

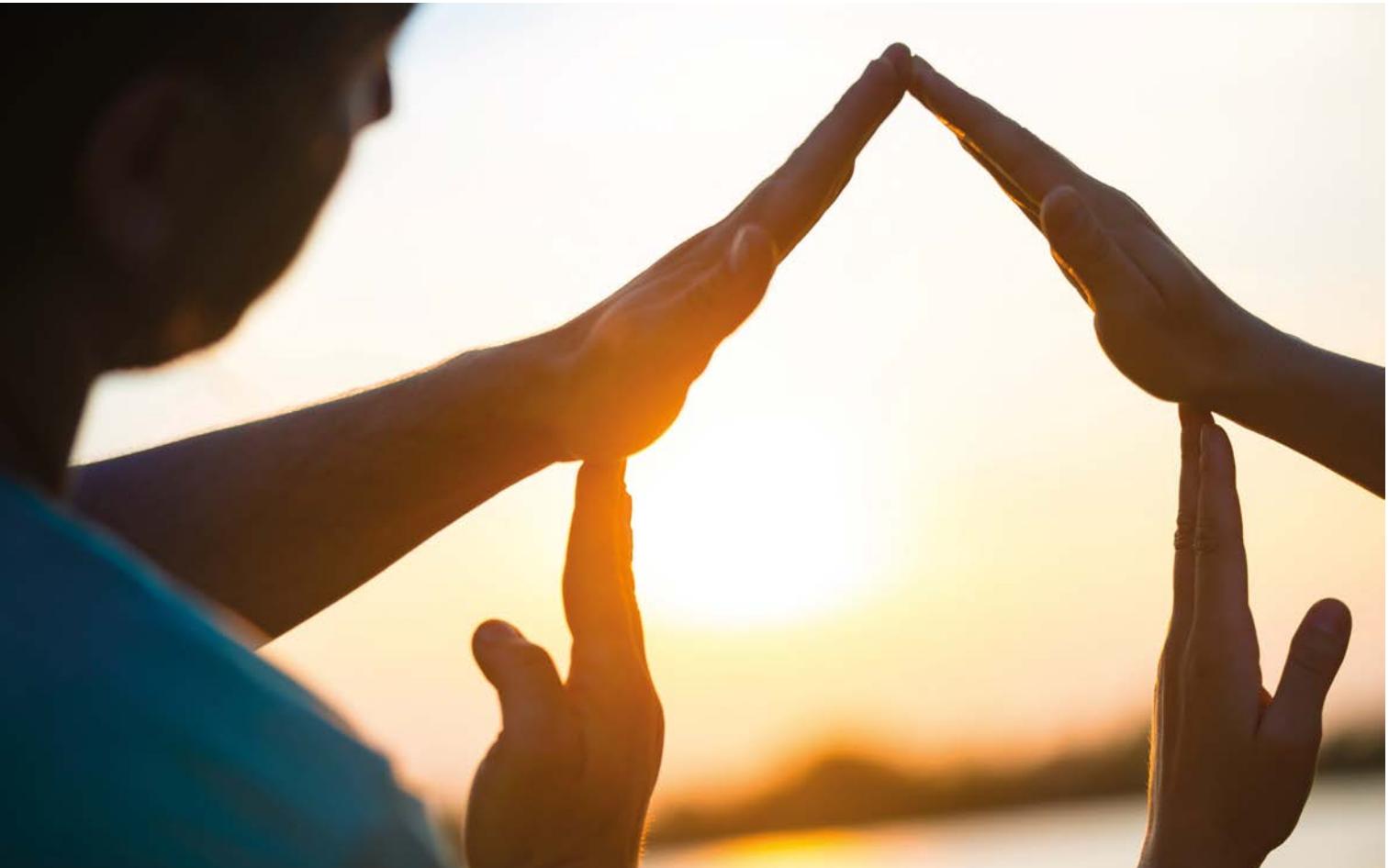


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Affordable housing: set for investment





Lack of supply has long been a feature of the UK housing market and people have been calling for more affordable housing for years. The sector has been poised for growth for decades, so why should things change now? Our research shows housing associations finally have the means to respond and the Brexit vote has reinforced the political impetus needed to unlock this pent up demand.

“The supply side of the housing market remains a focus because people recognise that we have not been building enough homes to keep up with the natural increase in population.”

Robert Gardener
Chief economist at Nationwide
August 2016

During the 1960s, 3.5 million new builds were completed. Compare this to the last decade, which saw barely 1.5 million units delivered and housebuilding at its lowest level since World War Two.

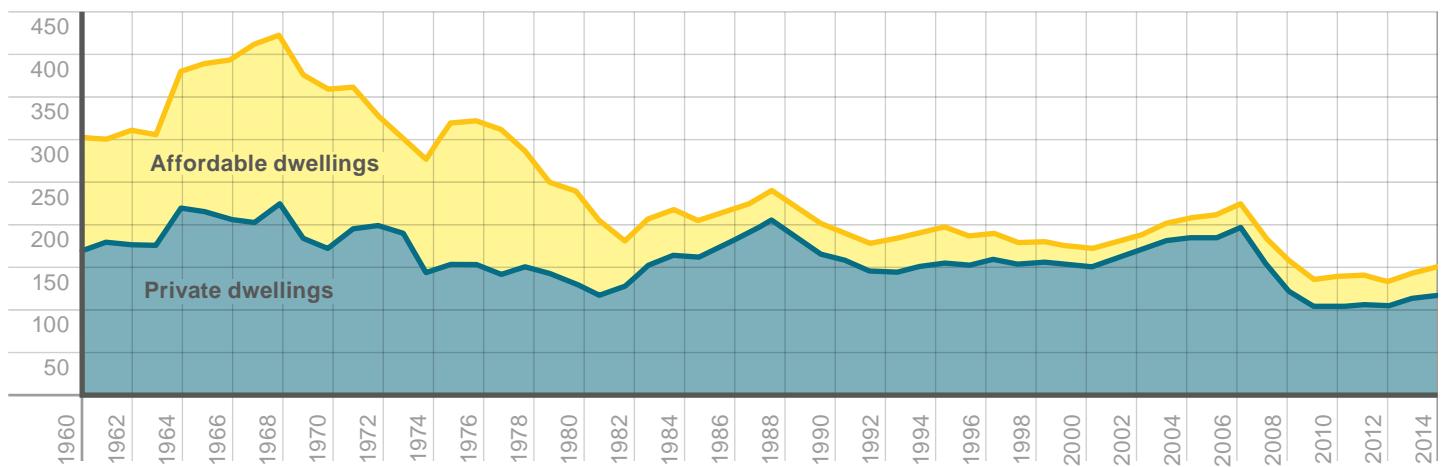
Affordable housing: the long view

The lack of affordable housing is not a new problem. Indeed, the last 40 years have seen a steady decline in the number of new builds. During the 1960s, 3.5 million new builds were completed. Compare this to the last decade, which saw barely 1.5 million units delivered and housebuilding at its lowest level since World War Two.

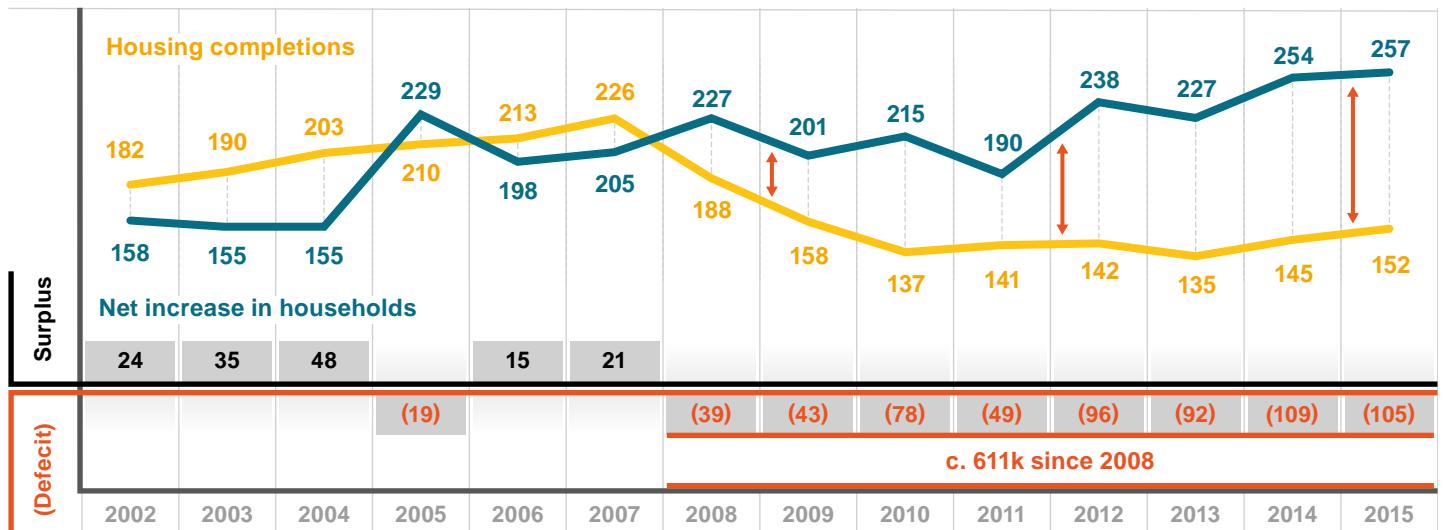
The bulk of this decline has been in the public sector – down around 80 per cent compared with the 1960s when slum clearances boosted what was then known as ‘social housing’ – and the private sector has failed to pick up the slack. Traditional social housing is far less common today and this article focuses on affordable housing, which represents the majority of modern ‘public housing.’

Until now, Registered Providers (RPs) made up of Housing Associations and Local Authorities have been hamstrung by limited government grants, planning constraints and a lack of political impetus. This is changing.

UK new build dwellings, thousand ● Private ● Affordable



Total housing completions vs. net increase in households, thousand



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Meeting demand: the funds are available

It is perhaps surprising that, in the era of austerity, there are now new routes to funding for local authorities and housing associations. The 2011 Affordable Rent Act and the Localism Act released them from their reliance on government grants. Although those grants were reduced, housing associations were given more freedom, including the ability to raise social rents from 50 to 80 per cent of market value, secured by an increase in housing benefit.

Crucially, tenant rents rather than government grants now fund affordable housing, bringing the sector more in line with the private market and creating a more attractive environment for private sector investment and greater debt financing (see below).

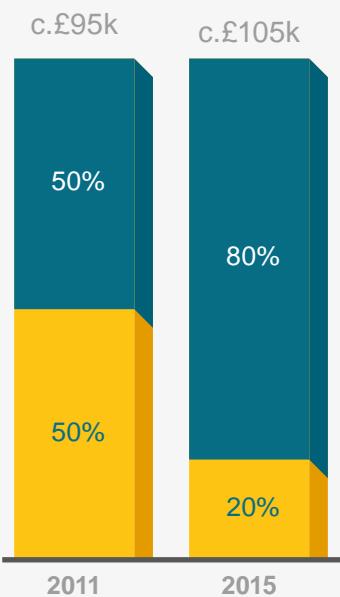
Meanwhile, since the introduction of affordable rents in 2011, RPs have also been tapping the bond markets. Against a backdrop of record-low interest rates, affordable housing remains an attractive asset class for investors. RPs now have more money and greater freedom to spend this new found investment.

“The UK rental market is dysfunctional, with ever increasing rents and increasingly poor accommodation. For this to change, and renting to become more affordable, we need to invest in the ‘new’, and build new homes to rent, and just stop inflating the prices of old housing stock.”

Paul Stanworth
Managing Director,
Legal & General Capital

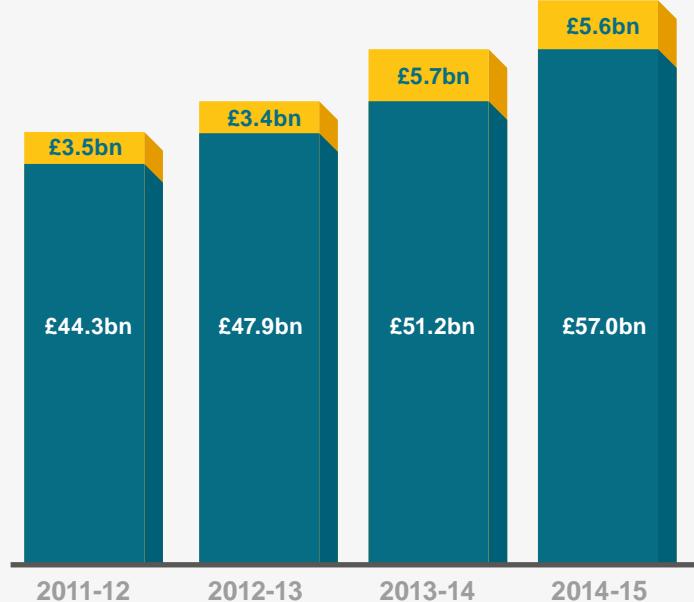
Funding per unit

- RP Resources / debt
- Government grants



YoY increase in long term debt of housing associations, £bn

- Long term debt added that year
- Long term debt at start of year



Against a backdrop of record-low interest rates, affordable housing remains an attractive asset class for investors.

Housing associations with the will to build

Today, enlightened RPs have started to function like private sector organisations. When CIL interviewed a number of housing associations after the EU referendum vote, the consensus was that development plans are going ahead, with many associations financing developments entirely through their own resources and debt without the need for government grants.

At the same time, the 2016 Housing and Planning Act introduced the extension of 'right to buy' to Housing Associations, with the expectation that they will replace all units sold with new affordable housing within three years. In London, in certain circumstances, there will also be a requirement to secure the development of two affordable homes for each dwelling sold.

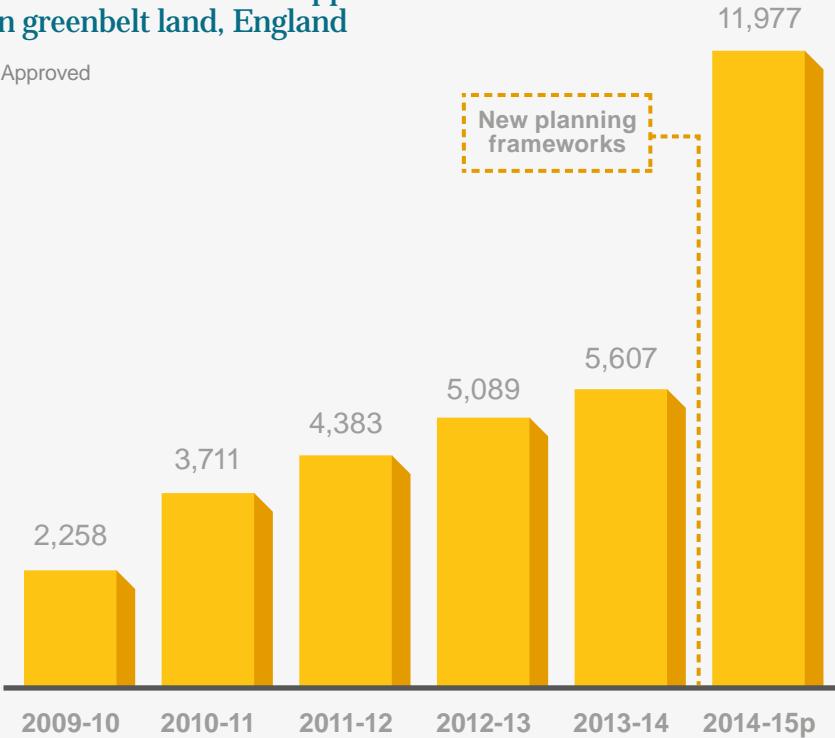
The National Housing Federation estimates that this will extend the 'right to buy' to 1.3 million additional tenants, adding further unit volume from 2020. Extension of the scheme will incentivise Housing Associations to invest their funds in new builds to replenish their stock, resulting in an increase in the number of new builds.

Planning is improving

Planning difficulties have long been the greatest single restriction on build numbers. In 2014 however, pressure to build new homes forced local councils to relax regulation and unlock access to greenfield sites. New, simpler planning frameworks have contributed to a higher rate of planning approvals on greenbelt land and created the conditions for growth.

Number of new homes approved on greenbelt land, England

● Approved



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Brexit has generated political will

A more supportive political climate for housing was ushered in at the back end of the coalition government, and this has been given fresh impetus by the referendum result. The Brexit vote has demonstrated disaffection among the hardest hit in society.

The traditional working class are feeling the strains of immigration on housing, public services and the labour market, without a share of the economic benefit. It is likely that investment in affordable housing will be used to garner support among this voter base in particular.

Speaking just a week after the referendum, Prime Minister Theresa May promised 'more housebuilding' under her government and said, "Unless we deal with the housing deficit, we will see house prices keep on rising. Young people will find it even harder to afford their own home" (July 2016). The new Chancellor has since announced additional funding for small housebuilders at the Conservative Party Conference.



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Implications for businesses and investors

Affordable housing now represents a significant area of opportunity for the construction sector; from housebuilders and main contractors to product providers and sub-contractors.

Since the financial crisis, affordable housing has been a difficult area. New build volumes have disappointed and did not fill the gap left as demand for social housing refurbishment under the Decent Homes Standard started to reduce. For this reason, many businesses moved their focus towards private housebuilding and other sectors which have shown better growth. Exploiting opportunities in affordable housing is likely to be a strategic priority for many in the sector. Historically, the sales process, type of

housing and fit out were quite distinct in the social sector versus private. This is no longer the case with housing associations and their builders operating much more like the private sector; buying similar products on similar criteria. In some cases, a development may be largely complete before it is decided whether it will be used for the affordable or private sector.

Countryside Properties and Westleigh are two businesses that demonstrate the ability to straddle both the affordable and private sectors. Both businesses also demonstrate the emerging equity investor interest in the sector: Countryside successfully floated on the stock market in early 2016, and Palatine Private Equity invested in Westleigh during the summer.

From a debt perspective, the hunt for yield is the overwhelming challenge for investors. The affordable housing debt market provides an opportunity to issue long term debt into a sector with highly experienced managers (Housing Associations), at a yield that compares favourably to sovereign debt. The yield is effectively underpinned by state payments in the form of Housing Benefit. We think there is a scenario in which long term debt for affordable housing becomes a significant asset class in its own right, particularly for pension fund allocation. As this asset class grows, the opportunities available for businesses exposed to the sector – and their investors – multiply.

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