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Capital at risk.

Delivering financial and social value through affordable housing

With supply constrained and the demand for affordable accommodation looking set to remain robust, we believe the sector offers investors a compelling opportunity to harness these favourable dynamics while also delivering a positive real-world impact.


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Local authority housing waiting lists have averaged 1.3 million households over the last four decades[1]; the need for more affordable housing in the UK is clear. This comes at a time where the key channels for new supply are undergoing notable challenges. However, in our view, this represents a compelling opportunity for institutional investors to increase exposure to a highly regulated sector, offering them the potential for sustainable returns and long-term, inflation-linked income, with simultaneous potential to deliver a tangible social impact.

1. DLUHC, Local Authority Waiting Lists as at Jan 2024

Key risk: The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

Consistently high levels of affordable housing delivery are required to meet the demand. Estimates suggest that 145,000 new affordable homes are required each year[2] but, on average, 52,000 affordable homes are built[3]. Government funding for affordable housing has been cut significantly and is 63% lower than 2010 levels. Much of the supply of new homes in the sector comes from traditional housing associations and affordable homes supplied as part of levies developers and housebuilders face when gaining planning permissions (Section 106/s106 contributions). Over the past decade, these two sources have accounted for 85% of affordable housing delivery with almost equal splits[4].

Traditional housing associations face financial pressures from rising debt costs, following interest rate increases over the past 18 months, and notable increases in maintenance and major repair costs for existing assets to adhere to building safety and decarbonisation standards. £7.7bn was spent on maintenance and repairs in 2023, a 20% increase on 2022, with housing associations projecting that these costs will grow to £9bn per annum over the next five years[5].

The policy of relying on s106 contributions, while sound in principle, does reveal its flaws during housing downturns as market/for-sale housebuilders reduce their housing output. This was also apparent during the three years following the global financial crisis. As housebuilding slowed, the affordable housing delivered through developer contributions was c.40% below the previous five-year average[6]. During that period, traditional housing associations were able to continue to help support affordable housing delivery. But given the challenges outlined above, the capacity to do so this time is more limited.

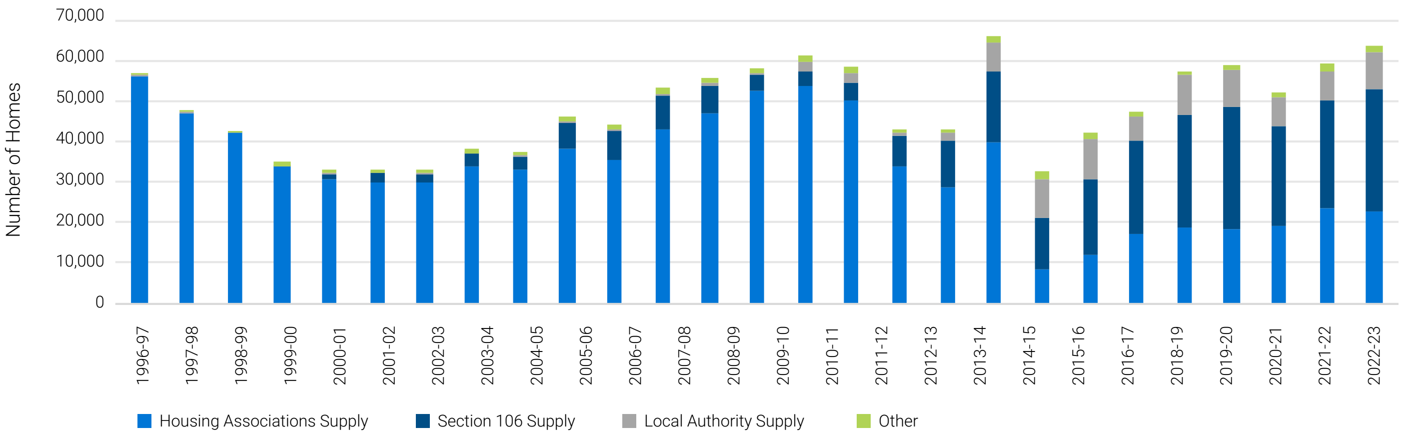
The growth of for-profit providers in the sector, backed by institutional providers, offers a potential route to sustainably increasing affordable housing delivery in the UK. Institutional investors with a more long-term view can adequately look through short-term market instability. This has been clearly demonstrated by the relative resilience in build-to-rent investment volumes in 2023. That year saw £4.5bn invested into the sector, down by just 2% compared with 2022, despite wider economic challenges[7]. The same level of consistency is needed to incrementally push affordable housing delivery closer to the levels required.

We believe this sector backdrop and the cashflow profile of affordable housing assets potentially represents a compelling opportunity for investors in search of sustainable returns, resilient income, and a distinct social impact.

We believe 2024 could also mark an opportunistic entry point into the sector for new investors. As capital markets have recalibrated to rising government bond yields, this has driven a correction in real estate values too. While residential assets have been more resilient than the wider real estate sector, they have not been immune. While the commercial sector has seen yields moved out by 140bps[8], affordable housing yields are 50 – 60bps higher now than in 2022[9]. The underlying market fundamental underpin for the sector, however, has only strengthened.

2. Heriot-Watt University & National Housing Federation – Housing Supply Requirements in Great Britain, April 2019
3. DLUHC, Affordable Housing Supply Statistics 2022-23 as at Jan 2024
4. DLUHC, Affordable Housing Supply Statistics 2022-23 as at Jan 2024
5. RSH, 2023 Global Accounts of private registered providers as at Dec 2023
6. DLUHC, Affordable Housing Supply Statistics 2022 – 23 as at Jan 2024
7. Savills UK build-to-rent market update – Q4 2023
8. CBRE UK Prime Yield Indices as at Jan 2024
9. CBRE Living Sectors Yield Matrix as at Nov 2023

Affordable housing supply



Source: DLUHC, as at Jan 2024.

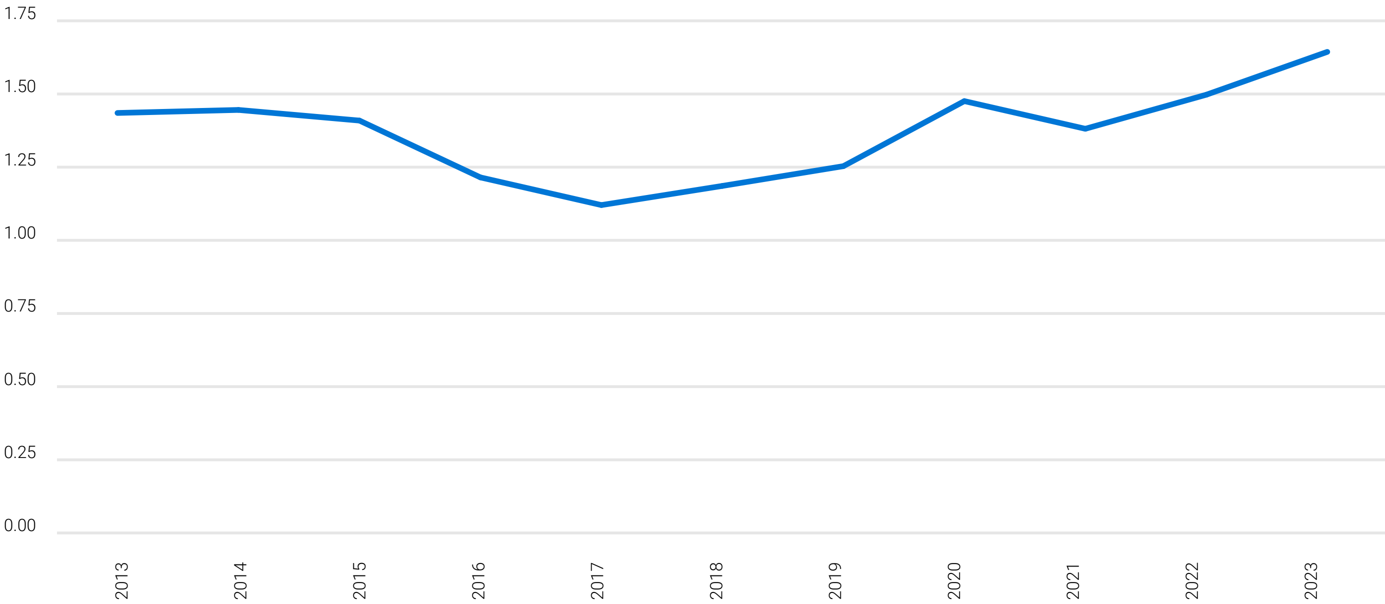
Key risk: The value of investments and the income from them can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

Furthermore, the need for inflation-linked income is at the forefront of LGPS investors' minds. We believe that affordable housing assets can deliver this effectively. Rents in the sector have an explicit link to inflation with leases that include annual rent increases typically based on a CPI/RPI + 0% - 1% framework.

The sector has historically seen high levels of occupancy and low arrears, potentially giving investors more clarity around long-term income growth. Vacancy rates in the sector have averaged 1.4% over last 10 years[10], with bad debts and arrears averaging 0.8% and 5.3% of gross income respectively[11].

Okement Park, Okehampton, Devon

For-profit affordable rent vacancy rate %



Source: RSH – Private registered provider social housing stock as at Oct 2023, RSH – Global accounts of private registered provider as at Dec 2023

Additionally, the affordable housing rent structure has historically been less correlated with the commercial sector. This suggests that some exposure to the affordable housing sector can provide a degree of diversification[12] from the cyclical nature of the wider economy.

10. RSH – Private registered provider social housing stock as at Oct 2023
11. RSH – Global accounts of private registered provider as at Dec 2023
12. **It should be noted that diversification is no guarantee against a loss in a declining market.**
13. Assuming CPI +1 rent standard over the whole period

Affordable housing rental growth correlation to commercial real estate sectors (2006 – 2022)

	Affordable rent[13]	Office	Industrial	Retail
Affordable rent	1.00	-0.35	-0.45	-0.12
Office	-0.35	1.00	0.31	0.63
Industrial	-0.12	0.31	1.00	0.08
Retail	-0.19	0.63	0.08	1.00

Source: CBRE and LGIM analysis.

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There are, of course, downside regulatory risks attached to rental growth given that government intervention has restricted this in the past. For example in 2023, the level of inflation-linked rent rises was capped at 7%.

With the election of the new Labour government, some uncertainty remains. However, we do note that there is recognition of the growing importance of institutional investment in the sector and the requirement for policy certainty.

The previous government proposes to require LGPS funds to have a plan to invest up to 5% in the UK, with assets to support levelling up.

Since forming the new government, Labour have reiterated their position that there are real opportunities for private institutional investors to play an important role in boosting the level of housebuilding across all tenures. The immediate policy announcements that have been made show that the government sees the housing sector as a key pillar in their ambition to boost UK economic growth.

Last but not least, investors are increasingly conscious of their ability to generate social impact through their investments. We believe that affordable housing is well-placed to deliver these outcomes. This is particularly the case for the LGPS in our view given the government's desire for pension funds to increase their investments in local areas across the UK.

The lack of enough fit-for-purpose housing, and the housing affordability issues that follow, is a significant social issue in the UK. Not only is this to the detriment of many households, it is also very costly for local authorities as they increasingly rely on more expensive temporary accommodation to house those in immediate need. Since 2010, the number of households in temporary accommodation has increased by 120%[14].

14. DLUHC, Live Tables on Statutory Homelessness as at Jan 2024
15. DLUHC, English Housing Survey 2021-22

Fountain Lane, Oldbury, West Midlands

Since 2010, the number of households in temporary accommodation has increased by 120%[14].

We believe investors into the affordable housing sector can generate tangible and quantifiable social benefits to demonstrate their commitments to responsible investing by enabling new affordable housing schemes to come forward and deliver new homes.

There is also potential to contribute to the UK's transition to net zero. At Legal and General, our sustainability framework sets out our aim that 100% of the homes we build will be net-zero carbon enabled. 96% of the existing portfolio of homes are EPC B or better, delivering homes that seek to minimise household bills and reduce energy poverty. This compares to the wider sector where just 4% of homes are EPC B or better[15].

With increasing demand from investors for stable income streams to match their long-term liabilities, our view is that exposure to the affordable housing sector has the ability to serve this objective well. The affordable housing sector offers a balanced mix of social value creation and the has the ability for financial returns. The underpin of an acute demand and supply imbalance, against a backdrop of a relatively favourable yield entry point, could position it well for future growth.

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Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM representative

LGIM is the global asset management business of Legal & General

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