

## **FUNDING FOR AFFORDABLE HOUSING : CHANGING REALITIES, CHANGING MARKETS**

By Ian Blelloch ACA LLB, Director, Chaco Ltd,

*This article is the second in a series sponsored by South East-based law firm DMH. The first article appeared on .....2003 and covered over-arching issues in the provision of affordable housing in the region. The series is based on the outcomes of a conference held by DMH earlier this year on "Affordable Housing In the South East : Improving the Supply".*

Private funders' perspectives are critical to any discussions about improving the supply of affordable housing in the South East.

This article considers four key questions and then goes on to explore how local authorities can facilitate the process, rather than acting as developers and owners, and support for this option.

### **Who are the private funders?**

Raising private finance for property transactions in the early 1990s was a very real challenge, as lenders and borrowers emerged battered and bruised from one of the worst property slumps since the end of the Second World War.

Since then, however, banks, building societies and institutional investors, the major providers of finance, have funded a booming housing market.

- Lending by **banks** and **building societies** has risen dramatically with the recovery of the property market, the emergence of a significant buy-to-let borrowing market and the success of the lending market in funding housing associations following the 1988 Housing Act.
- **Institutional investors** investing in property have seen the returns emerging from yield and capital growth comparing well to more traditional investment classes, particularly equities.

### **What is affordable housing?**

Circular 6/98 provides the following definition:

“ ‘affordable housing’ or ‘affordable homes’ ... encompasses both low cost market and subsidised housing (irrespective of tenure, ownership or

financial arrangements) .... to people who cannot afford to rent to buy houses generally available on the open market.”

An analysis of changes in the balance of housing tenure in England over the last 60 years is also illuminating :

	1938	1980	1981	2000
Owner occupied	32%	44%	56%	68%
Private rented	58%	32%	13%	10%
Social rented	10%	24%	31%	22%
Total	100%	100%	100%	100%

*Source: David Parker 1998*

Owner occupation is now the predominant form of tenure in England and accounts for 68% of the available housing stock. The private rented sector and social housing/local authority housing sector is effectively being left to cope with every other form of housing demand, whilst controlling only 32% of the housing stock.

This wide-ranging housing demand can be divided into the following categories:

- 1) “On the cusp” – mobile workers and workers on short term contracts.
- 2) “Middle income” - income earners above housing benefit thresholds and key workers, the victims of marital and relationship break-ups, and aspirants to home ownership.
- 3) “Social housing” - tenants within housing benefit thresholds.

The definition of affordable housing clearly does not include those in a position to afford to buy or rent on the open market (i.e. owner occupiers or those described as “on the cusp” above).

However, the definition clearly does cover those on middle income earnings (i.e. mid-market rented accommodation and shared ownership/equity) and those eligible for social rented accommodation.

This is because both groupings need housing that is affordable at levels that are at a discount to market rates (either to buy or to rent).

### **Why would private funders invest in affordable housing?**

In other words, how can they receive a combination of yield and capital growth ?

Circular 6/98 again offers guidance:

“It is intended to: .... ensure that affordable housing delivered through the planning system is likely to be attractive to lenders of private finance.”

It is essential, as a result, for affordable housing to offer funders a viable opportunity to earn a combination of rental yield and capital growth with or without public subsidy.

Registered housing associations have demonstrated that affordable housing in perpetuity with grant support can be funded successfully. However, affordable housing in perpetuity without grant support is simply not attractive or viable to private funders. It is also worth considering whether the exploitation of capital growth could be used to reduce the amount of grant necessary to achieve affordability and thus procure a greater number of affordable houses.

### **When do private funders invest in affordable housing?**

The following models are likely to be attractive to private funders:

#### **1) Mid-market rented model**

It is perfectly possible to set an initial rent based on the amount affordable by a person or family on middle income earnings, and then link this to inflation over a period of 20 to 35 years – an “Affordable Period”. The housing is thus provided at a level that remains affordable in real terms over a significant period of time.

After the end of this period, the housing would be transferred into the private sector (either sold to the existing tenants or to a third party) at market value in order to realise a capital gain.

The private funders thus receive a combination of rental yield plus capital return. The public sector receives a tangible planning gain (20 to 35 years of affordable housing) for a minimum of public sector subsidy.

#### **2) Social rented model**

It is possible to refine the model outlined above into a social rented model by extending the “Affordable Period” to match Social Housing Grant, which is written off after 60 years. The resulting income stream would be attractive as a long-term annuity investment.

The issue here is whether social rented accommodation should remain within the public sector for perpetuity or whether, like the model above, it should be released in time into the private sector in order to realise capital value.

This is undoubtedly a highly emotive issue. However, the imaginative use of capital growth would reduce the amount of public subsidy required and increase the amount of housing produced.

### **3) Shared ownership model**

The private sector has successfully funded shared ownership schemes developed by housing associations, as part of The Housing Corporation's Approved Development Programme, since the early 1990s.

This has been possible because the funder receives a combination of rental yield (out of the rents paid by the tenant) and capital growth (from staircasing receipts).

The exploitation of capital growth in order to provide a return to the private funder ensures that a minimum of public subsidy is required to create housing affordable to the tenant group in housing need.

### **Local Authorities as Facilitators, not Owner/Developers**

There is no doubt that local authorities play a key role in the provision of affordable housing in the South East.

Many see themselves as under attack from the private sector generally, and from erosion of the remaining housing stocks in their ownership from tenant Right To Buy.

However, it is most unlikely that local authorities will become major developers and owners of their own housing stocks again. There is no incentive for HM Treasury to allow this to happen.

In the absence of public grant, affordable housing must offer a viable funding opportunity to the private sector if it is to be provided. Three models are summarised above that are viable and provide for a combination of revenue and capital returns. Other refinements and variations can be introduced as required so long as the essential ingredients of the funders return are present.

A realistic vision for affordable housing in the future comprises the creation of large pools of housing through the planning process, with new stock (predominantly funded by the private sector) being added to the pool as older units that have reached the end of their Affordable Period are sold off.

However, this can only happen if the planning process is used to create or facilitate viable funding opportunities.

Planners may see their role as securing housing for persons in need in perpetuity. Whilst this objective is laudable, this approach is likely to be doomed to failure because limiting the use of property in perpetuity ultimately removes the opportunity to use realised capital growth as part of the financial return to private funders.

## **Planning Appeals**

The question of perpetuity has been considered in the planning appeal process and appears to support the notion that affordable housing in perpetuity is not practicable and this hinders rather than improves the supply of affordable housing in the South East.

One specific ruling which is particularly relevant is that in connection with the Old Albanians Sports Ground (Appeal Ref: APP/B1930/A/01/1073344) :

“On permanence ... this is not a realistic objective for affordable housing even where a RSL is involved ... the scheme, in the hands of a RSL operating under the auspices of the Housing Corporation, would offer benefits to the District for a substantial period of 20 years.”

## **Conclusions**

There is undoubtedly appetite for - and capacity within - the private sector to fund affordable housing in the South East.

However, it is essential that affordable housing is seen as and does offer a viable funding opportunity.

It is particularly important that rental yield and capital appreciation can be utilised by the private sector in order to generate their required returns.

Tying up capital appreciation by restricting the use of affordable housing in perpetuity will serve to reduce, rather than improve, the supply of affordable housing in the South East.

Local authorities need to modify their positioning from being developer/owners in their own right to facilitators.

This will be essential if a pool of affordable housing is to be created offering a substantial planning gain in terms of its affordability and the period of time for which it can be used.

*(1452 words)*

The Author

**IAN BLELLOCH    ACA LLB**

### **Qualifications**

- LLB (Hons)

### **Experience**

- 20 years in senior management positions (7 at Director level, 3 in top public sector position, including directorship of a regional regeneration fund)

### **Relevant skills and experience**

#### **Strategic Management**

- Managing investment portfolios on behalf of 5 major property funds
- Providing strategic investment advice for various public sector bodies
- Working with various housing associations to secure funding alongside central government support

#### **Risk management**

- Developing innovative funding mechanisms for a major London Borough in partnership with a large social housing landlord, and a major regeneration fund backed by a RDA
- Management reviews of a blue-chip UK based bank's UK and global exposure
- External audit for an international accountants

#### **Financial modelling**

- Analysis of financial models for innovative social housing provision proposals
- Promotion via participation in various Conferences

#### **Delivery mechanisms**

- Involvement in set-up of an RDA backed fund
- Promoting the social housing sector to funds for the Housing Corporation

#### **Financial investment services**

- Training design and delivery to social housing landlords