From bricks to billions?

Summary
- The UK is facing a housing crisis due to a growing urban population, high house prices, and a supply shortage.
- The new government has prioritised solving the crisis by aiming to build 1.5 million homes over the course of a parliament.
- Affordable housing offers a potential investment opportunity for pension funds, due to the significant demand, long-term returns, and diversification benefits.
- Investment in single-family housing, a rapidly growing market, could be the 'missing piece' in the broader conversation on affordable rental housing.

Callum Conway looks at the investment opportunities for pension funds within the affordable housing sector

It is no secret that the UK is facing a housing crisis. A growing urban population, skyrocketing house prices, and a supply shortage have created a lethal cocktail for the housing market, particularly for young people trying to get onto the property ladder for the first time.

According to the Office for National Statistics (ONS), the average house price in the UK reached £286,000 in 2023, up from £230,000 in 2013 – an increase of nearly 25 per cent over the past decade. Meanwhile, the National Housing Federation (NHF) says that at least 3.5 million people are waiting for social housing across England.

Ambitious targets

The new government has prioritised solving the crisis by creating more affordable housing – defined as offering a subsidised route to home ownership or subsidised rents for people on low incomes.

Its election manifesto, supported by the Autumn Budget, targets building 1.5 million new homes over the course of a parliament, including 100,000 social homes annually, and controlling rent prices by linking them to local income levels. Between 2022-2023, there was a net loss of 11,700 social rent homes, highlighting the scale of the challenge the government faces to reach their targets.

An opportunity for pension schemes?

As we reach a critical juncture in the housing crisis, do affordable housing funds represent an attractive investment opportunity for pension schemes? Hymans Robertson senior investment research consultant, Steven Grahame, says investing in UK residential real estate has several merits for three principal reasons. Firstly, there is significant demand for housing and a lack of new supply, which helps maintain rental and capital values over a forecastable period. Secondly, investment in housing generally requires new building and development, providing the opportunity to earn a potentially higher long-term return. This also delivers local and community benefits, including additional housing, employment and training opportunities, and broader community advantages. Thirdly, the inflation-linked affordable housing sector offers diversification benefits against commercial property.

A 2023 report from the British Property Federation (BPF), *Catalysing investment in social housing,* recognised the potential for pension schemes to help solve the housing crisis. The report said that UK pension funds are increasingly seen as a crucial source of capital for constructing and managing affordable housing, particularly in urban areas where demand outstrips supply.

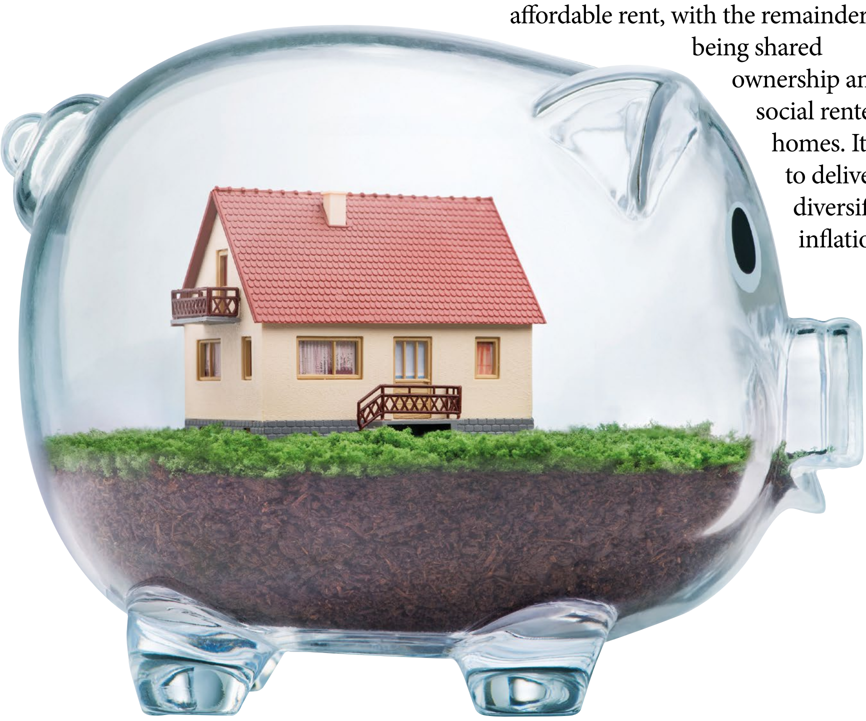
In the report, BPF policy director, Ian Fletcher, wrote that "pension funds and other sources of institutional capital are attracted to these sectors as they offer secure long-term income, but the government must do more to give them the confidence to invest".

Are pension funds capitalising on this potentially ripening investment market? According to an annual assessment by Better Society Capital (BSC), a social impact investor, more than half of £10 billion in social impact investment is driven into housing by pension funds, growing the market by 7 per cent in 2023. Pension funds are the biggest investors in Britain's social and affordable housing sector, representing around 40 per cent of the market, BSC said.

However, there is room for growth. In 2023, the allocation of pension funds to real estate and infrastructure (which includes affordable housing) was estimated to be around 10-15 per cent of total assets for many large pension funds, according to data from Preqin. But, a significant portion of this allocation is often directed toward commercial real estate, focusing less on affordable housing, which remains a largely untapped market.

Recent activity

One such body that has caught on to the attraction of affordable housing investment is the Access Pool – an investment partnership between 11 Local Government Pension Scheme (LGPS) funds across the UK. In the past year, it has overseen a flurry of commitments to real estate funds, such as Legal and General's (L&G) affordable housing fund, launched in July. Backed by a £125 million investment from the LGPS, the affordable housing fund holds over 750 homes, most of which will benefit from affordable rent, with the remainder being shared ownership and social rented homes. It aims to deliver a diversified, inflation-linked cashflow for investors. In August, the Greater Manchester Pension Fund (GMPF) invested a further £120 million into the fund.



"With traditional housing associations facing financial pressures, institutional investors, like Access, are proving themselves as reliable partners in directing long-term pension capital into areas that support society by unlocking more homes," L&G fund manager, Ali Farrell, says.

The L&G affordable housing fund outlines 'health and wellbeing' and 'equity and affordability' as its core social priorities, a goal that has become increasingly common for pension funds. According to the PLSA, 57 per cent of UK pension funds now track social impact metrics as part of their real estate investment strategies. This represents one aspect of environmental, social, and governance (ESG) investment considerations for pension funds.

Last month, *Pensions Age* reported on the Gresham House and Thriving Investments partnership, which aimed to create a UK-leading, eco-friendly affordable housing fund management platform which would eventually become a net-zero investment.

To date, the fund has successfully deployed nearly £200 million, amassing a portfolio of 1,557 affordable homes across England, of which over 1,100 are operational.

Thriving Investments CEO, Catherine Webster, says the partnership represents an increasing pension appetite for exposure to the UK housing market.

"Affordable housing represents a steady, long-term, and CPI-linked investment, which is particularly attractive for pension funds," she says.

Webster adds that her company's affordable housing partnership also aligns with pension schemes' ESG demands.

"We aim for our homes to use air-source heat pumps to help deliver a low-cost, low-carbon approach to energy.

"We also try to keep embodied

carbon as low as possible by looking for biodiversity net gain in the areas we build in. For example, we want the homes to be close to public transport so that we can reduce emissions released by cars."

Obstacles to investment

Despite the numerous 'green flags' affordable housing offers as an investment for pension funds, some barriers could make schemes think twice.

Regulation and planning legislation remain issues, the BPF warns, given the complexity of security permissions for new developments, especially in high-demand areas.

"Long delays in the planning process can increase risks and project costs significantly, particularly on larger complex schemes," reads its 2023 report.

The planning regime in the UK can delay the start-to-completion date, currently averaging around 2.8 years outside of London, according to data from Litchfields consultancy.

However, it says investors can mitigate these challenges through partnerships with local authorities, such as the Access Pool or housing associations.

Given the long-term nature of rental housing schemes, direct affordable housing investment also creates liquidity concerns, the Impact Investment Institute suggests, which may deter some pension funds that prefer liquid assets with quicker returns.

There are also reputational risks as the product is delivered to end users as consumers rather than businesses, according to Grahame.

"Selecting the right investment managers and partners is critical to alleviating these reputational risks and securing the targeted return," he says.

While the new government has declared its intention to address many of these obstacles through new policies and legislation, some commentators remain sceptical.

"They're saying the right things," says Webster, "but actions speak louder than words, and the devil will be in the detail.

"It's fantastic to have a new government that is so pro-housing and very vocally pro-housing. But their targets are ambitious, and they must find the money to achieve them."

WTW senior investment manager, Douglas Crawshaw, is also sceptical about Labour's promises.

He says that although affordable housing could become a more attractive investment for pension funds under the new government, political parties tend to say things to get votes and then not necessarily deliver on their promises.

"Inward investment into the sector must be encouraged by new government legislation, not stifled", he adds.

"Affordable housing represents a steady, long-term, and CPI-linked investment, which is particularly attractive for pension funds"

What about single-family housing?

One area of affordable housing that may mitigate many of these obstacles, while simultaneously working towards the government's goal of 1.5 million new homes, is single-family housing (SFH).

While the term 'affordable housing' includes social housing and private rental properties, SFH refers to single-family rental housing units, which can be newly built or renovated, according to Savills.

Savills head of build-to-rent research, Guy Whittaker, says most SFH falls into the "affordable" category, due to lower maintenance costs and fewer ancillary services required.

"This makes them immensely popular among young couples and families, with almost 90 per cent of occupiers under the age of 45."

L&G build-to-rent scheme director, David Reid, describes SFH as "the missing piece" in the broader conversation on rental housing.

Reid says the demand for affordable housing is enormous, but SFH has an important point of difference.

"Affordable housing is government regulated; SFH is not. Government-funded organisations provide social housing, while affordable housing is usually offered through private developers or landlords. In the single-family market, there is no grant or subsidy. It is funded by a solid investment from your capital partner's capital structure."

Reid points out that while operating costs are higher in the private market, rent is also considerably higher, meaning returns over time can be much more substantial for pension funds.

However, Crawshaw suggests the maintenance costs for SFH can be significantly more than those of other forms of affordable housing.

"If you have 200 units in a single block, you need one maintenance person on-site to fix your leaky taps or whatever the issue might be. The issue with SFH is that if you have 200 houses, unless they're all relatively close to one another, you'll need a team of maintenance people to manage the properties, driving up costs."

Yet, the UK's SFH sector is rapidly gaining momentum.

According to a Savills report, over £1 billion was invested in SFH in the first nine months of 2023 – more than triple the amount invested in 2022.

"Investors surveyed are aiming to commit more than £25 billion to the sector over the next five to 10 years," the report says.

While the demand for affordable housing outstrips supply, the sector could represent an attractive investment opportunity for pension funds, particularly those looking to target the social aspect of ESG considerations.

Written by Callum Conway