BUSINESS LDN

THE CASE FOR PRIVATE INVESTMENT INTO AFFORDABLE HOUSING IN LONDON

CBRE

October 2022

BusinessLDN, in partnership with CBRE and Arcadis, ran a workshop that brought together investors, developers, housing associations, professional services firms and public sector stakeholders to discuss the role of private investment in the affordable housing sector. Using insights gained from this workshop and wider research, this short report sets out why new models promoting private investment into affordable housing are a welcome development, how such investment should be harnessed to deliver social good and the steps that should be taken in London to secure more of this investment.

EXECUTIVE SUMMARY

There is a chronic shortage of housing, in particular affordable housing, in London and current rates of development will not satisfy the level of new homes needed as outlined in the London Plan 2021.

Subsidy, including grant funding, which is typically utilised to deliver the various forms of affordable housing is not sufficient to meet demand and therefore further investment is required.

In recent times, housing associations have been responsible for a large proportion of the affordable homes delivered, however, considering the current challenges – capital constraints, investment required into existing stock and meeting the decarbonisation agenda – innovative approaches and new sources of private capital are needed to accelerate the delivery of affordable housing.

Private investment into affordable housing is not a new concept and recent models for such investment, including For-Profit Registered Providers and joint ventures,

enable private capital to partner with local authorities and housing associations to deliver more homes without the use of additional borrowing.

The attractiveness of the sector to investors includes the general stability and inflation-linked nature of the income stream, low voids and bad debts, inelastic demand due to long waiting lists and the counter-cyclical nature of the market given demand is less correlated with economic cycles. Affordable housing being viewed as an impact investment can also enhance Environmental Social Governance credentials.

As more private investment comes into the affordable housing sector it is important to ensure that the types of homes delivered are consistent with local need and that the investment is aligned to wider social objectives while providing a fair return – there is good reason to believe all of this can be achieved.

To facilitate further private investment into the sector, central government should:

- Provide certainty over a rent settlement
- Level the playing field for all Registered Providers
- Streamline the bureaucracy associated with setting up a Registered Provider
- Raise awareness of the affordable housing delivery models available to public and private entities
- Update the approved provider lists at the local authority level

To facilitate further private investment into the sector, London government should explore two ideas:

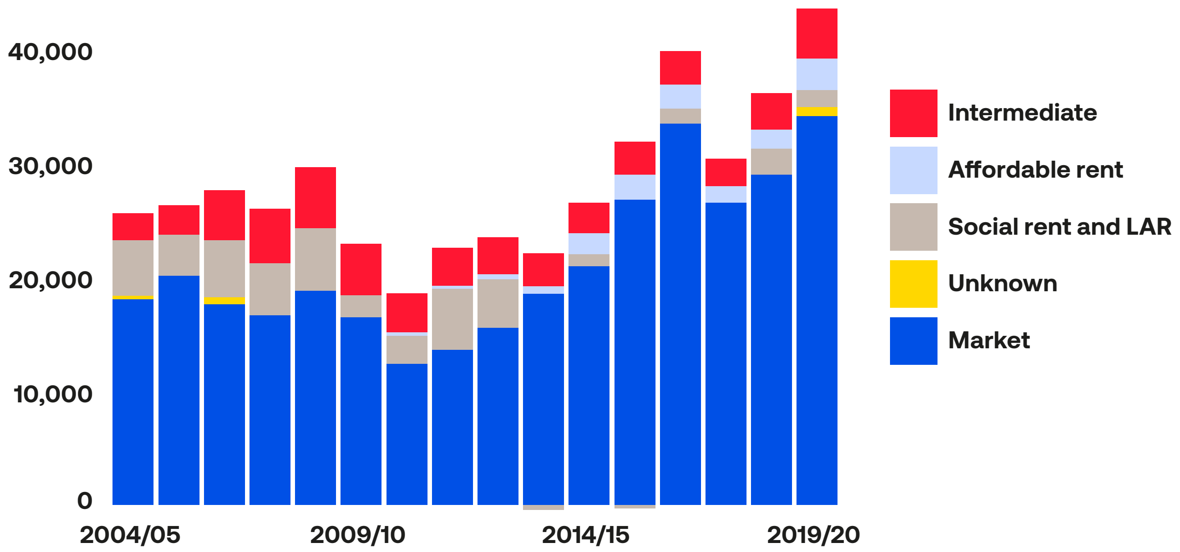
- Capitalisation of rental income: The affordable housing stock in London is worth approximately £67bn and generates surplus income of £2bn. There is an opportunity to release value by enabling private capital to acquire a proportion of this revenue stream. This in turn frees up capital for housing associations to utilise the capital raised to further develop their affordable housing pipeline.
- Ringfenced “top up” grant: A proportion of grant funding from the GLA’s current Affordable Housing Programme could be ringfenced to support schemes which are marginally viable and require a “top up” to ensure they can be delivered. This form of grant would be repaid to the GLA upon stabilisation of the completed development which is earlier than the grant recycling rules under the existing programme. This not only supports marginal schemes but also enables the delivery of more affordable housing where a developer has committed to delivering a scheme which comprises of 100% affordable homes.

LONDON FACES A CHRONIC SHORTAGE OF AFFORDABLE HOMES

The London Plan 2021 – the spatial strategy for the city – states that London needs 66,000 new homes a year and has a strategic target that half of all homes built in London should be "genuinely affordable"[1]. Housebuilding in London has not come close to reaching the levels required; provisional estimates show that in the capital in 2019/20, 43,850 new homes were built including 8,710 affordable homes[2].

The shortage of housing, in particular affordable housing, is a long-standing systemic issue in London. Since the formation of the Greater London Authority (GLA) in 2000, housing supply has increased but not by enough to meet the various housebuilding targets in the London Plan (see Figure 1).

Figure 1: Net conventional completions by tenure, London 2004/05 to 2019/20



Source: Housing in London 2021, The Evidence base for the London housing strategy, Greater London Authority: November 2021

1 *See Chapter 4 Housing, The London Plan 2021. The Plan's actual housebuilding target is in fact only 52,297 homes per year - a figure settled at the Plans Examination in Public due to constraints in land supply in the capital, amongst other reasons.*

2 *Housing in London 2021, The evidence base for the London housing strategy, Greater London Authority, October 2021.*

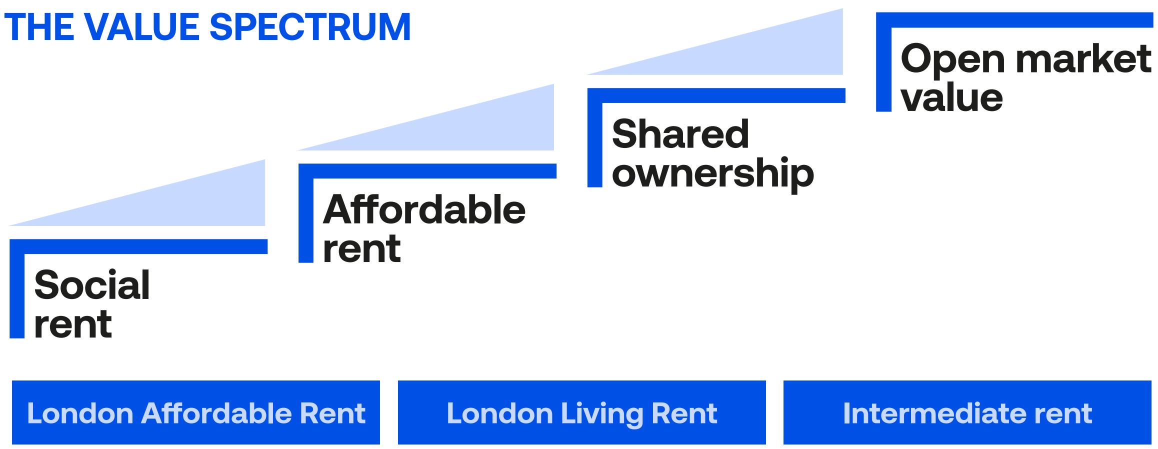
MORE INVESTMENT IS REQUIRED

To build affordable housing, some form of subsidy will always be required to make up for sub-market rents or purchases. Typically, the subsidy comes in the form of grant or through planning obligations (for example, Section 106 Agreements with developers to deliver affordable housing).

There are various types of affordable housing tenures in the UK, ranging from social rent, to affordable rent (set at a maximum of 80% of market rent) through to intermediate housing such as shared ownership (see Figure 2). The higher up the value spectrum the type of affordable home is, the less subsidy it requires.

The GLA estimates that around £4.9bn per year in grant funding is needed to deliver the level of affordable housing that London needs[3] but London has been given £4bn of affordable housing grant from Government for 2021/26[4], a reduction on the previous settlement.

Figure 2: Types of affordable housing



Source: CBRE

3 The 2022-23 Affordable Housing Funding Requirement for London, Greater London Authority: June 2019.

4 To note, £4.8bn of funding was obtained for the period 2016 to 2023, with this date having been extended due to the pandemic.

HOUSING ASSOCIATIONS ARE CONSTRAINED IN THEIR ABILITY TO DEVELOP NEW AFFORDABLE HOUSING

In recent times, housing associations have been a key source of affordable housing supply, delivering over 7,000 new homes in London in 2020/21[5]. However, in the short to medium term, housing associations are facing significant challenges, as outlined below, which will restrict their ability to focus on building new affordable homes.

Balance sheet pressure

The largest housing associations in London by homes owned and managed (commonly known as the G15) have assets of £54.8bn and debts of £25.5bn, equating to aggregate gearing of 47.4% (see table 1).

It is also notable that housing associations' interest coverage ratio – which is commonly used as a proxy for investors to determine a company's riskiness relative to its debt – has fallen for two years in a row, dropping from 174% in 2018 to 138% in 2020[6].

The fall means the sector is more burdened by debt expenses (and this does not reflect the likely negative impact the pandemic may have had on balance sheets as the figures only go up until March 2020).

5 *How many homes did housing associations build last year? National Housing Federation: 2021.*

6 *Regulator of Social Housing, 2020 Global Accounts of private registered providers, March 2021.*

Table 1: Summary financial status of the largest housing associations in London (2021)

Housing Association	Total Homes Owned and Managed	Value of Homes	Turnover	Operating Surplus	Debt Facilities (Drawn)	EBITDA MRI[7] Interest Cover	Cash Reserves	Gearing
A2 Dominion Group	38,395	£2,780m	£303m	£78.4m	£1,688m	63.6%	£52.1m	59.0%
Catalyst	c.37,000	£3,069m	£298m	£67.5m	£1,249m	124.2%	£159.7m	41.3%
Clarion Housing Group	125,514	£7,820m	£944m	£258m	£4,325m	151.7%	£131m	54.6%
Hyde Housing	48,721	£3,008m	£365m	£139.3m	£,1614m	162.5%	£162.4m	47.7%
L&Q	107,400	£10,906m	£1,052m	£307m	£5,459m	254.0%	£132m	49.0%
Metropolitan Thames Valley Housing	c.57,000	£4,525m	£446m	£138m	£2,000m	119.3%	£156m	40.0%
Network Homes	c.20,000	£2,064m	£247m	£41.7m	£1,095m	170.3%	£65.9m	46.4%
Notting Hill Genesis	66,537	£6,594m	£909m	£262.2m	£3,379m	165.4%	£79.5m	49.6%
One Housing	17,312	£1,702m	£184m	£2.5m	£903m	86.0%	£58.7m	57.0%
Optivo	c.45,000	£3,083m	£332m	£104m	£1,497m	143.3%	£86.8m	46.0%
Peabody	c.67,000	£7,004m	£630m	£195m	£2,920m	119.0%	£127m	37.0%
Southern Housing Group	c.30,000	£2,215m	£212m	£61m	£985m	38.7%	£35.7m	40.7%
Total	c. 660,000	£54,770m	£5,922m	£1,654.6m	£25,500m	133.2%*	£1,246.8m	47.4%*

*Source: CBRE, 2021. *Average. The information contained within this table has informed the figures used in the recommendations such as the average value of an affordable home is c.£83,000, the average income per home is c.£8,900 and the average surplus per home i s c.£2,500. To note, One Housing are now part of Riverside and Catalyst are now a subsidiary of Peabody ahead of a full merger in 2023.*

7 *Earnings Before Interest, Tax, Depreciation, Amortisation, Major Repairs Included.*

Investing in existing homes

Housing associations are having to spend large amounts of capital upgrading their existing stock, leaving less investment to develop new affordable housing. For example, London's largest housing associations expect to spend £3.6bn on building safety work by 2036 having already spent over £400m on such work since 2019[8]. And some estimates suggest that it will cost in excess of £100bn to decarbonise the UK's social housing stock[9].

BOROUGH BUILDERS

While the private sector and housing associations are responsible for the delivery of the vast majority of affordable homes, slowly but surely London's local authorities are starting to get back into housebuilding. Spurred on by the lifting of the borrowing cap placed on a local authority's Housing Revenue Account (HRA) and the London Mayor's £1bn council homes building programme to deliver 11,000 homes, many boroughs have established housing or property companies that are seeking to build affordable homes. However, the results of these efforts will take time to come through. In the seven years to March 2017, London boroughs built 2,100 homes, a modest amount, but significant progress compared with the 70 homes built in the preceding seven years. Lack of resources, funding and specialist skills to deliver large scale schemes all stand as significant barriers to the ambitions of boroughs to build.

Source: Housing Partnerships, Delivering the homes that London needs, London First, AECOM, Grant Thornton, London Councils: June 2021.

8 *Protect, Prepare, and Promote, G15 Spending Review 2021 Submission, 2021.*

9 *Inside Housing, The cost of net zero: social landlords' decarbonisation plans revealed, 23 November 2020.*

PRIVATE INVESTMENT CAN HELP TO DELIVER MORE AFFORDABLE HOMES

If London is to deliver the scale of affordable housing it requires, new sources of private capital and innovative ways of providing affordable housing are needed.

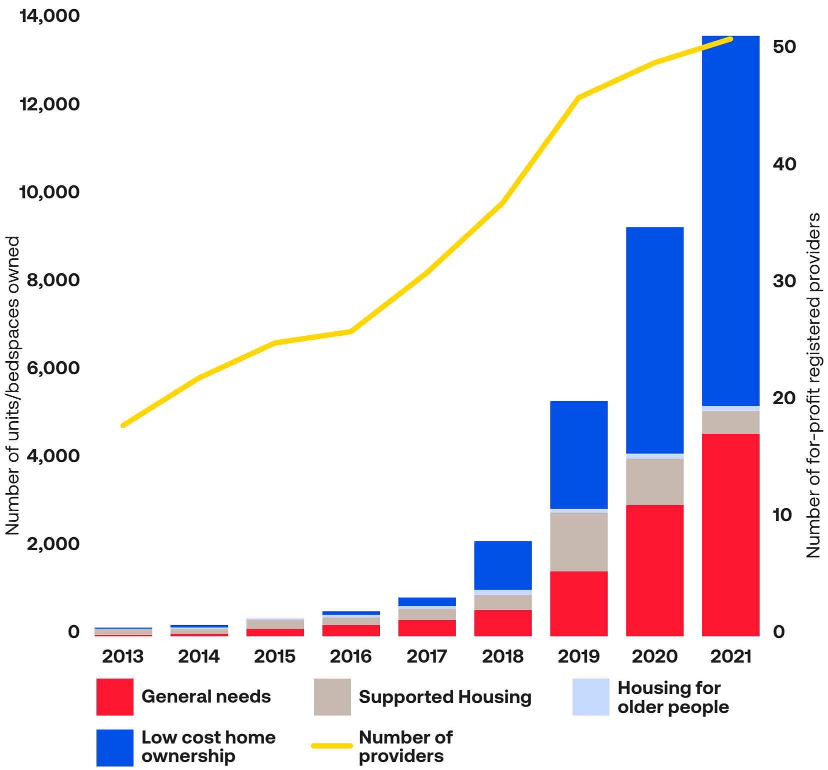
Unless there is a significant change in approach by Government, for the foreseeable future, the amount of affordable housing grant will be limited, so it must be effectively utilised, and part of this should involve attracting additional private capital into the market to maximise the delivery of new affordable homes. For example, via models such as For-Profit Registered Providers (FPRP) and joint ventures with local authorities or housing associations. This includes private investors becoming increasingly prominent as developers and owners of affordable homes and partnering with housing associations to provide housing management services. Such arrangements can effectively enable housing associations to facilitate the delivery of more homes without further borrowing[10].

In England, close to 14,000 homes are currently owned by FPRPs[11] but the rate of growth has been robust in recent years (see Figure 6) and looks set to continue.

10 *UK Social Housing: Building a Sector Standard Approach for ESG Reporting (White Paper), The Good Economy: May 2020.*

11 *Private registered provider social housing stock in England - sector characteristics and stock movement, 2020-2021, Regulator of Social Housing: October 2021.*

Figure 6: The Growth of For-Profit Registered Providers



Source: Regulator of Social Housing, October 2021

AFFORDABLE HOUSING IS AN ATTRACTIVE MARKET FOR LONG-TERM INVESTORS

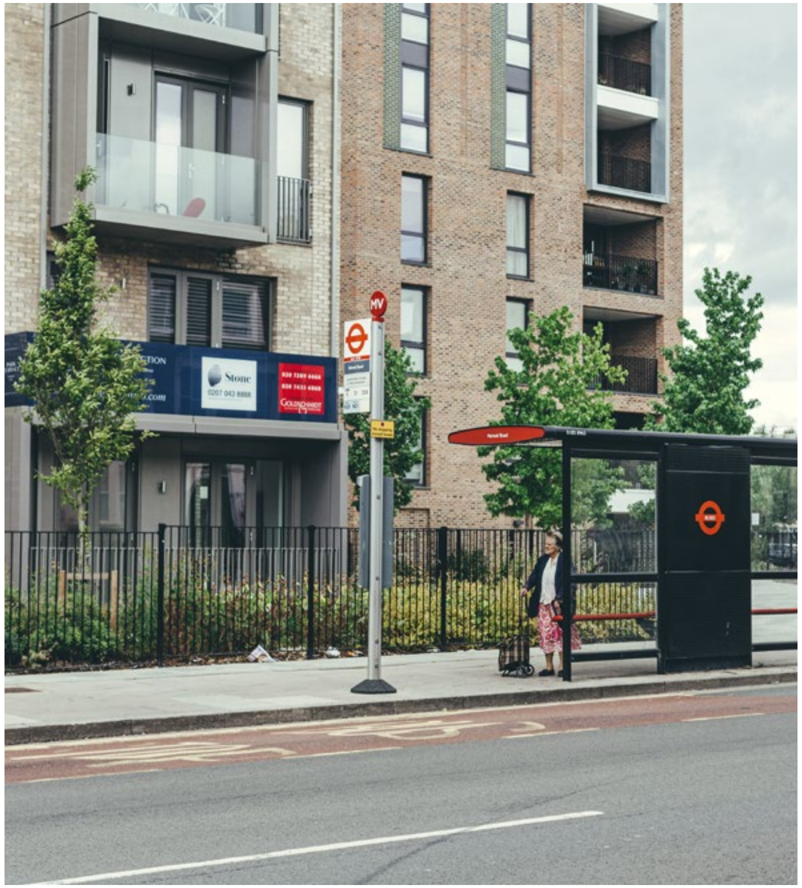
Private investment into affordable housing is not new. Private capital has, for a long time, been heavily involved in debt financing via the bond market for housing associations, so the fact that long-term investors are now seeking to own affordable homes is a natural evolution. Investors should welcome the opportunities the affordable housing market can provide as it lends itself to an attractive investment proposition. For example:

- Affordable housing is viewed as an impact investment, which can enhance investors' Environmental, Social and Governance (ESG) credentials.

- Demand for affordable housing is inelastic because of long waiting lists and with voids and bad debts being low, it makes such investments a relatively "safe bet", particularly as the sector is underpinned by regulation and Government support.

- The general stability of the income stream and the inflation-linked nature of investing in affordable housing is perfect for matching long-term pension liabilities.

- Affordable housing is considered counter-cyclical as occupier demand is less correlated with economic cycles.



THE DIFFERENT STRUCTURES FOR PRIVATE INVESTMENT INTO AFFORDABLE HOMES

1. For-Profit Registered Providers

Several investors such as L&G, M&G, Man Group and Blackstone (via its acquisition of Sage Homes), amongst others, are investing using FPRPs. They are taking a direct approach to investing into the sector whereby they will develop and hold affordable housing. Management can be undertaken in-house or outsourced to another provider. For example, L&G have partnered with 14 housing associations to manage their homes on its behalf.

2. Partnerships between investors/developers and local authorities

Estate regeneration is a good example of a long-standing form of investment by the private sector into affordable housing. To take but one of numerous examples[12], the Royal Borough of Kingston Upon Thames is partnering with Countryside to redevelop the Cambridge Road Estate, delivering approximately 2,170 homes, including a minimum of 114 additional affordable homes[13].

In addition to the many wider socio-economic benefits derived from estate regeneration, such partnerships also enable the public sector to access private capital and the skills and resources of partners which they may not otherwise have.

Another example of collaboration between investors and local authorities is the ongoing partnership between L&G and Croydon Council on the borough's residential portfolio. The council is using L&G investment to support their temporary accommodation needs with a portfolio of homes leased to and managed by Croydon Council for 40 years, after which ownership will transfer to the council's pension scheme for a nominal cost. Rents to L&G are set at below half of the Local Housing Allowance level, meaning that the council will receive a surplus during the lease period while investors receive a stable and steady return on investment.

12 *For further examples of estate regeneration schemes involving partnerships see Estate Regeneration, More and better homes for London, London First, Winckworth Sherwood, Terence O'Rourke: January 2017.*

13 *For further details see: www.cambridgeroadestate.com/regeneration/about*

3. Partnerships between housing associations and investors

Investors are also increasingly forming innovative partnerships with housing associations such as that formed between Hyde and M&G in March 2021 to build 2,000 shared ownership homes. Investment is also being secured into the sector via fund structures like CBRE Investment Management's (CBRE IM) £370m open ended UK Affordable Housing Fund (AHF). The AHF invests in housing stock in the UK with the aim of having a significant social impact. It focuses on social and affordable rented housing, shared ownership as well as other tenures, such as key worker housing and homeless hostels. The fund is not set up as a FPRP and deploys capital into the sector by partnering with housing associations who manage stock on its behalf. This model may prove attractive to investors who want exposure to the sector but do not intend to set up their own FPRPs.

HURDLES TO OVERCOME: ADDITIONALITY AND SOCIAL PURPOSE

Securing more private investment into affordable housing is not a panacea to increasing supply. Some of this investment may compete with 'conventional' housing association investment and will not, therefore, be providing additional affordable homes. At this stage, in a relatively new market, there is also evidence that private capital is primarily seeking investment opportunities in particular types of affordable housing, notably shared ownership (see Figure 6).

Even if the current focus of private capital is on shared ownership, this is still providing much needed affordable housing. As the market matures, the appetite for a broader range of investment within the affordable sector will emerge. There is already evidence of this with investors such as L&G, Blackstone, Man Group, CBRE IM and Funding Affordable Homes seeking to create portfolios with a mixture of affordable housing tenures.

There are also innovative models coming forward that provide additionality in the affordable housing market. The aforementioned deal between M&G and Hyde Housing is a prime example, effectively leveraging existing assets and freeing up capital to invest in new housing stock.

While additionality is important to think about there is also a political dimension to consider. Affordable housing is rightly considered an important part of London's social fabric with politicians from all sides looking closely at both the type of homes being built in their area and how tenants are treated. In some quarters, there may be a concern about how the intentions of private capital can be aligned to wider social objectives, while making a fair return from their investment. However, there is good reason to believe there is strong alignment. For example:

- Investors are increasingly focused on ESG; particularly around the social impact from their investment.

- Many of the companies investing are providing patient capital, wanting to see a return over the long-term, and understand the importance of maintaining the value of an asset and providing good customer service. These investors place a high value on their brand and reputation.

- There are also several examples of public sector pension schemes investing in funds or partnerships run by a private sector entity investing in affordable homes. This includes:
  - The Hammersmith and Fulham Pension Fund and Swansea and Strathclyde Local Government Pension Scheme (LGPS) have invested in the Man GPM RI Community Housing Fund which has raised £400m. The fund has also seen investment from Homes England, Big Society Capital and the Schroder BSC Social Impact Trust[14].
  - The Cambridgeshire and Northamptonshire LGPS funds invested nearly £100m in the M&G Shared Ownership Fund[15].
  - PGIM has seen commitments to its affordable housing fund from local authority pension asset pools, including the Northern Pool and the Brunel Pension Partnership[16].

14 Pensions expert, Pension funds poised to help social housing crisis, 23 September 2021.

15 PE Real Assets, LBHF Pension invests in Man Group's UK affordable housing fund, 9 June 2021.

16 Brunel Pension Partnership is comprised of ten LPGS funds and has approximately £30bn in assets under management.

MORE OF THE SAME OR A NEW APPROACH?

While it is welcome that the Government continues to fund an Affordable Housing Programme, the level of current investment is only scratching the surface of affordable housing need in London. In the short to medium term, there seems little prospect of significantly more funding from Government. When this is combined with the headwinds facing housing associations, forcing them to reappraise their development pipelines, the future looks challenging. This is not to say that the current system won't deliver more homes, but the volume won't be enough to solve London's chronic housing crisis.

So, there is a choice: more of the same or a new approach – one that continues with the existing models of investment into affordable housing supplemented by a conscious move towards securing more private investment into the sector. There is no shortage of private investment that could be deployed into affordable housing. The question is, do politicians want this investment to happen at scale and are they willing to proactively shape the market? The investment that has happened to date is welcome but, in some instances, it has almost been achieved in spite of public policy.

The opportunity now exists for national, regional, and local politicians to increase the delivery of affordable homes through attracting more private investment and, crucially, deliver positive social outcomes from such investment by guiding how it is deployed.

WHAT SHOULD CENTRAL GOVERNMENT DO TO SECURE MORE PRIVATE INVESTMENT?

Our recommendations are as follows:

Transparency in rules setting: The rent regime must provide certainty to long-term investors. In 2015, the Government changed its rent settlement at short notice requiring rents to fall by CPI – 1% for a set period and, at the time of writing, the Government is consulting on introducing a 5% ceiling, due to exceptional inflationary pressure, to annual rent increases from April 2023 to March 2024 previously fixed at CPI +1% as part of a long term settlement[17]. This The changes in 2015 caused significant disruption to the sector and if it were to happen again, while it is right to look at rents in the current extraordinary circumstances, it's likely that any change made this time round will also this will have an impact , it would dent the confidence of investors. Indeed, the Government acknowledges that its proposed changes will leave Registered Providers, "with less money to invest in providing new social housing, improving the quality and energy performance of their existing homes and providing services to tenants."[17] In the future, there would be considerable benefit in extending the length of time rent settlements last[18].

Level the playing field for all providers of affordable homes: One of the key differences and potential drawbacks of being a FPRP, as opposed to a Registered Provider (RP), is when it comes to grant liability (either from Homes England or GLA) and how the grant is treated and repaid. Unlike RPs, FPRPs are liable to repay grant funding they are in receipt of when a trigger event occurs – which includes staircasing (whereby owners of grant funded shared ownership properties buy further shares in the property), the disposal of grant funded properties or if the tenure is changed.

Tackling unnecessary bureaucracy: Establishing a RP is often a timely process, sometimes taking up to two years to set up. Over time, this process must be streamlined while ensuring that appropriate regulation of the for-profit sector remains in place

17 www.gov.uk/government/consultations/social-housing-rents-consultation

18 On the financial benefit of extending the length of the rent settlement see: Delivering a Step Change in Affordable Housing Supply, British Property Federation and Legal & General: March 2022.

A need to improve familiarity with new models: Some private investors have insufficient knowledge of the new models to be comfortable investing. In addition, a lack of familiarity from local authorities and RPs in these models can lead to suspicion and a reluctance to engage with investors. Central government, potentially through Homes England, could do more to educate other public bodies and investors on the merits of investing into the sector. Furthermore, the Regulator for Social Housing and Homes England could develop a best practice framework for private capital investing into the sector, as well as guidance for RPs and local authorities.

Reviewing approved providers: Once familiarity with new models has improved, central government should require local authorities to review their approved provider lists to ensure that barriers, whether real or perceived, which may prevent a new participant from providing affordable housing in a particular area are removed.

WHAT SHOULD LONDON GOVERNMENT DO TO SECURE MORE PRIVATE INVESTMENT?

The GLA has a good track-record of innovation when it comes to affordable housing having originally introduced the concept of strategic partnerships for affordable housing delivery, whereby affordable housing grant is provided to partners in a programmatic manner rather than on a piecemeal basis. Likewise, London's boroughs are innovating having set up Capital Letters[19] in 2019 to find private landlords with homes and partner them with local authorities to provide housing for families to move out of temporary accommodation.

Building on this innovation, outlined below, are two high-level proposals for how the GLA, in partnership with other organisations, could leverage its position of leadership in London and its affordable budget to attract more private investment to support the delivery of affordable housing in the capital. Further detailed analysis would be required for both proposals, but they provide a sense of what is possible if a concerted effort is made to leverage private investment into affordable housing delivery.

19 *For more about Capital Letters see https://capitalletters.org.uk/*

1. Capitalisation of rental income

Summary

Approximately 810,000 homes are owned by local authorities, other public bodies and housing associations in London[20]. Taking the average value of an affordable home to be c.£83,000 it could mean that the capital has affordable housing stock worth c.£67bn which in turn generates a surplus income stream of c.£2bn a year[21]. The capitalisation of rental income model (Figure 7) uses private capital to release value from existing homes to fund more housebuilding – similar structures have previously been used to deliver affordable housing.

20 *Table 100 Dwelling stock: Number of Dwellings by Tenure and district: England, 2020, DLUHC; latest update November 2021.*

21 *The £83,000 is a proxy figure based on Existing Use Value Social Housing Basis rather than an open market value which could be significantly higher. All figures are derived from the values in Table 1 on page 8.*

The proposal

Assuming that the properties generate a surplus, whereby the rental income exceeds the costs of repairs, management and maintenance, it could be possible to sell a proportion of the surplus income to an investor and use that money to build more homes. This is a faster way to use the surplus rental profit that would typically take 20-30 years to accumulate sufficient capital to harness. The public sector would not have to guarantee the rental income, although guaranteed income would attract the keenest prices, rather the private sector would share in the risk and reward of providing affordable housing[22].

There are several points of detail which would need to be developed further including:

- Finding the right arrangement for a deal with several possible options. Individual councils or RPs could proceed on their own, groups working collectively based on geographic proximity, or more ambitiously, the GLA could seek to coordinate a pan-London approach.

- Getting the correct structure in place. The homes would not necessarily have to be transferred into a vehicle to facilitate this – it could be done via a non-recourse lease arrangement or another structure. This type of lease structure would not require the RP to guarantee the rental income; it is a means for enabling an entity to invest in the sector without having to become an RP. For example, there could be a LGPS that wants to invest in the delivery of affordable housing in its local area. The LGPS is happy to share in the risk of investing in the sector, and therefore does not require a rental guarantee, however, it is not an RP and prefers leaving the role of delivering and managing affordable housing to experts. This structure enables the LGPS to invest without adversely impacting the covenant strength of the RP.

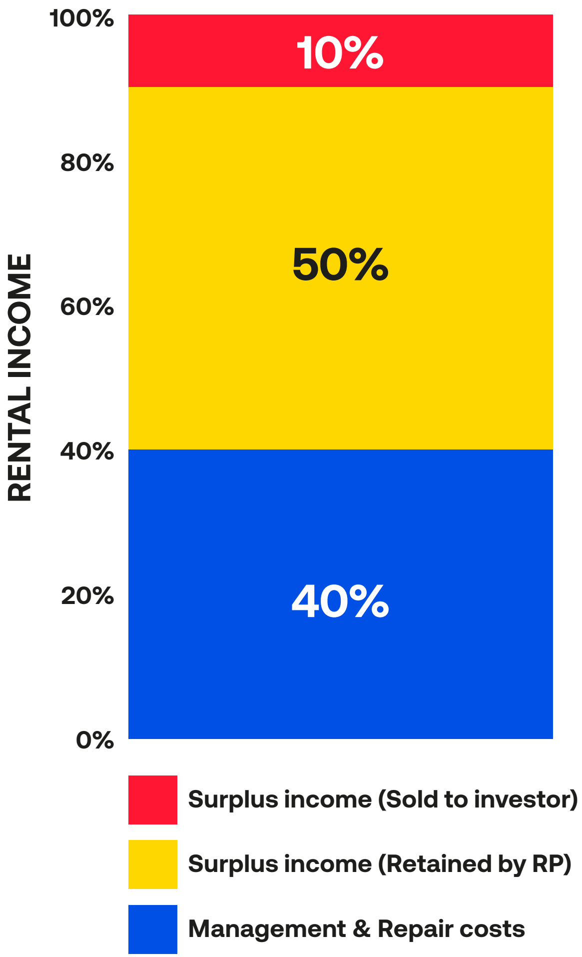
- Considering the legal ramifications of such an approach. As a concept, there would not appear to be any specific legal issues that make it a non-starter though that would need to be tested further including any nuances around who owns the homes (i.e. a local authority or RP).

The purpose of the capitalisation of rental income approach is to leverage in additional private investment for affordable housing at a faster rate than may otherwise occur. The approach would not impact on those living in the affordable homes – management activity would still be undertaken by the local authority or RP. Indeed, doing this type of deal could provide both more capital to enable improvements to existing homes, realising benefits to the current tenants, as well as the investment needed to build new affordable homes.

Theoretically, if 10% of the surplus income was capitalised from London's current affordable housing stock, £5bn of capital could be raised which in turn could enable the delivery of 20,000 more affordable homes.

22 For example, Long Harbour worked in partnership with the London Borough of Barking and Dagenham and Laing O'Rourke to build 477 affordable homes. Long Harbour structured and financed the design, planning and construction of the scheme. See https://www.longharbour.co.uk/barking-and-dagenham/

Figure 7: Capitalisation of rental income



Source: CBRE 2022

2. Ringfenced "top up" grant

Summary

This proposal would widen the scope for how the GLA deploys its affordable housing programme money. A proportion of grant monies could be ringfenced to support the delivery of housing schemes that have scope to deliver a greater proportion of affordable housing, and are deemed to be marginal from a viability perspective but would be deliverable with a grant "top up". To maximise the benefit of this ringfenced allocation, a key condition for its use would be that the "top up" is repaid upon stabilisation of the completed development, which is earlier compared to how grant is recycled under existing rules. For example, in circumstances where a developer's expectations of a scheme's value is marginally higher than that of an affordable housing provider, the GLA could step in to bridge the funding gap to support affordable housing being delivered. Once the scheme has been built, with the homes sold (shared ownership) and rented, the scheme is re-valued. The monetary differential between this valuation and the affordable housing provider's original valuation is returned to the GLA, with this money recycled into sites viable for affordable housing delivery (see Figure 8).

The proposal

In some instances, developers are willing to take a reduced value for a scheme in exchange for a guaranteed exit, providing that the transaction is economically viable for them. Using grant funding to convert private developments to affordable housing is a practice that is already undertaken, but more could be delivered with additional grant. This is not, however, without its challenges, which include:

- Finding the right price point for the developer to sell the site – typically this needs to equate to 80 to 90% of the open market value to make it economically viable.

- Finding the right price point for the affordable housing provider. They need to transact at a level that is financially prudent and deliver a scheme that has the right mix, tenure and density of homes in order to meet local housing need.

- Ensuring that all parties are happy with the approach to shared ownership homes within the scheme. To date, investors have favoured this type of affordable housing, but RPs have to be cautious about their total exposure to shared ownership and sales in general as it comes with risk, and if they are deemed by the regulator to have too much sales exposure their ratings can be downgraded. All parties therefore need to agree that the estimated sales prices can be achieved as it may be 18 months to 2 years (or longer in some instances) before the scheme is developed[23].

- Ensuring that such an approach, including the counting of outputs and the management of cashflow projections, is in keeping with the rules governing the deployment of money through the GLA's Affordable Housing Programme. Where divergence may be required from the current rules, the case could be made to government on the basis of the additional benefit the new approach will deliver.

In this proposal, additional grant funding is provided to schemes that are on the cusp of being viable for a 100% or predominantly affordable housing scheme but where there is approximately a 5% to 10% difference in pricing between the affordable provider and the developer. In the GLA's Affordable Housing Programme[24] (2021 to 2026), grant is only repaid if a trigger event occurs, such as a shared owner opting to acquire an additional stake in their property. However, in this proposal the top up grant is repaid when the scheme has stabilised - i.e. the shared ownership homes are sold and the rented homes let. Upon stabilisation, the scheme would be subject to an independent valuation with grant recovered at a rate of 100% above the value agreed with the affordable provider.

For example, if a scheme's value pre-grant was estimated by the affordable provider to be £9m, the developer's market value of the scheme was £11m, but £10m was the figure it was willing to transact at, the GLA could provide £1m of top up grant to support the transaction. If at stabilisation the scheme was valued at £9.75m, the £0.75m uplift would be repaid to the GLA and reinvested into another scheme. The remaining £0.25m could be recovered as per the existing grant recovery rules (e.g. a trigger event occurs as highlighted above).

Prior to any top up grant being provided, comprehensive due diligence would need to be undertaken to verify the accuracy of the assumptions being made by the parties to ensure that value for money is achieved. There is, of course, a risk that not all of the top up grant will be recovered (though if underwritten properly, this could be

23 With regard to rented affordable homes, investors will normally apply a higher yield to them if they are required to take construction and lettings risk. However, once a scheme is built and let (i.e. 'stabilised') it is generally viewed as a safer investment and the yields will be lower as a result.

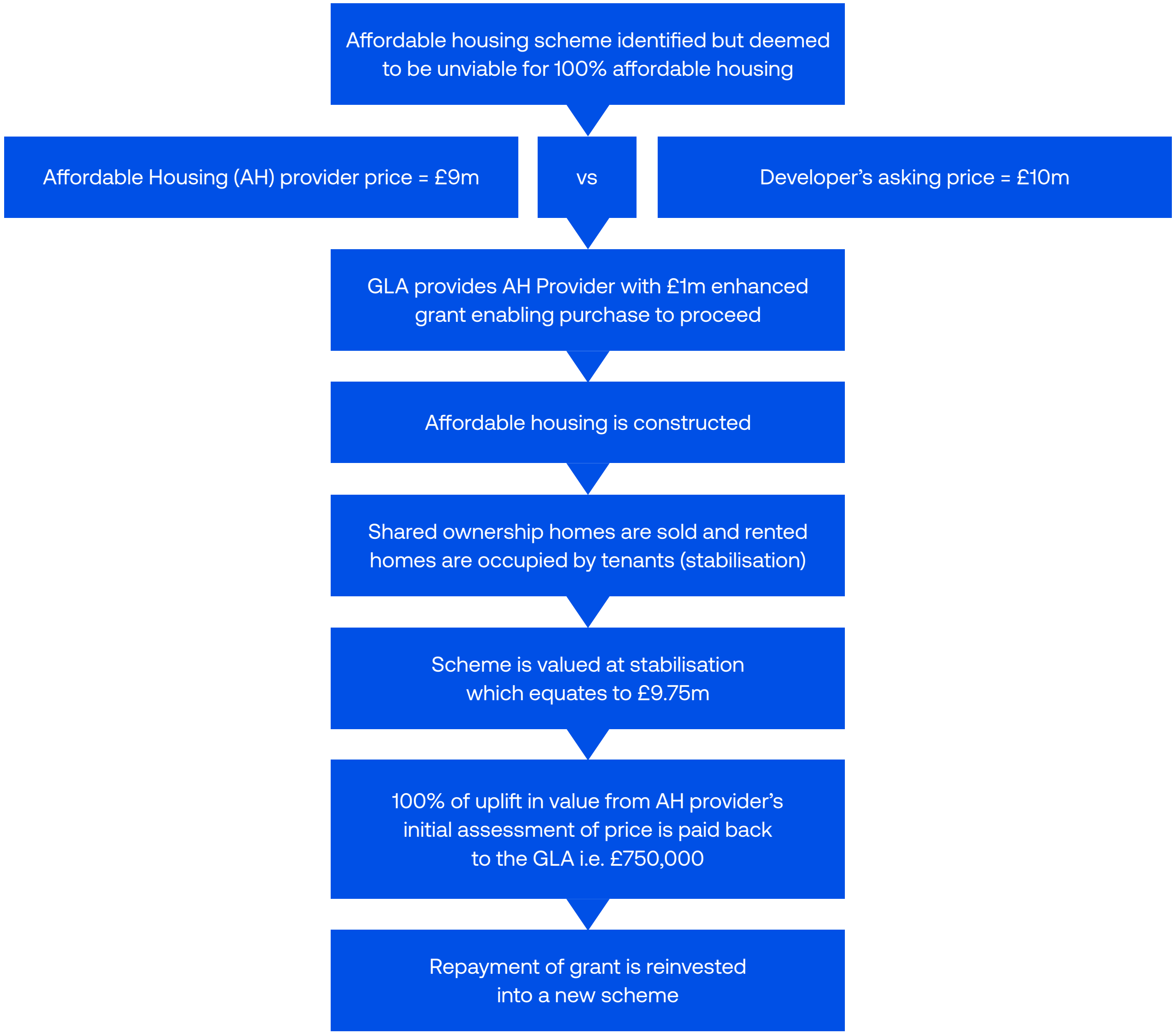
24 The point also applies to the 2016-2023 Affordable Housing Programme which was extended due to the pandemic.

minimised) and the ringfenced top up monies could eventually be totally used. However, even if that was the case, the benefit of more affordable housing would have been delivered, particularly if the top up grant can be recycled multiple times before it is eroded.

This proposition could be used by both RPs and private capital. As highlighted at the start of the report, housing associations are increasingly constrained in their ability to develop new affordable housing due to the cost of addressing fire safety works and the decarbonisation of existing homes, therefore enhanced grant would help them to increase affordable supply. But the proposal could also be instrumental in attracting more private capital as the financial risks of delivering affordable housing will be mitigated to a degree and the prospect of deploying capital at scale, by having a greater pipeline of schemes to invest in, are enhanced.

In the first instance, the GLA should trial this approach with a c.£10 million ringfenced top up allocation to test the concept. If proven to work, the allocation could be scaled up accordingly.

Figure 8: 'Ringfenced "top up" grant flowchart'



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