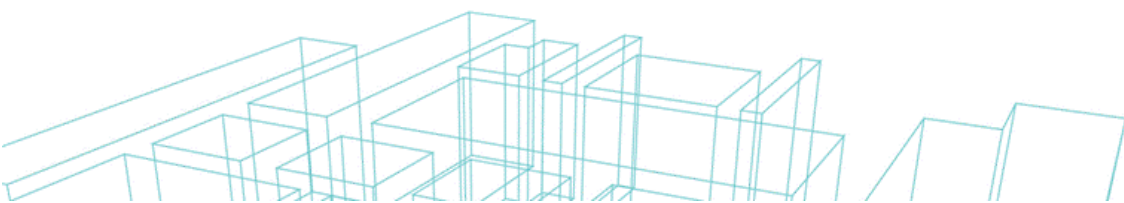


A summary of findings from:

Pellings Future Funding for Affordable Housing Seminar

October 2012



Purpose of this document

The purpose of this document is to summarise the Future Funding for Affordable Housing Forum which took place on 16th October 2012. The review will disseminate the quantitative results provided by an audience made up of senior executives from Registered Providers and Local Authorities, as well as a small number of investors, developers and contractors all of which have a specific interest in affordable housing. The total number of participants was 130.

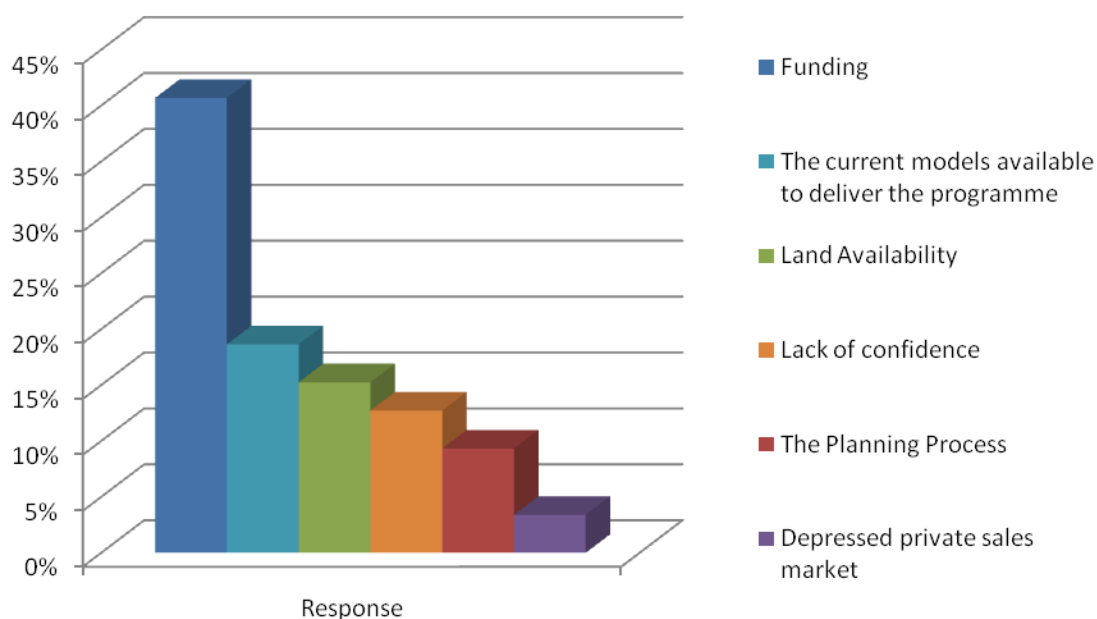
The seminars were led by three speakers who provided insight into the results of the survey and also their thoughts on the future of funding in the sector. This document will also encapsulate some of their key observations to provide indication where possible, of what the future may hold. The speakers comprised:

- Richard Claxton, Chairman, Pellings LLP
- Stephen Howlett, Chief Executive, Peabody
- Jim Saunders, Managing Director, Pinnacle Regeneration Capital

Overview

We live in a society where the requirement for all tenures of housing is rising yet delivery of houses is falling. Inside Housing recently reported that 1 in 10 people aged between 20-40 are living with their parents for financial reasons. As a result housing is high on all political parties' agenda's and was discussed widely at the recent party conferences with various proposals to meet the challenge set out. In his opening address, Richard Claxton questioned whether the current challenge of delivering 200,000 new houses a year is actually realistic. He cited that 'numbers have been on the decline since 2006, and even at this peak, only 183,000 starts were made. Delivery this year is anticipated to be only 50-60% of this target.'

With this clear evidence that the sector are having difficulty in meeting the required targets the audience were asked: [What do you consider will be the main barrier to building more affordable housing in the future?](#)



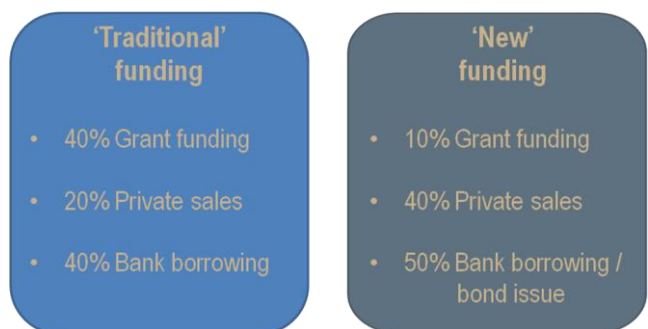
The restricted availability of funding topped the poll convincingly. Following discussion by the panel a general theme touched on by all speakers was the need for certainty in this area. Richard Claxton used the specific example of the existing Affordable Housing Programme due to end in 2015 with no clear indication of future grant, he stated that, 'we need to begin to investigate the alternatives.' This view was supported by Stephen Howlett who described the post-2015 unknown as the, '2015 cliff'.

Current funding models

Peabody and Pinnacle Regeneration are two very different models, and as 'not for profit' and 'for profit' organisations respectively, their approach to funding new developments vary significantly. Stephen Howlett and Jim Saunders provided brief presentations on their current approaches which have been summarised as follows.

Peabody

Stephen's illustration (right) demonstrates the primary funding challenge facing Peabody and all not for profit RPs. The new funding model for the period 2011-2015 seeing the reduction in grant funding subsidised by more private sales and increased borrowing against assets and the use of bonds. The implication of the new funding model is significantly more debt for Peabody. Using this model requires taking on 68% debt compared with 31% under the traditional model outlined. More debt translates into greater risk and Stephen expects to see signs of strain among some RPs, particularly the smaller RPs. This could well lead to mergers to consolidate their estates in order to leverage borrowing, and a potential reduction in financial ratings.



Despite the significant challenges that the current market and present funding conditions, Peabody's objective remains the same, 'to deliver good quality, affordable, and long lasting homes'.

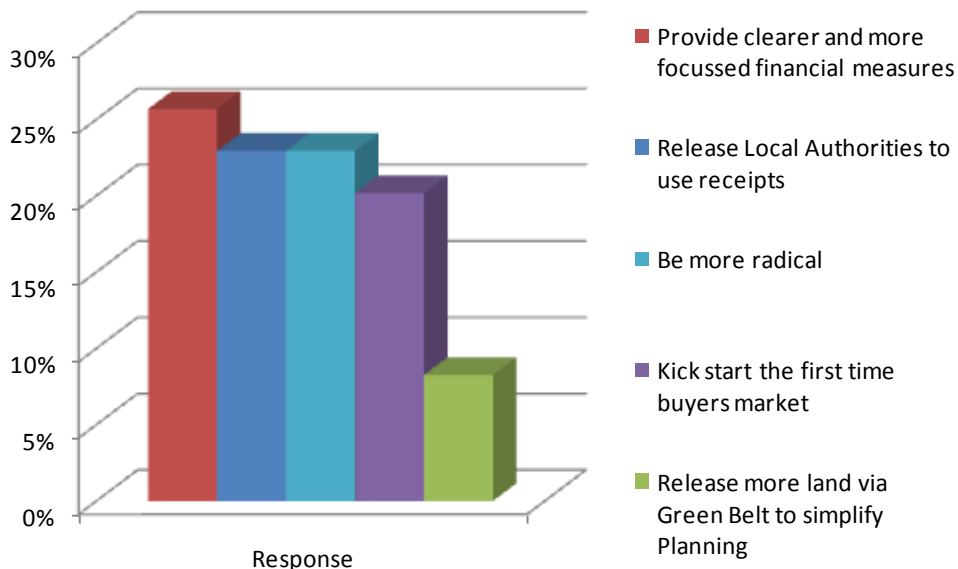
Pinnacle Regeneration Capital

The model of a 'for profit RP' is still in its infancy and continues to develop at speed. The Pinnacle model 'has no reliance on capital grant or debt funding mechanisms that are currently constrained in the market.' according to Jim Saunders. This means alternative institutional funding sources are required. With no quick fix, reduced grants, and the current market as it is, he envisages an opportunity for for profit RPs with access to shareholder funds to boost supply. More broadly he expects to see the private rented sector and affordable housing show signs of 'blurring into one over the coming years, particularly in lower value areas'.

REITs have been identified by Pinnacle as a potential source of funding and it is something that is being investigated. The realisation of an investment in affordable housing is 'in the region of 25-50 years', and Jim sees this low risk, long-term investment opportunity sitting comfortably in a pension or insurance portfolio. Pinnacle also expects Institutional Investors to provide funding using the leaseback model. This will see the development sold to an investor and leased back to Pinnacle for a period of 45 years in return for Index linked rent.

The Government's priority

With a view to understanding the part the government can play in meeting demand, the audience were asked: **What should be the main focus for Mark Prisk, the new Housing Minister?**



The mixed response again highlighted the uncertainty in the sector and the difficult job that the Government is facing. The one certainty is that they do have a significant role to play and that decisions have to be made sooner rather than later.

Stephen Howlett suggested that a change in attitude was needed, 'The Government must look upon the provision of funding as 'investment not subsidy' in order to develop long term solutions to the problem he said.

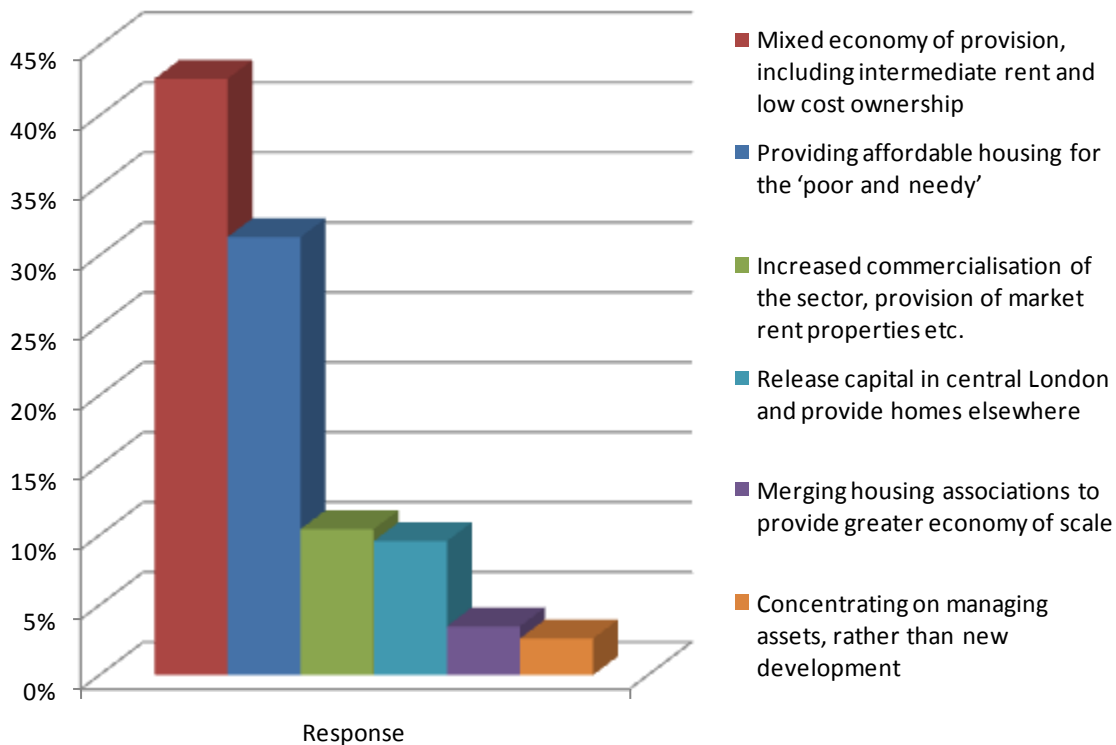
When the panel were quizzed on further Government initiatives that that will significantly impact on the RP Sector, their responses included a unanimous sense of apprehension about the future.

Firstly, the changes to Section 106 Agreements, 'S106 schemes make up a large proportion of new development for any RP' Stephen Howlett said. He then went on to quantify the potential loss stating that 44% of the current affordable housing programme comes from S106 sites, which equates to circa 35,000 homes per year. In the context of attempting to increase the number of affordable homes, this is a significant setback.

Secondly the proposed changes to the benefit system that the panel all expect to see implemented. These will see the rent that is currently paid directly to housing providers, paid to individuals as part of the Universal Credit Payment. Jim Saunders described it as an 'ideological rather than sensible approach' that will create a very difficult situation for RPs. He suggested that all RPs should be getting their house in order now in an effort to deal with it. Stephen Howlett backed up this sentiment fully, 'it is a challenge for us and the Government are aware of it,' he stated. As a demonstration of the potential scale of the issue, he went on to suggest that in his opinion it could feasibly be the cause of some RPs suffering a downgrading of their credit ratings.

Housing Associations' Priority

What should be the top priority for housing associations in the future?



The response gave a clear indication that whether built with public or private money the principles of traditional RPs remain high on the list of people's priorities. Providing affordable housing to alleviate the 'poor and needy' in London was the original aim of Peabody and Stephen Howlett was 'delighted' to see this score so highly as it remains core to their business model.

It is clear from the audience response that the concept of a mixed economy of housing provision for RPs is embedded in the sector's psyche, including social, affordable (which was identified as closer to 60% of market rent than 80%), and private sale within tenure blind developments. Stephen Howlett identified this mixed tenure provision as important for raising the capital needed to deliver affordable homes. He also called for the Government to give Housing Associations 'greater flexibility to manage and recycle their assets to unlock capital value' and deliver the homes that are needed in London.

For Profit vs. Not for Profit RPs

Predictably the question of the differences between a 'for profit and 'not for profit' RP, along with who is best placed to deliver affordable housing did arise, and it stimulated a lively debate.

Stephen Howlett, whilst recognising that there was a place for profit generating RPs, felt strongly that the principles that Peabody were founded upon should remain at the forefront of the organisations mission. This was summed up in his statement, 'when asked where our profits go? I say, our residents are living in it'. Stephen went on to provide a brief history of Peabody which was founded over 150 years ago by George Peabody. His initial donation

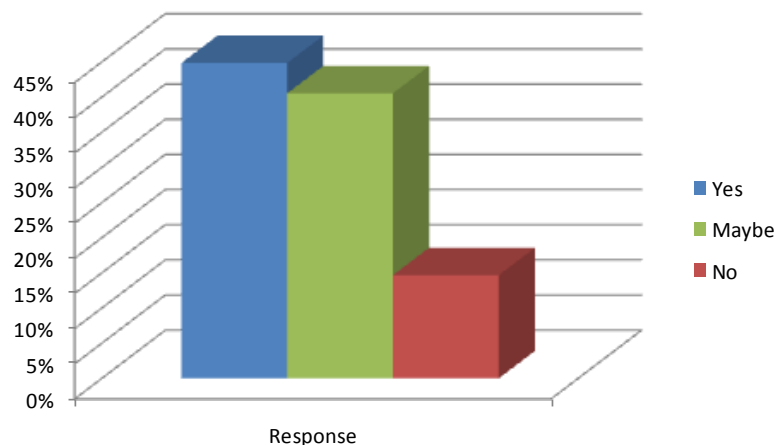
equates to the equivalent of circa £40m in today's money and through 'patient investment' over the years, the Peabody Portfolio is estimated to be worth in the region of £5 billion.

Jim Saunders countered by explaining that he believed, 'the not for profit organisations represent the engine of the RP sector,' but for profit RPs have an important role to play in attracting private equity investment to the affordable housing sector, and also driving operational efficiencies. In order for this source of funding to be available, shareholders will require a dividend that is proportionate to the risk of their investment.

He argued that having identified currently funding sources are limited, the need to bring new sources of funding into the sector is clear, and if this is to happen it will mean attracting equity investment, as opposed to solely debt funding into the mix. Affordable housing offers investors a secure long-term investment requiring 'patient capital' that enables a for profit RP to develop a 'sustainable mix and balance of homes' for the affordable housing community. For this reason he spelled out his desire for the Government to 'draw in new players such as for profit RPs' and move quickly on resolving how best the for profit sector should be regulated.

Following the exchange the audience were challenged to provide their input. They were asked, [will the introduction of for profit Registered Providers help accelerate affordable housing delivery?](#)

The thoughts of Stephen and Jim were reaffirmed by the audience with over 85% believing that for profit RPs will, or will maybe, play a part in accelerating affordable housing delivery. Less than 15% expected them to fall away completely.



In Summary

Despite the contrasting opinions of the evening the key message from all speakers and attendees was the same, although the future of funding for affordable housing remains uncertain we have to continue to deliver new homes for the entire cross section of society.

The result of the poll on what the Government's priority should be may well be the most telling of those taken on the evening. The spread of responses demonstrate the difficulty the housing sector are having in trying to predict which decisions the Government will take to stimulate new affordable development. However the direction they take over the coming few years will more than likely define the shape of the organisations that deliver affordable housing in the future.

Richard Claxton closed proceedings with a final thought, 'we have a responsibility to continue to find ways of providing affordable housing to those who need it and avoid further 'lost generations' with regards to housing'. On that the panel and audience were no doubt universally agreed.

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