



Delivering a step change in affordable housing supply

Presented by Simon Century

Managing Director of Housing, Legal & General Capital
and;

Vice Chair of the British Property Federation Affordable
Housing Committee

Summary

Increasing the supply of affordable housing requires new and innovative ways to fund the sector



We need a three-fold increase in affordable housing supply to meet current housing need

- Over the past 10 years, we have delivered 50,000 homes p.a. on average vs a need for 145,000 – a **95,000 shortfall**
- We estimate that increasing supply to 145,000 homes will require **£34bn of additional funding p.a.**

Housing associations cannot achieve this target alone – a new funding model is required

- We have modelled the housing association sector's balance sheet as a whole in order to estimate the maximum *theoretical* capacity of delivery at 77,000 homes p.a.
- However, taking into account considerable headwinds from issues such as building safety capex and decarbonisation we estimate the *realistic* sector capacity is **65,000 homes p.a.**
- Additional funding streams are urgently needed to meet the 145,000 target. We estimate the £34bn breaks down to **£10bn from new equity, £10bn from new debt** and **up to £14bn from additional subsidy** depending on tenure mix

The entire sector and Government now need to act in partnership to scale new models at pace

- Fundamentally, the only way to overcome the challenges in the years ahead is through a new coming together between all stakeholders - housing associations, institutional investors and Government
- Institutional investment can fill the £10bn equity part of the funding gap with the right **support from Government**. There are examples of exciting partnerships already being formed between investors and housing associations
- Support from Government is needed in the form of further subsidy, and policy changes such as a more level playing field
- A longer-term rent settlement will have the double benefit of helping to facilitate further investment at scale and also reducing the subsidy requirement per home

Chronic shortage of affordable housing

Number of new affordable homes built p.a. falls far short of demand

Annual Capital Funding

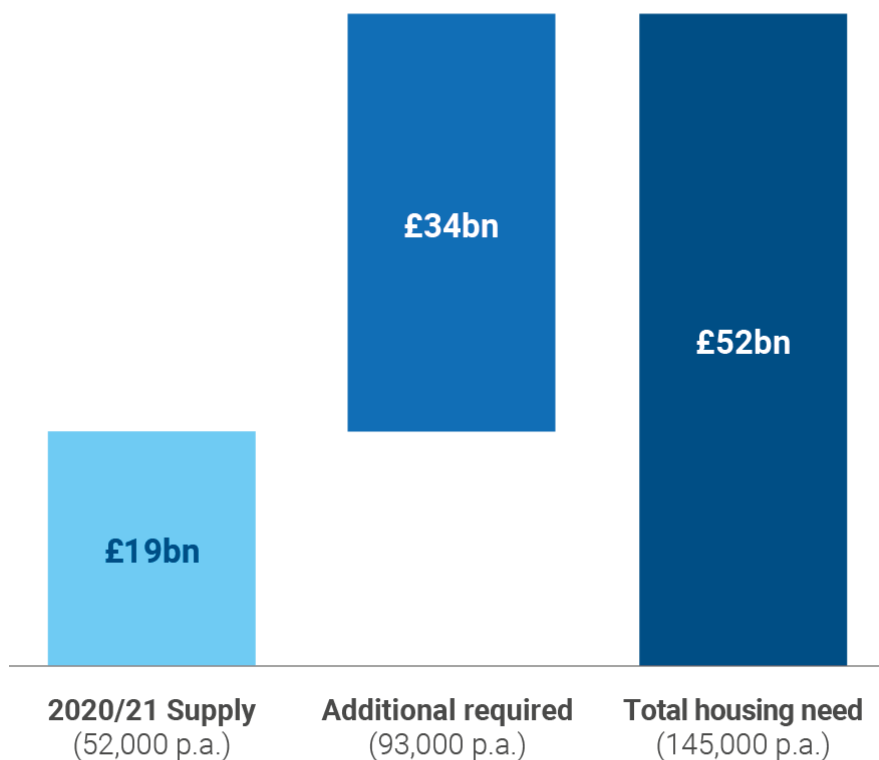


Table 1000, DLUHC, 2021

Annual Affordable Housing Completions

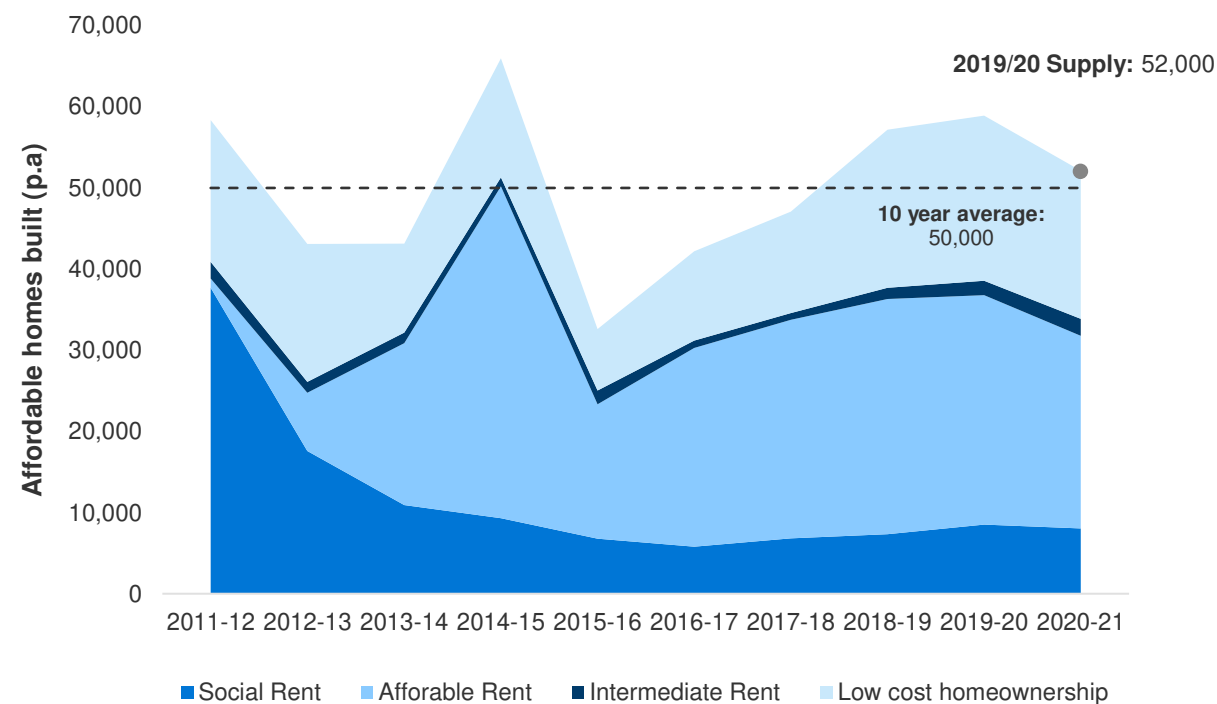
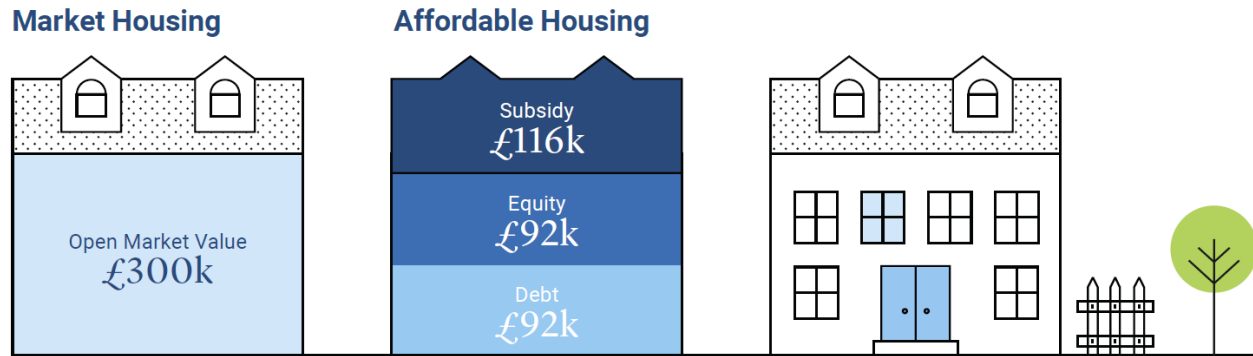


Table 1000, DLUHC, 2021

Affordable housing economics

Funding of new homes can be split into three parts



Illustrative example of capital structure for an affordable rented home, assuming 50% gearing.



Debt

The sector has a strong credit profile and debt is readily available. However, HAs are increasingly hitting debt covenants where constraints on equity and subsidy prevent them from taking on additional debt.



Equity

Housing Associations are constrained in their ability to raise new equity capital by their not-for-profit status, and must rely on retained earnings or cross-subsidy models.

The introduction of For-Profit Registered Providers ('FPRPs') in 2008 opened up a route to increase the equity capital within the sector.



Subsidy

Following a long-term trend away from supply-side to demand-side, overall subsidy provision remains at near historic lows. However, there has been a notable increase in subsidy levels in recent months with the new Affordable Homes Programme.

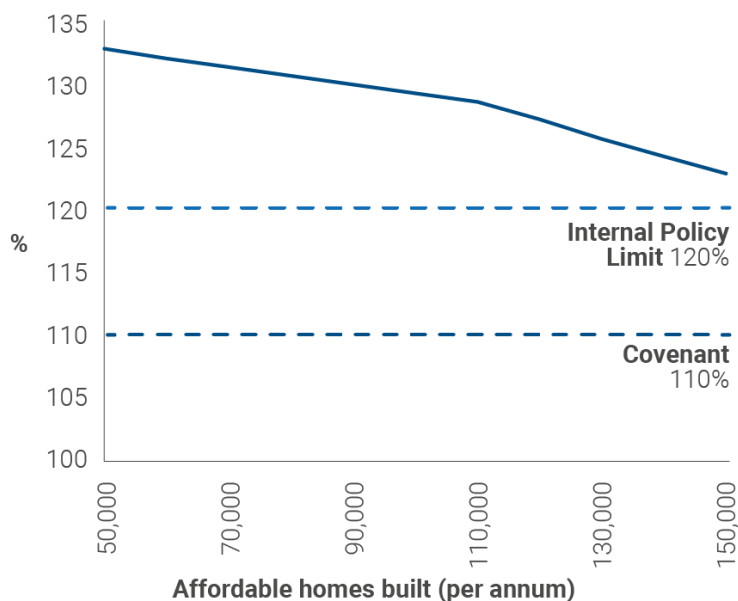
Theoretical sector capacity

Financial modelling outcomes - theoretical limit of c.77,000 homes a year



Asset Cover

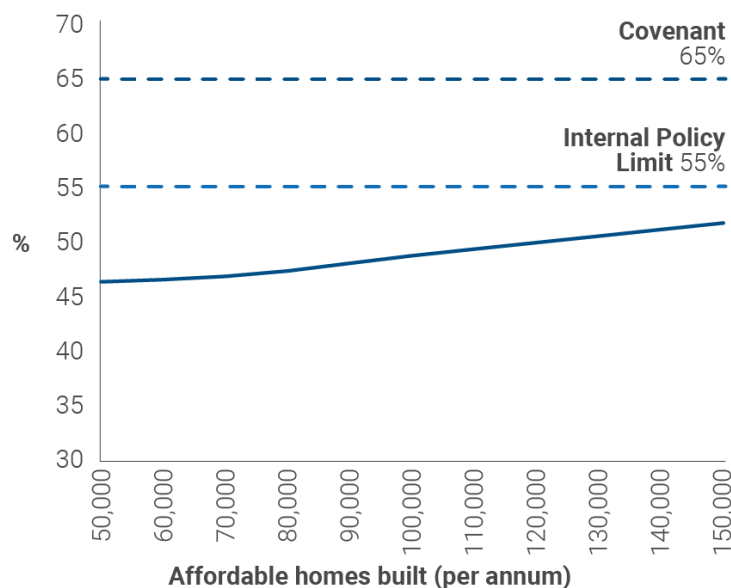
Ratio of the gross value of the business' assets to net debt.



Legal & General Capital, 2022

Gearing

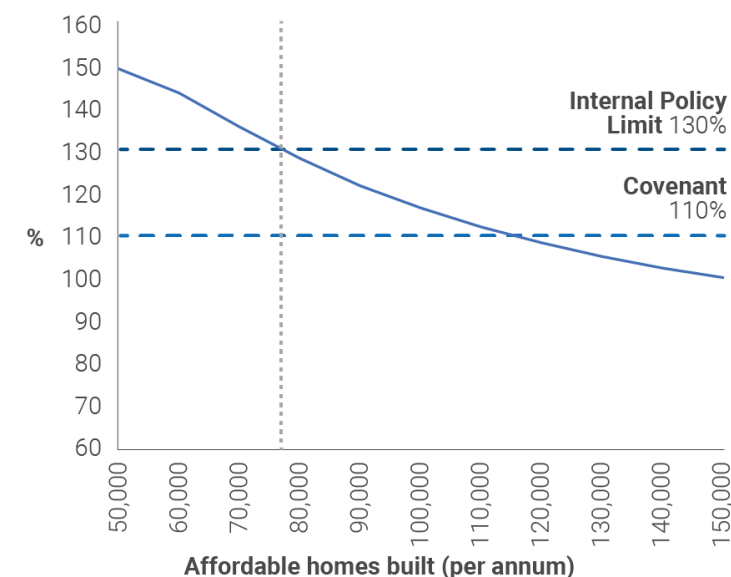
Ratio of net debt to the gross property value (on a historic cost basis)



Legal & General Capital, 2022

Interest Ratio

Ratio of EBITDA-MRI (surpluses generates) to interest payable. Of three metrics, this is the most significant rate-limiting constraint on supply with internal policy limits expected to be breached at just **77,000 homes** delivered per annum.



Legal & General Capital, 2022

True sector capacity

Once the powerful headwinds are taken into account, affordable housing supply is restricted to, at most, c.65,000 homes a year



Challenges and headwinds facing the sector



Fire safety repairs

Urgent need for capital expenditure on building safety following the Grenfell tragedy is estimated to require a non-recoverable funding cost of over **£10bn** to the sector, resulting in 2,600 fewer affordable homes p.a. being built over the next 5 years.

Decarbonisation

All affordable homes must be at EPC C and above by 2030, and achieve Net Zero Carbon emissions by 2050. HA's will need to undertake large-scale retrofitting programmes to their existing stock. It is estimated that will cost **£50bn** and result in 8,000 fewer homes being delivered p.a. for the next 30 years.

There are multiple other 'real world' factors, that weigh against capacity

Specific covenant terms

Stress testing requirements

Lack of ability to equity cure

Covenant changes through time

Increases in cost of financing

Risk of the cross-subsidy models

Development expertise

Risk appetite level

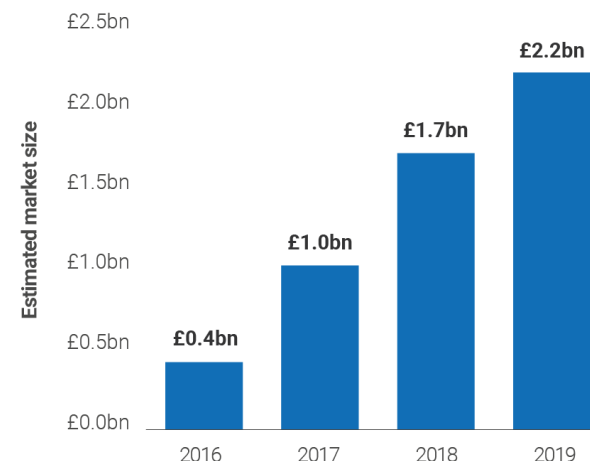
Meeting the equity funding gap

Institutional investment can work alongside HAs to unlock additional supply



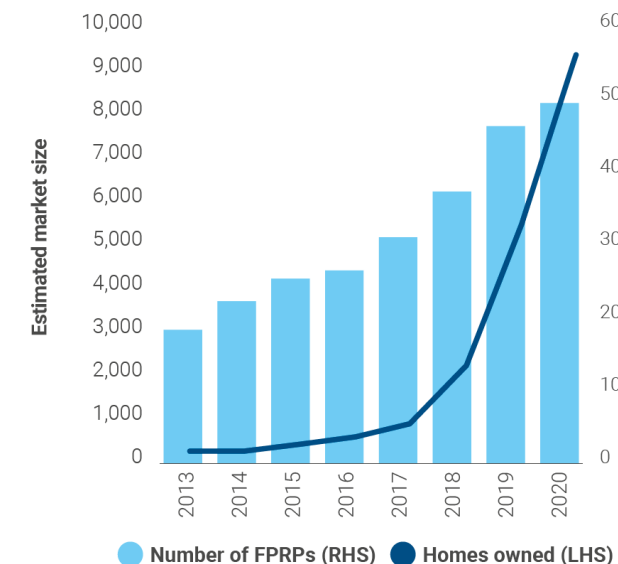
- Our modelling estimated an additional **£10bn** of equity investment (assuming 50% leverage) is required each year to meet the 145,000 a year target
- Institutional investors have long been lenders to the sector, and are active in other residential sectors such as student housing, later living and Build to Rent.
- A range of partnerships are now being formed between investors and Housing Associations to marry institutional capital with the skills, know-how and capabilities of incumbent affordable housing providers.
- There isn't a prescriptive approach, instead each partnership must be drawn up to best meet the needs of all parties (e.g. level of development risk, term of investment).
- Government can do more to facilitate investment. There are idiosyncrasies between the treatment of not-for-profit HAs and FPRPs.
- A more level playing field across the sector will encourage new investment into the sector and enable closer collaboration between HAs and institutional investors.

Estimated market size for institutional equity investment in UK affordable housing



Big Society Capital, 2021

Growth in FPRP stock



RSH, 2021

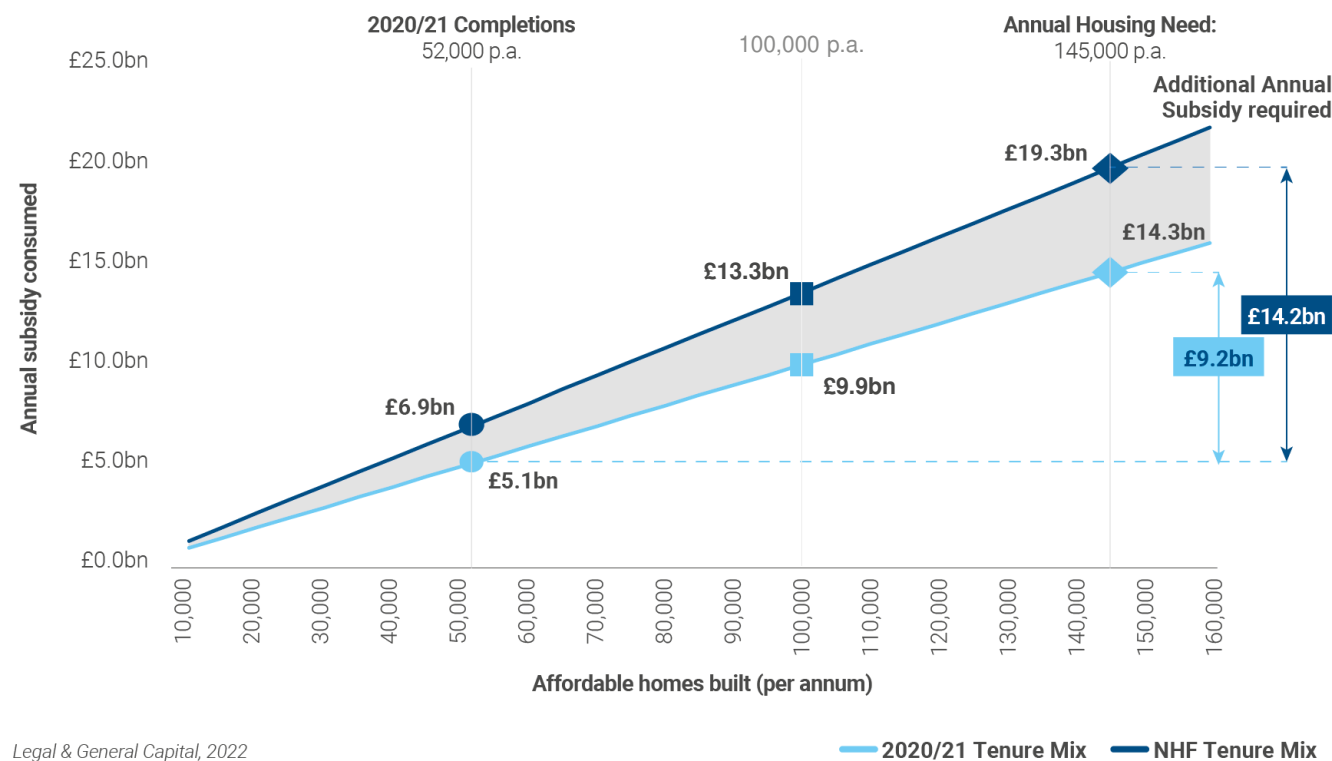
Meeting the subsidy funding gap

Sustainable increases in supply will require additional subsidy funding from Government



- Increasing supply to the 145,000 target will require a **£9.2bn** increase in the subsidy consumed p.a. (all else being equal).
- The tenure mix pursued has a large impact on the amount of subsidy consumed, delivering a higher percentage of social rent increases the subsidy requirement.
- Delivering 59% of homes for social rent, as per the NHF's proposal, would result in **£14.2bn** additional subsidy consumed p.a.
- There is a strong public investment case for government subsidy programmes, in addition to the immediate requirement to deliver on housing need.
- This is through the multiplier effect of increased economic activity, and by reducing the social externalities of poor housing.
- Long-term rent settlements could be very powerful – we estimate that the extension of rent policy until 2035 would reduce the subsidy requirement by c. £2bn a year.

Estimated Subsidy Requirements



2020/21 Tenure Mix: 16% social rent, 50% affordable rent and 35% shared ownership.

NHF Tenure Mix: 59% social rent, 18% affordable rent and 37% shared ownership.

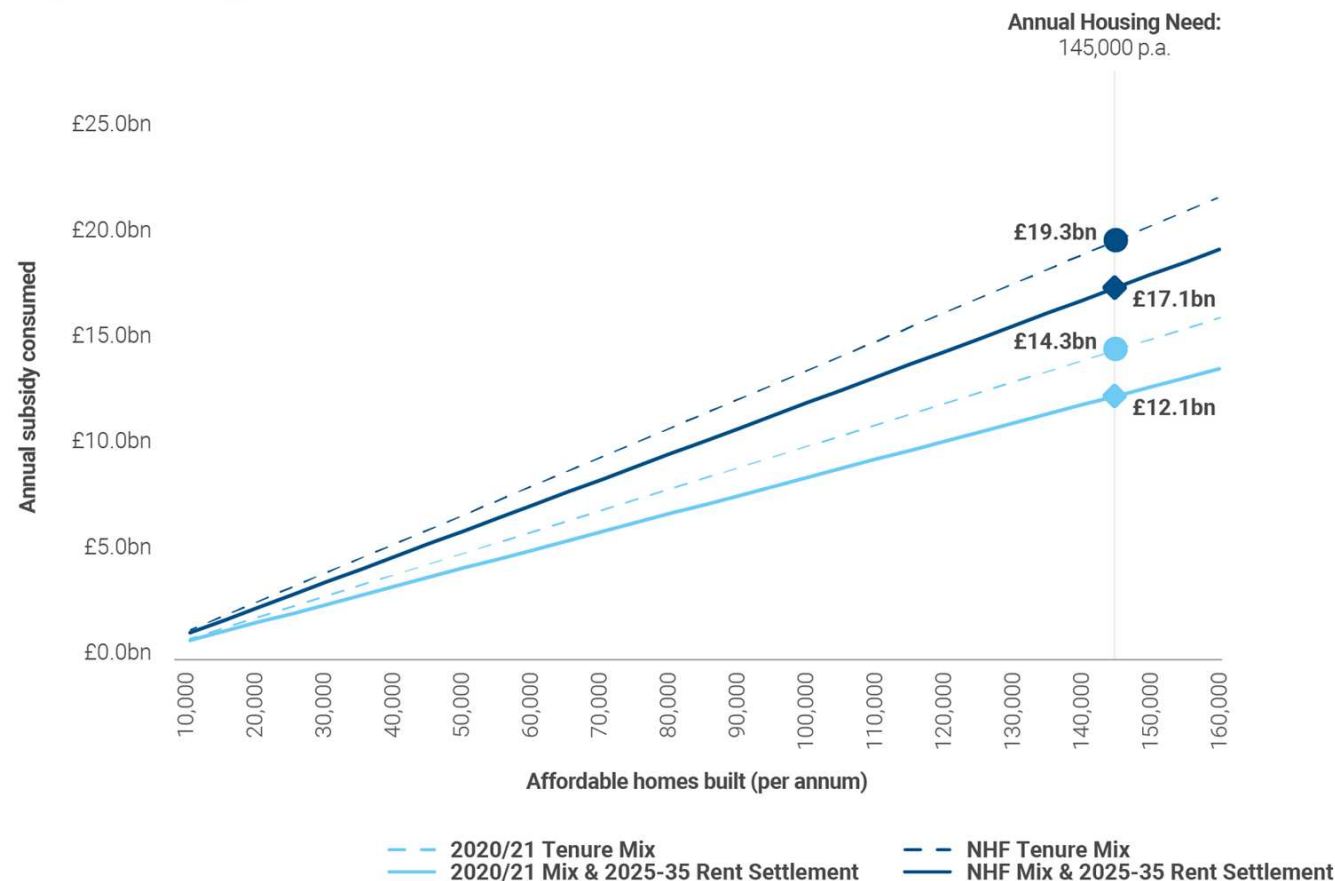
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Impact of 10-year rent settlement



Legal & General Capital, 2022

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Case Studies

Established partnerships between investors and HAs



Legal & General Affordable Homes

Legal & General set up its wholly-owned For-Profit Registered Provider in 2018 to develop and acquire affordable housing for long-term ownership.

It has since grown its development pipeline to over 7,000 homes throughout the country to help meet the needs of local communities and to deploy institutional capital at scale.

The Registered Provider operates using a framework of 14 housing associations and management partners that manage Legal & General's properties, and recently began the process of acquiring shared ownership homes from these partners with a landmark 47-home deal with CHP Homes.

Legal & General Affordable Homes signed a joint venture agreement with Coastline Housing in 2019, which is expected to see Coastline deliver between 100 and 300 homes per year to be owned by Legal & General Affordable Homes and managed by Coastline.

Legal & General Affordable Homes was also named as a strategic partner for Homes England under the Affordable Homes Programme in 2021.



M&G Real Estate and Hyde Housing

A new partnership to build over 2,000 high quality, sustainable shared ownership homes, with an initial investment of £61m to purchase 422 homes in London and Kent.

The deal was negotiated during the Covid-19 pandemic and announced in March 2021. This is direct response to the funding challenges faced by housing associations to ensure that existing homes are safe and sustainable and meet all the requisite safety requirements and the Government's Net Zero carbon agenda.

The collaboration will enable M&G, investing through their newly formed For-Profit Registered Providers, to buy existing stock and fund much of Hyde's shared ownership development pipeline, which in turn allows Hyde to recycle capital into new homes and other affordable housing initiatives. Through the partnership, Hyde have retained the property management responsibilities for the stock.

Both companies took significant time to ensure that they were aligned in their objectives to accelerate delivery of sustainable and affordable homes whilst seeking to improve customer services.



The opportunity

Making a step change will require co-operation from all stakeholders



Government

- 1 Review the subsidy provision**
Increasing subsidy levels by £9bn - £14bn to support the delivery of 145,000 new affordable homes per annum in conjunction of a review of targeting subsidy provision. This could be through increasing grant levels, or supporting new delivery models.
- 2 Rent settlement**
Longer term rent settlements will provide investors with reassurance to spur activity, reduce the amount of risk capital required for investment and lower the subsidy requirement per unit.
- 3 Create a level playing field**
Review treatment of For- Profit Registered Providers (e.g. tax positions, grant uplift treatment) to remove obstacles for closer collaboration between institutional investors and housing associations.



Housing associations

- 1 Partnership models**
Consider which models work best for the delivery of additional affordable housing and assist in achieving their other organisational goals.
- 2 Share affordable housing expertise**
Utilise their decades of experience and knowledge in affordable housing development, management to provide new high-quality affordable homes.
- 3 Find alternatives to mergers**
Weigh up partnership with institutional investors as a potentially more productive alternative to merging two capital constrained entities together.



Institutional Investors

- 1 Increase capital allocations**
Bring forward a greater allocation of long-term capital to support the sector as part of a diversified investment portfolio.
- 2 Maintain a flexible approach**
Structure partnerships that would work for all parties and matching to the appropriate source of capital (e.g. development risk, or stabilised assets).
- 3 Cross-pollinate from other sectors**
Institutional investors typically have a wealth of experience in adjacent sectors and can bring that to the table to aid new ventures.

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