IPF Research Programme 2011–2015

EXECUTIVE SUMMARY

Prospects for Institutional Investment in Social Housing

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

JANUARY 2015

This research was funded and commissioned through the IPF Research Programme 2011–2015.

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.

The Programme is funded by a cross-section of businesses, representing key market participants. The IPF gratefully acknowledges the support of these contributing organisations:

Foreword

IPF Research Programme 2011–2015

January 2015

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 research should, therefore, be a useful catalyst to the debate.

Researchers

Professor Michael Oxley, *Cambridge Centre for Housing and Planning Research, University of Cambridge*
Dr Connie Tang, *Cambridge Centre for Housing and Planning Research, University of Cambridge*
Professor Colin Lizieri, *Cambridge Real Estate Research Centre, University of Cambridge*
Nick Mansley, *Cambridge Real Estate Research Centre, University of Cambridge*
Dr Daniel Mekic, *Cambridge Real Estate Research Centre, University of Cambridge*
Dr Marietta Haffner, *OTB – Research for the Built Environment, Delft University of Technology*
Dr Joris Hoekstra, *OTB – Research for the Built Environment, Delft University of Technology*

Project Steering Group

Andrew Smith, *Mill Group*
Andrew Allen, *Aberdeen Asset Management*
Rob Beiley, *Trowers and Hamlins*
Richard Donnell, *Hometrack*
Pam Craddock, *IPF*

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Prepared by *Cambridge Centre for Housing and Planning Research* and *Cambridge Real Estate Research Centre Department of Land Economy University of Cambridge* with the assistance of *OTB Research* for the *Built Environment Delft University of Technology*.

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This research project was commissioned by the Investment Property Forum 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 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 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 well over £150 billion, equity investment in social housing accounts for only £0.4 billion of investment, 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, which 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 (the Homes & Communities Agency), is recognised as having a valuable role in potentially reducing the risk of investing in social housing.
- A low interest rate environment and the need to de-risk life and pension fund portfolios have supported a move to alternative low-risk assets. The value of index-linked cash flows is 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 portfolios via sale and leaseback, as well as by many of those that are interested but have yet to invest 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 mean 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, will result in 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 , together with the fact that investing institutions do not require that level of liquidity.
- Equity funding models used in Europe and North America do not seem to be readily implementable in the UK without substantial regulatory or financial 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 significant changes in housing finance and taxation, as well as 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.
- Greater equity investment in social housing may be encouraged by policy changes to include the introduction of 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.

CONTRIBUTORS

The Research Team gratefully acknowledges the generous assistance and valuable information provided by persons interviewed or who attended the round table discussion:

Ian Blelloch, Chaco
Yinka Bolaji, Genesis Housing Association
D. Braal-Verhoog, Centraal Fonds Volkshuisvesting
Duncan Brown, Knightstone Housing
John Bruton, Raglan Housing
Graham Burnett, USS
Geoff Chamberlain, Raglan Housing
M. Cieleback, Patrizia Immobilien AG
David Dickinson, Barking and Dagenham Council Pension
Rob Elliott, Peabody
E. Emmer, Waarborgfonds Sociale Woningbouw
Steve Faber, Internos
Steffan Francis, M&G
Rob Gardner, Redington
Pete Gladwell, Legal and General Property
Rob Griffiths, Longhurst Group
Jeremy Hunt, Trowers and Hamlins LLP
X. Jongen, Bouwfonds Investment Management
Angela Linton, Hillcrest
Vincent Mahe, Secrétaire Général Société Nationale Immobilière (SNI)
P. Minke, Aedes Vereniging van Woningcorporaties
R. Müller, Federal Institute for Research on Building, Urban Affairs and Regional Planning
Barry Nethercott, Network Housing Group
Mark Nieuwenbroek, Amvest
E. Rebers, APG
Jean-Pierre Schaefer, Former head of economic studies of Caisse des Dépôts-DFE (until 2013)
A. Scharmanski, Quantum Investment GmbH
Geoffrey Shaw, Blackrock
Ian Smith, Derwent Living
H. Spikker, APG
Jack Stephen, Thames Valley
Lee Sugden, Wakefield and District
Christian Tutin, Professor of Housing, University Paris Est-Creteil
Mark Washer, Affinity Sutton
Ian Wilson, CBRE Investors
Martin Zdrakov, Aviva Investors

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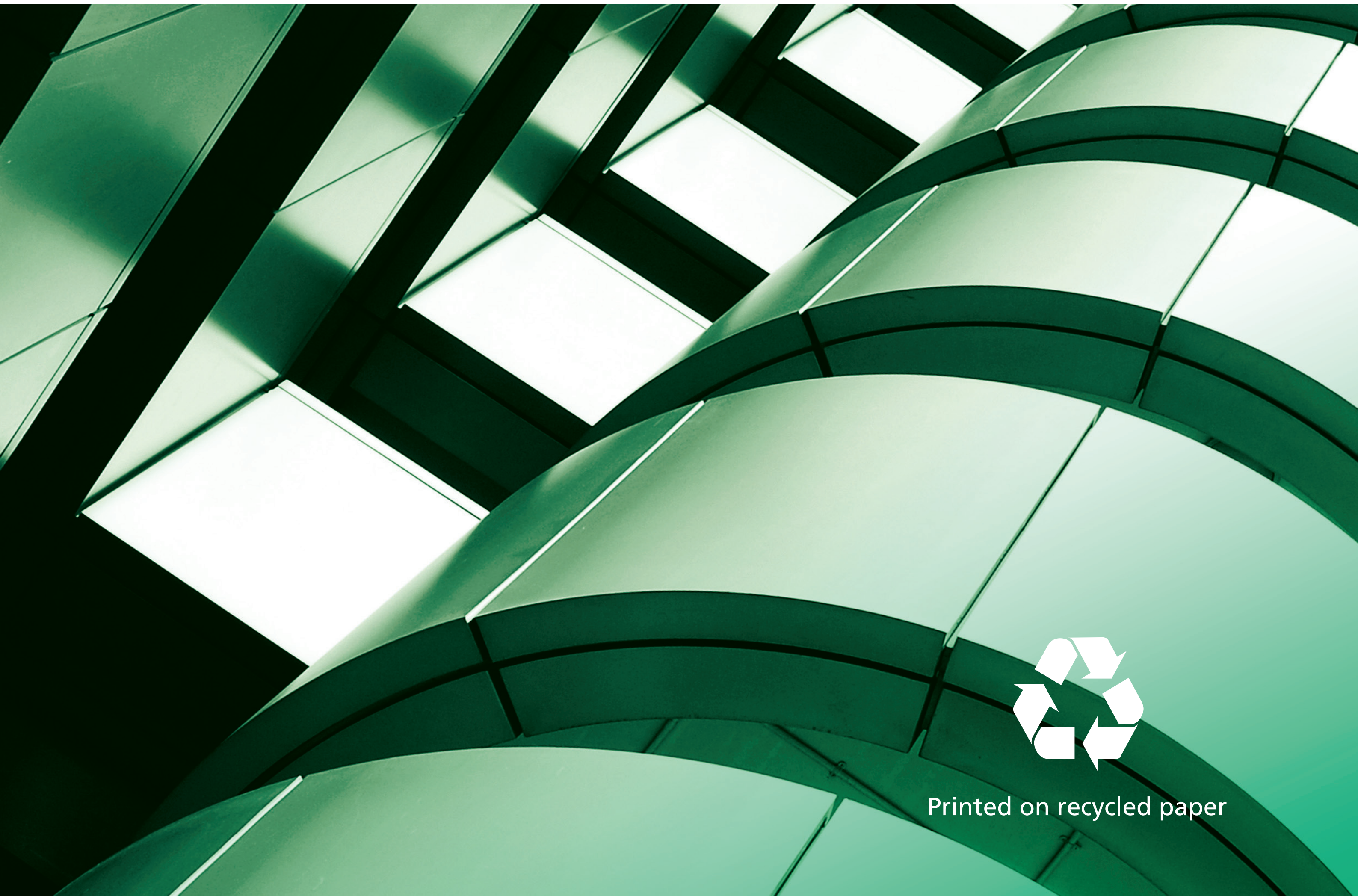
Investment Property Forum
New Broad Street House
35 New Broad Street
London EC2M 1NH

Telephone: 020 7194 7920
Fax: 020 7194 7921
Email: ipfoffice@ipf.org.uk
Web: www.ipf.org.uk



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