BIG SOCIETY CAPITAL

Mapping the Market

UK social and affordable housing funds

Helping institutional investors and their advisers navigate the rapidly growing UK social and affordable housing funds market

Updated Autumn 2022

bigsocietycapital.com

Executive summary

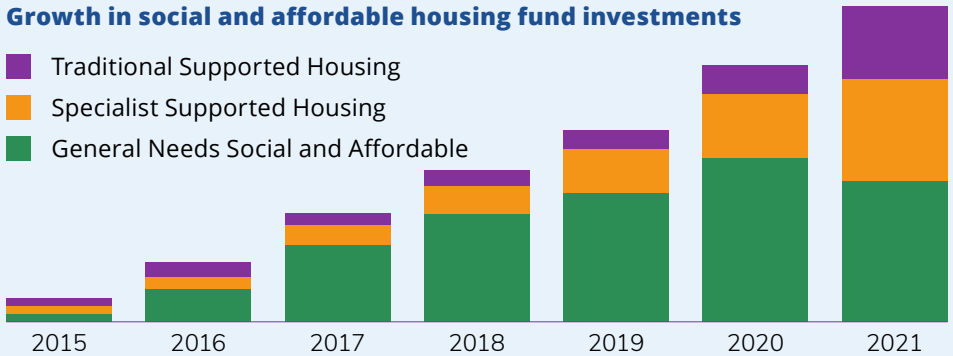
It's estimated that £16.9 billion[1] is needed every year for the next ten years to adequately respond to the chronic shortage of social and affordable housing in the UK. And over the past decade, the amount of private capital investing to respond to this need has steadily increased, most notably through equity investment from social and affordable housing funds. But not all investment opportunities are created equal, and to truly provide safe and secure affordable housing, funds should have clearly defined impact goals and a commitment to impact management throughout the investment lifecycle.

This market mapping aims to support institutional investors and their advisers as they navigate the rapidly evolving social and affordable housing fund market, by leveraging Big Society Capitals' expertise and resource in the sector. We have first-hand experience investing almost £200 million in 12 housing funds managed by eight fund managers as well as dedicated impact expertise; developing sector standards around impact practices which we believe is fundamental for investing in the sector. By sharing our knowledge and learnings, we want to help others make informed investment decisions, that include a robust assessment of managers' impact practices, as social and affordable housing becomes an increasing part of investor portfolios.

Funds market overview

The UK social and affordable housing fund market has grown substantially from virtually zero in 2012 to an estimated **£3.8 billion by the end of 2021** (£2.9 billion: 2020). Today, **19 managers** are running investment into a range of funds on behalf of a growing number of institutional investors.

Growth in social and affordable housing fund investments



Source: Big Society Capital

A market initially dominated by smaller, specialist managers has seen growth, largely driven by traditional real estate managers responding to demand from investors for greater diversification within their real estate allocation. **In the past 12 months, two new funds have closed[2], and seven new managers have entered the market** with investment propositions[3].

Increased appetite from private capital has been driven largely by investors seeking diversification within investment portfolios that offer attractive risk adjusted returns and real-world impact which include:

- Low correlation to other property markets and the wider economy
- Predictable long-term income, often supported by Government-backed, inflation-linked revenues
- Long-term asset-backed capital growth
- Genuine, measurable social impact

1 The House of Commons Library, Tackling the under-supply of housing in England, Feb 2022
2 Henley IM, Henley targets £1bn for new UK social housing fund, June 2022; PATRIZIA Global Partners, Our Funds, February 2022
3 Big Society Capital, Size of the UK social impact investment market, December 2021; data collected in response to UK Social and Affordable Housing request for proposals, March 2022

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1 Introduction to social and affordable housing investment in the UK

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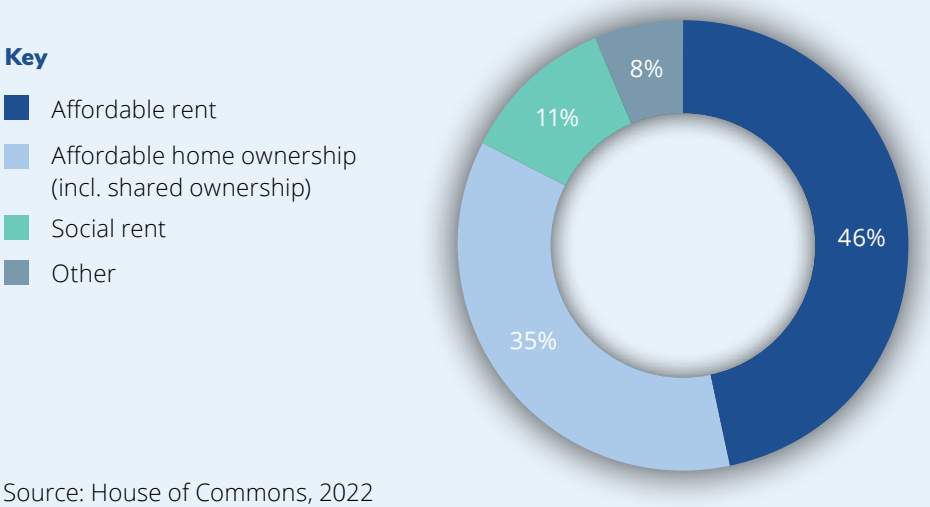
What is social and affordable housing?

Social and affordable housing includes a range of housing tenures (see Section 3) that are designed to meet the needs of people not well served by the mainstream rental and home ownership market including people: on lower incomes; with specialist housing needs; those affected by homelessness. Driven by the structural under supply of housing in the UK and a major cost of living crisis, social and affordable housing is needed by a growing number of people.

Of the 300,000 – 340,000 estimated new homes needed to meet the overall demand for housing in England, about 150,000 (each year to 2031) should be affordable. However, only about 50,000 new affordable homes were delivered in 2020/21 representing an estimated capital shortfall of £16.9 billion pa.[4]

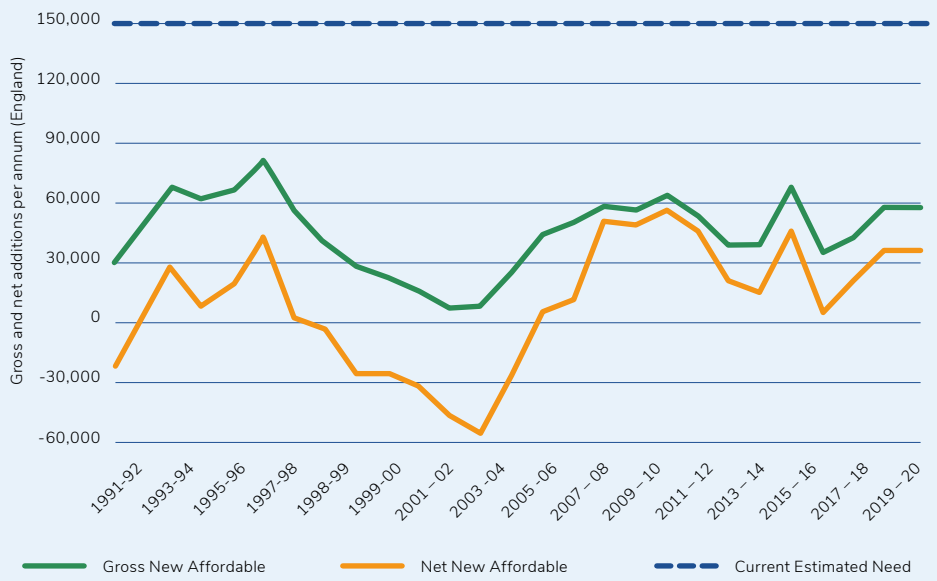
4 The House of Commons Library, Tackling the under-supply of housing in England, February 2022

Figure 1: Affordable housing supplied in 2020/21 by type



Source: House of Commons, 2022

Figure 2: Estimated shortfall of housing and capital supply per annum



Affordable housing supply is short 101,000 new homes p.a. This equates to a capital shortfall of £253.0 billion

Affordable housing need p.a.	150,000
Average gross completions p.a. (1991-2020)	49,000
Housing shortfall p.a	101,000
Average cost to build new affordable housing (2020)	£167,000/unit
Capital shortfall p.a.	£16.9 billion
Total capital shortfall	£253 billion

Source: Man Group GPM

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The investment landscape

The Government has committed significant amounts of funding through initiatives such as The Affordable Homes Programme and the recently announced Rough Sleeping Strategy to support the capital costs of developing and delivering social and affordable housing for rent or sale. However, to meet the shortfall in delivery, significant amounts of private investment capital are required.

Debt

Debt finance has been the predominant source of private funding for social and affordable housing for decades. The Housing Act of 1988 saw housing associations legally redefined as non-public bodies, allowing them to access private finance in the face of constrained public sector borrowing.

Since then, the supply of debt finance has risen rapidly. This supply has been driven by low interest rates and the ability of Registered Providers (RPs) to leverage large balance sheets to secure affordable loans to meet the growing demand for social housing, including through listed bond issuance. By 2020, long-term debt held by housing associations was over £80 billion, but it is increasingly less of a financing option, because the sector is reaching its covenant levels.[5]

Equity

Equity investment specifically into impact-led social and affordable housing has grown from virtually zero in 2012, to £3.8 billion by the end of 2021.[6] This growth has been driven by several sector forces: strong demand-supply imbalance, where demand is outstripping supply, incumbent affordable housing developers being financially constrained; and increased appetite from mainstream real estate investors in the asset class, given its attractive risk-adjusted return profile.

Equity investment has been made through both public and private investment vehicles (see Section 4). This trend is expected to continue with approximately 26 fund managers managing and/or raising UK social and affordable housing funds. These funds typically retain ownership of the property assets and lease it to housing providers in return for a portion of rental income. Funds may also sign agreements or joint venture agreements with housing providers (see Section 2, fund mechanics).

5 Savills, Housing Association Finance, May 2021
6 Big Society Capital, Size of the UK social impact investment market, December 2021

How is affordable housing delivered?

Most of the affordable housing in the UK is delivered through **Registered Providers** and **Section 106** planning permission agreements.

Registered Providers often referred to as Housing Associations are organisations that are run independently from councils. They are governed by the Regulator for Social Housing and are the main developers of new homes in the social housing sector.

Section 106 agreements (similar to a covenant) between a local planning authority and developer are designed to ensure benefit to the community, granting permission for a site combined with a requirement to include a certain portion of social or affordable housing units (usually 10-20% of all units). The resulting properties are termed 'S106-restricted'.

'Affordable rent' up to 80% of market rate.

'Affordable home ownership' at least 20% below local market value.

'Social rent' c50-60% of market rate.

Affordability

The market definitions of 'affordable' are regulatory definitions, but often fail to guarantee that the individuals targeted for those properties can genuinely afford to live there. For example, 80% of market rent in many boroughs of London is still a high level of rent.

Person-centred 'Affordability Calculators' can be used to assess the affordability of each housing unit in a portfolio. Meeting the person-centred affordability test means rent is ideally equal to or less than 33% of net household income. In contrast, rent above 40% of net household income would be classified as unaffordable.

Financial returns, risk, and impact

This section and here on in focuses on equity investment into UK social and affordable housing funds.

Social and affordable housing funds

Social and affordable housing funds seek to deliver risk-adjusted returns to investors through a combination of **long-term income and capital growth**.

Target total returns to investors typically range from 5% to 10%[7] net IRR over the fund life with target distributions of 3.5%-5% pa. These return targets will vary across funds depending on several factors including level of development risk, use of leverage, and the underlying yields on different types of housing tenure (see Section 3).

Return mechanics: The basic investment model (common across most strategies) is the fund buys property for social use, retaining ownership by leasing it to an RP and receiving rental income that supports distribution of a regular yield to investors.

Income: to the fund is paid by the leasing counterparty – usually an RP. Leases are typically inflation-linked and structured for longer than ten years, though this will vary by fund strategy.

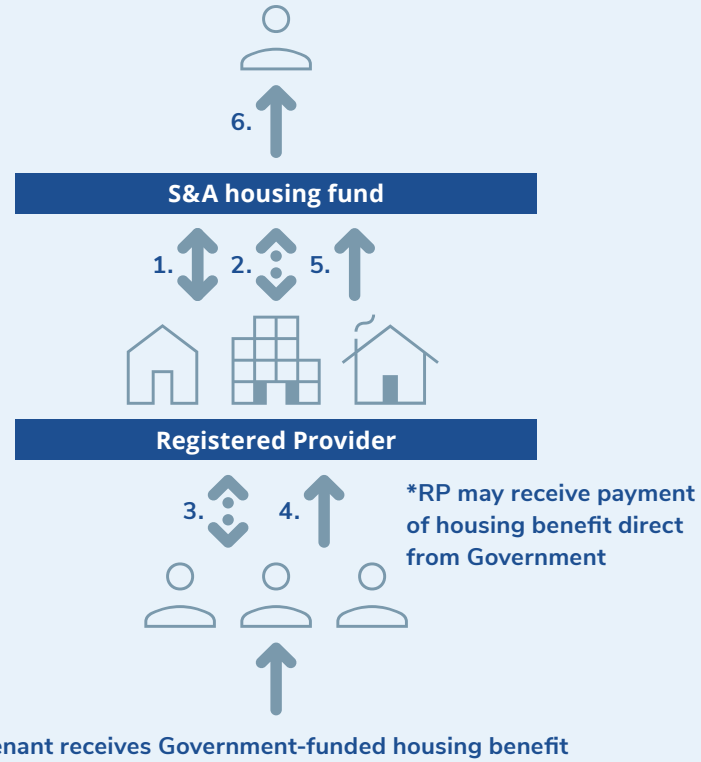
Revenue generated by the RP is used to service the lease agreement with the fund and is paid either by underlying housing tenants or directly by Department for Work and Pensions (DWP), depending on the type of benefit they are eligible for (see Section 3).

Note: The type and level of Government funded income will vary by fund.

Growth: the type of underlying assets owned by the fund will vary by fund strategy, ranging from new build housing developments to distributed housing, acquiring ordinary homes on ordinary streets (see Section 3). Funds that take greater development risk will look to target higher returns through development gains.

7 Big Society Capital, October 2022

Figure 3: Typical capital flows within a social and affordable housing fund structure, simplified for illustrative purposes only:



1. Fund develops/acquires property, and retains ownership
2. RP and fund enter into lease agreement (typically on FRI basis)
3. RP sub-lets property to tenants
4. RP collects rent from tenant*
5. RP services lease agreement returning income to the fund
6. Fund distributes income to investors (subject to distribution policy)

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Return characteristics

Return mechanics: Investors are particularly attracted to social and affordable housing investment, because of its potential to deliver long-dated, stable income that is inflation-linked and lowly correlated with other real estate income.

Long-dated, stable, inflation linked: Social and affordable rents are set by Government policy, which typically tracks CPI. These rent levels are typically reviewed on a four-to-five-year basis, offering good visibility for investors. It's worth noting that in August 2022, the Government announced a consultation proposing a 3-7% cap on social housing rent inflation for the next one to two years, which may result in a short-term deviation from tracking CPI. However, income is largely insulated from the sharp price movements seen in other real estate asset classes. This is due to the structural undersupply of affordable housing and the regulated nature of the sector which results in high demand for tenancies and, where delivered by experienced providers, historically high occupancy rates with relatively low volatility of rent levels.

Table 1: Annualised nominal rental growth and volatility, 1998-2020.[8]

	Office	Retail	Industrial	PRP Social Rent
Growth (%, pa)	2.02	0.46	1.95	3.28
Volatility	5.88	3.67	2.67	2.36

Low correlation: As a function of historically strong inflation linkage, low volatility, and the increased security of cashflows compared to other sectors, rents also present with low correlation to other real estate and income producing investments. Annualised growth and volatility from 1998 to 2019 show that social housing rents experienced superior growth and much lower levels of volatility than other real estate sectors (Table 2).

Table 2: Real estate rent correlation matrix, 1998-2020.[8]

	Office	Retail	Industrial	PRP Social Rent
Office	1.00			
Retail	0.56	1.00		
Industrial	0.69	0.64	1.00	
PRP social rent	0.02	0.11	-0.37	1.00

Capital growth: While most fund returns tend to be derived from income, over the long-term investors can expect capital appreciation on the value of the underlying assets owned by the fund, for which house price inflation (HPI) can be a good proxy.

HPI has typically been tracking on average 2% pa though we've seen pandemic-driven fluctuations with a peak of 13.2% in June 2021.[9] House prices vary geographically and this is likely to be more pronounced as a result of current macro-economic conditions.

Figure 4: Annual house price rates of change for all dwelling, UK January 2006 to June 2022.

Source: Office for National Statistics

8 Impact Investing Institutes, Is there an investment case for social and affordable housing in the UK, October 2021
9 Office of National Statistics, UK House Price Index, March 2021

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Risk

There are certain risks associated with social and affordable housing investment that we believe to be most material or commonly referenced by investors which are set out below.

Table 3: Key risk factors to consider

Risk factor	Return implications	Discussion	Key considerations
Counterparty risk – quality of counterparty that is leasing the property from the fund and its ability to service the lease agreement	Security of yield to investors Capital growth	Social and affordable housing is a highly regulated sector with many established RPs and local authorities. These are generally high-quality counterparties with low bad debt risk: Irrecoverable bad debt ratio averages <1% per annum[10]	**Look for** high-quality, financially resilient counterparties with strong operational capabilities and governance, and assess their ability to manage leases and underlying tenancies Ensure the fund manager establishes fair lease agreements that support long-term sustainability of counterparty, including appropriate lease length and level of indexation **Avoid thinly capitalised counterparties or those with limited track record or inappropriately long lease lengths (see Policy risk)** **Note:** This is particularly important in the presently volatile economic environment
Void risk – underlying properties owned by the fund are not let, impacting the revenues of the counterparty and returns to the fund	Security of yield to investors	Supply/demand imbalance means there are long waiting lists and lack of housing options, which reduce void risk and generally lead to high occupancy rates with low tenant turnover Lease agreements are between counterparty and the fund, therefore, if tenant eligibility changes, it shouldn't impact the revenues to RP. Non-eligible tenants would usually seek more appropriate accommodation and be replaced by another tenant	**Look for** strong partnership between manager and local authority, to ensure housing delivered meets local needs Work with experienced RPs that support residents during times of financial difficulty or distress **Avoid inexperienced RPs that lack experience working with local authorities and support service providers**
Policy risk – withdrawal of Government housing benefit or changes in rent levels, meaning lease terms set between fund and RP diverge from the underlying revenue received	Security of yield to investors	There is strong cross-party support for tackling housing crisis however the level of rent indexation will ultimately be set by Government In periods of high inflation, the rent rises may not keep up in the short term Leases between fund and RPs are typically on a full repairing and insurance (FRI) basis, therefore, there is also a risk that maintenance costs become unaffordable for the RPs	**Look for** funds that are long term in nature (>ten years) where short-term volatility is expected to normalise over its lifetime, with fair rent reviews and risk sharing mechanisms in place to protect RPs' long-term sustainability Mixed-tenure funds can add diversification to types of Government funding of underlying rent. For example, exempt accommodation for specialist housing falls outside the rent regime of social housing **Note:** Regulators have voiced concern about long lease structures with contractual rent rises that are disconnected from Government policy (see Impact and market level risks) which places undue pressure on the leasing counterparty

10 Regulator of Social Housing, Global Accounts of private registered providers, updated December 2021

Risk factor	Return implications	Discussion	Key considerations
Development risk – where funds take on development risk as part of their strategy, delays in construction and rising costs may impact fund returns	Duration to income Capital growth	A small number of social and affordable housing funds take on development risk. Most typically provide forward funding post development approval or acquire existing stock Target total return may be significantly higher for taking on development risk	**Look for** evidence of managers development track record, ability to win deals, robust **sensitivity analysis** to account for potential rise in costs, and relationships with strong development counterparties **Note:** Where funds are involved in development, the time to stabilised target yield is often longer **Avoid managers with lack of experience working with local authorities and landowners**
Resale risk – ability for the fund to sell housings assets in the future to provide liquidity to investors	Capital growth Liquidity	Most social and affordable housing funds invest in high-quality homes with strong alternate use	**Look for** funds that work with high-quality counterparties, ensuring proper maintenance and repairs are included in lease agreements and delivery of housing in desirable areas with transport links, school access to ensure property valuation rises in-line with the market **Note:** The ability to sell and stability of valuation will depend on type of property asset – some housing tenures may require reversal of specialist adaptations

Environmental, Social & Governance (ESG) risks

In addition to risks set out in Table 3, there are certain ESG risk factors that are particularly material to real estate investing, which are unfortunately not negated by the positive impact outcomes an investment might seek to achieve. ESG practices in real estate are rapidly evolving therefore we recommend investors engage with two key initiatives seeking to establish best practice: The Sustainability Reporting Standard for Social Housing (SRS) and the Better Buildings Partnership Climate Commitment.

The Sustainability Reporting Standard for Social Housing (SRS)[11]

This initiative launched in November 2020 as a means for social housing providers to demonstrate their environmental, social and governance (ESG) credentials in a transparent, consistent, and comparable way.

Better Buildings Partnership (BBP) Climate Commitment[12]

The BBP Climate Commitment acknowledges the transformation that is required across the real estate sector to deliver net zero buildings by 2050. The aim of the commitment is to leverage collaborative and tangible, strategic action on climate change.

11 The Good Economy, The Sustainability Reporting Standards for Social Housing
12 Better Buildings Partnership, Climate Commitment

Net zero and the cost-of-living crisis

In line with our international obligations under the Paris Agreement, the Government has legislated for the UK to reach net zero carbon emissions by 2050. According to the Climate Change Committee (CCC), household fossil fuel consumption to heat homes and water accounted for 13% of the UK's total carbon emissions. For RPs of social and affordable housing, the pathway to net zero outlined by the CCC is focused on retrofitting all housing first, with the vast majority of fabric energy efficiency improvements being completed by 2035 (and all social homes reaching EPC C by 2028), aiming to bring all social housing up to Energy Performance Certificate (EPC) C by 2030.[13]

For funds with strategies involved in acquiring existing housing stock (see Section 3), ensuring managers have factored in costs of bringing homes in line with net zero targets is an important area for due diligence.[14] This ideally means ensuring EPC ratings of A or B. Many properties with lower energy performance ratings (EPC below C) could become stranded assets from 2027, and will need to be retrofitted or rebuilt.[15] For impact- housing funds, EPC ratings of C and above which also play an important role in reducing energy consumption and affordability.

At the time of writing, the cost of living in the UK continues to rise, pushing an increasing number of households in to a cost of living crisis and the demand for social and affordable housing is expected to continue to grow, as more households struggle to make ends meet. Rising household energy bills will disproportionately impact people on lower incomes, who spend a higher percentage of their take-home income on essential goods and services than wealthier households. An important factor in helping manage energy consumption is improved energy efficiency of housing and achieving an EPC rating of C or higher. Ensuring social and affordable housing meets the highest possible EPC rating is increasingly important.

13 National Housing Federation, Defining net zero for social housing, July 2021
14 Inside Housing, Overcoming the hurdles to energy efficiency in social housing, July 2022
15 Bfinance, DNA of a manager search, Impact Real Estate, September 2022

Impact

Due to the nature of the asset class, and importantly the intended tenants, we believe that best-in-class social and affordable housing fund managers should live up to some sector standards for impact practices. These practices help ensure housing delivered truly meets people's needs and play an important role in driving long-term resilience, value creation and risk mitigation.

To claim impact, managers should live up to the principles defined by the Global Impact Investing Network's impact investing principles of intentionality and measurement[16]. But the expectations for fund managers in this market should also go further. There is an increasing amount of good practice to be found, that builds upon basic principles, and allows managers to define and underpin their impact credentials.

Five key impact areas for diligence

We encourage investors in their sourcing and diligence to consider these key questions and to utilise the associated resources.

Intentionality: Is there an explicit impact statement or objectives that identify the positive changes to people and planet? In the case of social impact, does this statement respond to a particular social issue (e.g. the cost of living, or shortage of key worker accommodation)?

Additionality: How coherent is the description of how key decisions, such as sourcing, partner selection or asset management, will deliver impact that wouldn't have been delivered otherwise? In social and affordable housing this is often associated with the extent to which supply is net additional to market, but can also be driven by deepening affordability, targeting need, delivering quality services or improving home and place.

Impact measurement: Having set impact objectives, managers should be delivering reporting to investors that demonstrates progress against those goals and targets. We encourage investors to engage with the Equity Impact Project (EIP)[17], co-led by Big Society Capital and The Good Economy collaboratively with 13 real estate managers that explores the important impact goals and measurement to consider. Managers should be encouraged to align with these reporting standards.

Impact practice: Impact practice goes beyond just impact measurement. This refers to the set of processes and practices that ensures impact considerations are embedded throughout the investment process. We encourage investors to engage with the Operating Principles for Impact Management's Impact Principles[18], a set of nine principles that draw on emerging best practice internationally. Investors and managers may elect to become signatories, including undertaking an independent verification.

Impact risk: Managers should be attuned to potential negative impacts that may materialise as a result of their strategy, and be able to articulate their understanding of these risks and the associated mitigants. These include:

a. Risks to individual tenants
b. Risk to providers that supply and manage the housing
c. Risk to the market as a whole, if unsustainable models and practices emerge and are replicated

Impact investments are defined by the following key principles[16]

Intentionality: Positive changes on people and planet must be intentionally identified and sought. This can be done by setting clear impact objectives and then pursuing these actively through the design and investment strategies purposely designed to meet those objectives.

Measurement: The positive changes sought must then be measured. This measurement should seek to 'prove' impact by providing evidence of impact achieved, but also 'improve' impact by using this evidence to inform decision-making and provide feedback to improve impact performance based on lessons learned.

16 The Global Impact Investing Network, Impact Investing
17 The Good Economy, Equity Impact Project
18 Impact Principles, Operating Principles for Impact Management

United Nation's Sustainable Development Goals (UN SDGs)[19]

An increasing number of institutional investors are seeking to explore whether their investment strategies can be aligned to UN SDGs. Social and affordable housing offers an attractive opportunity to do so. Alignment to SDGs can form part of a manager's impact statement or objectives (intentionality), so long as the mechanisms are clearly articulated (additionality) and performance managed (impact measurement and practice). Funds usually directly tackle at least one of the UN SDGs and indirectly contribute to several, including:

Sustainable investment models and market-level risks

Concerns have been raised about the nature and range of models, what constitutes 'good' and 'bad' practice, and the risks and opportunities of private finance in social and affordable housing. For example, Regulator of Social Housing concerns relating to the sustainability of index linked-leases on thinly capitalised counterparties; or questions raised as to the opaqueness of the relationships between developers, RPs and housing investment funds.

An impact investor in this space should facilitate investment flows into models where incentives are aligned and risks are shared, intentions are clear, and there is transparency and accountability to all stakeholders. Long-term impact capital from institutional investors should be well-aligned to the long-term nature and needs of the social housing sector.

19 United Nation's Sustainable Development Goals, The 17 Goals

3 Categorising social and affordable housing funds

Social and affordable housing fund strategies are diverse but they can be grouped in three overarching categories according to the types of housing that they deliver, the people they house and the level of support and care they provide.

These can be considered in line with three of Impact Frontiers' dimensions of impact (What, Who and How Much)[20]

	General Needs Social and Affordable Housing (GNA)	Specialist Supported Housing (SSH)	Transitional Supported Housing (TSH)
What	Typically, new-builds to address chronic undersupply of affordable homes available	Typically, bespoke/adapted new-builds filling the gap in supply of suitable homes for people with specific needs	Typically, homes acquired from existing housing stock that is refurbished
Who	People who cannot afford to rent or buy on the open market including key workers and low-income families	People with specific care requirements in the UK, including older people and people with learning disabilities or mental health needs	People with vulnerability or in crisis, including people who are experiencing or at risk of homelessness, and have experienced domestic abuse
How Much	**6.7 million people** in need of affordable long-term housing solutions with no care or support provided[21]	**>800,000 adults** with high-level, long-term care and support needs[22] Estimated demand for **29,000–37,000 units** of housing by 2028[23]	Estimated **189,500 people** with low-to-medium level transitional support provided needed over the medium term[24]

The categorisations of General Needs Social and Affordable Housing, Specialist Supported Housing and Transitional Supported Housing broadly align with the tenure types defined in the UK's policy and regulatory framework, but also covers private unregulated rental properties let at affordable (sub-market) rates.

When investors compare underlying strategies, there are important factors that differentiate the risk and return within each category, which are covered in more detail on the following pages.

20 Impact Frontiers, Norms, Five Dimensions of Impact
21 National Housing Federation, People in housing need, September 2020
22 IPPR, At a crossroads: The future of transitional supported housing, October 2020
23 Mencap & Housing LIN, Funding supported housing for all, April 2018
24 National Audit Office, The Adult Social Care Market in England, March 2021

General Needs Social and Affordable Housing

Typically, new-build flats or houses for people who cannot afford to rent or buy on the open market, including lower-income families and key workers. As well as regulated social and affordable housing, it can include affordable private rented sector.

Net initial yield range	Typically, 3-5%
Time from investment to income generation	12-24 months
% Government-backed income	50-80% depending on tenure mix of each strategy
Counterparty	Registered Providers e.g., housing associations and local authorities
Tenants	Families, single people and couples Young people and key workers
Care or support services	N/a
Housing tenure	Covers a wide range of tenure types, including: **Home ownership/discount market housing:** properties are offered for sale on selected sites with a discount on the full market value, and must be re-sold at the same level of discount **Shared ownership:** part buy, part rent model **Shared equity:** 100% ownership, with help of a shared equity loan as second charge on property **Social rent:** lowest rent level, set by the Government through national regime **Affordable rent:** up to 80% of local market rent **Intermediate rent:** 80-99% of local market rent
Source of rental income	Paid directly by tenant or owner Most tenants will be eligible for housing benefit via Universal Credit paid for by DWP, sometimes with private top-up In the case of shared ownership and shared equity, rents are paid privately
Property asset	New-build, self-contained dwellings
Capital appreciation	Moderate subject to levels of development risk and location
Typical acquisition methods	Acquire new-builds through forward funding or forward commitments
Lease length with counterparty	Typically, ten years +

Specialist Supported Housing

Typically, bespoke/adapted new-build housing and care for people experiencing vulnerabilities, to enable them to live more independent, stable and happier lives.[25]

Net initial yield range	Typically 5-7%
Time from investment to income generation	>24 months
% Government-backed income	100%
Counterparty	Registered Providers, e.g. housing associations and local authorities, and charities
Tenants	People with specific (often high) levels of long-term care and support needs, including older people, people with a learning disability or mental health needs, vulnerable young people, people who have experienced homelessness.
Care or support services	Commissioned by local authorities or health services
Housing tenure	Covers a wide range of tenure types, for people of working age with care and support needs and extra-care housing for people over 55 with care and support needs
Source of rental income	Tenants' housing benefits paid for by DWP. Exempt rent claims are determined by local authorities Rents are typically exempted from using social rent setting requirements to cover higher costs
Property asset	Range from shared accommodation to self-contained dwellings. May be purpose-built to suit tenants' needs and contain communal facilities but lease terms evolving to better align risk and returns
Capital appreciation	Subject to level of development risk, properties may have high levels of adaptation and require reversals prior to sale
Typical acquisition methods	Acquire new-builds through forward funding or forward commitments, or existing stock in open market
Lease length with counterparty	Typically, 20 years + but lease terms evolving to better align risk and returns

25 IPPR North, At a crossroads: The future of transitional supported housing

Transitional Supported Housing

Typically, existing housing stock provided to people with vulnerabilities or in crisis with moderate to low, medium-term support provided. Transitional Supported Housing represents about 30% of the overall supported housing sector.[26]

Net initial yield range	Typically 4-6%
Time from investment to income generation	<6 months
% Government-backed income	100%
Counterparty	Specialist charities and some Registered Providers
Tenants	Most vulnerable people in society, including: • experiencing or at risk of homelessness • who are young and leaving the care system • who have experienced domestic violence • with mental health issues • with drug or alcohol addiction • with disabilities • who are ex-offenders • who are asylum seekers
Care or support services	Some transitional support may be offered by housing providers, either paid for by a portion of rental income or secured separately from local authorities
Housing tenure	No specific tenure types
Source of rental income	Tenants' housing benefits paid for by DWP Exempt rent claims are determined by local authorities. Dwellings are typically let at Local Housing Allowance rates, which are used to calculate housing benefit for tenants renting from private landlords
Property asset	Self-contained dwellings, typically one to three bed
Capital appreciation	Through retrofit and general improvements
Typical acquisition methods	Acquire existing housing stock through open market
Lease length with counterparty	Typically, five to ten years

26 Duration of support is situational but typically lasts between six and twenty-four months. The nature of support is temporary, addressing specific situational need rather than permanent care requirements for example those resulting from chronic health conditions.

4 Funds landscape in the UK

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Over the past decade the UK social and housing funds market has grown significantly. This growth has been driven by a combination of specialist social investment managers and established global real estate investors, raising long-term institutional investment and in many cases establishment of for-profit RPs. In the past 12 months, two new funds have closed,[27] and seven new managers have entered the market with investment propositions.[28]

Table 4: Today there are 19 fund managers managing over £3.8 billion across 29 UK social and affordable housing impact funds (see methodology for basis for inclusion below):

Fund manager	Category	Total real estate AUM	Total social and affordable housing AUM	Number of funds[29]	Fund vintage(s)
Alvarium Investments	● TSH	>£1bn	<£1b	1	2020
CBRE	● GNA ● SSH	>£10bn	<£250m	1	2018
Cheyne Capital	● GNA	>£1bn	<£500m	2	2014, 2020
Civitas Social Housing	● SSH	>£1bn	<£1bn	1	2016
Columbia Threadneedle	● GNA	>£1bn	<£250m	1	2019
Edmond de Rothschild	● GNA ● SSH	>£10bn	<£250m	1	2015
Fore Partnership	● TSH	<£1bn	<£250m	2	2018, 2021
Fundamentum Group	● SSH	<£1bn	<£250m	1	2019
Gresham House	● GNA	<£1bn	<£500m	3	2017, 2017, 2021
Henley	● SSH	>£1bn	<£1bn	2	2017, 2022
M&G Real Estate	● GNA	>£10bn	<£250m	1	2021
Man Group GPM	● GNA	>£1bn	<£250m	1	2019
Patrizia	● GNA	>£10bn	<£250m	1	2021
PFP Capital	● GNA	<£1bn	<£500m	1	2018
PGIM Real Estate	● GNA	>£10bn	<£250m	1	2020
Resonance	● TSH ● SSH ● GNA	<£1bn	<£500m	7	2013, 2015, 2017, 2020, 2020, 2020, 2021
Schroders Capital	● GNA	>£10bn	<£500m	1	2019
Social and Sustainable Capital	● TSH	<£1bn	<£250m	1	2019
Triple Point	● SSH	<£1bn	<£1bn	1	2017

27 Henley IM, Henley targets £1bn for new UK social housing fund, June 2022; PATRIZIA, Our Funds, March 2022
28 Size of the UK social impact investment market, December 2021; BSC data collected in response to UK Social and Affordable Housing request for proposals, March 2022
29 UK social and affordable housing funds included only, see methodology and basis for inclusion. Real estate and UK Social and Affordable Housing AUM based on fund manager reported data.

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Methodology and basis for inclusion

All funds listed:

- Invest in UK residential property.
- Provide finance to acquire or develop property through lease-based structures, or in one case through a loan-based funding model.
- Provide homes for individuals who are not served by the private home ownership or rental markets.
- Commit to delivering positive impact for people by delivering high-quality, safe and affordable homes.
- Apply an impact framework to investment decisions.
- Have demonstrated an impact intent through an impact report.
- Have investments made into mission-led organisations such as housing associations and charities.
- Have reached at least a 'first close'.
- Multiple investors, therefore, single investor separately managed accounts are not reflected in this data.

For funds outside Big Society Capital's portfolio, we have not been able to verify the depth of the impact intent and quality of the impact practice beyond publicly available information.

Insights and what we're learning: 2022 Request for Proposals (RFP)[30]

In response to Big Society Capital and Cardano's 2022 joint RFP, we received 28 submissions with collective fundraising targets of up to £16 billion at final close. In comparison, for a similar exercise in 2020, we received 15 submissions looking to raise £10 billion representing a significant growth in market and pipeline activity.

Key insights:

- Majority of strategies fell in to general needs social and affordable category.
- Specialist Supported Housing focused strategies are growing in popularity.
- Only a small number of strategies focus on Transitional Supported Housing.
- Average target fund size was **£400 million.**
- **42% of submissions were open ended funds.**
- **Wide range in target net IRRs** ranging from **5-10%.***
- The emerging picture is the number of mainstream real estate managers looking to enter the market is increasing. This growth of non-impact dedicated managers re-enforces the **need for robust assessment of the quality of managers impact practices** as discussed in Section 2.

*Target net IRRs have increased since 2020 for GNA submissions (likely driven by higher capital appreciation assumptions and inflation) these returns are likely to be impacted by the current macro-economic environment.

30 Big Society Capital, Big Society Capital and Cardano are seeking investment strategy submissions for tackling the UK housing crisis

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Investment vehicle and fees

Investment vehicles used by social and affordable housing fund managers typically fall into one of the following:

- **Limited Partnership:** An unlisted collective investment vehicle, either closed-ended or open-ended in structure, depending on the profile of underlying assets.
- **Real Estate Investment Trust (REIT):** A publicly listed investment vehicle, typically evergreen, specifically designed to invest in real estate.
- **Property Authorised Investment Fund (PAIF):** An authorised investment fund structured as an open-ended investment company, which carries on a property investment business.

These structures are either open or closed ended:

- **Closed-end structures** can give more certainty that the impact of an investment will be maintained for the life of the fund, however a sale of assets may be required to provide liquidity to investors thereafter. To support their impact objectives, closed-end funds may look to transfer assets to subsequent 'follow-on' or continuation funds.
- **Open-ended structures** that can hold assets in perpetuity, may be seen as advantageous from an impact perspective, however, whereas in a closed-end fund the exit point is known and can be managed for, these funds will have redemption rights that could force sales. Noting the importance of liquidity to institutional investors, a growing number of opportunities are structured via open-ended funds, and investors should be mindful of the relatively restrictive initial lock-ups and subsequent redemptions offered.

The choice of investment vehicle structure should ultimately be driven by the characteristics of the underlying assets and long-term fund strategy, and similar vehicles tend to be used to invest within categories (see section 3). For example, SSH requires a longer time horizon and therefore funds in this category favour open-ended strategies and REITs.

When considering the continuity of impact for a social and affordable housing fund, one of the most important things for investors to test is the manager's alignment of interests and understanding of the impact risks associated with different strategies.

Fees

Fees vary according to the underlying asset and fund structure. Overall, social and affordable housing funds tend to have slightly higher fees than those of conventional real estate due to the specialist capabilities, proactive management and resources required to invest in the sector. We believe these fees generally present good value for money when considering the role, they play in delivering attractive risk-return and impact. Furthermore, we would expect the fees to reduce as the sector matures.

While there is wide dispersion of management fees across strategies, indicative of the recent and emerging growth in this sector, we do tend to see the same general features when assessing fund manager fees:

- **Management fees:** It is common to see a sliding management fee dependent on phase in fund life (higher in deployment, lower in investment period), early movers (lower fees for first £x of total committed capital), ticket size (lower fees for large ticket sizes), or tier system (higher bps. on first £x tranche of commitment and gradually lower for higher tranches of each commitment). Management fees are typically calculate based on NAV.
- **Performance fees:** Some funds may include performance fees though this is not common practice. Where there are performance fees, these tend to be 10% – 20% above a hurdle of about 4-6%.
- **Other fees:** Funds may charge fees in addition to management fees on a per annum basis for general administrative, legal, depository, or director expenses, as well as property-specific fees such as acquisition fees (calculated on gross sale value or gross development value), transaction fees, external property management fees, or advisory fees.

We would recommend comparing fees across funds on a total global expense ratio (TGER) basis,[31] and seeking benchmarks to compare the fee base where possible.

Leverage

Some fund strategies utilise leverage and where leverage is utilised, this is typically at 40% loan to value (LTV).

31 The Total Global Expense Ratio (TGER) facilitates the comparison of fees and costs between real estate investment vehicles that operate across different regions of the globe.

About Big Society Capital's social and affordable housing investments

Big Society Capital invests alongside others in housing funds that increase the supply of good-quality social and affordable homes. We work with specialist fund managers across all three categories. The common thread across our investments, is that fund managers partner with expert social enterprises and charities that are experienced in supporting vulnerable people.

Our investment numbers:

£187m
total invested in Big Society Capital

£1bn
total invested by Big Society Capital and other investors alongside us

8,500
number of people our investments are projected to provide homes for

Why we invest in social and affordable housing?

- It is core to our mission of improving the lives of people in the UK through investment with a sustainable return.
- Social and affordable housing delivers attractive risk adjusted returns.
- Investment can play a significant role in addressing the housing crisis; it can help address problems in the system and increase the supply of affordable housing.

We have supported the development of this market in several ways:

- **Investing as a cornerstone investor:** In new social and affordable housing funds, to help encourage other investors alongside us. For example, we seeded the first social and affordable housing funds managed by Cheyne Capital and Resonance, designed to bring equity capital to the social and affordable housing sector.
- **Working with social enterprises, charities and social purpose organisations:** To develop and seed investment ideas that answer unmet social needs through housing, alongside fund managers who are informed.

Table 5: Our social and affordable housing investments

Fund Manager	Fund Name	Strategy	Fund Size
CBRE Global Investors	CBRE UK Affordable Housing Fund	GNA SSH	>£250m
Cheyne Capital	Cheyne Capital Social Impact Fund	GNA	<£250m
Columbia Threadneedle	Columbia Threadneedle Housing Fund	GNA	<£100m
Funding Affordable Homes	Funding Affordable Homes Fund	GNA SSH	<£100m
Man Group	Man GPM RI Community Housing Fund	GNA	<£250m
Resonance	Affordable Homes Rental Fund	GNA	<£15m
Resonance	National Homelessness Property Fund 2	TSH	<£100m
Resonance	Real Lettings Property Fund LP	TSH	<£100m
Resonance	Resonance Supported Homes Fund	SSH	<£50m
Resonance	The National Homelessness Property Fund LP	TSH	<£50m
Resonance, Patron Capital	Women in Safe Homes LP	TSH	<£50m
Social and Sustainable Capital	Social and Sustainable Housing LP	TSH	<£100m
Social and Sustainable Capital	Social and Sustainable Housing 2 LP	TSH	<£50m

Important information

This research is for information purposes only and has been produced by Big Society Capital Limited in its capacity as a market builder for social impact investment. It is not investment research or a research recommendation, and has not been prepared in accordance with legal requirements designed to promote investment research independence. This research does not constitute an offer or an invitation to buy or sell or a solicitation of an offer or invitation to buy or sell or enter into any agreement with respect to any security, product, service or investment. Any opinions expressed do not constitute investment advice and independent advice should be sought where appropriate. All information is current as of the date of publication, subject to change without notice, and may become outdated over time. Links to third-party sites or pages are for information purposes only and such sites and pages are not the responsibility of Big Society Capital Limited and have not been reviewed or verified by Big Society Capital Limited. Following links to or from any other sites or pages shall be at your own risk.

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