

# Building A Position in U.K. Social Housing: An Introduction to the Asset Class for Institutional Investors

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Investments in U.K. social housing increasingly are attracting the attention of institutional investors who seek to achieve portfolio diversification along with the potential for superior risk-adjusted returns. As a sub-sector within infrastructure investment, the market for U.K. social housing bonds is sizeable and growing. A recent government survey noted that as of year-end 2021, Private Registered Providers (the main owners of social housing) had a total of £117 billion in financing facilities in place.<sup>1</sup> It is expected that an additional £41 billion in debt facilities will be needed over the next five years.<sup>2</sup> The asset class is characterized by long duration that can also offer attractive cash flows: average maturity at issuance is 25-30 years, and the issuers are typically viewed as single A credit quality.<sup>3</sup> Importantly, the projected strong demand for new high

quality, affordable rental units, as well as renovations and maintenance of existing units, could create a substantial flow of new investment opportunities for the foreseeable future. At the same time, the ESG-related aspects of social housing can help enable investors to invest in assets with a positive impact.

As a participant in the social housing sector for more than six years, MetLife Investment Management believes that a compelling argument can be made for including a strategic allocation to U.K. social housing in a multi-asset institutional portfolio. Accordingly, we believe institutional investors would be well advised to educate themselves about the track record, investment characteristics and demand drivers of this unique asset class.

## Deep Heritage of U.K. Social Housing

The history of affordable housing in the U.K. dates back at least to 1919, when initiatives to provide decent living conditions for troops returning from WWI led to the creation of government-sponsored rental units known as council housing. The construction of council houses accelerated dramatically post-WWII, spurred by the need to replace housing stock destroyed by the Blitz.<sup>4</sup>

However, “social housing” as it is known today really came into existence in the 1980s, as government policies shifted the development of affordable rental units away from local councils toward housing associations, most of which are now private entities.<sup>5</sup> Although social housing in the U.K. continues to enjoy some form of government subsidies, most owners of such housing are so-called Private Registered Providers (PRPs). PRPs mostly consist of not-for-profit entities, although a number of for-profit entities are also present in the sector. In October 2021 it was reported that the social rental housing sector consists of 4.1 million homes, or 17% of all residential dwellings in the country.<sup>6</sup> PRPs accounted for 2.5 million homes or 61% of the social housing sector, with local authorities being responsible for the remaining 39%.<sup>7</sup>

The bulk of the financing for U.K. social housing – approximately 70% – comes from private sources.<sup>8</sup> Debt funding accounts for the majority of capital raised by PRPs, although specialist REITs have brought public equity into the sector. There is also some private equity

activity, although this capital source is still in its infancy.<sup>9</sup> Investors often find it preferable to invest in projects sponsored by not-for-profit entities, as they do not have the same incentive to pull cash out of a project to boost their returns.

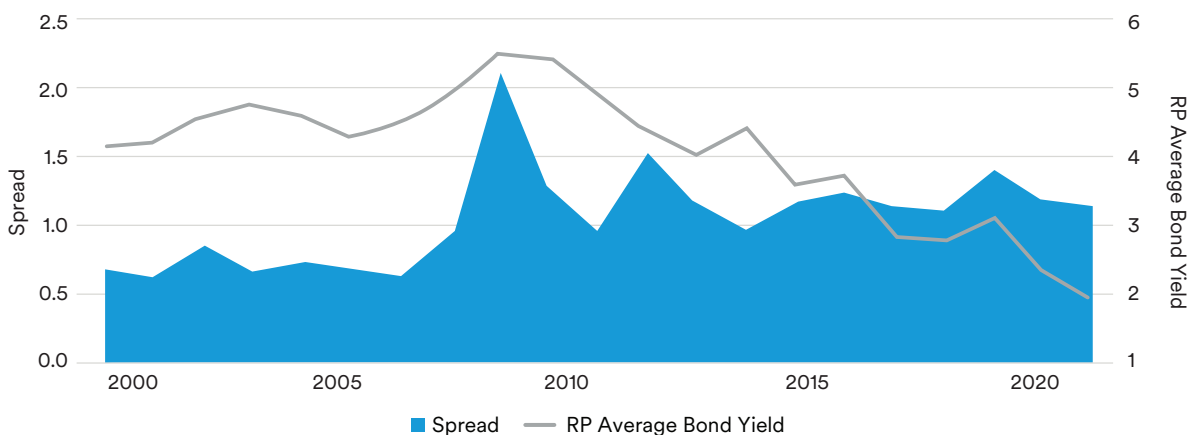
## Infrastructure-Like Characteristics

For those investors considering where social housing might fit into their portfolios, MIM believes it should be viewed as being more akin to an infrastructure investment, rather than real estate. Like infrastructure, social housing is an essential service, regulated and supported by government authorities. The long (25-30 year) duration of social housing bonds, as well as their cash flow characteristics, are also similar to infrastructure investments. Depending on the business model of the PRP or REIT, the issuer may also benefit from contracted cash flows, as a result of long term leases with local authorities. Leverage for social housing bonds is typically modest, with debt-to-equity ratios near 50% and strong interest coverage.<sup>10</sup> As noted earlier, issuers of social housing bonds typically have a credit rating equivalent to single A. The risk of default can also be mitigated by the fact that regulators can intervene to provide financial assistance or effect changes in management in cases of financial stress.

Social housing’s appeal as an investment is also due in part to the predictable rent structure and overall supervision mandated by regulatory entities. The system

**Figure 1 | Credit Spreads for Social Housing Bonds Remain Steady (%)**

Average registered provider (RP) bond yields and the spread over the risk-free rate (maturity adjusted)



Source: M&G, Bloomberg

of annual rent adjustments for regulated housing units ensures that rents remain affordable for tenants while still providing the potential for attractive returns for owners. From 1997-2020, for example, social rents increased by an average of 3.3% annually, although currently the rent adjustment is set at CPI + 1% for the next five years.<sup>11</sup> Additionally, the Regulator of Social Housing provides an ongoing assessment of registered housing providers and rates them in terms of governance and financial viability.

### Potential for Portfolio Diversification

We believe the potential for attractive risk-adjusted returns and reliable cash flows associated with social housing bonds make them well worth considering as vehicles for sector diversification. The following chart provided by Property Funds Research suggests that including social housing in a multi asset portfolio can help improve risk adjusted returns.<sup>12</sup>

In addition to its return characteristics, as a component of an institutional portfolio, social housing can help provide diversification from other infrastructure investments such as energy, utilities, transportation, water, etc. This may be important for traditional investors in long-duration, fixed income assets, such as insurance companies and pension funds, which typically have higher-than-desirable sector concentrations. For example, the Bloomberg U.S. Long Credit Index reveals that the top five sectors make up more than 65% of the index.<sup>13</sup> The Euro Aggregate Corporate 10 Year Index and the Global Aggregate Corporate 10 Year Index

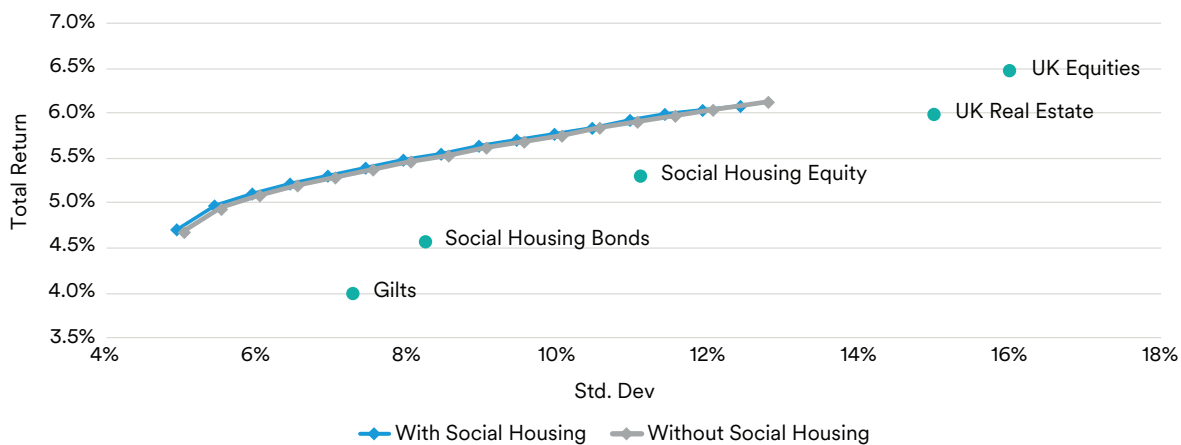
are also highly concentrated with the top five sectors comprising 79% and 73%, respectively.<sup>14</sup>

### Potential for Future Investment Opportunities

While the supply of social housing constructed in recent years has been substantial, demand is higher still, which should help lead to future opportunities for investment in the sector. With respect to total demand, there are an estimated 1 million households on local authority waiting lists.<sup>15</sup> Social housing is expected to be an important component in closing this vast housing gap. According to a report published by the Housing, Communities and Local Government Select Committee of the House of Commons, England requires more than 90,000 net additional social rent homes per year.<sup>16</sup> Significant capital expenditure also will be required to be linked to decarbonization, as well as better safety and fire protection measures. Overall, PRPs forecast that they will need new debt facilities of £41 billion over the next five years to fund social housing development projects.<sup>17</sup>

There is no mystery as to why the demand for social housing is so large, given that conventional, non-subsidized housing is priced beyond the reach of many U.K. households. Affordability varies widely by region. Country-wide, the median house price as a multiple of gross annual earnings was 7.69 times in 2020, up from 6.84 times in 2010.<sup>18</sup> In London, the median house costs 11.8 times annual earnings, and in the South East the ratio is 9.92 times.

**Figure 2 | Multi-Asset Portfolio’s Efficient Frontier With and Without Social Housing Equity Investments**



Source: Property Funds Research for the Impact Investing Institute, October 2021.

Income level, of course, is another factor in the need for social housing. The lowest income areas in England were the Midlands, North West, North East and Yorkshire, according to a 2021 report by the Office of National Statistics. That said, while London and the South East had relatively higher incomes, housing costs also ranged higher, as noted above, and thus affordability was more of a problem.<sup>19</sup>

Potential investors in social housing bonds should note that a key driver of demand, population growth, also varies regionally. Overall, England's population is expected to grow 5.0% through 2028 (from a 2018 base). But, the East Midlands region is expected to demonstrate the highest growth rate, at 7.0%, followed by the South West at 6.8%. London and environs will be just below the median, at 4.9%, with the South East at the low end of the growth scale at 4.4%.<sup>20</sup>

Responding to the demand catalysts noted above, there are major social housing development plans across all regions. That said, the COVID-19 pandemic paused many of these development plans, due to lockdowns and supply chain disruptions. In addition, PRPs recognize the need to prioritize expenditures for maintenance, safety and energy-saving improvements – a shift in investment that may lead to delays in delivering new units. In any event, PRPs have the flexibility to implement their development plans at an appropriate pace, and thus can allocate funds either to new units or to maintenance/upgrades as needed.

## Social Housing is an ESG-Positive Investment

We believe the fact that U.K. social housing is fundamentally aligned with sound environmental, social and governance (ESG) principles should appeal to many institutional investors. Clearly, this form of housing satisfies a significant societal need for affordable housing, especially for individuals and families with specialized care and support needs. There also is an increasing focus by the U.K. government and owners on energy-efficient projects. For example, in 2021 the government launched its Social Housing Decarbonisation Fund, which allows social housing providers to apply for public subsidies to make major energy upgrades to their units.<sup>21</sup> In the first phase of the Fund, £160 million was set aside for energy-saving improvements, with a total of £3.8 billion allocated to be spent over a 10-year period.

Social housing also is eligible for sustainability-linked financing, an increasingly popular structure that offers incentives to investors based on the achievement of



certain KPIs. According to Fitch Ratings, public bonds labelled as either “green” or “sustainable” totalled almost £5 billion in 2021, as supply was, “supported by domestic investor appetite and international capital inflows.”<sup>22</sup> In this regard, the International Capital Markets Association (ICMA) has established a set of principles for sustainability-linked bonds that may encourage more issuers to link bond pricing to their ability to hit general ESG targets.<sup>23</sup>

## Conclusion: The Role of Social Housing in a Diversified Portfolio

For institutional investors, adding a position in social housing to their portfolios may be a classic example of “doing well by doing good.” Across the U.K., the social housing sector provides more than 4 million homes for those with lower incomes or special care needs.<sup>24</sup> In order for the number of social rental units to increase at the level recommended by the government – some 90,000 net new homes annually – it will be essential to tap the resources of the capital markets.

Fortunately, social housing bonds appear to fit the requirements of many institutional investment portfolios, offering potentially attractive risk-adjusted rates of return, credit ratings equivalent to a single A, and cash flows over a long duration<sup>25</sup>. In addition, given the growing focus on investments with a positive ESG impact, we feel social housing debt instruments that support a valid societal purpose can have a positive impact on investor portfolios.

## Endnotes

- <sup>1</sup> Bloomberg
- <sup>2</sup> Bloomberg
- <sup>1</sup> Quarterly survey for Q3 (October to December) 2021 - Summary - GOV.UK ([www.gov.uk](http://www.gov.uk))
- <sup>2</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 45).
- <sup>3</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 45).
- <sup>4</sup> BBC News, "A History of Social Housing" (April 2015).
- <sup>5</sup> Social Housing Matters, "History of Social Housing" (March 2022).
- <sup>6</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 12).
- <sup>7</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 12).
- <sup>8</sup> IPE Real Assets, "UK social housing: Investment case stacks up for institutional investors" (Feb. 2022).
- <sup>9</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 45).
- <sup>10</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 45).
- <sup>11</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 46).
- <sup>12</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 87). This chart was published in October 2021 and it was run in October 2021 based on forward looking estimates rather than using backward looking data from indices.
- <sup>13</sup> Bloomberg, March 31, 2022
- <sup>14</sup> Bloomberg, March 31, 2022
- <sup>15</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 11).
- <sup>16</sup> Building more social housing - Housing, Communities and Local Government Committee - House of Commons ([parliament.uk](http://parliament.uk)) (July 2020, Fig. 6).
- <sup>17</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 45).
- <sup>18</sup> House price to workplace-based earnings ratio - Office for National Statistics ([ons.gov.uk](http://ons.gov.uk)).
- <sup>19</sup> Mapping inequality in the UK ([ons.gov.uk](http://ons.gov.uk)).
- <sup>20</sup> Subnational population projections for England - Office for National Statistics.
- <sup>21</sup> <https://www.gov.uk/government/publications/social-housing-decarbonisation-fund>
- <sup>22</sup> Green, Sustainable Bonds Increase UK Social Housing Sector Debt ([fitchratings.com](http://fitchratings.com))
- <sup>23</sup> ICMA drives ESG bond issuance with new principles | IFR ([ifre.com](http://ifre.com))
- <sup>24</sup> Social housing sector stock and rents statistics show impact of pandemic - GOV.UK ([www.gov.uk](http://www.gov.uk))
- <sup>25</sup> Impact Investing Institute, "Is There an Investment Case for Social and Affordable Housing in the U.K.?" (Oct. 2021, pg. 45).

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## **Appendix**

This appendix contains details for the preceding charts and provides additional information for greater accessibility.

## Credit Spreads for Social Housing Bonds Remain Steady (%)

**Note:**

- All values are approximate
- The area graph has these characteristics:
  - 2000 to 2007: Varies by about 0.25%
  - 2008 to 2011: Rises sharply to 2.15% and falls sharply to 0.95%.
  - 2012 to 2020: Varies by about 0.50%.
- The line graph rises gradually to about 2.25% in 2009 and then declines moderately.
- Source: M&G, Bloomberg

| <b>Year</b> | <b>Spread</b> | <b>RP Average Bond Yield</b> |
|-------------|---------------|------------------------------|
| 2000        | 0.65          | 4.20                         |
| 2005        | 0.70          | 4.30                         |
| 2010        | 1.15          | 5.15                         |
| 2015        | 1.20          | 3.35                         |
| 2020        | 1.20          | 2.50                         |



## Multi-Asset Portfolio's Efficient Frontier With and Without Social Housing Equity Investments

### Note:

- All values are approximate
- The line graphs show 16 readings for assets "With Social Housing" and "Without Social Housing". These readings appear in the first 32 rows of the table below.
- The remaining 5 rows in the table below are assets presented as a dot plot.
- The line graphs track each other closely and rise along a smooth curve.
- Source: Property Funds Research for the Impact Investing Institute, October 2021

| <b>Asset</b>               | <b>Std. Dev.</b> | <b>Total Return</b> |
|----------------------------|------------------|---------------------|
| With Social Housing - 1    | 5.00%            | 4.54%               |
| With Social Housing – 2    | 5.50%            | 4.95%               |
| With Social Housing – 3    | 6.00%            | 5.10%               |
| With Social Housing – 4    | 6.50%            | 5.20%               |
| With Social Housing – 5    | 7.00%            | 5.30%               |
| With Social Housing – 6    | 7.45%            | 5.40%               |
| With Social Housing – 7    | 8.00%            | 5.50%               |
| With Social Housing – 8    | 8.50%            | 5.55%               |
| With Social Housing – 9    | 9.00%            | 5.65%               |
| With Social Housing – 10   | 9.45%            | 5.73%               |
| With Social Housing – 11   | 10.00%           | 5.78%               |
| With Social Housing – 12   | 10.55%           | 5.80%               |
| With Social Housing – 13   | 11.00%           | 5.95%               |
| With Social Housing – 14   | 11.50%           | 6.00%               |
| With Social Housing – 15   | 12.00%           | 6.05%               |
| With Social Housing - 16   | 12.50%           | 6.07%               |
| Without Social Housing – 1 | 5.05%            | 4.70%               |

|                             |        |       |
|-----------------------------|--------|-------|
| Without Social Housing – 2  | 5.55%  | 4.90% |
| Without Social Housing – 3  | 6.05%  | 5.05% |
| Without Social Housing – 4  | 6.30%  | 5.20% |
| Without Social Housing – 5  | 7.05%  | 5.27% |
| Without Social Housing – 6  | 7.55%  | 5.35% |
| Without Social Housing – 7  | 8.05%  | 5.45% |
| Without Social Housing – 8  | 8.70%  | 5.50% |
| Without Social Housing – 9  | 9.05%  | 5.60% |
| Without Social Housing – 10 | 9.50%  | 5.70% |
| Without Social Housing – 11 | 10.05% | 5.75% |
| Without Social Housing – 12 | 10.60% | 5.80% |
| Without Social Housing – 13 | 11.05% | 5.90% |
| Without Social Housing – 14 | 11.80% | 6.05% |
| Without Social Housing – 15 | 12.05% | 6.05% |
| Without Social Housing – 16 | 12.95% | 6.15% |
| Gilts                       | 7.30%  | 4.00% |
| Social Housing Bonds        | 8.30%  | 4.55% |
| Social Housing Equity       | 11.10% | 5.30% |
| UK Real Estate              | 15.00% | 6.00% |
| UK Equities                 | 16.00% | 6.50% |