IN FOCUS

FOR-PROFIT AFFORDABLE HOUSING

May 2024

Centrus

A challenging landscape lined with opportunity

Introduction

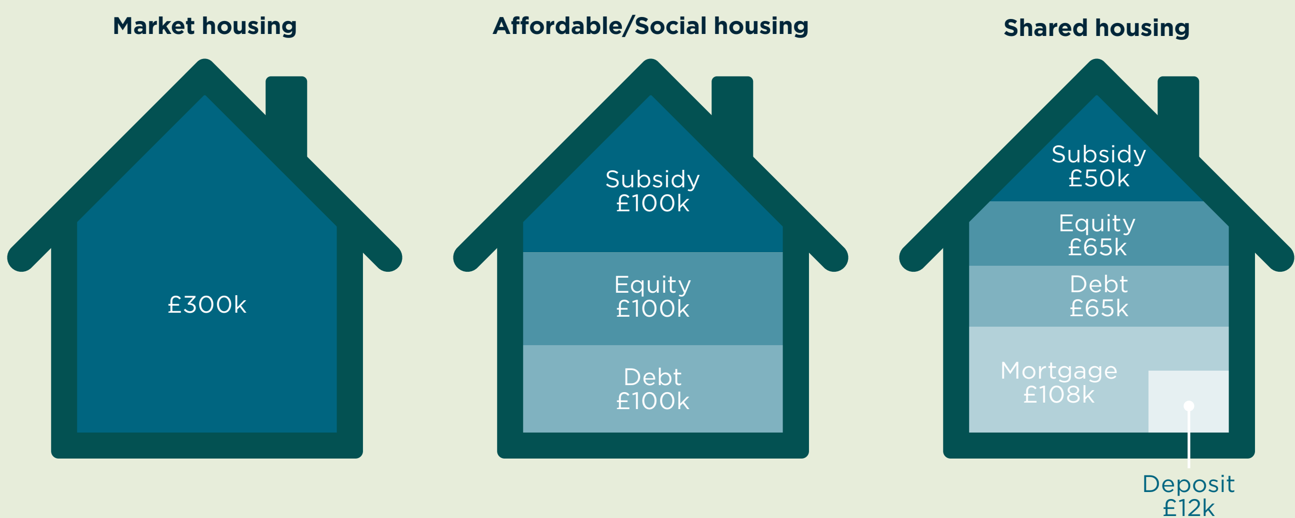
For-Profit Registered Providers (FPRP) have prompted a significant shake-up of the UK affordable housing market. But the landscape is an unusual one. At present, a majority of providers are small developers, yet a significant majority of the stock is with a few larger institutions – and there have been few trades between FPRPs, a function of the nascent nature of the sector.

Analysis based on Savills research earlier this year suggests 39% of the 70 registered FPRPs are independent developers, yet they account for only 6% of homes. In comparison, 90% of all stock is owned by institutions, despite the fact that they make up less than a quarter (21%) of the FPRPs; highlighting the weight of capital residing with the institutions.

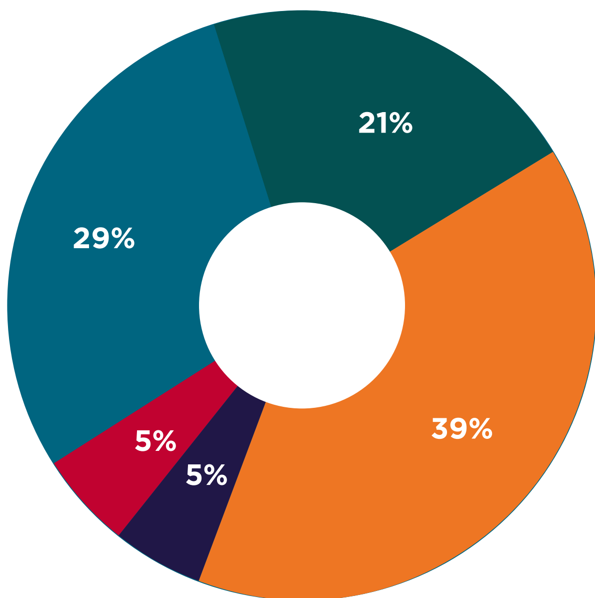
Recent successful fundraisings of c £250m in aggregate by the likes of Octopus, Savills Investment Management and Edmond de Rothschild, reflect a growing appetite by institutions to access this sector.

For-Profit Affordable Housing – how it works

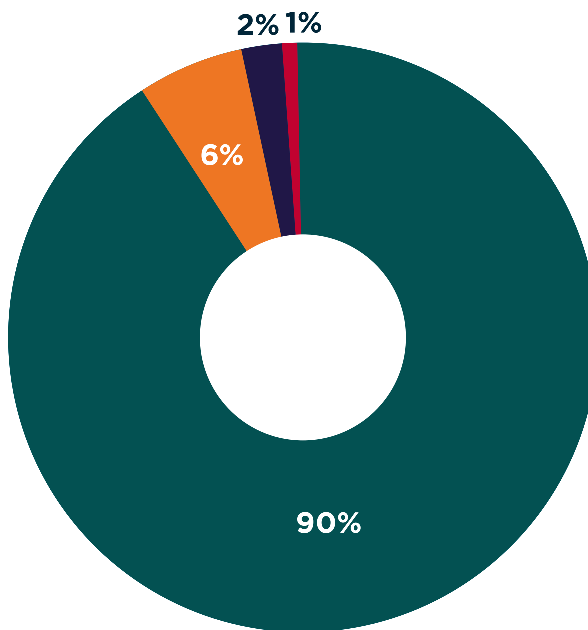
Illustrative examples of capital structure for the two main housing schemes offered by For-Profit Housing Associations: affordable housing and shared ownership, assuming 50% gearing.



Number of FPRPs



Number of homes



- Institution
- Developer
- Private Equity
- Housing Association/Local Authority
- Independent

Source – Savills Research 2024

Investors have been closely monitoring the growing appetite from housebuilders to do packaged deals as witnessed by Vistry/Sage/Leaf Living, the Blackstone-backed platforms for affordable and single-family rental housing, striking an almost 3,000-home transaction towards the end of last year. Similar deals have been announced between Vistry and housing associations (Clarion and Abri) as well as with Homes England, totalling c 2,700 homes. Given how focused investors are on the scalability of these platforms, accessing new-build homes directly from housebuilders is central to their growth strategy.

Similarly, the market has caught the attention of institutional investors looking for a long-term return, many of which, aside from unlocking deals with housebuilders, are also seeking to take advantage of the increased appetite from existing housing associations to form partnerships to deliver new schemes or recycle old stock.

At Centrus, we are on a mission to build a better society, by delivering the sustainable funding that essential services – such as affordable housing – need to thrive in the long term. As the first instalment of our In Focus series, this white paper will take a look at the market challenges and the impact on housing supply, as well as the opportunities, demand and potential benefits of partnerships between investors and housing associations.

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Challenges leading to a reduced supply of housing

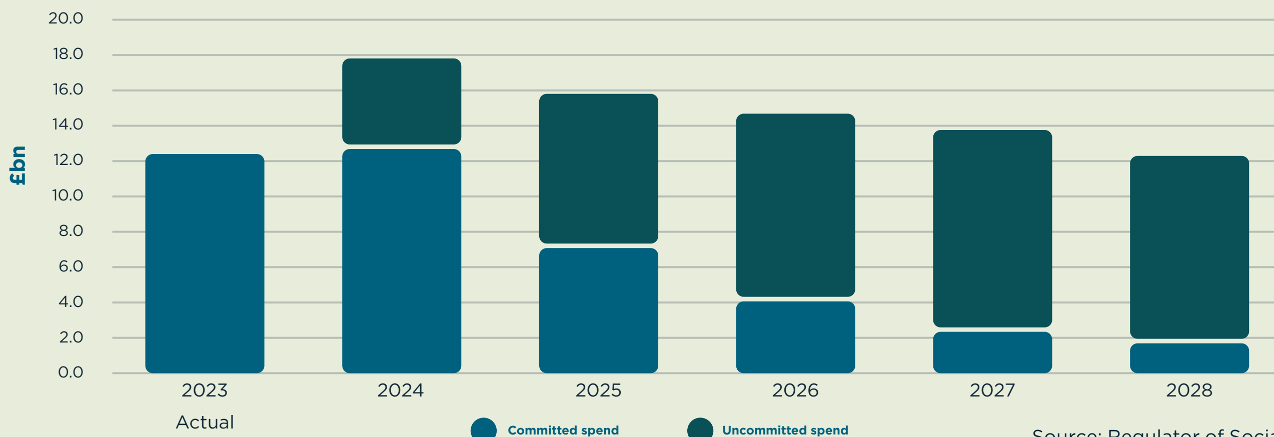
There's no shortage in demand for houses. The National Housing Federation stated that England needs 145,000 new affordable homes per year. However, a turbulent economy, the high interest rate environment and fiscal constraints are combining to prevent what would otherwise be a major public sector-funded housebuilding programme. Following more than 15 years of a sub-1% bank rate, the markets now expect rates to settle at around 4-5% for the foreseeable future. As well as making borrowing much more expensive, this has also had an impact on land prices, which still remain high and have not adjusted to the new rates environment.

"Higher interest rate environment and increased build costs, although there has been some stability more recently, and a slowdown in the for-sale housing market, have led developers, housebuilders and housing associations to pull back on new development activity. However we are now beginning to see early evidence of acceptance of the new reality of higher-for-longer interest rate levels and a pick-up in deal activity."

"The UK For-Profit Affordable Housing sector is primed for a multi-year investment boom, with institutional investors and platforms vying for early mover advantage."

Phil Jenkins, CEO

Planned development spend



Source: Regulator of Social Housing FFR 2023

> "Only 24% of the Housing Authority forecast spend is committed. £15bn out of £62bn, over the next five years, significantly lower than the % in 2021."
>
> **Omer Fazal**
> Managing Director
> Head of Real Estate

The impact of this has been especially prevalent for traditional housing associations. Whereas overall planned development figures across the industry over the next five years are down c 16% according to financial forecast returns (FFR) data, traditional housing associations have lowered plans by 18%; revising initial plans for 365,000 units down to 301,000.

Another key indicator of heightened uncertainty demonstrated by the FFR data, is the committed spend. From 2023 to 2028, committed spend makes up only 37% of the forecast spend, accounting for £28bn of the forecast £74bn. This is also changing the forecast make-up of housing types, with a predicted 25% reduction in units developed for outright sale, while sub-market rent development is down 17% and low-cost home ownership (LCHO) down by 12%.

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Challenges faced by housing associations and local authorities

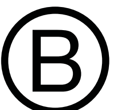
Both associations and local authorities are also feeling the impact of financial constraints. Housing associations are particularly under pressure, while local authorities are grappling with financial capacity and shortages in both skills and resources.

One of the biggest pressures being applied, stems from soaring repair and maintenance costs, which has made up an increasingly large part of spend for housing associations. Spending on repairs and maintenance jumped by over £1bn from £6.5bn in 2022 to £7.7bn in 2023, and more than £2bn in a four-year period from £5.4bn in 2019.

The interest cover, a key metric for housing associations and their credit quality, is currently at the lowest rate since the late 2000s, evidenced by a drop from 153% EBITDA MRI interest cover in 2019, to 103% in 2023. The all-in interest costs for housing associations have more than tripled, with new marginal cost of debt close to 5-6%. While housing associations are generally well hedged, the significant increase in interest rates is also placing further pressure on forward-looking business plans. EBITDA MRI interest cover ratio – a key credit metric which looks at cash available to cover interest expense after repair and maintenance spend – is down from 2.5x cover to 1.25x for 2024, according to forecasts from 2021 to the latest in 2023.

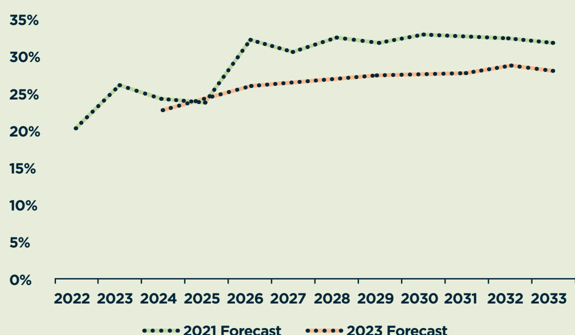
"We have seen a material jump in repairs spend: £7.7bn in 2023, up 18% from 2022 and 43% from 2019, driven by cost inflationary pressures and regulatory push to improve stock condition. This has put increased pressure on HA's credit capacity and amplified the dependence of the capital structure on debt and subsidy"

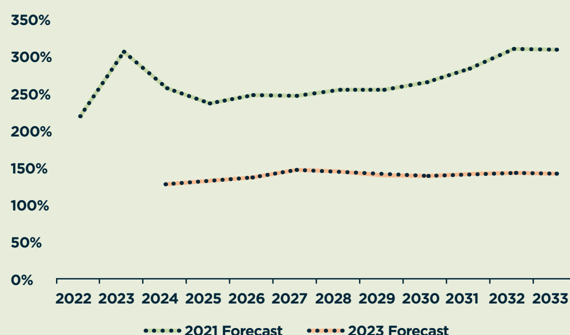
Omer Fazal
Managing Director
Head of Real Estate

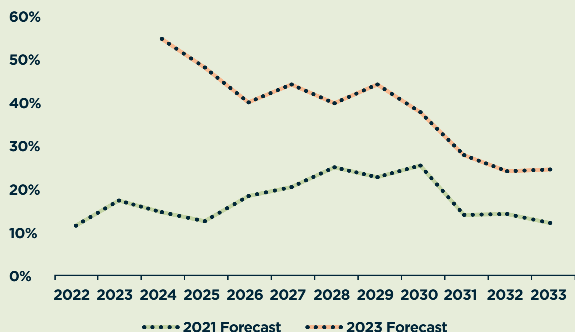


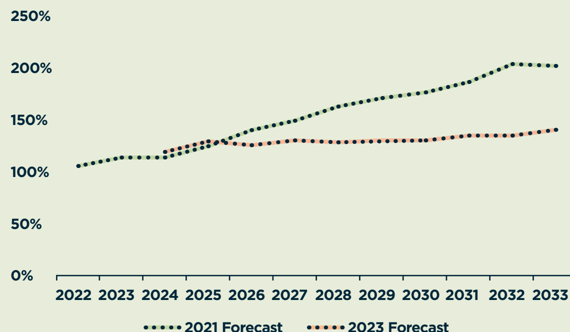
This gives a partial explanation as to why housing associations are prioritising existing stock over development. Since 2018, prioritisation of existing stock skyrocketed from 34% to 95% in 2023, showing how much of a barrier rising repair and maintenance costs are having on further investment and development. Though increased costs are a driving factor, regulation of the quality of homes (such as the Decent Homes Standard), fire safety regulations, and a large proportion of stock being under-invested, have also contributed to challenges over the past few years.

EBITDA MRI ICR forecast for 2024 has dropped from 2.57x in 2021 to 1.28x in 2023









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Market opportunities and demand

While housing associations and local authorities have remained under pressure, opportunities have opened up for new entrant investors. As traditional housing associations have dialled down their development forecasts, in contrast for the for-profit sub-sector, providers are forecasting a slight rise in development over the next five years – expecting 33,000 units compared to an initial estimate of 31,000.

The investment opportunity here has not gone unnoticed, especially among investors looking at new-build programmes, working to take up s106 allocations, or eyeing up existing stock for retrofit investment.

The critical investment context here is unwavering demand. The housing market for new-build property has been adversely affected by mortgage rate rises, which has led to a lower delivery of stock from housebuilders in the open market. On the other hand, a multitude of households are on the waiting list for social and affordable rent in England, and shared ownership offers a less expensive way into home ownership.

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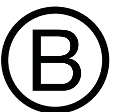
The outstripped demand has led some of the more established FPRPs to agree packaged deals with housebuilders, such as the £819m deal when Vistry, partnered with Leaf Living and Sage Homes to deliver 2,900 homes, with 48% of those being affordable. Given the subdued nature of the current private sale marketplace, this is something we expect to see more of.

Anecdotally, some FPRPs are at the early stages of exploring the retrofitting opportunities, including larger FPRPs which have a wider array of investments including renewables and clean tech. They can consider bridging these skillsets from across their portfolios to maximise these opportunities and take older stock from stretched housing associations.

"The Sage-Vistry deal from last year is a prime example of market participants coming together to unlock much-needed new housing, which is 49% below estimated housing need. Given the large land banks, pipelines and development skillsets embedded within HAs, we see in partnerships a win-win-win for long-term capital, HAs and communities."

Omer Fazal
Managing Director
Head of Real Estate



Benefits of partnerships

Housing associations

Partnerships between investors and housing associations can be fruitful for both sides. Housing associations receive access to necessary investment capital and market-tested risk and governance processes, while providing expertise and skills to developing and managing housing on a scale which private capital tends not to possess. Investors can also bring in knowledge and experience from other sectors, and aid the growth of operational platforms, ultimately contributing to increased output and driving economies of scale. The recent partnership between the Greater London Authority, Berkeley and Homes England provides a good example of a strategic partnership to this effect.

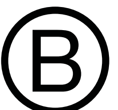
Investors

Investors gain rapid access to existing products, which enables accelerated growth, especially when coupled with the expertise provided by housing associations and local authorities, which have experience in operating within a regulated and reputationally sensitive sector.

Being involved with housing associations who work in the non-profit space adds credibility to development schemes, and also provides investors with an opportunity to align their ESG targets and societal purpose. Housing associations are now also a lot more open to the prospect of a partnership; according to Savills' Private Capital in Affordable Housing spotlight report, released in 2023, 89% of housing associations would now consider some form of partnership with an FPRP, with 43% already partnering with one in some capacity – a stark contrast from the previous year, in which only 62% agreed that FPRPs had any form of role in solving the housing crisis.

89%

of housing associations would now consider some form of partnership with an FPRP



Conclusion

It's clear that the past few years have thrown up a number of challenges that have stunted progress. Despite that, there is a large addressable market, with stretched housing associations and a tight lending landscape, which will open up the possibility of beneficial partnerships and will in turn work to address housebuilding shortages.

Despite the trials and tribulations, the outlook remains positive. Savills estimates that by 2028, there'll be roughly 100 FPRPs, with 113,000 units – a significant rise from 2023. This will go a long way to addressing the urgent requirement for different housing options, and will see a substantial increase in low-cost home ownership units.

However, while private capital can plug the gap, it cannot plug any subsidy gap that currently exists in the financially constrained environments. Investors will need to gauge appetite, and assess areas in the market where a partnership can bring worthwhile benefits to both themselves and housing associations and local authorities.

At Centrus, we are a leading financial advisor in the affordable housing sector, having completed and advised on since 2021 on: 14 housing association mergers covering c 340,000 units, c £12 bn of debt capital[1] for HAs and c £360m for FPRPs, and are actively supporting HAs and private institutional capital providers and FPRPs on strategic projects and capital raises.

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