The Affordable Housing Report

2024

How an increase in institutional capital can unlock affordable housing supply amid a challenging backdrop

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Unlocking the opportunity

Challenges to increasing affordable housing delivery remain but significant new capital continues to be attracted to the sector.

As the UK emerges from a period of economic upheaval, the debate around the housing crisis continues to dominate headlines. While easing inflation and higher wages may suggest better times lie ahead, affordability remains a key challenge.

Adding to the pressure, development activity has slowed, curbed by higher financing costs, build-cost inflation, and regulatory uncertainty. The delivery of homes of all tenures is almost certain to fall before it recovers.

A slowdown in delivery comes against the backdrop of a long-term need for more housing of all tenures, but particularly for affordable housing. There are currently 1.2 million households on social housing waiting lists in England unable to afford private rents or access home ownership, government figures show.

According to the National Housing Federation (NHF), 145,000 new affordable homes are needed each year in England to meet demand, with 56% of that figure needing to be delivered in London and the South East.

Current delivery falls considerably short of that. Figures from the Department for Levelling Up, Housing and Communities (DLUHC) show that 63,605 new affordable homes were added to supply last year in England. This represented a 7% increase in delivery year-on-year and was the highest level of new affordable housing supply since 2014-15, but it is still chronically behind need.

> "There are currently 1.2 million households on social housing waiting lists in England unable to afford private rents or access home ownership."

Section 106 agreements accounted for 47% of affordable housing delivery last year, up from 44% the previous year and from 18% a decade ago.

DEVELOPMENT PRESSURES

Meeting the supply challenge is not going to be easy, particularly given the considerable pressures ahead for future affordable housing supply. Housing Associations (HAs), who have driven affordable home delivery in recent years, are near to borrowing limits and unable to raise new equity due to their not-for-profit status.

145,000

new affordable homes are needed each year in England to meet demand

In addition, they are now facing new financial headwinds due to costs associated with decarbonisation of their existing homes and fire remediation programmes. The NHF has estimated the impact of fire safety repairs for the sector alone would equate to a non-recoverable funding cost of over £10 billion.

Consequently, many have announced plans to scale back development programmes to focus investment on existing stock. It means that, whilst in previous market downturns HAs have played a key role in maintaining housing supply, they are unlikely to be able to deliver at higher volumes over the coming years.

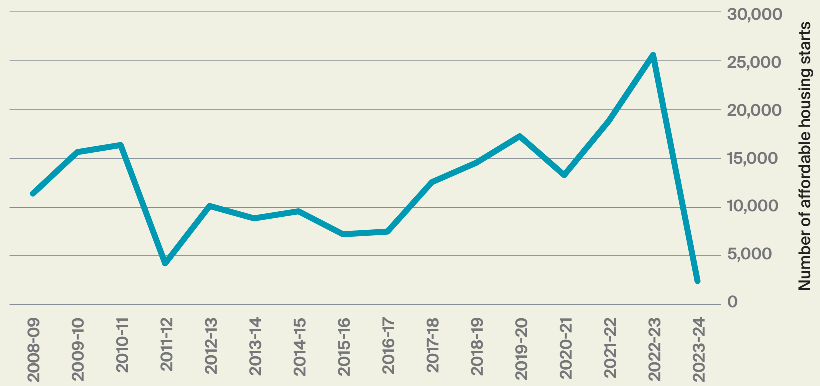
Official figures from the Greater London Authority confirm that affordable housing starts in London fell a staggering 90% to just 2,358 in the 12 months to end March 2024, for example, down from 25,658 the previous year. Across England, the latest data on affordable housebuilding shows that grant-funded starts of social rent, affordable rent and shared ownership properties fell by 60% year-on-year in the first half of the 2023/24 financial year.

> "Section 106 agreements accounted for 47% of affordable housing delivery last year, up from 44% the previous year and from 18% a decade ago."

This will present more opportunities for For-Profit Registered Providers (FPRPs) and investors to build their development programmes, particularly through the increased use of partnerships.

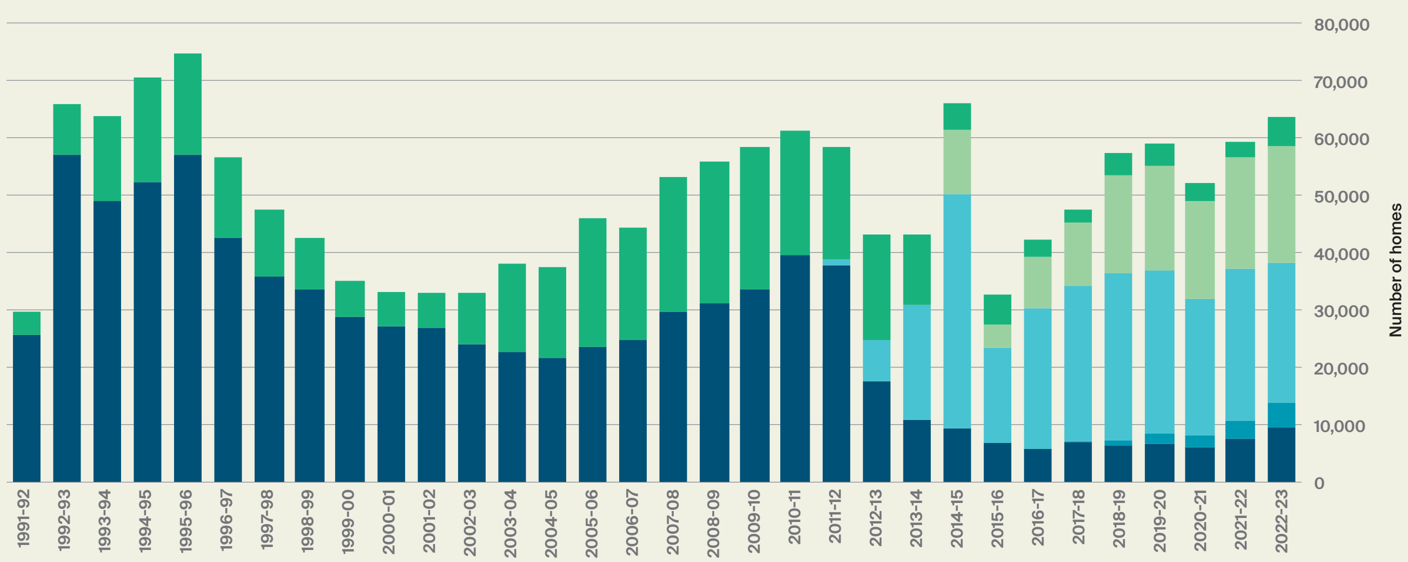
Fig 3: London affordable housing starts drop 90%

Total starts 2008-2024



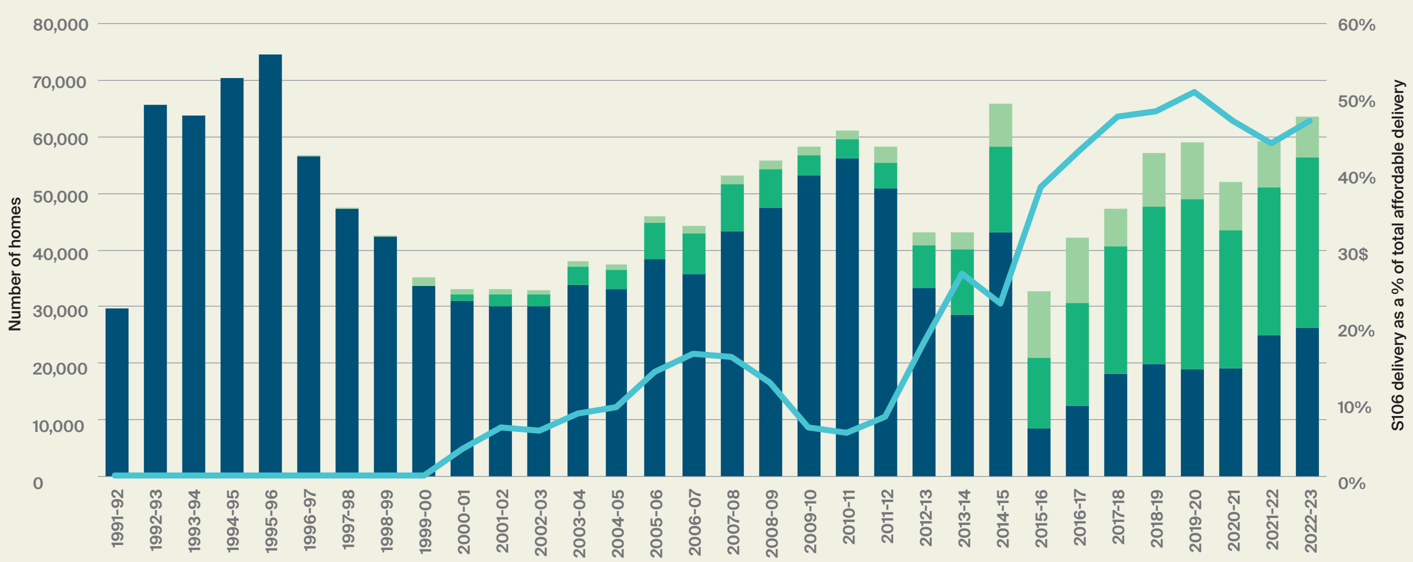
Source: Knight Frank Research, GLA

Fig 1: Affordable housing delivery by tenure



Source: Knight Frank Research, DLUHC

Fig 2: Affordable housing delivery by funding type



Source: Knight Frank Research, DLUHC

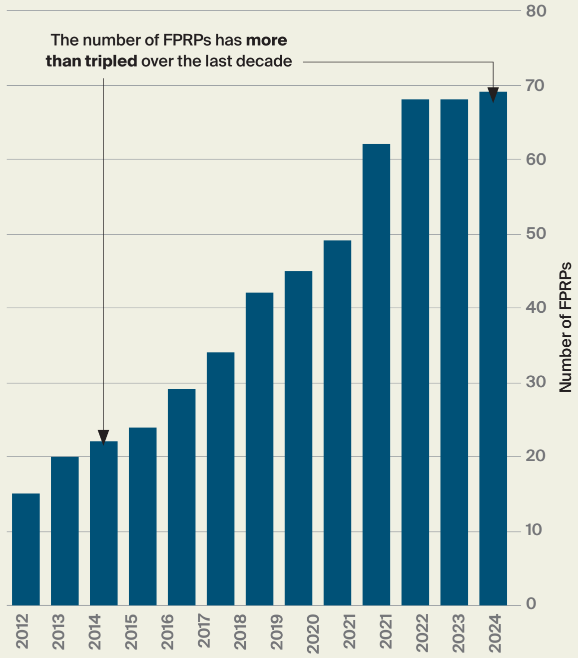
The rise of private capital

It is likely that, with insufficient public funding available to plug the supply gap on its own, more institutional capital is needed, combined with an increase in grant levels from government.

At the start of 2024 there were 69 FPRPs. This has more than tripled in the last decade. These new institutional investors bring an additional financing route that was previously not available, increasing the total capacity in the sector.

Fig 4: Growth of for profit registered providers

Number of FPRPs



Source: Knight Frank Research, Regulator of Social Housing

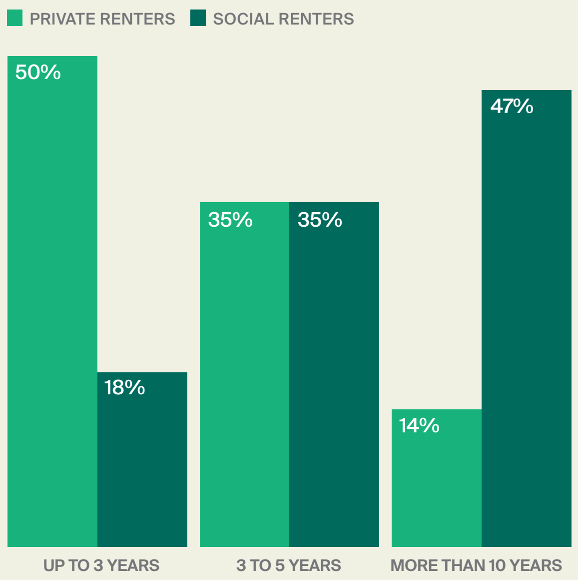
For institutions, the continued supply and demand imbalance, long-term income and inflation-hedging characteristics make affordable housing an attractive proposition. It also offers strong ESG attributes, particularly with regards to the social impact of delivering new affordable housing.

In addition, more affordable rents mean longer tenancies. Longer tenancies mean lower void periods, turnover costs, maintenance spend and more secure income streams. In the UK, 47% of social renters have been in their current home for over 10 years, with only 18% renting for less than three years. This is almost directly inverse to renters in the private sector.

> "For institutions, the continued supply and demand imbalance, long-term income and inflation-hedging characteristics make affordable housing an attractive proposition."

Fig 5: Social renters make 'stickier' tenants

Length of time in current home



Source: Knight Frank Research, English Housing Survey

A GROWING MARKET FOR FOR PROFIT PROVIDERS

FPRPs now own 29,272 affordable homes. This represents growth of 40% since 2022, yet it remains a fraction of overall affordable housing stock at just 0.9%. While the number of HAs still greatly outweighs the number of for-profit players, the sector is expanding, and we expect the ratio will continue to shift year-on-year in favour of FPRPs.

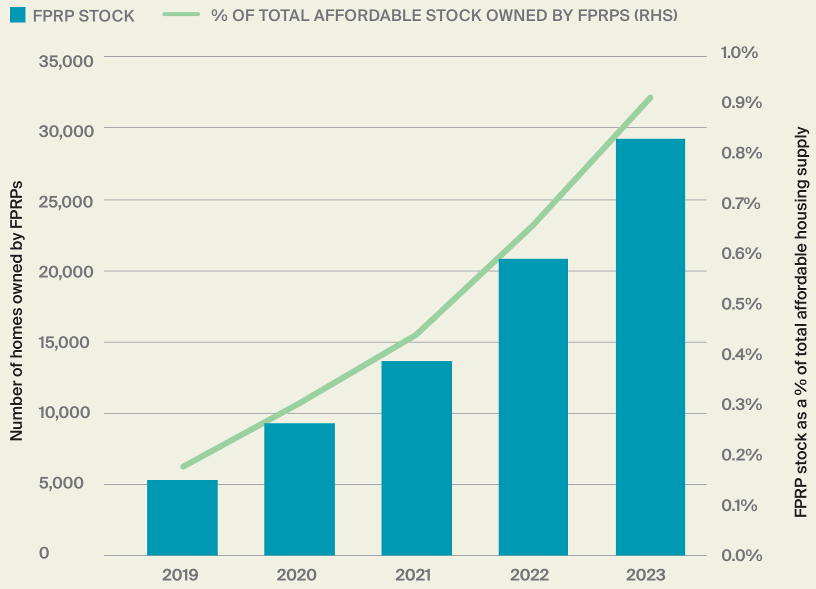
Projections and current delivery rates mean we estimate that institutional ownership will nearly treble over the coming five years, rising to more than 86,000 homes by the end of 2028. Yet even then it will still only account for a small portion of the market. In the short term, the rising cost of capital may act as a constraint to future growth of existing FPRPs but we expect to see greater levels of activity from new entrants in the coming years.

86,000

Knight Frank estimate of the number of homes owned by FPRP by the end of 2028

Fig 6: Stock owned by for profit registered providers (FPRPs)

As a % of total affordable housing stock



Source: Knight Frank Research, Regulator of Social Housing

SHIFTING DEMAND

Traditionally, FPRPs have expanded their portfolios through acquiring Section 106 properties from developers and grant-funded developments. In addition, there is growing interest in acquiring older housing stock.

The wider development slowdown is likely to result in fewer Section 106 deals being completed this year, yet the appetite to fund large best-in-class deals from remains, particularly from FPRPs. Knight Frank recently advised Canary Wharf Group on its forward sale of 294 affordable-rent homes to CBRE IM's UK Affordable Housing Fund for £84 million. Other key deals to have transacted over the last 12 months include a c.£245 million partnership agreement between Vistry homes and Blackstone-backed Sage to forward fund 1,393 affordable homes for rent and shared ownership, and a £110 million joint venture between Clarion and London Square to deliver a mix of affordable and private sale net-zero carbon homes, all demonstrating the depth of capital currently looking at the sector.

In the absence of any other government schemes, and a slower sales market, it is likely that an increasing number of private units will be switched to shared ownership or other affordable tenures. Data from Molior, for example, shows that in London a quarter of the units absorbed or sold in the first three months of the year were switched to affordable.

> "For profit registered providers now own nearly 30,000 affordable homes, that represents growth of 40% since 2022 as more and more investors enter the market."

STRONG FUNDAMENTALS WILL DRIVE MORE INSTITUTIONAL CAPITAL

Despite the current challenges in the economy, the long-term fundamentals of the sector remain robust. A persistent undersupply of new homes and ongoing affordability challenges in the private sales market will ensure strong demand for affordable homes continues. Given the challenges for HAs attracting more institutional capital to the sector will be vital to support an increase in high quality and sustainable affordable housing.

New capital, new opportunities

Paul Hawkey
Head of Affordable Housing

Over the last few years there has been a significant increase in institutional capital looking at the affordable housing sector. While higher financing costs may have put the brakes on some of that growth, overall demand remains strong, and will increase as costs ease.

As well as helping to boost much-needed supply, the introduction of more capital into the sector has been beneficial for developers, not least in terms of boosting competition at a time when many HAs face considerable pressures regarding their existing portfolios. Accordingly, there are new opportunities for developers beyond the traditional investors and deal structures considered in the past, particularly when it comes to selling and acquiring Section 106 stock. This has been particularly welcome given a shift away from HAs acquiring 'ready-made' Section 106 stock, towards buying land and tailoring schemes to their own requirements and preferences from the outset.

The potential for partnerships between FPRPs, local authorities developers and HAs is also growing, supported by a willingness on the part of many FPRPs to find innovative solutions to deliver and fund development amid a challenging backdrop. The need for more FPRP capital is high, if the supply of much-needed new affordable housing is to be maintained.

Affordable Housing Investor Survey

Our Affordable Housing Investor Survey canvassed the views of more than 30 of the leading for profit and not for profit registered providers currently active in the market to understand their housing priorities.

Key takeaways

77%

of survey respondents plan to increase their investment into affordable housing over the next five years

50%

identified a lack of subsidy or grant funding as the biggest obstacle to increasing supply

Social rent

is the tenure of choice for survey respondents, followed by shared ownership

40%

believe partnerships have become more important as a route to increasing supply

ESG Performance

is the main driver of investment into the affordable housing sector

79%

are targeting a minimum EPC B at new developments or acquisitions

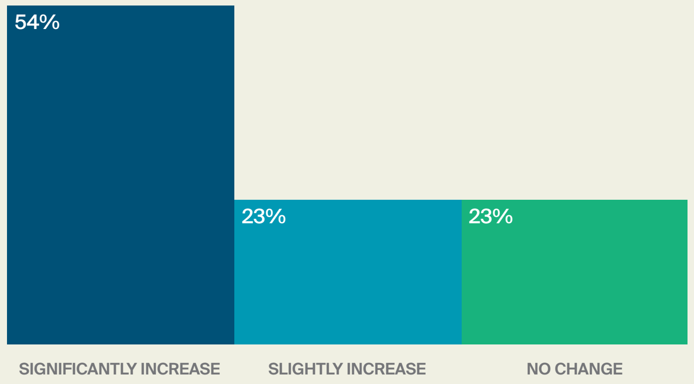
INVESTOR APPETITE REMAINS

While some in the sector have paused or slowed acquisition and development activity in the wake of increasing costs and market uncertainty, investor appetite for more affordable homes remains substantial. More than three quarters of respondents to our survey plan to increase their total investment into affordable housing over the next five years. Stability of policy, particularly of rental policy, grant funding, and Section 106 supply routes, will be vital to underpinning this confidence.

77%

of respondents to our survey plan to increase their total investment into affordable housing over the next five years

Fig 7: How do you expect your total investment into affordable housing to change over the next five years?



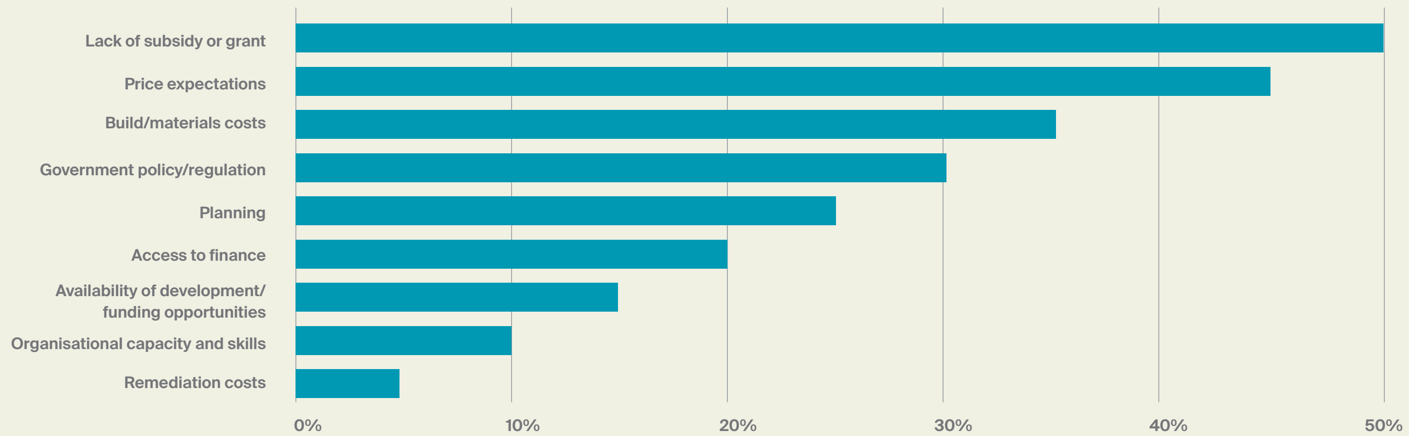
Source: Knight Frank Research

GRANT FUNDING IS A CHALLENGE

A lack of subsidy or grant funding was identified by 50% of respondents as a particular obstacle to increasing affordable housing supply, more than any other. Research by L&G and the British Property Federation has previously estimated that a minimum of £14 billion in annual government funding is required as part of a package of public and private investment to deliver the required 145,000 affordable homes each year outlined by the NHF. Second was price expectations (45%), followed by build and material costs (35%) and government policy and regulation (30%).

Fig 8: What are the biggest challenges to providing more affordable homes?

Respondents could select up to three



Source: Knight Frank Research

Fig 9: Which tenures are you hoping to deliver in the next five years?

Respondents were asked to rank preferred tenures

1. SOCIAL RENT
2. SHARED OWNERSHIP
3. AFFORDABLE RENT
4. LONDON AFFORDABLE RENT
5. MARKET SALE
6. LONDON LIVING RENT
7. DISCOUNT MARKET RENT
8. MARKET RENT

Source: Knight Frank Research

CHANGING OF THE GUARD

Social rent remains the tenure of choice for most survey respondents, followed by shared ownership and affordable rent. A preference for social rent is likely driven by a combination of local authority need, as well as the higher levels of grant funding which are available relative to other affordable tenures which can support site viability. Demand for shared ownership has been boosted following the withdrawal of Help to Buy, providing buyers unable to afford market housing for sale an alternative to private renting.

> "Social rent remains the tenure of choice for most survey respondents, followed by shared ownership and affordable rent."

GROWTH IN PARTNERSHIP MODELS

Grant funded development remains the preferred route to increasing affordable housing supply, followed by Section 106 opportunities. The survey results also reflect changes in the market, with partnerships next on the list. Some 40% of respondents said that this route to housing delivery had become more important over the last year. In comparison, and reflecting current market conditions, Section 106 opportunities have become less of a priority for a third of respondents reflecting the challenges in the wider development market. We see growing appetite from HAs to partner with investors and FPRPs, as business plan pressures continue to drive the need for new capital. Indeed, as HA capacity for development is constrained, the need for investor FPRP capital is high, if the supply of much needed new housing is to be maintained.

40%

of respondents said that partnerships had become more important over the past year

Fig 10: How has your attitude to increasing affordable housing supply via the following means changed over the last 12 months?

	More important	No change	Less important
S106 opportunities	20%	47%	33%
Grant funded development	33%	60%	7%
Partnerships	40%	53%	7%
Development JVs	33%	60%	7%
Purchasing of private units / bulk acquisition	33%	40%	27%

Source: Knight Frank Research

ESG AT THE FORE

More investors are looking towards the affordable housing sector as firms look to meet ESG goals as well as to engage in responsible investment. Reflecting this, our survey found that ESG performance is the most important factor in attracting capital to the sector, with it providing significant social value and impact.

Addressing the shortfall of supply relative to demand was the second most important factor, followed by the returns profile.

Fig 11: What are the key factors driving your investment in the affordable housing sector?

1. ESG performance
2. Shortfall of supply vs demand
3. Returns profile
4. Income growth
5. Stability of income
6. Diversification

Source: Knight Frank Research

SUSTAINABLE FEATURES IN DEMAND

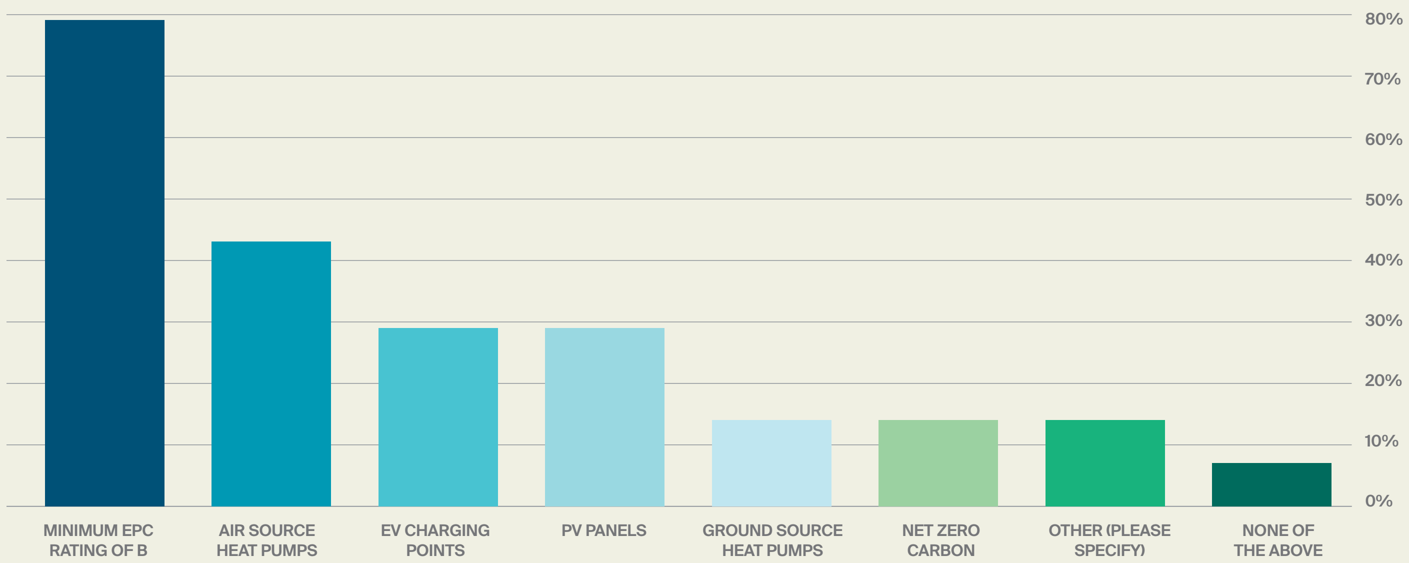
We are seeing more investment in sustainable developments and features. Most survey respondents said they are targeting a minimum of EPC B. This will help to continue to improve the quality and energy efficiency of overall affordable housing stock, where 30% of existing dwellings are EPC D or below, compared with 55% in the PRS.

Reflecting this, sustainable features are becoming more of a priority. Air source heat pumps are the most in demand, with 43% of investors stating these features are required at developments. Some 29% said EV charging points and PV panels are also expected to be included.

43%

of investors surveyed said that air source heat pumps are now required in developments.

Fig 12: Which of the following, if any, do you require at your schemes?



Source: Knight Frank Research

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We like questions, if you've got one about our research,
or would like some property advice, we would love to hear from you.

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