Sage Homes

Orion House
5 Upper St Martin’s Lane
London WC2H 9EA

T: +44 020 8168 0500
E: enquiries@sagehomes.co.uk

Clive Betts MP
Chair, LUHC Committee
House of Commons
London SW1A 0AA

24 July 2023

Dear Mr Betts,

Thank you for recently meeting with me and my team. As requested, I am following up with a summary of Sage Homes’ views in relation to your Committee’s ongoing inquiry into the finances and sustainability of the social housing sector.

As a Registered Provider (RP) of affordable housing and England’s largest provider of newly built affordable homes since March 2021, Sage Homes is committed to providing high-quality, well managed and customer-focused affordable housing, whilst also bringing significant, stable capital to the sector. In turn, this enables increased access to high-quality affordable housing for the people who need it most[1].

Please find below some of our thoughts on the many and varied challenges facing the social housing sector, the opportunity that stable institutional capital can play in delivering new affordable homes, and recommendations to help attract further investment into the sector.

The need for greater investment in affordable housing

As highlighted in evidence submitted by Legal and General (L&G) to your Committee's inquiry[2], and in its report with the British Property Federation (BPF) [3], there is an urgent need for greater investment in UK affordable housing.

Housing Associations and traditional not-for-profit providers do not have the capacity to meet the UK's long-term demand for affordable housing on their own. BPF and L&G estimate that – at maximum capacity – Housing Associations can only deliver less than half of the UK's current affordable housing needs (65,000 new homes annually versus long-term needs of 145,000 homes a year). This is on top of a backlog of 1.4 million households on social housing waiting lists.

Due to current economic challenges, traditional providers are expected to fall even further below this level. Rising costs of servicing debt, prolonged high inflation impacting

[1] https://www.sagehomes.co.uk/about-us/

[2] Written evidence submitted by Legal & General [FSS 020]

[3] Written evidence submitted by the British Property Federation [FSS 053]

management and maintenance costs, and temporary caps on rent increases, amongst other challenges, mean traditional providers are increasingly faced with a difficult choice between prioritising existing homes at the expense of investment in new affordable housing stock. Housing Association development could fall to as low as c.35,000 new homes a year. In evidence to your Committee, the Chartered Institute of Housing stated that 44% of local authorities have reduced or plan to reduce new housing developments, and 25% have halted new developments entirely[4]. Last month, Southern Housing announced it would reduce new developments from more than 1,500 annually, down to just 250 each year over the next three years as a "direct consequence of the depletion of capacity"[5].

Against this backdrop, private capital can play a crucial role as part of the solution to addressing the UK's affordable housing needs. As your Committee will be aware, institutionally funded RPs have grown exponentially in recent years. A recent Savills report projected that the number of homes owned by for-profit RPs will increase four-fold by 2028[6]. Savills estimates these RPs, including Sage Homes, will commit £27 billion towards the delivery of new affordable homes in the UK by 2027 – enough to fund 140,000 homes.

Institutionally funded RPs have become an essential component of the UK's much-needed housing sector diversity, especially at Affordable Rent and Shared Ownership levels. Sage Homes has committed to over £3.5 billion of investment and delivered nearly 12,000 new affordable homes to date, with a total of over 20,000 homes in the pipeline (delivered and exchanged). This level of investment by Sage Homes and others has enabled thousands of people to access safe homes, tackle council housing waiting lists and provide a first step onto the property ladder.

Whilst this model has already delivered success, there is significant potential and opportunity to expand – both in terms of the numbers of RPs and its scale. To help realise this, we recommend three key changes that – if implemented – would help attract new entrants to the market and, in turn, increased investment.

Measures to encourage greater investment in affordable housing

1. A predictable investment environment

The success of the institutionally funded RP model in aligning the aims and incentives of long-term investors with societal benefits of providing new affordable housing has been predicated – above all else – on its ability to generate a secure, predictable, long-term, inflation-linked income stream for investors. This view is also shared by the traditional not-for-profit RPs, as highlighted in your evidence session of 21 June.

To support the whole sector, we strongly agree that future rent settlements should be guided by two fundamental principles:

i. Long term rent settlements

Interference in what is supposed to be a reliable rent expectation deeply undermines investor confidence in the sector. This is because investors are unable to have certainty on the stable long term cashflows that the regulated affordable housing sector otherwise

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[4] Written evidence submitted by the Chartered Institute of Housing [FSS 035]

[5] https://www.socialhousing.co.uk/news/southern-housing-reduces-development-to-just-250-starts-a-year-82142

[6] Spotlight: Private Capital and Affordable Housing – 2nd May 2023

provides. The announcement in 2015 of a four-year, 1% annual reduction in social rents was, at the time, estimated to have resulted in 27,000 fewer affordable homes being built, according to the National Housing Federation[7]. Credit agency Moody also said this intervention meant the stability of the sector to investors had "…been eroded by the sudden removal of the rent-setting formula"[8].

ii. Indexation

Before the 2016 rent cuts, the operating margin on social housing lettings – a key measure of financial 'headroom' of the RP sector was at 31%. By 2022, according to the global accounts reported by the Regulator for Social Housing, the operating margin on social housing lettings had fallen to 25%[9]. Analysis indicates that, due to the exceptional cost inflation in 2022 and rent caps at 7%, in the 2023 global accounts, the operating margin on social housing lettings could fall to c.19%. At this reduced operating margin, the business plans of many RPs will start to fail at much lower levels of market shock than was previously the case. This reduction in the financial stability has been noted by the Regulator (over 20 organisations were recently downgraded to V2) and the downgrade in the ratings of the sector by the credit agencies[10]. These downgrades will feed through to higher borrowing costs – which will increase the proportion of spend on financing, and therefore reduce the spend on new homes and investment into existing homes. Indexation is critical to keep rents in line with RP costs to ensure stable business plans for the long term.

2. A level regulatory playing field

The regulatory system affecting institutionally funded RPs has emerged over time and largely prior to the expansion of this part of the RP sector. This has created a number of anomalies which require operators to establish numerous entities and complex legal arrangements, creating delays and resource constraints for investors – resulting in reduced competitiveness against other potential real estate investments. Removing these barriers through simplification (for example, by levelling the regulatory playing field and facilitating access to new RP entities) would help attract greater institutional investment and, crucially, encourage new entrants (for example, other major pension funds and insurance companies not currently invested in the sector) to invest in affordable housing.

Whilst there is significant existing investor appetite, addressing the current funding gap in affordable housing can only be achieved by increasing both the scale and the number of institutional investors in the sector. Encouraging appropriate new entrants will also help create a more sophisticated and diverse sector, in turn enhancing the long-term sustainability of the institutionally funded RP model.

The Savills report previously referenced concluded that nearly 90% of not-for-profit RPs wanted to partner with institutional RPs to do more than was being delivered through current plans. The different legislative treatment between different providers makes the ease of

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[7] https://researchbriefings.files.parliament.uk/documents/SN01090/SN01090.pdf

[8] ibid

[9] https://www.gov.uk/government/news/rsh-publishes-2022-global-accounts

[10] Social housing providers continue to comply with regulatory standards following regrades from RSH - GOV.UK (www.gov.uk)

Housing Associations and new entrant RPs working together very difficult, and therefore unnecessarily restricts greater collaboration.

Removing anomalies in the regulatory and legislative framework would also provide practical everyday benefits for tenants and shared-ownership homeowners.

For example, institutionally funded RPs are currently unable to access anti-social behaviour injunctions due to a legislative obscurity within the Anti-Social Behaviour, Crime and Policing Act 2014[11]. This is because a Housing Provider is specifically defined as a "non-profit private registered provider of social housing". Whilst the Act came into force prior to the growth in for-profit RPs, today, this inadvertently complicates and slows down the process to help communities where anti-social behaviour is taking place in for-profit RP managed homes.

Government is well placed to review these anomalies now that the sector has matured with large scale reputable providers, assessed in-depth by the Regulator for Social Housing. Aligning the regulatory framework between all RPs will further help in delivering against the wide variety of challenges facing the sector from improving current housing stock, to the need to keep delivering new affordable homes at scale.

3. A common approach across the regulatory bodies

Sage Homes has held discussions with several market participants over the last 12 months, with a view to bringing in more institutional capital to the sector.

That process has led to one realisation: most of the largest UK institutions with appropriate, stable capital to direct into the social housing sector at scale (namely, insurance companies and pension funds) are regulated by the Prudential Regulation Authority (PRA), and operate under the Solvency II regime which – as currently applicable to these investors – usually disincentivises large investments into real estate, including in social and affordable housing.

Put simply, Solvency II requires investors to put aside a certain amount of capital depending on the nature of the investment they are undertaking. This differentiates between what are considered limited risk investments (for example, investments into debt products such as government bonds), compared to those deemed riskier (for example, capital investment in direct real estate). If one investment falls into the latter category, it means more capital needs to be reserved, and will therefore not be deployed into additional investments.

By nature, social housing investments present more limited risks (given the indexed nature of the rents and the strong imbalance between supply and demand), compared to other real estate investments (for example, in commercial property or free-market residential housing). This is a clear area where the Solvency II regime uniformly restricts capital availability that could be appropriately deployed into new social and affordable housing.

If the social housing and prudential regulatory regimes would be aligned, for instance through the ongoing Solvency II reforms (where greater regulatory proportionality could be applied to social housing investments, recognising the more limited risks posed, compared to other areas of real estate), that could further strengthen the desire for additional investors to enter the sector.

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[11] Anti-Social Behaviour, Crime & Policing Act 2014

Sage Homes

Thank you once again for taking the time to meet with us. Should further clarification or detail be helpful on any of the above, we would be more than happy to assist you and your Committee, whom I also copy this letter to.

Yours Sincerely,

Mark Sw

Mark Sater
CEO