buildoffsite

Conference 2013

Unlocking Housing Opportunities

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SOCIAL HOUSING

What Next?

- Major government Investment into social rented housing is over
- New affordable housing programme grant volumes hugely reduced
- New affordable rent regime – reduced grant levels
  lettings up to 80% OMV
- New programmes embrace market entry owner occupation,
  shared equity and rent-to-buy opportunities
- Grant is now “top-up” to a largely private sector funded market
- The opportunity for institutional investment is obvious –
  grant replaced by <u>equity</u>

PLANNING

The Planning System and Political Demands

> “Traditional” planning gain routes to affordable housing supply challenged

> Recession has torn viability out of section 106 legal agreement structures

> Renegotiation of terms and conditions of agreements a complex process

> Political demands for increased levels of affordable supply are unchanged

> Boils down to who can deliver what, where, how and when to meet demands

> Agenda to meet key targets especially for residential provision across London and the South East

INVESTMENT

Institutional equity investors therefore have an unrivalled set of opportunities to:

- fund residential provision across a range of tenures
- invest in £multi-million projects where traditional homebuilders fear to tread
- take on high profile and prestige developments in key urban locations
- achieve attractive returns for
  - rental income yields against a rising private sector rental market
  - equity yields from rent to buy, shared ownership/equity models
  - long-term asset value growth and future disposal/trading of assets
- obtained by new types of partnerships with constructors and registered providers and Local Authorities

WHO ARE THE INVESTORS?

There are a number, and investment sources are growing, including:

> Institutions

> Pension Funds

> Property Groups/ Asset Management Enterprises

> LA's subject to their HRA CAP's and the availability of land

> Registered Providers - especially if changes to rules for investing into REITs (Real Estate Investment Trusts) are realised.

> Any investor with a business approach supporting investment into equity for rental yield and long-term return on growth in asset values.

SELECTING THE RIGHT SITES

- What sort of development opportunities are the most suitable?
- Inevitably want areas where demand for private rented homes is high/exceeds supply
- In locations which meet the needs of the private sector renter
- Often young professionals with busy lives, requiring ease of mobility
- Preference for proximity to key public transport nodes, especially London commuters
- With supporting facilities and infrastructure – including supermarket, gym, restaurants, other “lifestyle” products and services

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SELECTING THE RIGHT SITES

> Want locations where the resulting revenue stream adequately supports the investment of capital into development works

> With good yields on rental incomes over the period in which the asset is retained by the investor

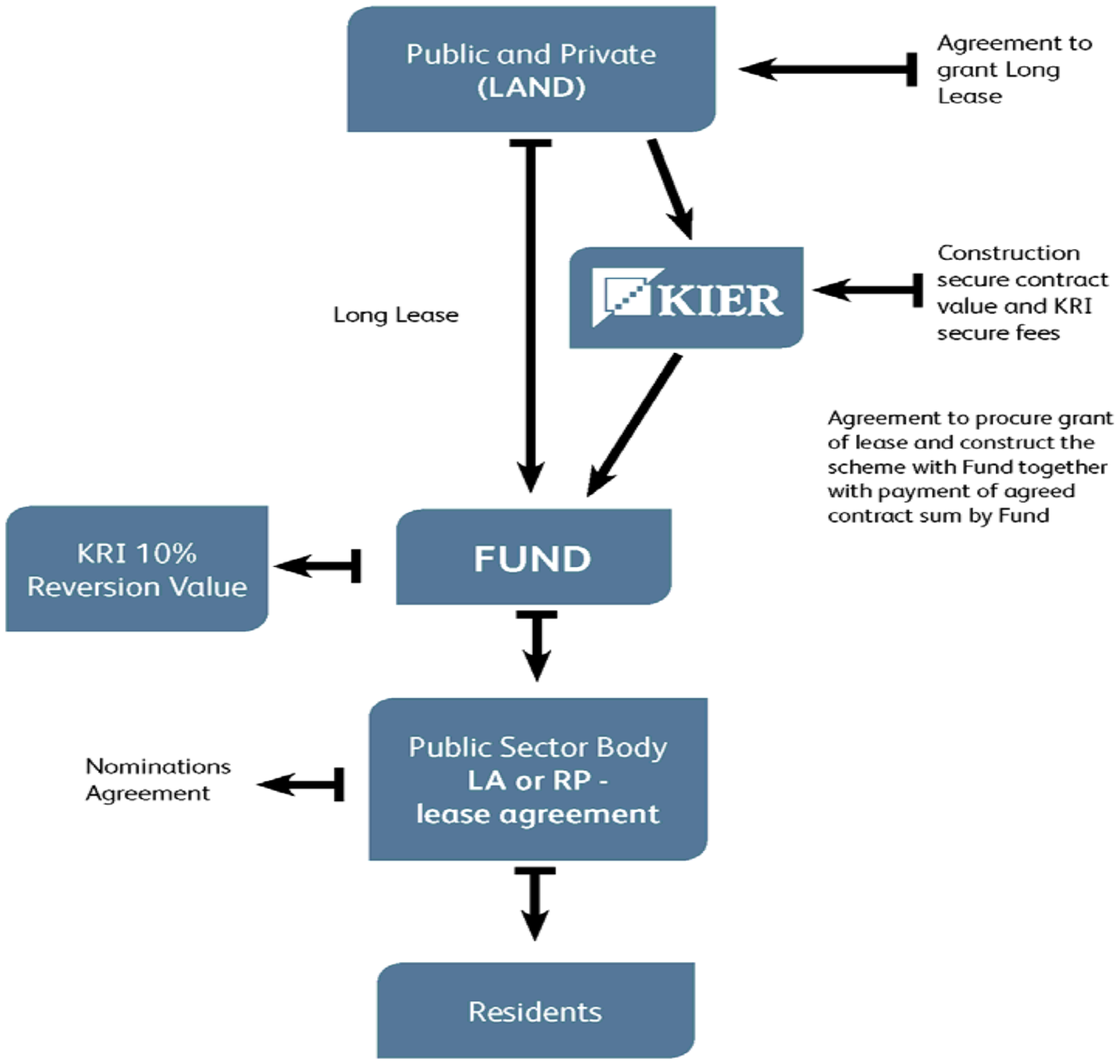
> With historic market comparable data which demonstrates clear potential for substantial improvement in asset values over time

> Ideally tied in with a deferred purchase arrangement for land or other financial mechanisms for share of proceeds on future asset sales

> In situations where the type of development undertaken adds value and/or enables an element of a project to be built and delivered which could not be achieved through the traditional speculative investment model

A combination of factors will apply specific to each location – but these are some sound and logical basic principles

PROCESS MAP



Public and Private
(LAND)
Agreement to
grant Long
Lease
Long Lease
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Construction
secure contract
value and KRI
secure fees
Agreement to procure grant
of lease and construct the
scheme with Fund together
with payment of agreed
contract sum by Fund
KRI 10%
Reversion Value
FUND
Nominations
Agreement
Public Sector Body
LA or RP -
lease agreement
Residents

USING THE PROCESS TO DELIVER MORE HOUSING

- Requires substantially less grant than former social rented regime
- Provides an attractive commercial proposition for investors
- Construction delivery acquired at competitive rates through major constructors or increasingly off site
- Spreads any available grant across a larger number of new homes
- Provides investor/developer with guaranteed take-up from completion

USING THE PROCESS TO DELIVER MORE HOUSING

- Risk of open market sales reduced or removed
- Properties purchased outright by tenants/part owners over time
- Natural progression opportunity from affordable rent – part-full ownership
- Opportunities for grant recycling to sustain affordable rented housing within the scheme as proceeds of purchaser buy-outs are realised
- Greater diversity of tenure both from the outset and over time

THE OPPORTUNITY FOR BUILDOFFSITE

BuildOffsite has the potential to deliver to these new partnerships:

> Fast-track manufacturing and delivery of projects with just in time delivery

> Volume, scale, capacity and certainty of delivery

> Consistency in quality of components, finish, performance and durability

> Energy efficient, environmentally sustainable delivery solutions

> Integrated technologies within building fabric

> The best smart, affordable, logical option for investors, constructors and residents

> Risk transfer from funder and contractor – into factory-controlled conditions

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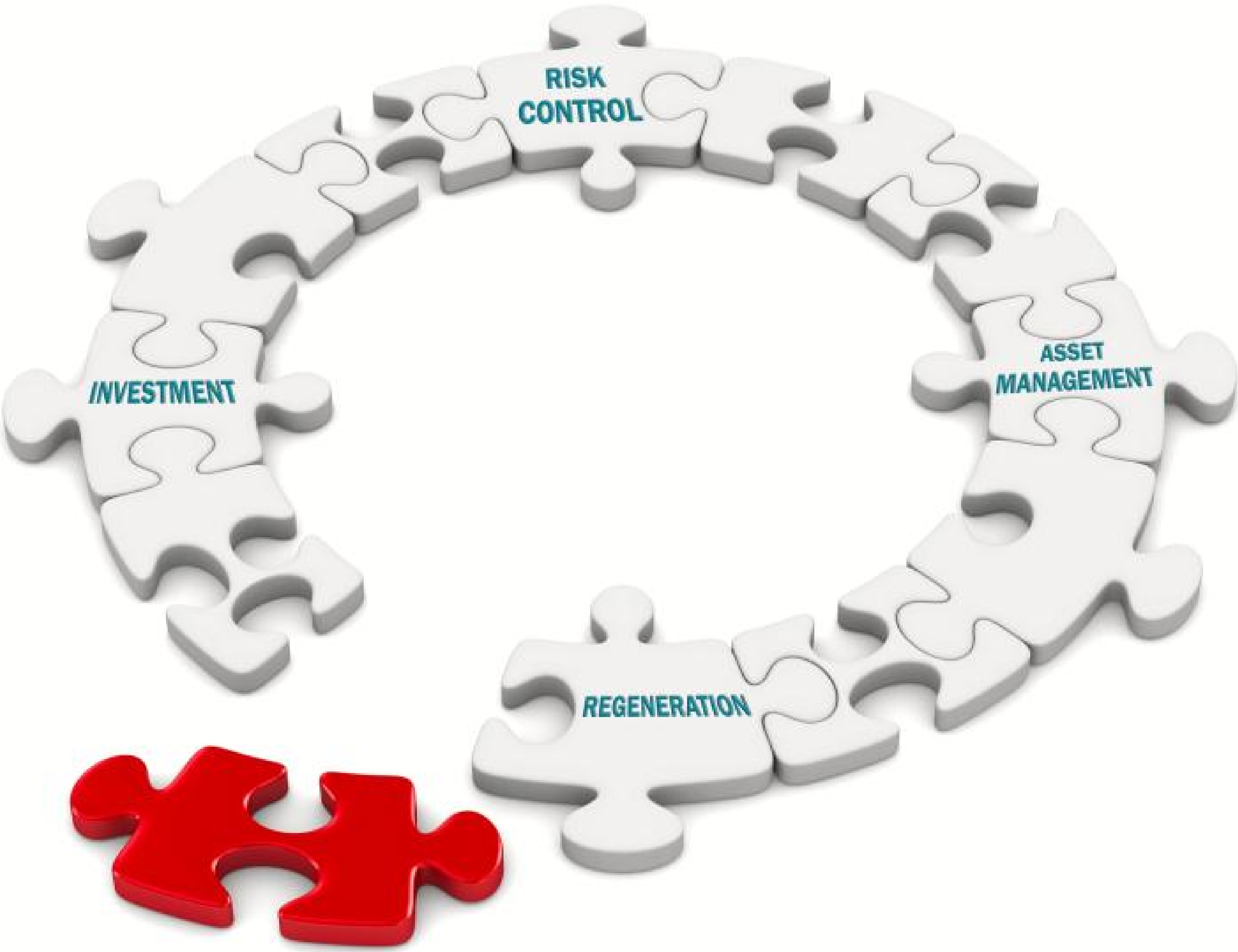
THE THREAT TO BUILDOFFSITE

- The sector really isn't that involved at the moment – needs to get "on the radar"
- Partnerships are happening with providers, investors and constructors
- Little evidence of those partnerships extending to manufacturers
- "Ad hoc" procurement arrangements tend to favour traditional/ on-site "known" forms
- Buildoffsite is well represented in healthcare and student accommodation sectors
- Some of the forms and massing of new residential schemes should suit Buildoffsite
- But the message is that you could very well miss out unless you act in response!

ACTION REQUIRED BY BUILDOFFSITE

- Buildoffsite providers need to step up and make their voices heard.
- Address selective market development opportunities most suited to Buildoffsite.
- Invest time and effort in developing the right solutions to meet programme needs.
- Argue; market; convince and persuade – this business is by no means guaranteed!
- There are large-scale opportunities available for the brave-hearted.
- Consider what you have to offer, work up propositions which break new ground.



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THE ANNUITY BASED MODEL

> New housing development generating on indexed income, guaranteed by a local authority (LA) or Registered Provider (RP) for a time relevant period

> This guaranteed income creates opportunity to secure a line of working /development capital low yield external investment on institutional scale

> This prime funding de-risks property development but relies upon a certain mix of local finance ingredient market conditions to work

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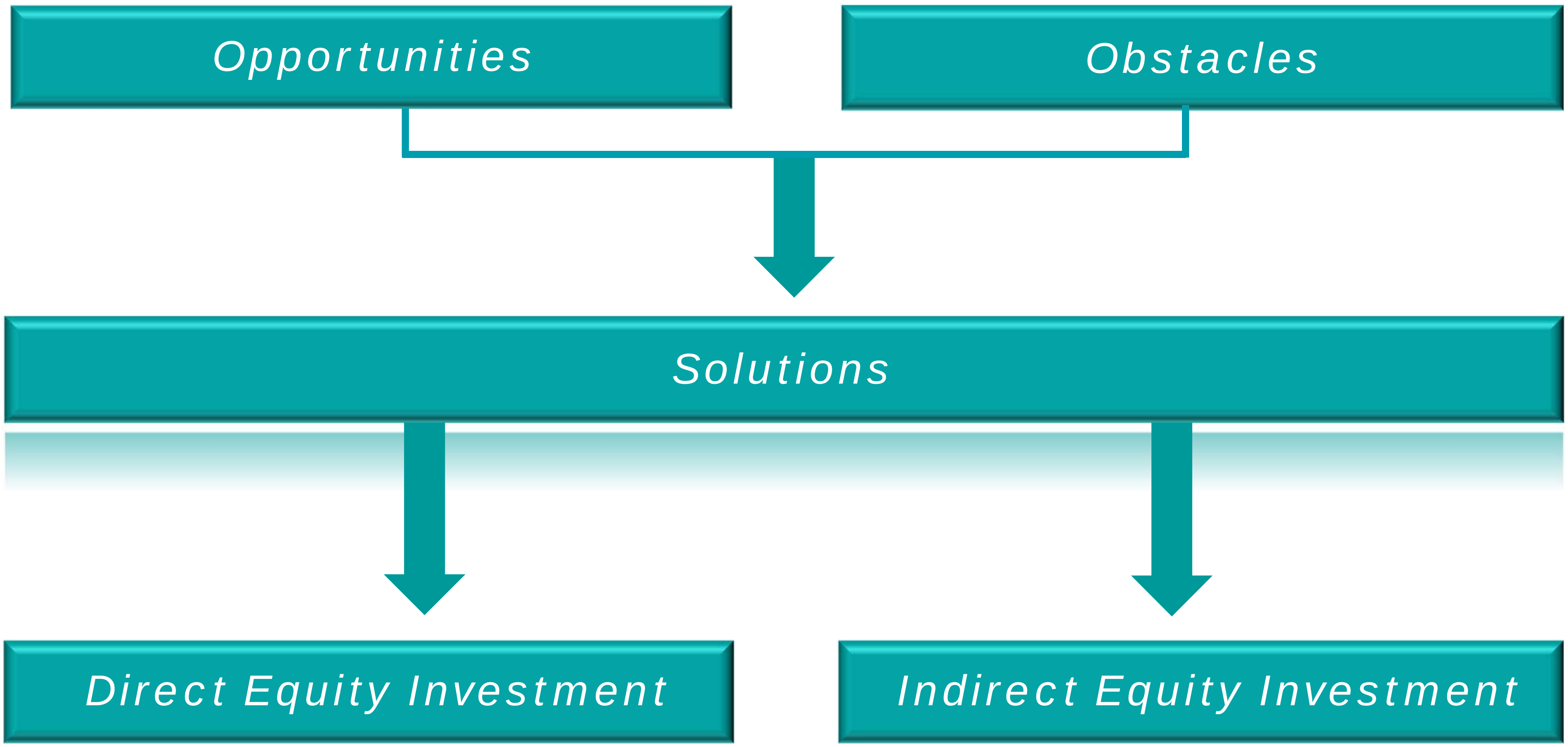
EQUITY INVESTMENT IN HOUSING



THE OPPORTUNITIES

- Rental market is maturing and more institutionally investable.
- We now have better portfolio management from the private sector and a housing association sector that is more accessible to the institutional investor.
- The banks held the housing association sector but with the change in banking the RP's are more open to leasing and management.
- The government has initiatives that will both stimulate housing but provide some rental stability in a period where a lot of analysts don't project house price growth.
- Initiatives for private sector and more interest from public sector to increase housing supply is producing investment yields that are meeting institutional targets in both running yields and total return.
- Land input combined with contractor margins or low cost government supported loans can produce housing at discount to asset value in order to buffer downside and gear up side.
- Much of the public sector housing has indexation which can match liabilities or hedge inflation.
- Ability for RP's and LA's to develop outside of grant based regime.

THE OBSTACLES

- > Planning complexities and the release of land to service demand.
- > Structural differences between established commercial and new residential markets.
- > Reduced availability of development finance – need for construction funding to build.
- > Housing benefit effect on affordable and PRS market
- > Positive and negative factors of the governments housing stimulus package.
- > Public procurements and EU directives.
- > Shortage of product and buy off the shelf, need to develop stock to meet demand.
- > Public sector lead in times, complex models, tax and legal structures and delivery vehicles.

EQUITY INVESTMENT

Direct Equity Investment

Those that had already invested opting for the Direct funding route:

- Tax efficient
- Control over the investment
- Asset performance that is reasonably predictable
- Movement follows property market (more or less)

As investors obtain greater knowledge of and comfort with the underlying social and affordable housing market, we would anticipate greater appetite for direct equity investment and risk sharing both in terms of income and operating risk.

This should be possible without the funding increasing to levels associated with the property market risk (similar to that achieved in the student market).

Name on the rent book

Indirect Equity Investment

- Investment liquidity
- Obviates the need to get involved in housing management
- Not directly associated with investment, ie Name not on the rent book
- Critical mass
- Tax transparency
- Good quality housing management

To achieve diversification of operator and the geographical location of sites, access for smaller funds, secondary liquidity and a buffer between assets and the institution we would expect some investors to have a preference for investing indirectly through asset owning special purpose vehicles.

Name not on the rent book

How the model fits with future housing solutions with investors

Affordable Housing	*(lower risk lower reward)*
Private Rental Sector (PRS)	*(higher risk higher reward)*
Affordable with PRS	*(blended to suit required return)*
Cultural shift in attitudes towards renting	*(demand)*
Creation of a proven track record	*(government initiatives)*

Changing attitudes to investment driving equity investment in RP's and LA's

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