

Mapping the Market: UK Social and Affordable Housing Funds

by Big Society Capital

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Introduction

Over the past decade, an increasing amount of capital has flowed into residential housing in the UK, helping to address the chronic undersupply of affordable homes. The National Housing Federation estimate that £12.8 billion is needed every year for the next ten years to adequately respond to this shortage. One solution is to grow the amount of private capital investing into the sector through social and affordable housing funds. These funds have clearly defined impact goals and are committed to impact measurement and management throughout the investment lifecycle.

The UK social and affordable housing funds market has grown substantially from virtually zero in 2012 to an estimated £2.9 billion by the end of 2020¹. Today there are approximately 16 managers running investment into a range of social housing funds on behalf of a growing number of institutional investors. This is a sector which has historically been funded by debt and is seeing increasingly flows of equity-like capital.

Increased appetite from private capital has been driven largely by investors seeking greater diversification and, attractive risk-returns which include:

- | Low correlation to other property markets and the wider economy
- | Steady long-term income, supported by government backed inflation-linked revenues
- | Long-term capital growth

This market mapping aims to support institutional investors and their advisers as they navigate this rapidly evolving market by:

- Outlining the range of strategies within the social housing funds umbrella
- Explaining the key drivers of impact, risk and financial returns
- Sharing our experiences in investing over £150 million into a range of UK social and affordable housing funds and our expectations of market growth going forward

Social and Affordable Housing is set to become an increasing part of investor portfolios – something that Big Society Capital is excited to support.

Due to a chronic shortage of affordable housing, there are over 95,000 households, including over 121,000 children currently spending each night in temporary accommodation in the UK, double the number ten years ago².

“Social and affordable housing investment done well offers institutional investors the potential to achieve their financial and impact objectives”

**Anna Shiel, Head of Origination
Big Society Capital**



1) Based on the Big Society Capital market sizing data. Separately, from the submissions we have received through our Request for Proposal issued in 2020, we also know that collectively, 19 of the funds are seeking to raise almost £10 billion.
2) UK Government, Live tables on homelessness (2021)

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What are social and affordable housing funds?

For the purpose of this mapping, we refer to social and affordable housing funds as investment vehicles that predominantly:

- Invest directly into UK residential property
- Provide “equity-like” finance to acquire or develop property through lease-based structures
- Provide homes for individuals who are not served by the private home ownership or rental markets
- Commit to delivering positive impact for people by delivering high quality, safe and affordable homes
- Apply an impact framework to investment decisions
- Commit to measure, monitor and report against intended impact

Non-housing focused real estate strategies such as urban regeneration or other types of social property such as healthcare facilities or student accommodation will not be a focus of this report.

“Equity-like” finance

Instead of providing loans, many social and affordable housing funds develop or acquire property for social use. The funds retain ownership and lease property to housing providers in return for a portion of rental income. In addition to leases, funds may also sign management agreements or joint venture agreements with housing providers.

Opportunity to generate impact and contribute to the United Nations Sustainable Development Goals (UN SDGs)

For investors looking to optimise for impact in their social and affordable housing portfolios, different impact strategies exist that all contribute to positive outcomes on people’s lives:

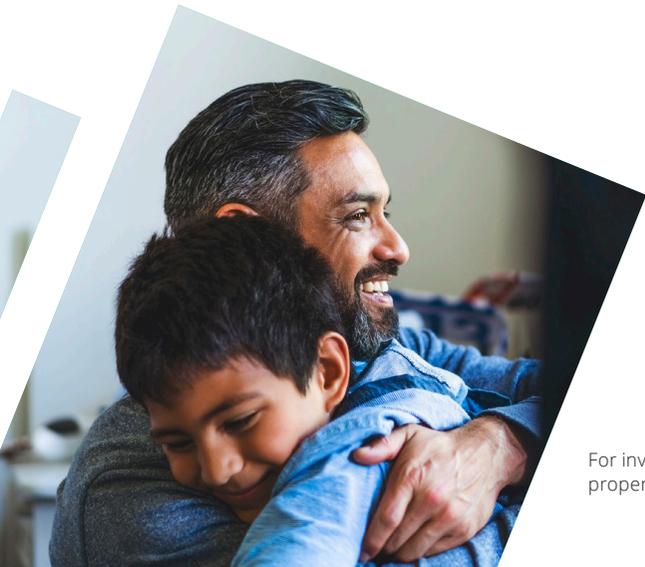
Increase supply	Target social need	Deepen affordability	Ensure quality services	Improve home and place
Deliver affordable housing that would otherwise not be built	Focus provision on addressing unmet national and local needs	Supply housing that is truly affordable to local people	Ensure providers deliver positive outcomes for tenants	Design the built environment for people and communities

Investors can use these strategies to set **impact objectives** that reflect the contribution they want to make to particular social issues such as the lack of supply, affordability or a lack of housing for vulnerable groups. These then provide the basis for impact reporting.

An increasing number of institutional investors are also seeking to explore whether their investment strategies can be aligned to UN SDGs and social housing offers an attractive opportunity to do so. Social and affordable housing funds usually directly tackle at least one of the UN SDGs and indirectly contribute to several including:



For investors, fund managers and housing providers interested in learning more about approaches to articulate, measure and report on social and environmental impact for social property funds, we recommend the Sustainability Reporting Standard for Social Housing (SRS) framework: <https://esgsocialhousing.co.uk/>



The financial case for social and affordable housing funds

1 Diversification

Social and affordable housing funds could act as a diversifier in investors' portfolios. There are two key contributing factors:

1. Low correlation to economic growth driven by a structural undersupply of affordable housing and the regulated nature of the sector insulating against sharp price movement.

2. Low correlation with the broader real estate sector including commercial property and private housing, as income levels are set by government policy.

2 Long-term index-linked income

Leases are typically structured for longer than ten years and rental growth is determined by government policy, which currently tracks CPI. Rent levels are typically reviewed on a four to five year basis, offering visibility for investors. The CPI forecast for the next five years is 1.4% higher on average than open market rental growth.

3 Significant need for private capital

There is a fundamental structural undersupply of housing, one that has accumulated over the past few decades. With government grants decreasing, there is a greater need and opportunity for private capital to deliver social and affordable housing through both debt and equity-like models.

Social and affordable housing funds generally deliver financial returns through a combination of:



Income
Rental income is commonly generated through lease terms that are **long-term and index-linked**, typically paid for by the Government.



Capital growth
Investors gain exposure to the UK residential property market and benefit from potential capital appreciation of assets.

Inflation forecast vs. open market rental growth

Year	CPI p.a.	Open market p.a
2021	1.5%	(2.7%)
2022	1.9%	0.4%
2023	1.8%	1.4%
2024	1.8%	1.6%
2025	1.9%	1.5%
Average	1.8%	0.4%

Source: HM Treasury Medium Term Forecasts for the Economy – February 2021, Investment Property Forum UK Consensus Forecasts (Winter 2020/21)

Rent correlation (by real estate sectors)

	Social Affordable Housing	Private Housing	Retail	Office	Industrial
Social/Affordable Housing	1.0				
Private Housing	0.4	1.0			
Retail	0.0	0.7	1.0		
Office	0.2	0.6	0.5	1.0	
Industrial	-0.2	0.4	0.7	0.7	1.0

Source: CBRE, UK Affordable Housing, the Investment Opportunity (Nov 2018)



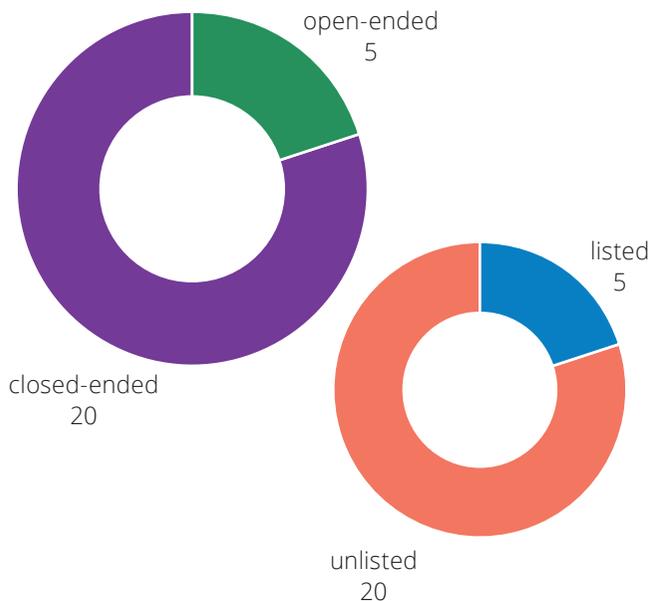
60,000 Estimated number of additional affordable homes needed per year to meet rising demand¹

1) Savills, Affordable Housing – Building Through Cycles, 2018

The size and projected growth of the market

A market initially dominated by smaller specialist social and affordable housing managers has seen growth, largely driven by traditional real estate managers responding to demand from investors for greater diversification within their real estate allocation.

The UK social and affordable housing funds market at the end of 2020 comprised¹:



25 Funds launched
by

16 Fund managers



totalling

£2.9bn

As at end June 2021, there are:

5 New funds
under development

3 Fund managers



entering this market

£8.2bn

total target fundraising²

Methodology/ basis for inclusion

This mapping is based on our in-house market research, it includes funds which:

- a) have demonstrated an impact intent through an impact report; and
- b) have investments made into mission-led organisations such as housing associations and charities.

For funds outside of Big Society Capital's portfolio, we have not been able to verify the depth of the impact intent and quality of the impact practice beyond publicly available information. Returns are based on target returns and not adjusted for actual performance to allow for relative comparison. We have only included funds with multiple investors, therefore, single investor separately managed accounts are not reflected in this data.

1) Big Society Capital Market sizing data and RFP data

2) This target includes both launched funds and ones raising or in development

Three categories of social and affordable housing funds

Social and affordable housing fund strategies are increasingly diverse. They can be grouped in three overarching categories according to the **types of housing** that they deliver, **the people they house** and **the level of support and care they provide**.

These can be considered in line with three of the Impact Management Project's Dimensions of Impact (WHAT, WHO and HOW MUCH)¹.

Categories of social housing strategies



Specialist Housing (SH)

WHAT: Typically, bespoke/adapted new builds filling the gap in supply of suitable homes for people with specific needs

WHO: people with specific care requirements in the UK including: older people, people with learning disabilities or mental health needs

HOW MUCH: estimated >700,000 people with high level, long-term care and support needs²



Transitional Supported Housing (TSH)²

WHAT: Homes acquired from existing housing stock that is refurbished

WHO: People with vulnerability or in crisis including: people who are experiencing or at risk of homelessness and survivors of domestic abuse

HOW MUCH: estimated 189,500 people with low-to-medium level transitional support provided, needed over the medium term³



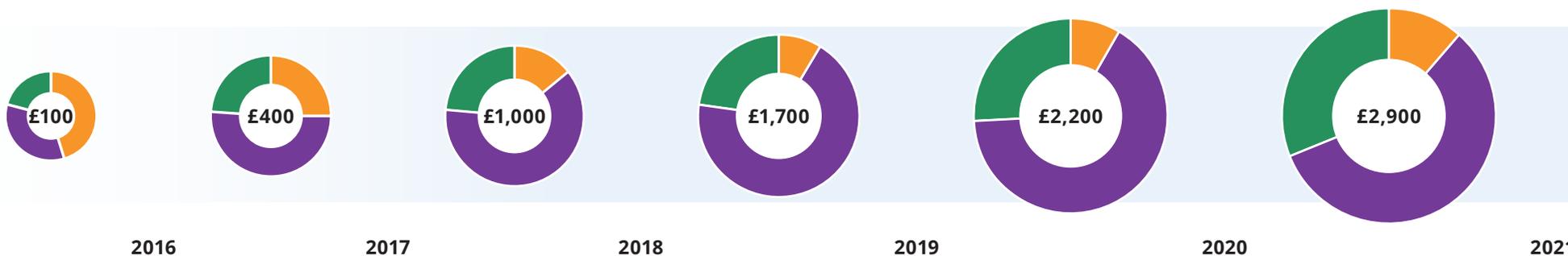
General Needs Social & Affordable Housing (GNA)

WHAT: Typically, new builds to address chronic undersupply of affordable homes available

WHO: People who cannot afford to rent or buy on the open market including: low-income families

HOW MUCH: estimated 3.8 million people in need of social rented housing and significantly more looking for other types of affordable long-term housing solutions with no care or support provided⁴

Growth in the social and affordable housing funds market (£m)⁵



1) What is Impact: <https://impactmanagementproject.com/impact-management/impact-management-norms/>

2) Specialist Accommodation Review 2016: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/572454/rr927-supported-accommodation-review.pdf

3) IPPR 'At a Crossroads', 2020: <https://www.ippr.org/research/publications/at-a-crossroads-the-future-of-transitional-supported-housing>

4) People in Housing Need, 2020: <https://www.housing.org.uk/resources/people-in-housing-need/>

5) Big Society Capital Market sizing data, based on amounts investments outstanding, rounded to the nearest £100 million. For private funds outside of BSC portfolio, invested capital has been used as a proxy.

Key factors for categorisation of social and affordable housing funds

The categorisation of Specialist Housing, Transitional Supported Housing and General Needs Social & Affordable Housing broadly aligns with the tenure types defined in the UK's policy and regulatory framework, but also covers private unregulated rental properties let at affordable (sub-market) rates¹. When investors compare underlying strategies, there are important factors that differentiate the risk and return within each category². See slides 10 - 12 which map each category to the factors below.

	Description	Key considerations	Key financial risk factors
Counterparty	Who is leasing the housing from the fund i.e. mission-led housing providers such as housing associations, specialist charities and local authorities	Counterparty's ability to manage lease and underlying tenancies	Counterparty's financial resilience, operational capabilities and governance
Tenants	Who is living in the housing	Tenant's individual income and personal circumstances determine the type and level of government housing benefit being paid	Changes to policy and level of payment Eligibility of tenants to receive benefit
Care or support services	Type of additional support and care available to tenants	Additional benefit may be available for people with higher support needs; care is typically commissioned separately and contracts may not align with tenancies, but may be crucial to tenant outcomes and sustainment	Housing provider's ability to deliver appropriate care and support Changes to policy and level of payment Eligibility of tenants to receive benefit
Housing tenure	Legal status under which individuals have the right to occupy their accommodation e.g. rental or ownership	Determines long-term objective of fund, source of long term revenue (e.g. housing benefit and private top-up) and routes to exit	Changes to demand for particular tenure type Viability of different tenures in different locations depending on levels of government subsidy attached
Property asset	The physical type of housing asset owned by the fund	Local housing market determines acquisition values, rent levels and resale potential Value – add opportunity through refurbishment	Changes to local house prices Costs associated with repairs and maintenance
Acquisition methods	Source and method of acquiring and/or developing housing	Speed with which tenants can be housed and income received Ability to achieve economies of scale and speed of deployment	Determines level of development exposure and gain, refurbishment requirements, and ongoing asset management needs
Lease lengths	Duration of lease between social and affordable housing funds and counterparty (not their tenants)	Certainty of level of income and associated indexation	Appropriateness of length and indexation given counterparty's financial and operational stability

1) UK Regulatory Framework: <https://www.gov.uk/government/collections/regulatory-framework-requirements>

2) Where we refer to counterparties, we typically mean mission-led housing providers such as housing associations, charities and also local authorities in some instances.

How categories typically compare

The following charts seek to illustrate some typical characteristics of these categories - this is based solely on what we see in the market today.

Development exposure



Social and affordable housing funds focused on developing new build housing typically participate post-planning approval.
Development risks are typically mitigated through the use of forward funding or forward commitment arrangements.

Average time from investment to income generation



Average time to income generation is affected by time to acquire/develop housing plus time to secure underlying tenancies.
Variables driven by scale and intensity of demand, council referral rates and approval processes.

Typical lease length



As well as lease length, investors should also examine lease terms such as break clauses and rent review mechanisms, which vary across funds.
While longer leases can appear to create greater certainty of income, it is important to look at the underlying tenant demand profile and suitability for the housing provider

Typical % government-backed income



% of government-backed income is typically higher for SH and TSH where tenants' vulnerabilities are higher.
For GNA, personal income is sometimes supplemented for example, in the case of shared ownership and key worker housing.

Note: for illustrative purposes only, not to scale.

Specialist Housing



Typically bespoke/adapted new builds for people with specific (often high) levels of long-term care and support needs, although some funds focus on repurposing existing housing to make it suitable.

Counterparty	Registered Providers e.g. housing associations and local authorities, and charities.
Tenants	People with care and support needs including: older people, people with a learning disability or mental health needs, vulnerable young people, people who have experienced homelessness.
Care or support services	Commissioned by local authorities or health services.
Housing tenure	Covers a wide range of tenure types, including Specialist Supported Housing for people of working age with care and support needs and extra-care housing for people over 55 with care and support needs.
Source of rental income	Tenants' housing benefit paid for by Department for Work and Pensions (DWP). Exempt rent claims are determined by local authorities. Rents are typically exempted from usual social rent setting requirements to cover higher costs.
Property asset	Range from shared accommodation to self-contained dwellings. May be purpose-built to suit tenants' needs and contain communal facilities but lease terms evolving to better align risk and returns.
Typical acquisition methods	Acquire new builds through forward funding or forward commitments, or existing stock in open market.
Lease length	Typically 20 years + but lease terms evolving to better align risk and returns
Net initial yield range	Typically 5-7%



Key areas Big Society Capital assesses:

1. Fund manager's process to assess and partner with excellent housing providers that demonstrate ability to secure funding for and deliver quality support and care to vulnerable tenants
2. Level of appropriate risk-sharing between fund and housing provider as indicated through lease terms such as break clauses and rent setting mechanisms
3. Whether properties are selected and designed to be well aligned to tenant needs, as well as strategic relationships with developers and local authorities, which is preferred over non-commissioned provision where some bad practices have been observed

Transitional Supported Housing



Typically existing housing stock provided to people with vulnerabilities or in crisis with moderate to low, medium-term support provided¹.

Counterparty	Specialist charities, and some Registered Providers
Tenants	People with vulnerabilities or in crisis including: people who are experiencing or at risk of homelessness and survivors of domestic abuse
Care or support services	Some transitional support may be offered by housing providers, paid for either by a portion of rental income or secured separately from local authorities
Housing tenure	No specific tenure types
Source of rental income	Tenants' housing benefit paid for by DWP. Exempt rent claims are determined by local authorities. Dwellings are typically let at Local Housing Allowance rates, which are used to calculate housing benefit for tenants renting from private landlords.
Property asset	Self-contained dwellings, typically 1 - 3 bed
Typical acquisition methods	Acquire existing housing stock through open market.
Lease length	Typically 5-10 years
Net initial yield range	Typically 4-6%



Key areas Big Society Capital assesses:

1. Fund manager's process to assess and partner with excellent housing providers that demonstrate ability to secure funding for and deliver quality support to vulnerable tenants
2. Setting appropriate rent levels and lease terms which genuinely reflect costs and risks of providing the homes
3. Fund managers are able to procure suitable homes for target tenant groups and demonstrate longevity of revenue funding to provide support where appropriate

¹) Duration of support is situational but typically lasts between six and twenty four months. The nature of support is temporary, addressing specific situational need rather than permanent care requirements for example those resulting from chronic health conditions.

General Needs Social and Affordable Housing



Typically new build flats or houses for people who cannot afford to rent or buy on the open market. As well as regulated social & affordable housing, it can include affordable private rented sector.

Counterparty	Registered Providers e.g. housing associations and local authorities
Tenants	People who are unable to afford renting or buying on the open market
Care or support services	n/a
Housing tenure	Covers a wide range of tenure types, including: <ul style="list-style-type: none"> · Social rent: lowest rent level, set by the Government through national regime · Affordable rent: up to 80% of local market rent · Intermediate rent: 80-100% of local market rent (e.g. for key workers) · Shared ownership: part buy, part rent model
Source of rental income	Tenants' housing benefit paid for by DWP, sometimes with private top-up. In the case of shared ownership, rents are paid privately
Property asset	New build, self contained dwellings
Typical acquisition methods	Acquire new builds through forward funding or forward commitments
Lease length	Typically 10 years +
Net initial yield range	Typically 3-5%



Key areas Big Society Capital assesses:

1. Fund's ability to generate substantial and credible acquisition pipeline, through assessment of relationships with developers, local authorities and housing providers
2. Fund manager's process to assess and partner with credible housing providers that demonstrate ability to manage leases and tenancies
3. Fund manager's approach in determining mix of housing tenure types in relation to local housing needs (e.g. scale of demand and affordability)

The fund manager landscape

Today, there is a diverse range of social and affordable housing fund managers, spanning boutique sector specialists to global real estate managers, launching dedicated impact strategies. Some managers and funds specialise in a single category, others opt to diversify across a range of tenure types, lessees and sub-sectors.



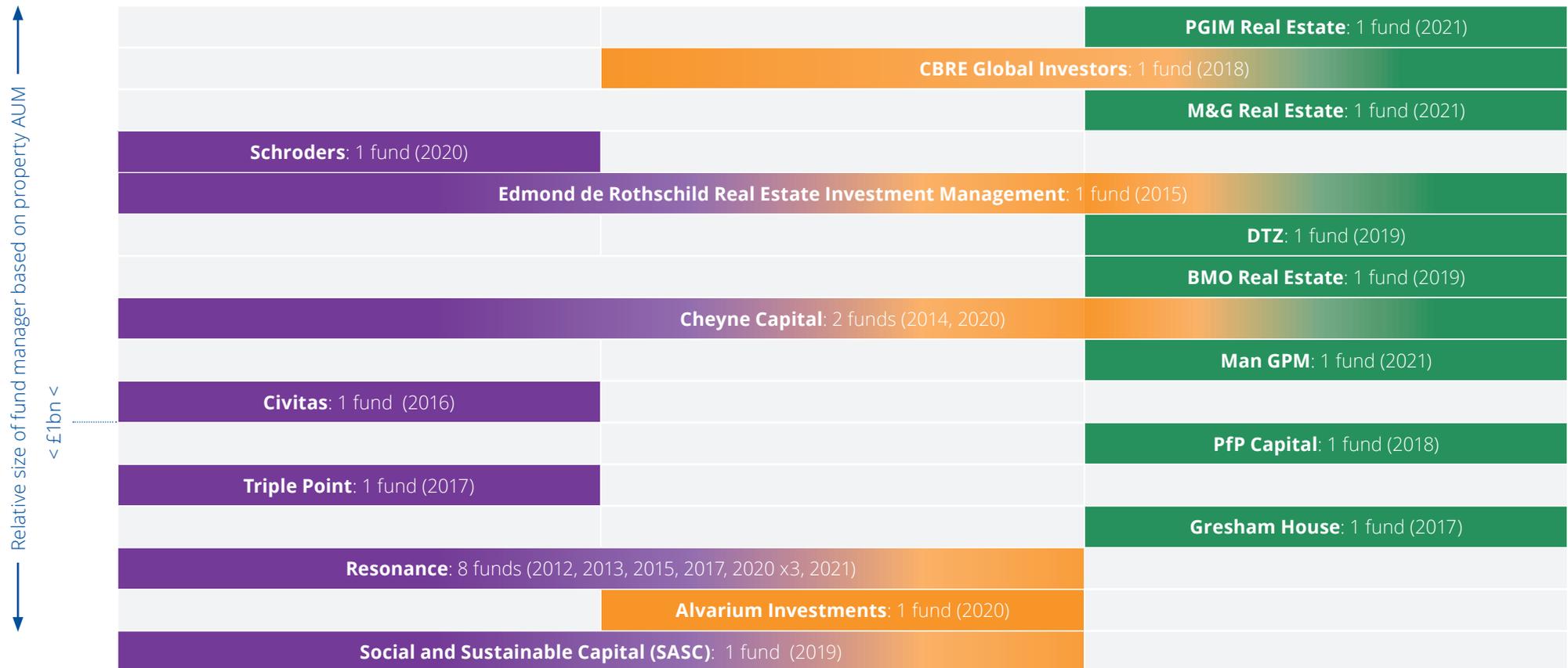
Specialist Housing



Transitional Supported Housing



General Needs Social & Affordable Housing

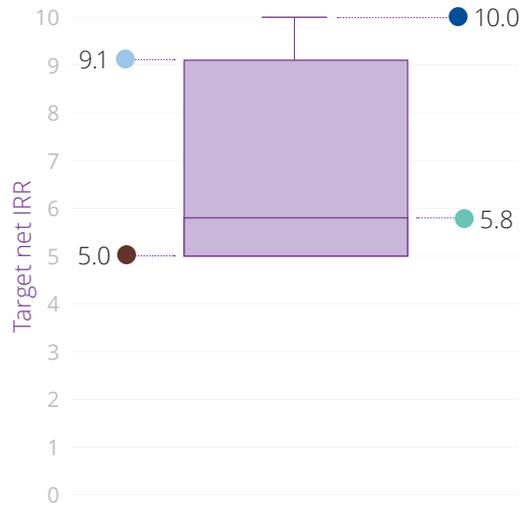


Return targets and their drivers

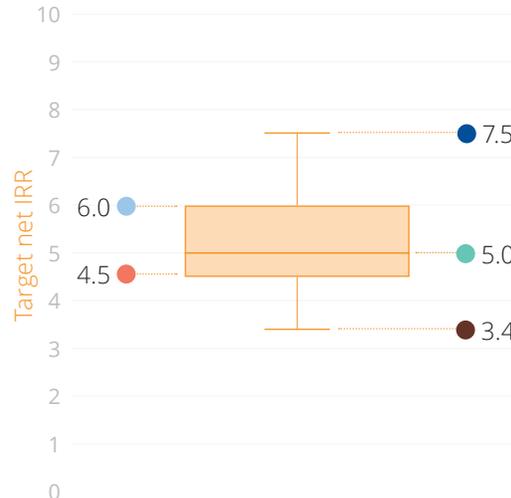
Funds that have launched since 2017 and those that are actively fundraising have an average return target of 6% net IRR, ranging from 5.5% to 10%. Target returns tend to be higher for Specialist Supported Housing, as they potentially benefit from development gains and generally receive higher rental income. This is followed by General Needs Social and Affordable Housing, where higher returns are also driven by potential development upside and a wider range of rental income sources that include private top-ups. Transitional Supported Housing returns tend to be lower due to the level of entitled housing benefit, but generally it carries less development risks, has a quicker deployment period and stronger alternative uses.



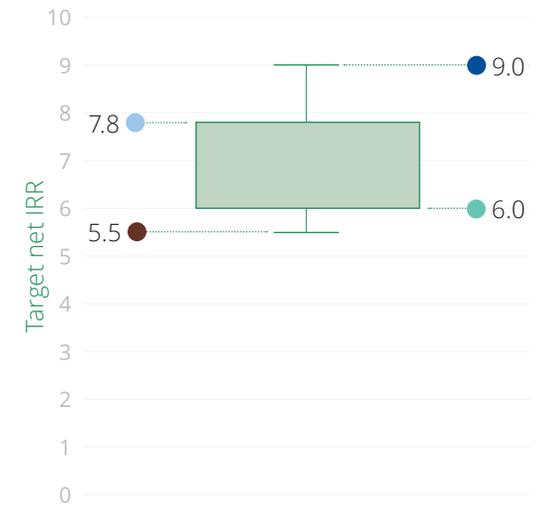
Specialist Housing



Transitional Supported Housing



General Needs Social & Affordable Housing



Key: ● Maximum | ● 3rd Quartile | ● Median | ● 1st Quartile | ● Minimum

Net IRR is typically generated through a combination of development gains, capital appreciation and rental income. Rental income is typically higher than TSH and GN due to higher support needs of tenants. Higher level of returns is balanced by greater development exposure and, in some cases, more limited alternative uses. SH requires higher levels of housing specifications, adaptations and sometimes maintenance costs.

Net IRR is typically generated through a combination of capital appreciation and rental income. Lower level of returns is balanced by no / lower development exposure, high levels of demand and strong alternative uses.

Net IRR is typically generated through a combination of development gains, capital appreciation and rental income. Rental income and level of demand depends on mix of tenure types. Higher level of returns is balanced by greater development exposure.

Source: Returns based on target IRRs for 26 funds launched in the last 5 years or currently raising based on Big Society Capital market data and responses to 2020 Request for Proposal. Four funds launched prior to 2017 which are included in 25 funds launched figure on page six have been excluded from this dataset to allow for relevant comparison.

Our journey and experience

At Big Society Capital, we recognise the benefits of taking a diversified approach, investing across all three categories of social and affordable housing funds.

To date, we have supported the development of this market in a number of ways:

Investing as a cornerstone investor: in new social and affordable housing funds to help encourage others investors alongside us. For example, we seeded the first social and affordable housing funds managed by Cheyne Capital and Resonance designed to bring equity-like capital to the social and affordable housing sector.

Working with social enterprises, charities, and social purpose organisations: to develop and seed investment ideas that answer unmet social needs through housing, alongside fund managers who are informed by a deep understanding of social issues.

Developing a common framework for impact practices with institutional investors and housing providers: supporting fund managers and institutional investors who have the commercial skills and networks to attract more capital at scale, to generate an even bigger impact and improve sector impact practices.



Our investment numbers:

>£150 million

Capital committed

c £500m

from investors alongside us

16

Social and affordable housing funds

Together with other investors, we have delivered:

SH 558

Specialist supported homes

TSH 815

Transitional supported homes

GNA 1,435

General needs properties

Social and affordable housing investment done well offers institutional investors the potential to achieve their financial and impact objectives.

As investors ourselves, with first-hand experience navigating the rapidly evolving social and affordable housing funds market, we want to share our knowledge and learnings with others to support better and more informed investment decision making from other investors.

If you'd like to know more about our journey and experience in social housing market and how we can work together, please contact:

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Important information

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