money (0.50%) goes to the Fonds National d'aide au logement (FNAL), which uses it to finance housing allowances. The rest of the contribution (0.45%) is transferred to registered intermediary organisations (CIL: Comités Interprofessionnels du Logement) and chambers of commerce. These organisations finance social housing and urban renewal operations and provide financial support, advice and services to households. As compensation for their financial help, the intermediary organisations are often made shareholders of social rental landlords with a private character. They also receive allocation rights for social housing: a significant part of the social rental dwelling stock is reserved for the employees of the companies that are involved in the 1% logement scheme. Finally, it should be noted that the French social rental landlords also receive indirect fiscal subsidies from the state since they pay a lower VAT rate and the Caisse des Dépôts loans are accompanied by an exemption from the local land and property taxes. The state compensates the loss of fiscal income incurred by regional and local authorities.

The information provided above shows that institutional finance hardly plays a role in the French social rental sector. Nevertheless, recent information shows that the European Investment Bank has recently (July 2014) signed a partnership agreement with the Caisse des Dépôts. Since institutional investors may buy securities from the EIB, this partnership agreement may lead to some form of (very) indirect institutional investment in the French social rental sector. However, until now, the importance of this still seems to be rather marginal (information provided by Jean-Pierre Schaefer).

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3. Institutional Investment in the French Intermediate Rental Sector

The French government has been trying to stimulate investment in the intermediate rental sector for several decades. This is due to the fact that there is a continuing shortage of affordable rental dwellings for middle-income groups, especially in areas with a strong population growth such as for example the Paris region and cities like Bordeaux and Toulouse. In principle, investment in the intermediate rental sector is supported for all types of investors: HLM organisations, profit-making parties (including institutional investors) and individual households. For HLM organisations and profit-making parties, special loans are available: The Le Prêt Locatif Social (PLS) and the Pret Locatif Intermédiaire (PLI). The main characteristics of these two loans are shown in Table B2. However, institutional investors are generally not interested in taking up PLS and PLI as they are accompanied with rather strict conditions for the rent setting, the income of the tenants and the duration of the tenancy arrangement. Consequently, almost all PLI and PLS loans are taken out by social rental landlords. However, in terms of financed dwellings, most of the investment in the French intermediate rental sector takes place by individual private rental landlords, stimulated by the fiscal incentives that the French central government provides (see Hoekstra, 2013).

Recently however, two important new developments have taken place in the French intermediate rental sector that aim to further enhance investment by social rental landlords and institutional investors in this sector. Firstly, a new legal and taxation framework that gives the French intermediate sector a more formal position has been introduced. This legal framework gives HLM organisations the opportunity, albeit under strict conditions, to set up a branch organisation that provides intermediate rental housing. Furthermore, the new framework provides some tax advantages to institutional investors that choose to invest in the intermediate rental sector; these investors pay a lower VAT rate (10%) and are exempt from paying local property taxes for a period of 20 years (information provided by Jean-Pierre Schaefer and Vincent Mahe). Finally, a new initiative has been developed that aims to attract institutional investors to the intermediate rental sector: The Fonds Logement Intermédiaire (FLI).

The Fonds Logement Intermédiaire (FLI)

The Fonds Logement Intermédiaire, formerly called Argos, has been initiated by the Caisse the Dépôts and its branch Société Nationale Immobilière (SNI). SNI is one of the largest landlords in France and manages more than 185,000 social rental and almost 90.000 intermediate rental dwellings. The FLI was officially launched on 24 July 2014. Apart from SNI, the fund consists of seven institutional investors, mainly active in the field of insurances and pensions. All these investors already have an affinity with investment in residential property. The aim of the fund is to create 10,000 new intermediate rental dwellings (in 2014) in areas with a tight housing market. The fund will have an investment capacity of €1.7 billion. Half of this amount of money comes from own equity of the fund participants, whereas special bank loans are available for the financing of the remaining half. The fund expects to have a yearly net rental yield of 3.5% a year, and a total yield (including the future sale of the dwellings) of 7% (IRR). The fund will run for a period of 20 years, after which all the dwellings will have been sold. The rental contracts have a term of six years.

The new intermediate rental dwellings will be integrated in so-called mixed programmes with at least 25% social rental housing. The new intermediate rental dwellings will generally have two or three rooms, a floor area of an average 54 square metres, and a rental price that is about 15% below the market price. The fund takes the form of a Société Civile Immobilière and will be managed by the company Ampere Gestion (HSBC, 2014).

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In 2015, the FLI attempts to attract additional investors, including institutional investors from abroad. For this purpose, they have scheduled meetings with two big Dutch pension funds (APG and PGGM) as well as with some German institutional investors. For 2015, the FLI plans to construct 8,000 new intermediate rental dwellings. FLI does not construct the new intermediate rental dwellings itself but buys them from construction companies and project developers. Property developers that want to build dwellings for FLI can submit their plans to the fund, which will then make a selection through a tender procedure.

4. Institutional Investment in the Market Rental Sector

The amount of money that institutional investors in France invest in the market rental sector varies per year, but generally ranges between €500 million and €1 billion. Every year, institutional investors add 3,000 to 6,000 new market rental dwellings to the French housing stock; this is a small fraction of the total French housing production that is generally between 300,000 and 400,000 dwellings per year. According to a panel of institutional private rental landlords (Ad Valorem, 2010), the main impediments to residential investment in the market rental sector are the strict regulations (rent regulation, tenant security) with regard to letting (36%) and the relatively low yields (34%).

The importance of institutional private rental landlords has significantly decreased in recent decades. Their share within the total private rented sector dropped from about 12% in 1984 to about 3% to 4% nowadays. Especially the insurance companies, who used to be important private rental landlords, have disinvested considerably. They have moved their investment to financial markets where returns tend to be (or at least used to be) higher (Hoekstra and Cornette, 2014). Within the property sector, these kinds of investors appear to have a preference for offices and retail property rather than for residential property. Nowadays, only 2% of the investment of French insurance companies is directed to the residential sector (information provided by Vincent Mahe).

According to Vincent Mahe, there are three main reasons for the relatively limited investment by French institutional investors in the residential sector in recent years. First of all, the strong tenant protection in France, and the broad societal support for this, plays a role. Institutional investors are afraid of non-paying tenants. Not only because it is difficult to evict them, but also because evicting non-paying tenants can lead to 'bad advertising' and give the institutional investors the image of a 'bad guy'. This is something that they want to prevent at all costs. Secondly, French housing policies and regulations (rent regulation, tenant protection and particularly the availability of fiscal advantages) are not very stable and often change once a new government has been installed. This leads to insecurity with regard to the yield that institutional investors can expect in the medium and longer term. Thirdly, after the strong house price increases in the period between 1999 and 2006, many institutional investors expected a house price decline after 2007. In anticipation to this, they started to sell part of their residential property. In reality, however, the post-2007 house price decline in France was fairly limited: after a house price decrease in 2008 and 2009 price levels recovered and in 2011 and 2012 the nominal house price index was already above the 2007 level (EMF, 2013). Finally, there has been a lack of investment products for investors that do not want to exploit and manage the residential property in which they invest themselves. Obviously, the newly created FLI attempts to fill this gap (information provided by Vincent Mahe).

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The returns that institutional investors in the private rental sector can make are dependent on both the returns from renting and the returns from capital growth (potential increase in property prices). According to the IPD France Annual Property Index, the returns from letting were 3.3% in 2011, whereas the return from capital growth was no less than 8.2% in that year, thus resulting in a total return of more than 11%. Over a longer time period, the total returns show a positive picture as well - they were on average 9.8% per year in the period 2001 to 2011 (see Table B3). Despite these positive figures, the interviewees (Jean-Pierre Schaefer and Vincent Mahe) point out that many institutional investors are still reluctant to invest in residential property. The various non-economic factors outlined above will definitely play a role here.

Table B3: Returns on investment in property, IPD France Annual Property Index (results to 31 December 2011)

	Total yield	Total yield (%)	Rental yield (%)	Capital yield (%)	Total yield per annum		
	1997=100	1 yr	1 yr	1 yr	3 yrs	5 yrs	10 yrs
All Property	372.5	8.4	5.6	2.7	5.5	6.5	9.5
Retail	637.9	9.5	5.9	3.5	6.3	8.4	13.0
Offices	374.3	7.2	5.7	1.4	5.0	5.9	8.7
Industrial	343.3	6.2	7.4	-1.1	3.1	3.8	8.6
Residential	321.4	11.7	3.3	8.2	7.1	7.3	9.8
Other	370.6	9.6	6.2	3.1	7.6	8.3	10.4

Source: www.ipd.fr.

5. Summary and Conclusions

With regard to the investment possibilities for institutional investors in the French social rental sector, the following two conclusions may be drawn:

- Investment possibilities in the social rental sector are virtually non-existent as a result of the financial and regulatory constraint. The available returns are thought to be insufficient for investors. However, the desirability of these constraints is sometimes questioned.
- As a result of new policy initiatives, the investment possibilities in the intermediate rental sector have recently increased. The role that institutional investors could play in increasing the housing supply for middle-income groups is now high on the political agenda. In the near future, non-French institutional investors will possibly also enter the intermediate French rental sector.

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APPENDIX C: COUNTRY REPORT – GERMANY

In this report, the prospects for institutional investment in social rental housing (taken as rental housing subsidised with bricks-and-mortar subsidies) are discussed. The report is based on a brief literature study about the most important elements of housing policy and is complemented with information from respondents by phone and email, on the topic of institutional investment in relation to social housing.

This report covers the following topics:

1. Definition of social renting
2. Subsidisation
3. Rent control for not-subsidised rental dwelling
4. Financing of real estate
5. Financing of subsidised rental dwellings
6. Conclusions

1. Definition of Social Renting

Unlike the other countries considered in this study (UK, France, the Netherlands), the standard division of rental housing stock into social and private rented sectors on the basis of ownership does not apply in Germany. Until 1990, a non-profit tax (versus profit) status existed for landlords in former West Germany. The non-profit landlords were also referred to as 'social' landlords: the rental cooperatives and the municipal housing companies. Since the abolition of the non-profit tax status, Germany officially has only had private landlords (Oxley et al., 2010 based on Bundesamt für Bauwesen und Raumordnung, 2007). In 2011, the private rental sector had a size of about 52%[50] of total stock (Cornelius and Rzeznik, 2014; Kofner, 2014). The size of the rental cooperative sector amounted to about 5%. Individually-owned private renting dominated the private rental sector with a share of almost 34%, while private companies owned exactly 7% of stock.

A second special aspect of former West German housing policy, which is still relevant today, is the social market economy philosophy that finds its origins in the era of the Weimar Republic (1918-1933). Instead of the principles of capitalism, the social market economy philosophy promotes that social welfare is best served by bringing about economic progress; the market dominates, and government intervention is designed to support the proper operation of market forces. The time-limited bricks-and-mortar subsidisation in (rental) housing, the market-led rent regulation (Mietspiegel) and the fact that market investors are providing subsidised rental housing are characterising features of the housing system, which Droste and Knorr-Siedow (2007) call the 'market-based' system (see also Busch-Geertsema, 2004, 2000; Cornelius and Rzeznik, 2014; Haffner, 2011).

This history implies that social housing as a concept formally does not exist – only dwellings that are subsidised via the housing subsidy laws (Wohnraumförderungsgesetze) (see also Kofner, 2014). These dwellings are called social in this contribution.

In the interviews, it was argued that the rent control system in fact meant that all dwellings in the private rental sector were also in the 'social' sector. This is not, however, the 'normal' definition of social (also not in this report.

[50] Germany has the biggest rental sector in the European Union (Dol and Haffner, 2010).

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2 Subsidisation

The system of bricks-and-mortar subsidies for 'social' housing that is in place today has existed since the 1950s. The law of 2001 overhauled the law of 1956, but did not change the mechanisms. Either low-cost loans or interest subsidies can be received in the rental sector (though the law applies to homeownership as well) in exchange for price limits (agreement on rent and rent increases) in combination with dwelling allocation rules. The system of bricks-and-mortar subsidies is designed as a concession model, temporarily ring-fencing subsidised dwellings from the rest of the housing market under a special regime (Busch-Geertsema, 2000; Haffner, 2011; Haffner et al., 2009). The average period of the subsidy is said to be 15 years nowadays (Cornelius and Rzeznik, 2014).

In September 2006, central government transferred its powers for the bricks-and-mortar subsidisation, including their price/rent regulation and allocation, to the federal states. Since then, federal states have been able to design their own social housing investment policies. The shift in responsibility was accompanied by a financial compensation paid annually by the federal government until the end of 2013; now extended to the end of 2019 (Bundesgesetzblatt, 2013; Bundesregierung, 2009; Haffner, 2011; Oxley et al., 2010).

As the system of bricks-and-mortar subsidies is designed as a concession model, the dwellings move to the unsubsidised rental sector when the subsidy period terminates. From the almost 2.5 million available subsidised rental dwellings in 2005, it was expected that no more than almost 1.8 million dwellings would be left at the end of 2010 (Haffner, 2011 from Bundesamt für Bauwesen und Raumordnung, 2007), representing less than 5% and, in terms of rental stock, less than 8%. Kofner (2014) estimates the number of social dwellings at about 1.6 million, while Cornelius and Rzeznik (2014) estimate the share of social rental stock at 4% in 2011. As the subsidised sector has shrunk in number of dwellings, low-income households nowadays will increasingly be found in the private rental sector.

3. Rent Control for Non-subsidised Rental Dwelling

Since the 1970s, rent control in Germany has been concerned with protecting sitting tenants, which will have the right to an indefinite contract; not new tenants. Rent control for sitting tenants in the free-financed rented sector can occur by several legal means, but is always market-led. Rent changes for sitting tenants must be based by law on the rents of three similar rented dwellings. Alternatively, rent changes can be based on a so-called Mietspiegel (translated as rent mirror), a database with local reference rents of non-subsidised market rents. Most major towns and cities will have such a database of reference rents in place. Reference rents are based on comparable quality characteristics for buildings and dwellings and their locations (Haffner, 2011; Oxley et al., 2010).

Changes in the rent law of 2001 have made it possible to compile a 'scientific' Mietspiegel instead of a 'regular' one. The former must be compiled along scientific lines, e.g. based on a hedonic regression analysis or with 30 observations per bundle of dwelling characteristics considered. The advantage of a reference rent database put together based on scientific principles is that rent rises are easier to implement than with a normal one – especially where the rent is lower than the maximum rent according to the Mietspiegel. It makes obtaining the tenant's permission, which is compulsory for any rent increase easier for the landlord, if the rent has not been changed for the past 15 months and if the request for a rent increase has been submitted after at least 12 months. Apart from 'normal' rent increases, landlords are allowed to increase rents after modernisation with a maximum of 11% of modernisation costs (from Haffner, 2011; see also Cornelius and Rzeznik, 2014).

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The market rents that are agreed for new contracts in the four years preceding the reference date for the Mietspiegel represent the market effect on the rent levels in the Mietspiegel. Next there are various elements in the (scientific) Mietspiegel that slow down the increases in market rents. Firstly, there is the maximum rent for existing contracts given certain quality characteristics. Secondly, the contracts of the four years (and not for example the last year) prior to initiating the Mietspiegel will be included. In a rising market, the reference rents will lag. Thirdly, there is a correction after two years. If this is done in line with inflation, inflation may be lower than rent increases on the market. Finally, there is the general rule that rents may not increase by more than 20% within a three-year period (Kappungsgrenze; from Haffner, 2011).

Because of increasing rents (and house prices) in recent years, the limit of 20% has been lowered to 15% in regions where scarcity in dwellings increases prices. Federal states designate these regions. Rent increases due to renovation measures or changes in operating costs are not taken into account when determining the limit (Cornelius and Rzeznik, 2014).

Rents for new leases in the market rented sector could be negotiated freely in the past, as long as they were not considered exorbitant rents under economic criminal law. However, the federal government has proposed the introduction of a ceiling for the amount of rent in new tenancy contracts as well. Accordingly, the new rent may not exceed 10% of the reference rent in a municipality. The proposal is that only the first rent contract of a newly constructed dwelling will be exempted from this regulation. And it will only apply to tight housing markets to be designated by the federal states. About four million rental dwellings are located in such areas. The draft law was planned to enter into force in 2015 (Cornelius and Rzeznik, 2014). In the interviews the introduction of this so-called rent brake (Mietbremse) by mid-2015 was confirmed. However, it was also signalled that a political discussion has started to the effect that that any contract of a newly built dwelling should remain exempted from the rent brake. Also, it is not the intention that once a rent level is set in contract, it will have to be lowered in the next contract.

4. Financing of Real Estate

Bettink (2013) explains that real estate has been predominantly financed by bank credits. Usually, 80% to 90% of total financing volume could be provided by a single financier. Loan financing was also a piece of information that came out of the interviews.

Kofner (2014: 51) confirms that there are not many other options to be observed in the market, even though:

> There are no obvious barriers to institutional investment in private rented sector dwellings. However, it [institutional investment] occurs only rarely. Open-end property funds usually tend to neglect residential buildings[ ][51]. Close-end property funds concentrate on certain niches of the residential segment, e.g. student dwellings[ ][52]. Insurance companies and pension funds usually have a very low share of real estate in their portfolios. On average it is far below the legal maximum share, the effective share being around 5%. German REITS are not allowed to invest in existing residential buildings ... Foreign Private Equity Funds, on the other hand, have closed a lot of important package deals in the years before the GFC. Nowadays the public opinion relating to takeovers of public housing companies by Private Equity Funds is hostile.

[51] One of the interviewees explained that this is the result of return-considerations and the fact that the management intensity required is large.
[52] One of the interviewees commented that the situation has changed in the past five years. There have been a number of fund issues, also blind Pool Funds. At the same time special funds for institutional investors came into existence (see also main text about pooled versus individual funds).

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> Also, they have turned to other investment targets. Recently, the housing portfolios of South German Landesbanken were sold to consortiums of German institutional investors. Those investors seem to have changed their minds about residential real estate investment.
>
> The performance record of the German capital market in terms of allocating equity funds to residential investment is surely poor[53].[ ] This is evidenced by the small number of listed housing stocks (for the most part a result of the exit of Private Equity Funds via Initial Public Offerings).

According to para. 3 Section 5 of the Regulation (Anlageverordnung), a maximum 25% real estate share of the total portfolio is allowed for life insurances and pension funds.

Bettink (2013), however, warns that real estate financing will change dramatically. The financing volume of 80% to 90% provided by a single financier will be impossible, he warns, once the stricter capital requirement affects the assets and liabilities of financiers – less finance will be available for real estate. This will open up the path for exotic and more expensive products such as mezzanine capital, private equity and equity-like forms. Some organisations have tried to finance their projects through the issue of the corporate bonds. The interviews have not signalled these trends, as the professional property companies interviewed apply a much lower LTV than 80% or 90% (see below).

Furthermore, Bettink (2013) states that insurance companies will be interested in financing and, possibly, acquiring ownership of real estate. This change in behaviour is attributed by Bettink (2013) to the low returns on alternative investments. In the interviews, insurance companies were reported to enter the finance market (not the direct ownership market). The match between receiving and paying returns (3.5% to 4%) would be attractive as well, as also Bettink (2013) argues. The leverage would be low, at 20% to 25%. However, for offering a complete investment service, the expertise of insurance companies will be insufficient.

From the interviews, it was revealed that institutional investors have been interested in real estate for some time, owing to low alternative returns. Smaller institutional investors tend to go for the indirect investment and bigger ones may choose direct investment options in rental dwellings (that almost by definition will be multi-family dwellings). It was also explained that practically no direct object investment exists in subsidised residential property. Investment will be organisation-based.

Professional asset management companies (which may be quoted on the stock market) offer individual funds for large clients, next to the pooled funds for smaller sums of money. Professional asset management companies generally own their dwellings and invest in new construction, in the acquisition of existing stock and in renovation. Periodic rejuvenation of stock is not considered desirable in an environment where house prices are rising[54].

[53] One of the interviews offered a contrasting view in that the allocation of equity funds is regarded to work well as the market for listed companies is said to work well. There are not many countries where listed companies operate. Furthermore, the situation around REITS in Germany is said to be no different than in other countries.

[54] Rising house prices are regarded as a trend for the future as new construction levels are not regarded as sufficient to cover demand increases (Günther and Hübl, 2009).

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The political insecurity was mentioned as a main returning worry, next to the worries about sufficient returns. Most recently, the introduction of the rent brake (Mietbremse) in 2015 has been decided on. If the regulation passes Parliament, the rents for new contacts will no longer be able to be set relatively freely in areas of scarcity – but no higher than 10% above the rent that the Mietspiegel shows for a bundle of dwelling characteristics. The proposal is that only the first contract for a newly constructed rental dwelling is excluded from this new regulation in order to prevent the choking off of new construction. At the moment, the share of dwellings would amount to 0.3% to 0.4% of stock that is annually constructed. In practice, there will be little market rent left, was the conclusion. However, another interviewee explained that a political discussion has started, which may end up exempting any contract of newly built dwellings (see above).

5. Financing of Subsidised Rental Dwellings

Given that real estate in Germany is largely financed by bank loans, it must be assumed that subsidised rental housing is largely financed with a loan as well. However, from the interviews it became clear that the LTV of the property companies that invest institutional funds in residential property is much lower than the 80% to 90% mentioned by Bettink (2013; see above). One of the interviewees explained that on average the LTV amounts to 20% (the usual loan term is seven years). Investors are risk averse, was the explanation. No exotic financing products are being used. The housing market is complex enough already, was the comment that was made.

Based on a seven-city case study, Bundesinstitut für Bau-, Stadt- und Raumforschung (2012, p.4) concluded that subsidised rental housing is mostly the domain of municipal housing companies nowadays. Commercial companies are not showing much interest in options. Furthermore, returns from subsidised rental dwellings will be lower than those in non-subsidised rental dwellings; especially those located in medium to good locations. This may be the reason why direct investment in subsidised rental dwellings by institutional investors is non-existent, as supported by interviewees.

One of the interviewees indicated that indirect investment in subsidised rental housing by institutional investors hardly exists, because present-day cash returns of 3.5% at the most would be lower than those of 4% to 5% usually required by commercial institutional investors. This result comes about because the subsidies do not cover the difference between subsidised pre-determined rent levels and rent increases compared to market rent and expected market rent increases[55]. Even though the investment horizon generally is longer-term than shorter-term, a period of 15 years to wait for the possibility to earn a market return from then on (when the dwellings are no longer bound by the subsidy scheme), is considered a too long a horizon considering market uncertainties. Also, the Kappungsgrenze possibly prevents reaching market rent level within three years, extending the period of 15 years to a minimum of 18 years until achieving market return.

Interviews confirmed that in the past the organisations generally have not acquired subsidised portfolios, unless the dwellings were part of the portfolio, either because of subsidisation or because of the increasing requirements by cities that there should be 20% to 30% social renting in a new project (see also Cornelius and Rzeznik, 2014). Such portfolios would however only be bought if risk-return profiles were acceptable. Exceptions apparently confirm the rule. One of the interviewees explained that their share of subsidised rental dwellings amounted to 20% or more. This was said to be the outcome of the strategy to invest in rental dwellings that deliver a rent-to-income ratio of 25% to 30% in the middle, better - located segment. Another strategy was one in which subsidised dwellings would be acquired at the end of their subsidy period, once future returns were more predictable.

[55] It was also stated that the bricks-and-mortar subsidy system effectively subsidises the developer. Even though the rent and the quality will be acceptable, the additional housing costs (for energy and other services, etc.) will be relatively high for the tenant.

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The biggest problem (next to the smaller return than in the past) was seen to be the political insecurity. As an example, it was mentioned that cities are able to change their requirements on numbers and rent levels within time horizons of two or three years. As a result, the argument was that returns can change dramatically. If possible, subsidised investment will be kept at a relatively low level.

However, in an environment of rising house prices, it may be more difficult in the future to realise presently required levels of return. Therefore, investment in subsidised rental housing may become more attractive, as long as it is seen as more attractive than alternative returns. In combination with the city requirements of 20% to 30% subsidised rental stock, the share of investment in subsidised rental housing may increase.

6. Conclusions

Institutional investment in residential rental property in Germany does not seem to have been a major activity in the past, but seems to have the impetus to grow. Part of the explanation given can be found in the observation that capital requirements for banks will be stricter, thereby causing a decrease in loan capital available from banks, which is considered the normal way of financing (residential) real estate. Another explanation is based on the low alternative returns, which allow for investigating ‘new’ investment options, and apparently having brought insurance companies into the market as lenders.

Also, there has been growing interest from other institutional investors. The argument of relatively low returns on alternative investments may also make investment in subsidised rental housing a more attractive alternative than in the recent past, considering the stronger regulation of (new) rental contracts in existing dwellings and the increased use by cities of a required share of subsidised rental in new construction.

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APPENDIX D: COUNTRY REPORT – THE NETHERLANDS

In this report, the prospects for institutional investment in social rental housing (taken as housing with a regulated rent) are discussed. The discussion is based on a brief literature study about the most important recent developments on the housing market and is complemented with information from respondents by phone, and sometimes also by email, on the topic of institutional investment in relation to social housing. This report covers the following topics:

1. Definition of social renting
2. Falling house price after the GFC makes residential investment more attractive
3. Policies to support the growth of the middle segment of the rental sector
4. Finance of housing investment by social landlords
5. Institutional investment in the rental sector
6. Conclusions

1. Definition of Social Renting

A social landlord in the Netherlands (called woningcorporatie) is an accredited landlord according to the Housing Law of 1901. It is a non-profit organisation whose core mission is to provide housing for low-income households. Official statistics define any dwelling that is owned by a social landlord as a social rental dwelling. The market share of the sector amounts to about 30% and represents the largest social rental sector in the world. Any rental dwelling a social landlord does not own is therefore classified as a private rental dwelling in the statistics. In other words, any dwelling owned by a private landlord will formally not be called a social dwelling. The size of the private rental sector has decreased to less than 10% nowadays (Haffner, 2013, 2014; Haffner et al., 2009, 2014).

Regarding the distinction of regulated and deregulated (liberalised) rent, in 2009 about 92% of rental dwellings had a rent that is regulated by government, while 8% had a rent that is called deregulated or liberalised; in the latter segment, no regulation on rent level takes place by government. The rent level determines whether a rental dwelling will be classified as one with a regulated or deregulated rent. In 2009, of the rental dwellings that social landlords owned, 4% were dwellings with a deregulated or liberalised rent, while 96% of those dwellings were dwellings with a rent regulated by central government. For private landlords, regulated rent was still prominent (about 70% in 2009) compared to deregulated rent stock (about 30%). For this study, social rental dwelling is defined as a rental dwelling with a regulated rent. The landlord will be indicated as the landlord with a stock of regulated rental dwellings. The term social landlord is reserved in its classical sense for a woningcorporatie[56].

Another factor that affects the rent level is the quality point system which forms the basis for determining the maximum allowable rent for dwellings with a regulated rent – only 57% of dwellings could have a regulated rent in 2009 – if the market allows for such a rent level. Such a rent level will be more realistic in urban areas, one interviewee explained. In the hands of the social landlords, the share of dwellings that quality wise could have a regulated rent is about 60%. The conclusion must be that there is large potential of about one-third (92% minus 57%; 2009 numbers) of rental dwellings of which rent in principle can be liberalised, if the market will bear such a rent level (and increase), once a new tenant moves in. Sitting tenants in the regulated rental sector are protected by annual rent increases, which are determined by the central government – hence the terminology of regulated rents (see below for the income-related rent increases that were applied in 2013 and 2014).

[56] For information on Dutch social landlords (Vereniging van Woningcorporaties), see Aedes (2013).

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In the interviews, it was revealed that the portfolio of institutional parties nowadays on average contained about 20% to 40% of rental dwellings with a regulated rent. Vereniging van Institutionele Beleggers in Vastgoed Nederland (IVBN, 2014, p.5), the Dutch umbrella organisation of institutional investors, states in their annual outlook on the rental market that their members own 57,000 dwellings with a regulated rent amounting to a share of 46% of the total of 125,000 dwellings in IVBN members' portfolio in 2012, while 40,000 of those dwellings point wise had the potential to be deregulated. In addition IVBN members, other landlords are also active in the private rental sector. Depending on the source, the size of the private rental sector is estimated to be more than 500,000 and close to 700,000 dwellings in 2009 (Haffner, 2014; Haffner et al., 2014).

2. Falling House Prices after the Global Financial Crisis Make Residential Investment More Attractive

The Dutch economy has been relatively hard hit in the aftermath of the GFC, moving into and out of three recessions since the start of the crisis[57] . According to Eichholtz et al. (2014, p.3), since 2008 nominal house prices have fallen by approximately 18% and ". . . the balance between house prices and rent levels has nearly reached its long term average". From interviews, it appears house prices in the Netherlands presently are bottoming out and, if so, will offer new opportunities for investment in the private rental market.

Furthermore, Eichholtz et al. (2014, p.3) point out that "Investment opportunities in the Netherlands are growing", based on a number of other developments in the residential property market. Firstly, they (p.6) conclude that "reasonably good total returns … [are] accompanied by moderate risks … and steady income streams". The steady income stream is supported by the fact that tenants (of institutional investors) generally pay their rent in a disciplined way (little arrears; p.15). "Compared to other asset classes residential property investments show the best correlation to inflation [implying a moderate inflation hedge … and] good diversification opportunities" (Eichholtz et al., 2014, pp.8-9). On the return-risk ratio the Netherlands scored lowest due to the price fall that followed the GFC. Aside from portfolio considerations, investment opportunities will be supported by demographic developments and 'too' low volumes of new construction since the impact of the GFC crystallised. Also, the new policies for the owner-occupied sector (annual reduction of mortgage interest deduction for all cases as of 2014, allowing it to be used only for annuity loans as of 2013 for new cases and lower limits for loan-to-values for mortgage loans) will improve the relative attractiveness of renting in comparison to owning. One of the interviewees doubted that these measures would reduce subsidisation of home ownership to an extent that more expensive rental dwellings could compete with home ownership.

3. Policies to Support Growth of Middle Segment of Rental Sector

In 2010, a new coalition government under the leadership of a Conservative-liberal prime minister aimed to move housing towards 'more market' with a 'more marginal' social rental sector. The latter should be more focused on housing those in need, while other landlords should be able to supply dwellings as well, allowing for a 'better' development of supply than in the past. In short, the 2010 government aimed for what it called a better balance on the rental market by curtailing social renting and allowing for better yields for investors in rental housing with more market-conforming rents (Donner, 2011). When the government fell in April of 2012, the only proposal that had been accepted by Parliament by November 2011 was for the system of rent control based on quality points to take more into account the popularity of dwellings: in government-designated areas where dwellings are scarce a number of quality points could be taken into consideration allowing for a higher rent level once a new tenant moved into the dwelling (Haffner et al., 2014).

[57] http://www.joop.nl/economie/detail/artikel/19560_nederland_weer_in_recessie/; 9 May 2014.

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At the same time, negotiations took place with the European Commission (EC) about the interpretation of the state aid rules in order to safeguard that state aid was necessary and used proportionately. The negotiations resulted in the decision of the EC to stipulate a national income limit for the allocation of social rental housing. The construction and management of social rental housing in European Union terminology are now considered as Services of General Economic Interest (SGEIs). Such dwelling stock is called the so-called SGEI stock. According to this rule, social landlords were to allocate at least 90% of their vacant dwellings per year to households with a certain maximum income (41% of all households) as of 1 January 2011. This income limit is applicable at the moment of allocation, households cannot be evicted if income surpasses the limit. Rental contracts are indefinite (Elsinga et al., 2008; Elsinga and Van Bortel, 2011; Haffner et al., 2014; Tasan-Kok et al., 2013). Since 2011, the EC monitors annually the progress to ensure that countries meet its guidelines. The EC also monitors the access and affordability of social renting for households with a low income[58].

The income limit agreed on with the EU in principle will affect the demand for private rental housing positively. This agreement can be considered to coincide with the ideas of the present government, which has been in office since autumn of 2012. It, as well as its predecessor, is aiming for a more targeted social sector and for achieving a better balance in the rental market, by creating conditions that allow for better yields for investors in the deregulated rental segment. In combination with falling house prices and numbers of construction and transaction, stricter loan regulation and stricter allocation of social rental dwellings, all signs seem to point to an increased new housing demand and new housing supply in the private rental sector (Haffner, 2014; Haffner et al., 2014).

The most recent policies and policy intentions seem to steer the new supply in private rental dwellings towards the deregulated segment of the rental market, most likely towards the middle segment of the rental market. These policies complement the situation where supply is meagre, because of the competition with the regulated rental sector (where rents are regulated, while quality wise they could be deregulated).

As a means to execute budget cuts following the GFC, the so-called landlord levy was introduced. Since 2013, social landlords (later broadened to all landlords who own more than 10 dwellings with a regulated rent) are required to pay a landlord levy[59]. In order to be able to pay for the levy, higher annual increases of regulated rents in 2013 and 2014 were introduced for households with a higher household income than the EU income level set for the allocation of social rental dwellings[60]. According to an interviewee, the combination of levy and income-related rent increases resulted in relatively large rent increases in 2013 and 2014 which might cause affordability problem in renting.

[58] http://www.aedes.nl/content/artikelen/woningmarkt/europa/europese-commissie--monitor-.effecten-hervormingen-.xml.

[59] The Landlord Levy (verhuurderheffing) is calculated upon the aggregate ('WOZ') value of the houses. An exemption exists for the value of the first 10 houses of each owner. For 2013, the tariff was 0.0014% (http://www.rijksoverheid.nl/documenten-en-publicaties/circulaires/2013/07/09/informatieblad-verhuurderheffing-2013.html). Up until 2017 the rate will increase in 2014 to 0.381%, 0.449% in 2015, 0.491% in 2016 and 0.536% in 2017 (http://www.rijksoverheid.nl/onderwerpen/huurwoning/verhuurderheffing).

[60] In 2013 and 2014, the annual rent increase amounted to 4% for the EU target group, 4.5% for households with a higher income and 6.5% for households with the highest incomes (http://www.rijksoverheid.nl/onderwerpen/huurwoning/huurverhoging?utm_campaign=sea-t-bouwen_wonen_en_leefomgeving-a-huurwoning_huurverhoging&utm_term=huurverhoging %202013&gclid=Cj0KEQjwmayfBRDo25CR9un4hvEBEiQAv9fBbXqV6TW7hyFGpxTR-kQWITrkrjhdNZFeKgmSegGg3xEaAjyk8P8HAQ).

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Recent proposals have been put forward to make the private rental sector more attractive to invest in. These included the creation of temporary tenancy agreements (instead of mostly permanent rent contracts) in certain situations and the freeze of the liberalisation threshold rent level at the 2014 level of €699.48 per month. For social landlords, in relation to the state aid legislation, they are required to separate their social tasks from their commercial tasks, either in an accounting way or a legal way. Also, the system of income-related rent increases is replaced by a system of rent pooling (the so-called huursom approach). The new system aims to encompass a more market-conforming element in the quality point system to reflect taxable market value. This value would replace the scarcity points that were introduced in the system in 2011 (Blok, 2014a). The expectation now (according to the interviews) is that the minister would like this change to be realised halfway through next year. Last but not least, the EU income limit should be temporarily (5 years) extended (Blok, 2014a). Meanwhile, in the face of these reforms, the Dutch government announced that it will monitor the affordability and availability of social housing, following EU recommendations.

The combination of these measures aims at growing the middle segment of the private rental market (€700 to about €1,000 per month) over the longer term. Actions that will accelerate this trend are dwellings being moved from a regulated rent to a deregulated rent, if that can be done quality wise and regulation wise, and constructing purpose-built new private rental dwellings. One interviewee pointed out that under such constellation, social landlords will not be able to construct new dwellings with a deregulated rent (non-SGEI stock, see next section) unless no commercial party is interested.

Furthermore, commercial parties will be able to buy dwellings with the potential of the rent to be deregulated (or which are already deregulated) from social landlords. Central government has set up rules to facilitate such transfers. For the classification of regulated/deregulated, the rent level is no longer the determining factor, but the number of quality points (142 maximum in 2013 for a dwelling to have a regulated rent). The rules are stricter for complexes of dwellings with less than 10% of dwellings in the regulated segment than for complexes with 10% or more dwellings with a regulated rent. They are also stricter when the sale is not to another social landlord. If a complex with dwellings with a liberalised rent or to be liberalised rent is sold for 100% of the market price, no profit sharing or continuation of renting activities under the same conditions as before the sale need to be agreed on (Blok, 2013). Whether the rules – which according to one of the interviewees have been recently made less strict – will facilitate the stock transfers from social landlords to commercial actors remains to be seen.

4. Finance of Housing Investment by Social Landlords

At present, social landlords generally finance their investment through private sector borrowing, e.g. loans from the so-called sector banks, such as the for-profit BNG Bank and the Dutch Water Board Bank (NWB). The shares of both banks are in the hands of different government and/or statutory bodies. Their aim is to provide financing for the public sector and/or for societal beneficial purposes, such as for financing of dwellings of social landlords.

A unique feature of the social rental financing system in the Netherlands is[61] that these loans (since the negotiations with the EU, these should only be for SGEI stock) are guaranteed by the Guarantee Fund for Social Housing. In order to be able to guarantee a loan, a social landlord puts before the WSW once a year its financial planning for all its planned activities, including refinancing. This type of financing does not focus on individual projects but on the balance or the organisation (balance or organisation financing). The WSW

[61] Waarborgfonds Sociale Woningbouw; known by its Dutch abbreviation, WSW; see also: http://www.english.wsw.nl/profile.

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then determines a maximum amount of the guarantee for the year in question. The maximum LTV of 50% is allowed, while a normal LTV would be about 27%. A maximum loan term allowed for a guaranteed loan is 50 years, which has never been used in practice.

The WSW guarantee enables member social landlords to raise money on the capital market on the best possible terms. WSW guarantees that the loans will be serviced throughout their contractual term, if the social landlord is not able to do so. The member social landlords guarantee the finance of other members. The backstop position is assumed by central government and the municipalities. It comprises an irrevocable commitment to make interest-free advances available, if WSW's capital falls below a predetermined minimum relative to its total guaranteed capital. Therefore the rating agencies have awarded WSW high ratings (AAA and AA+) and these are equal to the rating of government bonds from the Netherlands. The government guarantee backing up the financing of the social rental sector (the non-SGEI-stock) makes the sector a relatively attractive investment opportunity for financiers as risks of non-payment are taken away. Additional security is provided by the Central Housing Fund (Centraal Fonds voor de Volkshuisvesting, CFV)[62], which is responsible for the financial health and the financial reorganisation of social landlords in financial trouble.

Social landlords in search for the 'cheapest' loan offers based on the standard loan contract of the WSW, nowadays increasingly seem to be serviced by other organisations than the so-called sector banks (BNG Bank and NWB). The share of sector banks in the amount of newly guaranteed loans is slowly decreasing from 90% in 2009 to 88.5% in 2013, while the share in the new loan volume of the year from institutional investors has increased from 1.2% to 7.9%. Loan volume in 2013 amounted to €5.5 billion[63].

The increased interest from institutional investors can roughly be explained by two factors. Firstly, WSW has actively sought to stimulate a new, thus diversified, supply of finance. Secondly, with the current low interest in especially Dutch and German government bonds, the search for yield causes institutional investors to consider alternative attractive investments. In particular, insurance companies, also from Germany, are discovering the finance of social rental housing as a way of asset-liability matching in the longer term (preferably a loan term of more than 10 years). In the interviews it was assumed that pension funds are not following suit as they are more interested in hedging their inflation liabilities. Another interviewee offered that pension funds operate large volumes. On the other hand, sometimes pension funds provide a loan to social landlords, even though this activity was said to be limited.

New financial sources for social landlords are developing. Negotiations are taking place on the first loan from the European Investment Bank (EIB) that may be provided to one of the social landlords. The EIB is able to make a competitive offer as it is a non-profit organisation that can get funds for low interest rates because it is backed by the European member states. One item of negotiation is the content of the loan contract. Another item of negotiation is the object of the loan. Normally, the EIB will finance projects and not organisations. Also, the EIB finances projects that match specific EU goals, such as sustainability goals, while social landlords will search for organisation financing. Last, but not least, EIB is interested in bigger amounts than individual social landlords will need. This may pave the way to large-scale combined borrowing by social landlords. It was mentioned that other social landlords will be interested in following suit, if the first initiative is successful.

[62] http://www.cfv.nl/over_cfv/corporate_story.
[63] see also: Waarborgfonds Sociale Woningbouw, 2014: 23; http://www.english.wsw.nl/investorrelations/download.

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For the financing of non-SGEI stock, a number of initiatives have been explored, such as some social landlords obtaining credit ratings (while other are considering). However, in the interviews, it was stated that these ratings take the current guarantee structure into account. Other initiatives that involve the development of financial products specifically for social landlords (e.g. sale and lease back of land to commercial parties) are also said to depend on the guarantee structure for social rental finance, while they might not compare favourably to the present financing options (such as a normal loan). If the separation of tasks that government proposes for social landlords in the amendment bill is realised, the non-SGEI stock will, however, need to be financed against market conditions (including market risks). It remains to be seen whether finance will be offered, once the state security is no longer available for the loans for the non-SGEI stock. An option may then be for social landlords to combine their financial needs into one large loan request on the capital market. A disadvantage of such cooperation is that this type of combined loan will not allow for tailoring and or for interest rates be known beforehand.

Currently the future of investment in the regulated segment of the rental market looks relatively gloomy considering the landlord levy and government emphasis on the middle-price segment of the rental market.

5. Institutional Investment in the Rental Sector

Historically, pension funds invested directly in rental housing. But this was not their core business, and they realised that the investment was achieved in relatively inefficient way (relatively heavy on manpower). This resulted in the outplacement of residential stock to a professional real estate company in a property fund not quoted on the stock exchange. There are no residential real estate companies that are quoted on the stock market; instead the legal form is a holding company (participatiemaatschappij). The fact that there are only these types of holding companies operating on the Dutch rental market is regarded as a barrier for the entrance of non-Dutch investors. The biggest difficulty for such an investor may be sale of the interest in a residential company. Negotiations with potential buyers about price and conditions would be complicated. It was observed, however, that the market is becoming a little more dynamic. Another barrier that was mentioned in comparison to other capital cities was the fragmented portfolio.

Basically, all institutional investors of any significance are investing in the rental market including the regulated part, but all invest indirectly, most likely via the four of the 30 or so members of IVBN that directly invest in rental housing. In 2013, they invested about €2.7 billion in the residential real estate (a 25% LTV was named as normal based on risk and leverage considerations).

The most important criterion that was mentioned for investment in residential stock – which may take the form of new construction, renovation/maintenance or the acquisition of existing stock for pension funds – is the expected return (risk-return profile). Important will be that the expected annual direct return is attractive, while expected indirect return is relished. Pension funds and holding companies will confer formally in the meeting of shareholders and also informally to agree on the strategy of investment. Generally, institutional investors are satisfied with their residential investments, as the risk-return profile is attractive with relatively low risks in combination with a decent return (see also Eichholtz et al., 2014).

Generally, it was thought that the Dutch housing market has reached its lowest point on house prices; albeit with regional differences. It is considered a good point in time to get in; also because other investment options (government bonds and savings) are not delivering high returns. This is contrary to a couple of years ago; Germany is now considered an expensive market, after house prices and rents generally have shown a

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rising trend in the past few years. However, demand surveys seem to indicate that consumers have developed a liking for the middle segment of the rental market. Policy is also aiming to develop that segment. It has inter alia also made owner-occupation relatively more expensive (see above).

A new initiative on the Dutch investment market was described in the interviews as the Dutch Investment Institute (Nederlandse Investeringsinstelling; NII). This is now in the phase of formation that should culminate in the start of operations before the end of 2014. It unites a number of institutional investors and aims to facilitate the increase in investment in the Dutch economy (possibly housing) from a point of view of societal responsibilities. However, the risk-return profiles that will be relevant will be the commercial ones. The expectation is that win-win situations will be created. For its success it was suggested that for projects that take place on the interface between public and private parties a reliable public policy is needed. Pension funds would like the Dutch government to give out index-linked debt (as government bonds). That way they will be able to secure index-linked pensions in the future, while government will be able to pay for the index-linked future increase out of increased revenues from income tax based on inflation-based increases of income. Another observation about NII was that it unites a number of actors (institutional investors), which can be considered a strong point (broad base), but there's the question of creating common goals and common win-win situations across the board.

Institutional investment in regulated rental stock

Basically all institutional investors of any significance have been investing indirectly in the rental market including the regulated part (see above). However, in the past few years, little investment in new stock with a regulated rent has taken place because of the impact of the GFC on the Dutch economy and the housing market, but also because of new (proposed) policies that make investment less attractive and returns uncertain. Rent control as such was also mentioned as constraining entrepreneurial freedom. Regulated rental stock used to be, the longer tenancies compared with the deregulated rental stock with its higher turnover costs (competition with owner-occupation).

If the risk-return profile was 'right', stock acquisitions with dwellings with a regulated rent would also have taken place. Talks are taking place between property companies (holding companies) and social landlords, but without any resulting deals as yet. The restrictions connected to the acquisition of a portfolio with a regulated rent (see above; see also Blok, 2013) are mentioned as a barrier. These are national rules in relation to rent increases and profit sharing at the point of sale of the dwellings by the institutional investor who is said to buy the total risk, but not the total benefits. In relation to this point, it was observed that the 30% to 40% share of regulated stock in the portfolio is therefore likely to become a thing of the past.

However, the largest sale in Dutch history of dwellings of a social landlord to a fund manager contradicts this claim, as around 70% of dwellings sold are in the regulated segment. This sale of about 5,500 dwellings of a social landlord to a German fund manager was due to a social landlord's bad derivatives investment[64]. The social landlord in question needs to sell 30% of its dwellings in order to rectify the financial situation. The ministry responsible for housing still has to agree to the sale, as well as the supervisory board of the social landlord. The buyer is a foreign real estate investor that is listed on the stock market and has bought the portfolio for a foreign pension fund[65]. In the Netherlands, however, discussion is taking place, according to one of the interviewees, as to whether 'social' stock should be sold off to commercial investors and under what conditions the sale should take place.

[64] http://www.nrc.nl/nieuws/2014/07/24/vestia-verkoopt-voor-half-miljard-aan-woningen/.

[65] It has a history of investing on behalf of a number of large foreign pension funds (http://realestate.ipe.com/patrizia-ploughs-german-pension-money-into-dutch-housing/10002579.fullarticle).

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As around 70% of the 5,500 dwellings that have been sold in the deal described above have a regulated rent, WSW will have evaluated the sale according to its criteria. WSW has to give written permission for the sale of stock of social landlords. It was reported in the interviews that sales of social housing stock (of smaller size) have been taking place regularly. WSW has to evaluate whether the relationship between loan amount and collateral for the social landlord in question will still be in accordance with risk norms after the sale. A legacy from the past is that still about 5% of guaranteed loans consist of loans for non-SGEI stock. Presumably a sale of those dwellings will have to be evaluated by the WSW as well, as they affect the relationship between collateral and loan amount. CFV also has to give permission for the sale from the point of view of financial reorganisation.

In relation to the sale of portfolios by social landlords, the general opinion in the interviews was that the future is uncertain. New policies such as the landlord levy and proposals about the administrative or legal stock division in SGEI versus non-SGEI stock of social landlords may or may not cause increasing sales of stock of social landlords.

In relation to investment in the regulated stock more generally, one of the opinions was that the landlord levy is considered as an unfair tax for non-social investors in the regulated segment of the rental sector. The interviewee argued that these investors did not receive the same benefits (e.g. guarantee) as social landlords did. On the other hand, it was proposed that non-social investors do not have to contribute, if the WSW must fulfil guarantee requirements. Since the introduction of the levy in 2013, it has affected investment decisions as an extra cost that lowers the acquisition price amongst investors willing to pay. Another point of view during the interviews was that there will be little new investment in the regulated rental sector in the near future. Instead, the strategy will be to liberalise rents (after adding value), if possible, when a new tenant moves in.

For future investment, it was furthermore observed that it will be important to see whether rents can be increased in the longer term, when expected income increases may not be in line with the desired rent increases. The investment period that is taken into consideration is usually 10 years. Holding companies may have a strategy (depending on expected returns and cash flows) to rejuvenate their stock annually. However, it was stated that property companies' strategies will most likely not be focused on much more investment in the regulated segment of the rental market (unless it concerns the refinancing of dwellings and the refurbishment activities).

New initiative

The central government has recently asked an advisory commission to provide information on alternative financial instruments for housing finance (see also: Commissie Alternatieve Financieringsarrangementen Woningmarkt-II, 2014). One of the proposals was the development of a mixed housing fund (gemengd woningfonds). At the time of writing, five social landlords, two fund managers and two institutional investors are cooperating in a pilot fund. Social landlords will sell (some of) their non-SGEI or potentially to-be-deregulated stock to the fund partly in exchange for the receipt of participation shares. Half of the equity comes from the social landlords, half from institutional investors. The dwellings are managed by the fund manager. The main aim is to maintain the renting status of the dwellings and not to sell them once the tenant moves out. One interviewee added that another aim is to have the fund operating by the end of the year.

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However, partners involved voiced some concerns, one of those being the 10% legal maximum for SGEI-stock in a complex that is allowed to be sold by social landlords[66] (Blok, 2014b). If a complex contains less than 10% of SGEI stock, the non-social sales regime is applicable. In the interviews, it was explained that the 'social' sales regime allows for profit sharing rules as well as rules for rent increases (see above).

6. Conclusions

On institutional investment in the regulated rental sector in the Netherlands, the main conclusion must be that in the recent past institutional investment found its way indirectly into the regulated rental segment. For the future, this trend may be broken. The conclusions are multiple, however:

- The stock of social landlords (woningcorporaties) comprised mainly rental stock with a regulated rent.
- These activities have been financed mainly by sector banks (BNG and NWB) and have been guaranteed by the Guarantee Fund for Social Housing (WSW) with member social landlords and the Dutch state (national and local) as background safety net. The Central Fund for Housing (CFV) is responsible for financial control and financial reorganisations.
- Since 2009, the share of loans from institutional investors has increased from 1.2% to 7.9% in 2013 from a total volume of newly guaranteed loans of €5.5 billion in 2013. WSW and social landlords have actively searched new, diversified supply of finance. Also, with the search for yield, especially insurance companies are discovering the finance of social rental housing.
- Historically, pension funds have moved from direct to indirect investment in rental housing. This has resulted in the outplacement of the residential stock to a professional real estate company into a property fund that is not quoted on the stock exchange.
- There are no residential real estate companies quoted on the stock market; instead the legal form is a holding company (participatiemaatschappij).
- Basically, all institutional investors of any significance are investing in the rental market including the regulated part. All invest indirectly, about €2.7 billion in residential real estate.
- The regulated rental stock owned by institutional investors accounted for about 40% of the total rental stock.
- Quality wise, a large share of that stock has the potential to be moved into the deregulated rental segment of the market, if the market will bear the higher rent level.
- On some occasions, pension funds provide a loan to social landlords, but this activity is said to be limited.
- Policy changes based on Dutch and EU regulations aim to give more leeway to the market sector. In combination with house price declines in response to the GFC, the Netherlands seems to have moved to the position where investment into the middle segment of the rental market seems to be an attractive business opportunity. This will entail, if possible based on quality and regulation, the movement from the regulated rental stock to the deregulated rental market segment. It will also entail new investment by institutional investors into the deregulated rental stock.
- The sale of regulated rental stock from social landlords or the investment in new construction may only take place (possibly also via NII), if rates of return turn out to be satisfactory for the buyers, taking into account all the costs, including the landlord levy.

[66] http://www.actieagendabouw.nl/eerste-pilot-gemengd-woningfonds-vergevorderd-stadium/;.

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