

Affordable housing – investing for income and long-term impact



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With demand for housing set to grow, the case for investing in affordable housing is stronger than ever, giving LGPS investors the chance to make an important contribution to society while meeting their long-term investment objectives.

Over recent years, the global conversation around inequality and injustice has grown in volume and urgency, with many calling for collective action to tackle these challenges. The Covid-19 -pandemic is not simply a public health crisis, it is also affecting societies and economies at their core and will increase poverty and inequality globally. According to the United Nations, over half a billion people are expected to be pushed into poverty as a result.

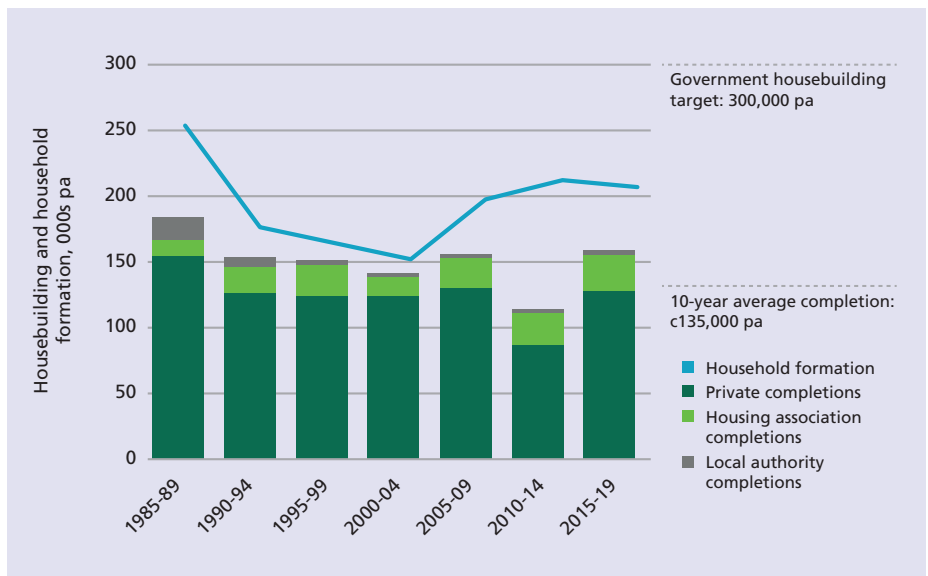
Those increasing levels of poverty are likely to make the UK housing market, which also suffers from a supply/demand imbalance,

more unaffordable for a generation. The long-standing undersupply of affordable housing will inevitably be exacerbated as unemployment worsens and more families struggle to pay private rents. The government has pushed for RPs (registered providers) of affordable housing (government-funded bodies tasked with maintaining assets, managing tenants and providing additional housing) to be self-sustainable and deliver higher rates of new homes to the market each year. However, RPs simply do not have enough equity capital to reach their housebuilding targets. This has created a need for private sector investment to fill the gap while helping to provide a long-term benefit to society.

A compelling investment case

In addition to ongoing increases in demand and the positive social impact of an investment in affordable housing, the sector

Figure 1: The gap between demand and supply



Source: MHCLG, ONS. As at July 2020

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has some key investment characteristics that make it particularly well suited to Local Government Pension Scheme investors, including long-term, predictable income streams matching pension liabilities, and the ability to generate 6%+ net internal rate of return to investors over a 10-year hold period. The investment case includes:

- **Security of income**

RPs are regulated and receive funding from the government. Private investors typically let assets to RPs on long-term operational leases, often 20 years or more, and they generate one of the most secure and consistent income streams in the real estate sector.

- **High occupancy rates, low tenant turnover**

Occupancy rates are consistently very high in the sector, with demand outstripping supply and tenant churn relatively low. There are long waiting lists for affordable housing, and if a tenant leaves voluntarily, they must find accommodation in the private market. As a result, tenant stays are significantly longer than in the private housing market and deliver a consistent income stream.

- **Income growth tracks inflation**

Rental growth is set by government policy, not driven by market forces. Rental uplifts are typically index-linked and reviewed every five years. So future rental levels are far more predictable than if they were set in the open market.

- **Stable and predictable capital values, diversification**

Affordable housing capital values are driven by the rental stream generated by the asset, and as rents are secure, predictable and indexed, capital appreciation is created in line with the steady increase in rental income. Hence, the fundamental drivers are different to those underpinning GDP growth and market forces that influence house prices in the private market. Therefore, values are insulated against the market downturns that affect private housing.

A framework for maximising impact

We take a broad view of sustainability, believing that environmental, social and governance factors are interrelated and cannot be tackled in isolation. There is much debate and evidence on the suffering caused by housing insecurity on individuals and the positive impact of good quality affordable housing on regional competitiveness, economic performance, citizens' health, wellbeing and quality of life.

To focus efforts where the most impact can be made, it is crucial that LGPS investors measure the impact their investment is having. Opportunities should be assessed on a project-by-project basis to select investment assets that will deliver the best outcome for those who need it most. This structured approach to decision-making also

helps to balance the contribution made across locations, so LGPS investors can contribute to the social good in their local community as well as across the nation.

Investing for long-term value and values

The long-term demand/supply imbalance in the UK housing market that underpins investment in affordable housing is well understood. However, the investment characteristics that make returns from the sector particularly stable and resilient have been overlooked by the institutional market. The sector provides stable, predictable income and index-tracking rental growth, offering a compelling investment case while also making an important contribution to society. When guided by expert investment management, these characteristics result in an attractive risk-adjusted return profile, which aligns closely with the priorities and values of LGPS investors and is expected to remain resilient through difficult economic conditions, as it has proven over multiple economic cycles.