Affordable Homes Acquisition Scheme

A briefing paper

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Overview

Reforms to the planning system and mandatory housebuilding targets for councils will not be enough to unlock the required level of funding to meet ambitions for affordable housing supply.

The Prime Minister recently reaffirmed an ambitious government target to build 1.5 million new homes in England during the life of this Parliament. He acknowledged that bold action is needed to get there.[*] Underlying this target is the Labour Party Manifesto commitment to achieve the biggest increase in social and affordable housebuilding in a generation.

Reforms to the planning system and mandatory housebuilding targets for councils will not be enough to unlock the required level of funding to meet this ambition for affordable housing supply.

We are proposing a new funding vehicle, making greater use of government guaranteed debt, that could provide significantly more homes at affordable rents. Use of government guaranteed debt reduces finance costs, but more critically allows debt service payments to be structured in line with projected portfolio earnings, offering a financially sustainable approach to support new affordable housing supply. We call this initiative the Affordable Homes Acquisition Scheme or AHAS.

> "Overall, we estimate that the level of capital grant required by government can be decreased by up to 35% points relative to the Affordable Homes Programme.[†]"

Deployed alongside current government initiatives, AHAS has the potential to stimulate the creation of new affordable homes with reduced grant at scale.

* Plan for Change Speech Dec 2024

† The AHAS model assumptions support a c. 20% grant at the Affordable Rent compared to an estimated 50%+ grant component required in AHP

Introduction

Significant government intervention is urgently needed to boost the supply of affordable housing, which is currently stalling.

Affordable rent housing shortage

There is a compelling case to reallocate more of the support from demand-side measures, such as housing benefit, toward supply side interventions[1] – and in particular, making more use of government finance guarantees.

The country is not building enough homes, especially affordable rent options. Although the average net additions of 233,000 per annum for the last seven years is an improvement on the 130,000 homes developed in 2011–12, it is still not enough to reach the target of 1.5 million homes over the life of this Parliament. Whilst affordable home delivery was strong in 2023–24, future supply is at risk in the light of a 51% drop in affordable home starts year on year in the twelve months to Q2 2024,[2] as social landlords encounter mounting financial pressures. In addition, the Government priority of additional Social Rent homes puts greater pressure on the existing limited capital grant available.

The 2021–2024 deepening crisis as social housing costs outstrip revenues

The stark drop in affordable housing development has mainly been caused by the dramatic increase in build and finance costs over the last three years.

- Higher interest rates have rendered many new developments uneconomic. In addition, they have greatly reduced profitability on historic stock worsening many registered providers' financial position.
- This has been particularly severe for larger housing providers in London and the South East[*] with the burden of significant older housing stock. Their revenues are now insufficient to meet interest payments on debt.[3]
- Development costs are also increasing due to workforce shortages across the sector. One third of housing associations report a deficit of 11–25% on individual developments.[4]

* EBITDA MRI cash interest cover falling below 100% for several G15 members

> For the first time since 2009, the cost of servicing debt for private registered providers exceeded net earnings in the 2023–24 financial year.[5]

Alongside this, mandatory fire and building safety upgrades,[6] retrofitting obligations, and regulatory pressure to increase quality are weighing down on social housing providers' profitability. While better standards are essential, in the short term they don't generate income and constrain development capacity.[7]

This has knock on effects in the wider housing market. Many housing associations are prioritising land-led developments and stepping back from s106 purchases. The Home Builders Federation estimates there are 13,000 affordable rent homes ready to be built now – but with no potential buyers.[8, 9, 10] Unless developers can dispose of s106 properties to registered providers, their pipelines become blocked.

This results in a worse outcome for both government and tenants. Expenditure on housing benefit, including Housing Allowance within **Universal Credit, is forecast to increase from £30 billion to over £70 billion**[11] **by 2050.**

Today 88% of annual expenditure on housing subsidy is spent on housing benefits as opposed to building new homes, compared to just 5% in 1973.[12]

Meanwhile, many lower income households must rely on the PRS[13] – and sometimes Temporary Accommodation. However, quality is lower in the PRS and rents have outstripped housing benefits, often taking an excessive share of household incomes.[14] The share of new market rental listings that are affordable on housing benefit alone is only just over 10%.[15]

Temporary Accommodation has numerous negative social impacts – for example children under five in Temporary Accommodation have higher rates of respiratory infections and poorer rates of nutrition.[16]

Proposed changes don't go far enough

- **Planning**: Better resourcing of planners and mandatory local housing targets are supportive of increased new housing numbers. However, they are unlikely to be sufficient and do not directly make housing development financially feasible or new housing affordable.
- **Long term rent settlement:** The five-year rent settlement confirmed by the Chancellor of the Exchequer in the autumn budget assists housing associations and funders in their strategic planning, but many prospective developments remain financially unfeasible.
- **Capital grant:** With much higher housing costs, greater capital subsidy per home is necessary. This can now reach up to 70% of cost for Social Rent housing in Wales, with similarly high percentages likely to be necessary in England.[17] There is limited overall capital grant available to support such higher grant rates.

Affordable Homes Acquisition Scheme

Our proposed £500m pilot scheme would acquire approximately 2,500–3,000 homes and could scale to a £2bn annual scheme.

AHAS provides a way forward

We are proposing a £500m pilot scheme which would acquire approximately 2,500–3,000 homes. We envisage that this could scale to a £2bn annual scheme – helping to increase the delivery of homes for affordable rent by 25% relative to current figures.[18]

The AHAS scheme aims to restore growth in new affordable housing in two main ways.

1. As an independent entity, off housing association and government balance sheets, AHAS relieves housing associations of much of the financial burden of new development, whilst maintaining their commercial and operational involvement in managing more social homes and serving their tenants.

2. AHAS is financed by a mixture of long-term debt and participant equity. The government guarantee of the debt minimises funding cost and permits a reprofiling of debt structure.

   The latter allows debt servicing cost to start low and increase over time to align better with the revenue generating potential of the housing assets at affordable rents.

Combined, these make new affordable housing development financially feasible with much lower levels of capital grant – a key benefit at a time of constrained public finances.

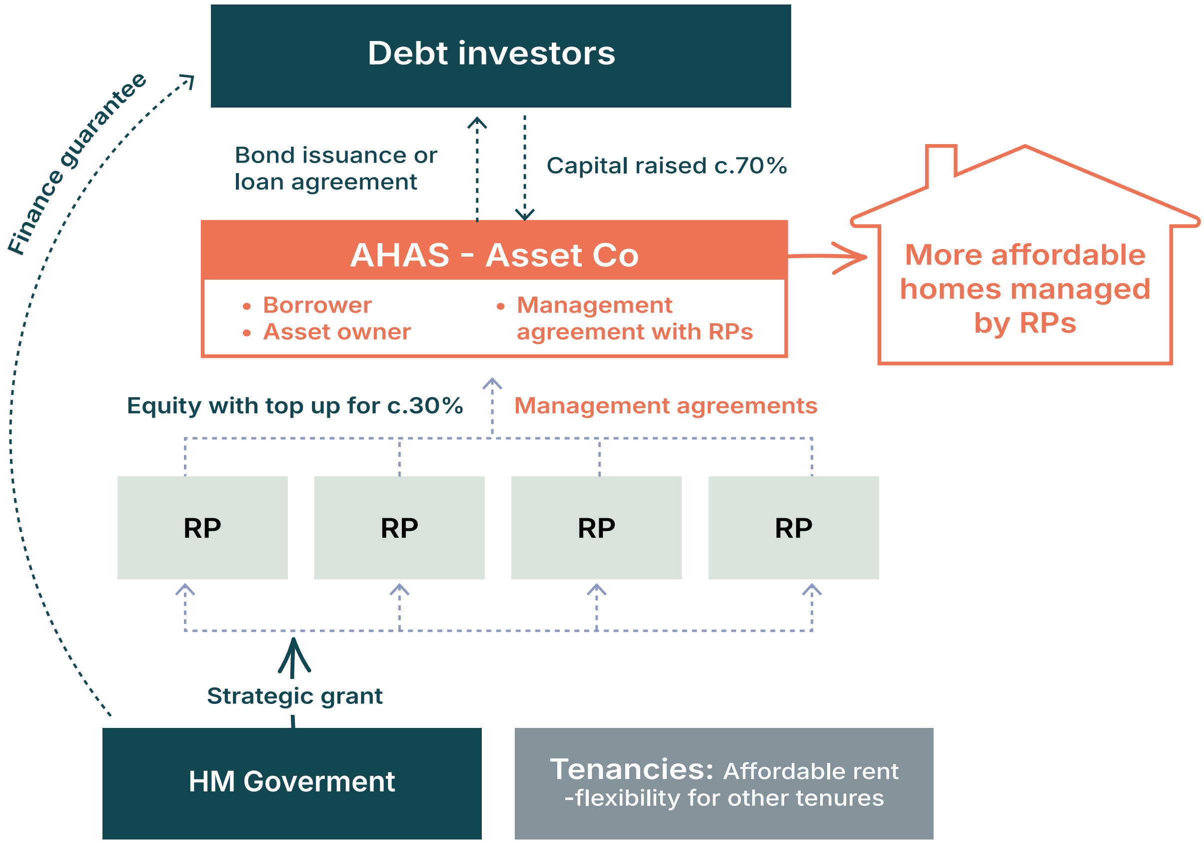
The main features of the scheme are as follows:

- **Owner:** AHAS envisages a new independent entity is established with a social purpose - Asset Co. This raises a combination of debt and equity and could potentially receive some grant* – and uses this to acquire homes.† Asset Co retains a suitable liquidity risk margin in cash.
- **Homes:** We envisage these are forward purchases from existing housing association affordable development pipelines, but purchases could be targeted towards other new build developments or existing stock.
- **Landlord:** These homes and tenancies are managed by housing associations.

* AHAS raises 70% debt, with the balance in the form of equity largely from participating housing associations and potentially partially funded by capital grants

† Initial feedback is that Asset Co would not be required to be a registered provider

Figure 1. How the AHAS scheme works – the flow of finance



RP = registered provider (e.g. Housing Association)

- **Tenure:** Homes are let under existing affordable housing tenures. Our central assumption is rents are set at the Affordable Rent but this is flexible within the model. Social Rent would require more capital grant per home, but would still achieve savings in grant relative to other schemes.
- **Debt Structure:** Underlying this is a government guarantee. This guarantee lowers the initial cost of capital and allows for better alignment between the debt service costs and the revenue generating potential of housing assets at affordable rents.

How AHAS complements the Affordable Homes Programme (AHP)

We see the AHAS scheme as complementary to other forms of subsidy offered to the sector but with the potential to achieve greater leverage from a limited supply of capital grant. Whilst s106 developments have, without grant, supported over 45%[19] of new affordable homes, the principal source of capital grant available to the sector is the Affordable Homes Programme 2021–26, delivered by Homes England and, in London, by GLA.

Typically, in a AHP scheme grant is placed alongside market debt and equity from registered providers to provide funding for new homes. The capital grant covers part of the development or acquisition cost for landlords, reducing their debt servicing costs, allowing lower rents to be charged.

Prior to 2021, typical capital grants for affordable rent properties might have been 20–30% of cost.[20] In 2022 the BPF estimated that this had increased to c. 40% of cost for an Affordable rented home and c. 60% for a Social rented home.

The Affordable Homes Guarantee Scheme (AHGS)

AHGS is a £6 billion affordable homes funding scheme which provides low-cost debt to housing associations by using government-guaranteed bonds issued by a special purpose vehicle to reduce borrowing costs and pass savings to housing associations developing homes for sub-market rents.

The AHGS works alongside the AHP grant – by combining the AHGS's lower debt costs with AHP grant funding, registered providers can stretch their financial resources further, enabling them to deliver more affordable homes than they could under the AHP alone.

We estimate in today's market conditions this has increased further, and grant would have to cover 50–70% of the development or acquisition costs to restore financial feasibility. So, we are faced with a stressed social housing market, where the amount of AHP grant can support less than half the new affordable homes than it could three years ago.

AHAS could act to complement the AHP and make the available £12bn capital grant fund[21] go further – in terms of the development of new homes per £ of grant expended. We have compared the AHAS scheme against AHP to illustrate the differences of AHAS against the current model of government subsidy.

There are two ways in which the AHAS scheme differently harnesses the power of capital grant: the ownership structure and the debt structure.

1. Ownership structure

As illustrated in Figure 1, unlike under the AHP, in AHAS, housing associations are commercial participants, but do not directly borrow money to purchase the housing assets. Instead, an independent Asset Co is established to raise finance and purchase the homes.

Asset Co is financed with a combination of debt and equity. Equity is provided by housing associations, supported by capital grants from government. These grants may be directly invested into the Asset Co or channelled through housing associations, forming part of their equity investment.

Each housing association holds a minority stake in Asset Co and accounts for it as an equity investment. This structure enables housing associations to provide more affordable homes with limited additional financial burden.

2. Debt structure

The government guarantee enables the lower grant share in three ways:

i. **Lower cost of debt:** which in turn facilitates a lower net rent. Debt of c.70% with an interest margin saving of c. 60 bps reduces interest costs by approximately 10%.

ii. **Higher proportion of debt:** reducing the need for equity and grant.

iii. **Innovative reprofiling of debt:** enables the scheme to profile debt to achieve lower annual servicing costs with a corresponding higher terminal value payment.

This final point is key. Conventionally, affordable housing providers use net rent arising to meet interest costs and repay debt over the debt term. The AHAS step-up bond profile instead pushes debt service payments to the end of the term – relying on house price growth and refinancing or, if needed, portfolio sales to pay down the scheme debt raised.

The AHAS model adjusts the profiling of the payments to reduce the need for grant. This creates a trade-off relative to the AHP between the amount of outstanding debt at the end of the bond term, and the amount of grant needed up front to create a feasible scheme.

For the same ability to cover its debt obligations, the AHAS decreases the amount of grant required upfront whilst increasing the outstanding debt and the future reliance on growth in house prices to provide sufficient asset cover.

Risk considerations

Residual Values

The large terminal debt payment exposes the guarantor (HMG) to greater risk than the Affordable Homes Guarantee Scheme (AHGS) where loans are backed by RP covenants with additional security from RP assets charged. We have therefore tested for AHAS the likely degree of asset cover available by reference to historic house price growth.

House price growth over a 30 year period has historically been consistently above the rates required in the AHAS scheme. In our central scenario house price growth is required to be c.2.9% per annum. Historically the minimum annualised house price growth over a 30-year period is 5.9%.[22]

Accordingly, we believe that the AHAS structure offers HMG as guarantor an acceptable risk of low default and meanwhile offers a much more efficient use of capital grant. As an alternative to providing ever greater supplies of capital grant up front, the AHAS scheme assigns greater future refinancing risk to government but with a long–term (30 years) during which it can be determined if debt repayment is best provided through a sale of the underlying homes portfolio, a refinancing or a combination of the two.

Lending relationships

Housing associations have important commercial relationships with private sector lenders, investors and funders and over recent years have become increasingly reliant on them for the bulk of their funding. Covenant restrictions might require housing associations wishing to participate in the AHAS scheme to obtain lender approval or waivers, though if the principal source of equity invested in the scheme is government capital grant this is less likely. Additionally, AHAS will provide a new source of earnings to housing associations, supporting key financial metrics such as interest cover. In any event, it will be important for the AHAS scheme to be viewed as complementary and additive to existing commercial relationships by all stakeholders.

AHAS outcomes

Overall AHAS achieves the following:

1. **Greater affordable home supply:**
   AHAS could scale to support government to increase the supply of affordable homes by c.2,500 to 3,000 homes p.a. – all in existing affordable rent tenures.

2. **Support social landlords:**
   AHAS provides an off balance sheet model for social landlords to weather their current financial fragility, to develop their social housing pipelines, with continuing management of new homes.

3. **Capital grant goes further:**
   Upfront grant in the scheme is only 15–25% – significantly below current alternative scheme levels. Additional grant would be needed for homes at Social Rent – but much less than in alternative schemes.

   In parallel with a number of other initiatives we believe the AHAS can play a pivotal role in supporting the Government’s objectives by rapidly delivering more affordable housing with a reduced reliance on grant funding.

4. **Contingent liability for government:**
   The government guarantee underpinning the bonds issued would remain a contingent liability with only a small portion of the guaranteed debt value falling on the government balance sheet based, as is likely, on a default risk assessment.

[6] For further details see https://www.gov.uk/government/publications/housing-guarantee-scheme-rules-affordable-homes-guarantee-scheme-2020/affordable-homes-guarantee-scheme-2020

Next steps

1. Establish a cross-governmental working group

Set up a dedicated working group including representatives from the Ministry of Housing, Communities and Local Government (MHCLG), HM Treasury (HMT), Homes England, and the Department for Work and Pensions (DWP). This group would oversee the scheme's development, ensuring alignment with wider housing and fiscal policy objectives.

2. Define scheme objectives and key parameters

Confirm with the working group the scheme's parameters, leveraging its inherent flexibility. This includes decisions around:

- Tenure (e.g. social rent, affordable rent, shared ownership, temporary accommodation)
- Type of housing (new build vs. acquisitions; development issues e.g. stalled s106 schemes.
- Geographic priorities to address regional housing needs effectively.

It is important to note that changes to these parameters will directly influence the amount of grant required for the scheme.

3. Engage stakeholders

Work closely with local authorities, housing associations, and infrastructure investors to gain their input and support. This engagement will help identify and address practical challenges, ensuring the scheme's successful implementation.

4. Develop an Outline Business Case (OBC)

Prepare a robust business case that evaluates AHAS against alternative approaches to delivering affordable housing. The OBC should assess value for money, scalability, and alignment with government priorities, providing a solid foundation for further development as follows:

a. Identify scheme rules and eligibility and what the government offer is to the wider market.

b. Address the financial, regulatory, legal, tax, classification, accounting and operational specifics of the scheme.

c. Design market engagement mechanisms that ensure transparency, value for money and alignment with government aims ensuring robust governance and accountability.

5. Assess Public Sector Net Financial Liabilities (PSNFL) impact

Following a robust risk assessment and by reference to treatment of other guarantee schemes, determine the amount of the scheme obligation that is be classified as on-balance sheet for government accounting purposes, focusing on the impact of PSNFL.

Annex: Supporting material

Conventional bond

The chart below shows the provider cash surplus from a hypothetical Affordable Rent portfolio. It assumes the capital structure is the same as in our central AHAS model, with 70% debt, 10% equity and 20% grant and with the debt raised as a conventional bond or term bank loan.

Figure 2. Conventional Bond - Affordable rent scheme cash surplus (20% grant)

Surplus is negative throughout the lifetime of the scheme – and so more grant is required to make the scheme viable.

Historically, housing associations could take a long-term view and subsidise the cash deficit from new properties entering their portfolio with the positive flows from established homes for ten years or more. However, the scope to do this today is much more limited as the size of the financial deficit on new homes has widened and higher costs for existing properties, including new retrofit and cladding rectification have depleted surpluses.

Our model estimates that you would need a **grant share of 55% of the homes purchase cost** to operate the portfolio at a cash surplus from year 10 but as much as **75% to operate at a cash surplus from year two.**

Step-up bond

We have profiled a step-up bond with an initial debt servicing cost of 1.75% - significantly below the debt servicing costs in a conventional term bond which would likely be c.6%. For the profiled bond, each five years the coupon increases by 0.5% pts. This profile enables a cash surplus on the affordable rent portfolio from the outset of the scheme.

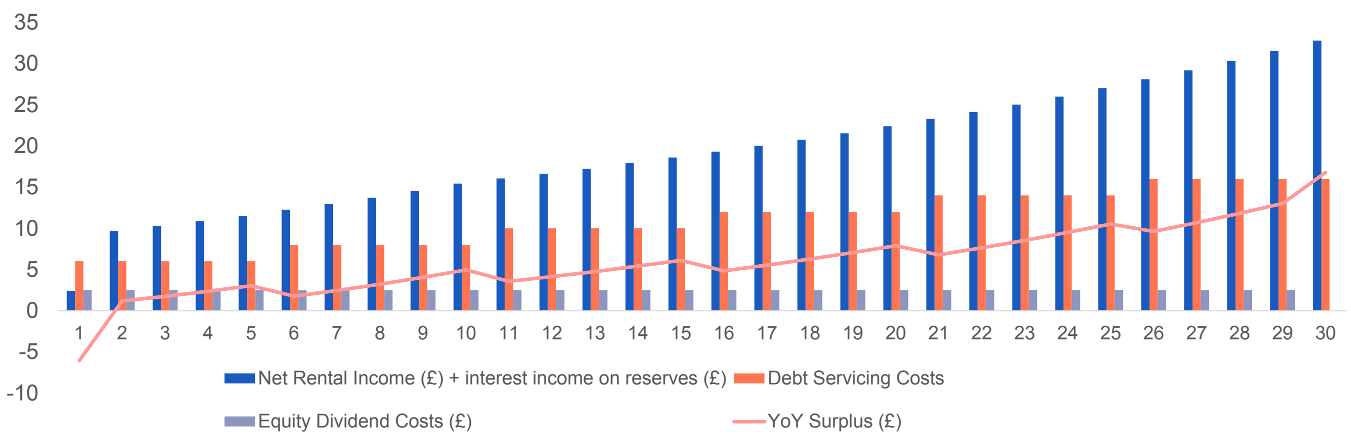
Set against this is the much larger terminal repayment relative to a conventional bond to achieve the same level of investor annualised return or IRR. Whereas in a conventional bond, the debt is either repaid during term or the terminal payment is equal to the initial borrowing amount, in the step up bond it increases by 3.65x over the 30 year period in this illustrative example.

Table 1. Illustrative step-up bond vs conventional bond profile, principal = 100

	1–5	6–10	11–15	16–20	21–25	26–30	Terminal payment	IRR
Conventional	6	6	6	6	6	6	100	6%
Step-up	1.75	2.25	2.75	3.25	3.75	4.25	365	6%

Under the same net rent assumptions the AHAS Affordable Rent scheme is now able to generate a cash surplus from inception with 20% of grant.

Figure 3. Step-up Bond – Affordable rent scheme cash surplus (20% grant)



AHAS Trade-offs

The table below looks at three key outcomes for the AHAS and the AHP scheme.

- **Does the model generate enough cash during the scheme to at all times cover its outgoings?**

  The AHAS model supports cash debt service cover at equivalent or higher ratios than a typical AHP model in the crucial early years of the portfolio.

- **Do house prices increase enough over the scheme life to cover the terminal debt payment obligation?**

  There should be sufficient asset cover in the AHAS model, albeit that it is much more exposed to residual asset values than a typical AHP model.

- **What share of capital grant is required to make the scheme viable?**

  The AHAS model could operate with a grant proportion of 20% for a rental portfolio at the Affordable Rent.

Key tests to determine success:		AHAS	AHP
1	Does the model generate enough income during the scheme to cover its costs?	Debt service coverage ratio (cash): **1.9x**	Debt service coverage ratio (cash): **1.65x**
2	Do house prices increase enough over the scheme to cover the terminal debt payment?	Debt to Assets ratio at bond term: **75%**	Debt to Assets ratio at bond term: **10%**
3	Does it decrease the amount of grant needed by government?	Grant proportion of funding: **20%**	Grant proportion of funding: **55%**

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Endnotes

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