# SUPPORTING HOMELESSNESS PREVENTION AND ALLEVIATION THROUGH INVESTMENT IN THE PRIVATE RENTAL SECTOR

**October 2014**

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This report represents the views of the authors alone and not those of any individual or organisation that has supported the work or provided advice and input along the way.

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## Summary and Conclusions

There is a pressing need for additional investment in affordable accommodation which can meet the needs of homeless households which are currently in temporary accommodation or at risk of becoming homeless. Alongside the significant numbers of homeless households, there are growing financial pressures facing some local authorities which are finding the costs of sourcing accommodation directly from the private sector are increasing sharply.

The consequence of the increased costs of provision is greater pressure on local authority housing budgets, with the potential to result in reductions in spending on homelessness prevention and other critical support services to cover shortfalls.

While local authorities have the power and capacity to acquire portfolios of property directly, or via a local authority company, the borrowing associated with the upfront investment required is classified to the public sector. Detailed modelling of the potential financial returns from investing in a portfolio of properties acquired and then let at rents close to local housing allowance highlights that on a stand-alone basis returns, however, are unlikely to be sufficiently high to attract external commercial investment without some form of additional support. This view was supported by detailed discussions with a number of potential institutional investors, which highlighted that there was significant appetite to invest in residential property, including portfolios targeted towards homelessness prevention and alleviation, but subject to any portfolio meeting an appropriately risk adjusted level of returns.

There are a number of forms support could take to help improve the risk adjusted return. One of these is a central government guarantee scheme to cover the principal and interest associated with debt investment in property schemes established to provide accommodation for homeless households or those at risk of homelessness. On the assumptions adopted in the report, a £600m guarantee scheme, offers the potential to move up to 6,000 households out of temporary accommodation, approximately 10% of the current homelessness population. If appropriately structured, the cost, in terms of an increase in public sector debt, would be substantially less than direct investment. The scheme could potentially cover both new build as well as purchase of existing property, although the timescale associated with new build is likely to be substantially longer. However, this guarantee proposal has not been formally discussed or reviewed by Government and, as such, no certainty can be given of its eventual provision.

A central government guarantee could be potentially delivered through the existing infrastructure developed as part of the existing Affordable Housing or Private Rented Sector guarantee schemes, although further work would be needed to confirm viability of this route. In this regard, it is noted that the existing and proposed delivery arrangements for these schemes makes no provision for any additional guarantee programme and alternative delivery routes may be required.

In addition, there is a strong case for establishing in a complementary manner some form of central advisory support to facilitate activity and achieve a critical level of impact.

Furthermore, as greater clarity comes over the form of the forthcoming social investment tax relief, it would be worth considering more explicitly the role for social investment in schemes of this kind. The proposed tax reliefs may be able to improve financial returns sufficiently to incentivise additional investment and increase the supply of well managed long term private rented sector accommodation available. One possible route to achieve this would be to potentially modifying existing investment tax incentive structures, such as the Enterprise Investment Scheme, to explicitly include property used for this explicit social purpose.

# Background

**Increasing numbers of homeless households**

Throughout England, the number of households in temporary accommodation on 31 March 2014, arranged by local authorities under homelessness legislation, was 58,590. Although much lower than the peak in 2004/5, this figure was 6% higher than a year earlier and 21% above the level of March 2011. The total figure included 43,530 households with dependent children and/or a pregnant woman, and in total there were 80,560 children or expected children in these households. 74% of all households in temporary accommodation are in London, a proportion which has remained relatively constant over the last five years.

Throughout England there has been an increase in the number of acceptances where the reason for homelessness was the ending of an assured short-hold tenancy. The ending of an assured short-hold tenancy has been the most frequent reason for the loss of last settled homes for the last six consecutive quarters and represented 27% of all acceptances nationally in the last quarter and 36% for London.

**Local Authorities have responsibility for homeless families**

Part 7 of the Housing Act 1996, as amended by the Homelessness Act 2002 and the Localism Act 2011, places statutory duty on local authorities to provide assistance to people who are homeless or threatened with homelessness. Authorities must consider all applications from people seeking accommodation or assistance in obtaining accommodation. A main homelessness duty is owed where the authority is satisfied that the applicant is eligible for assistance, unintentionally homeless and falls within a priority need group. The priority need groups are specified in the legislation.

Where a main duty is owed, the authority must ensure that suitable accommodation is available for the applicant and his or her household until a settled home becomes available for them. Where households are found to be intentionally homeless or not in priority need, the authority must make an assessment of their housing need and provide advice and assistance to help them find accommodation for themselves. Where the applicant is found to be intentionally homeless but falls in a priority need category the authority must also ensure that accommodation is available for long enough to give the applicant a reasonable opportunity to find a home.

**The cost of homelessness provision is rising faster than the overall number of homeless families**

While the number of households in temporary accommodation remains significantly below the levels of ten years ago, the headline figures mask increasing financial pressures faced by authorities in housing households. The availability of accommodation which can be sourced through long term leases within the temporary accommodation benefit rate has substantially declined in recent years in some areas . This has forced many local authorities to rely increasingly on bed and breakfast or nightly paid accommodation, the cost of which can be more than double that of leased accommodation. In addition to the financial pressures, the greater use of bed and breakfast and nightly paid accommodation reduces the degree of security authorities can offer to tenants as the supply is not within the control of local authorities. The consequence of these factors is increased expenditure by local authorities, placing pressure on budgets and resulting in reduced expenditure on other services.

## Project Overview

DCLG commissioned Social Finance, a not-for-profit financial services firm focused on improving social outcomes, to explore ways of using institutional investment to increase the supply of long term, well managed, Private Rented Sector Accommodation for homeless households at Local Housing Allowance level rents. This includes both the purchase of existing property and new build. The aims of the project included:

- Increasing supply of PRS accommodation for homeless households
- Increasing quality and management of this accommodation
- Improving tenant security
- Increasing supply of accommodation within local authority boundaries
- Supporting new development
- Encouraging development of PRS accommodation that remains affordable
- Providing a better-value for money solution than current provision

A successful scheme has not only the potential to improve outcomes for those families living in the properties acquired, but also to offer a substantial improvement in value for money for both central and local government. Value for money benefits principally arise from a combination of lower rents to tenants leading to reduced pressure on housing benefit as well as reduced spending by local authorities on more expensive forms of temporary accommodation. Lower rents are potentially achievable through lower funding costs and economies of scale of operation (management and maintenance) for portfolios of property compared to the existing providers of private rented sector accommodation, who are typically small scale private landlords[1].

The project has worked with four pathfinder local authorities over a period of six months; London Borough of Enfield, Birmingham, Bristol City and Cambridge City, to develop a number of potential models which could be used to help increase supply of suitable accommodation. This partnership work has been invaluable in helping identify the critical challenges facing local authorities in this area and establishing potential solutions which have helped shape this report and its conclusions and recommendations.

A viability analysis was completed with each local authority. This viability concluded that a scheme would be potentially viable, with viability defined as a steady state net operating income of above 4%[2] in three out of the four areas[3], without the need for upfront subsidy. Additionally this partnership working helped develop and identify a number of the key considerations

Based on the initial work conducted, one of the four pathfinder authorities has now progressed to submitting a business plan for council approval and is looking to implement a project during

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[1] DCLG English Landlord Survey, 2010; reported that 89% of landlords were private individual landlords and that more than three quarters (78%) of all landlords only owned a single dwelling for rent, with only 8% of landlords stating they were full timelandlords.

[2] External Investor feedback highlighted that for a proposition to be considered for external investment, a minimum requirement would be for the portfolio to deliver a net operating income yield of above 4%.

[3] Viability analysis for Cambridge concluded that neither the acquisition of street properties or new build development would be able to deliver a net operating income of over 4%. This was a consequence of a low initial gross yield of less than 5%. The low initial gross yield is driven by two factors: 1) house prices within boundary of Cambridge City are relatively expensive, and 2) the local housing allowance is based on a broad rental market area (BRMA) which covers a geographic area beyond the city, which encompasses a number of lower rent areas. A high level viability assessment would suggest a scheme would be potentially viable in a number of areas around Cambridge City including parts of South Cambs, Bedford and Peterborough.

first half of 2014. Separately the work undertaken with another local authority has also been shared directly with a neighbouring authority and has been used as the basis to launch a pilot scheme during first half of 2014.

A seminar was held on November 4th 2013 with representatives from around 25 local authorities and provided an important opportunity to canvas a wider range of opinion and perspectives. The project has also benefited from the advice and guidance provided by an expert advisory group including representations from a range of organisations, which met regularly throughout this project to review progress. Meetings were conducted with a number of additional private sector organisations during this project including potential investors, tenant and asset managers, and registered providers, who have also provided constructive challenge and feedback.

In addition to this report, a technical guide for local authorities as well as a financial model to assess viability have been developed which are available for use. The structures and financial model have been developed with consideration of the acquisition of a portfolio of street property. This reflects the desire by local authorities to consider activities which can be completed immediately to help address homelessness numbers, and the time lags of introducing new build developments. However it is not viewed that the inclusion of new build developments would have a material impact on the analysis presented, and both the financial model and structures can be easily adapted.

## Potential Investment Structures

A number of potential structures have been considered. The following section provides a summary of the three principal models which have been identified. They can be summarised as;

- a local authority company;
- a private sector company;
- a joint venture approach between local authority and private sector partners.

Models which involve investing through the housing revenue account or directly by the local authority were excluded from consideration, given the impact of right to buy obligations on viability.

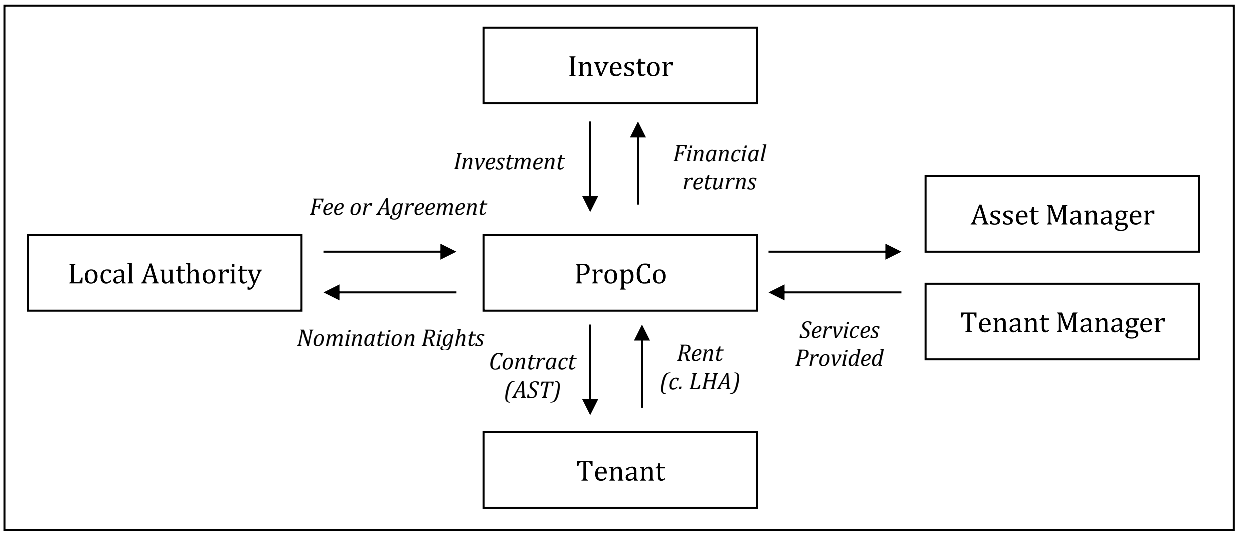
While there are important distinctions between the various models, each has common features and fits within the generic model described below and depicted in Exhibit 1.

The model for purchase of existing street property follows the following stages.

- The target number of properties and property characteristics (bedroom number/size etc.) are identified
- Investors provide funding for the property investment vehicle (PropCo) through a combination of debt and/or equity
- PropCo identifies and acquires properties that meet required financial viability conditions, either street properties or potentially new build. PropCo could undertake the identification or acquisition of properties directly, or could potentially use a third party property finder commissioned for this purpose
- Properties renovated to an acceptable standard, with Decent Homes Standards as a minimum
- Properties are made available as settled, long-term accommodation, to tenants who are either homeless and currently housed in temporary accommodation, or at risk of homelessness, potentially with the local authority having a nomination right
- Properties let using an assured short-hold tenancy, at rental levels at or below local housing allowance rates
- Properties managed at scale by professional managers, who undertake maintenance and repairs, as well as rent collection and tenancy management
- Rental increases are undertaken in a transparent manner with reference to developments in benefit levels

A scheme of this kind could relatively easily be adapted for developing new-build properties.

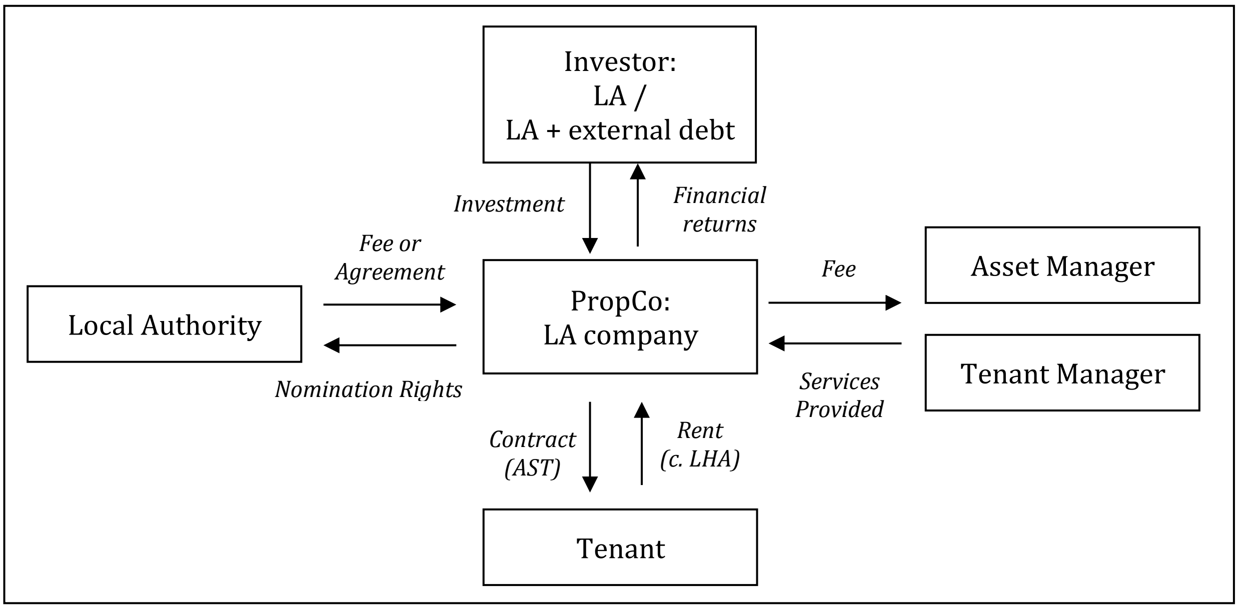
**Exhibit 1: Summary generic investment model**




**<u>Structure A: Local Authority Company</u>**

In this model the local authority uses the power it has to set up a local authority fully owned company to acquire or develop properties (Section 95 of the Local Government Act 2003 or Section 1 of the Localism Act 2011 (general power of competence)). The company is 100% owned by the local authority (joint venture structures are discussed in Structure C), but if able to secure external debt finance that is cheaper than borrowing from the Public Works Loan Board (PWLB), it may draw on external debt finance. Properties are let to tenants by the company on an assured short-hold tenancy basis, and do not attract right to buy considerations.

**Exhibit 2: Summary local authority company led investment model**



**Advantages**

- Local authorities have the greatest control in this approach. While the company would operate as an independent entity from the local authority, through the setting up and ownership of the company, the local authority has the most control. This includes control over the nomination of tenants, rent setting policy, as well as the flexibility to add or reduce the number of properties the company owns to adapt to local circumstances.
- Implementation is potentially quickest. This approach avoids the need for procurement if fully operated and managed by the local authority, as it would be possible to use the Teckal exemption, potentially speeding up implementation. Procurement requirements would still need to be met if the local authority decides to use an external asset or tenant manager, although it may be possible to extend existing asset and tenant management contracts if these are already in place with a private sector provider.
- Funding for this approach could come from external debt investors as well as the local authority. Initial conversations with external investors have indicated an interest in lending to this vehicle if the debt is guaranteed by the local authority.

**Disadvantages:**

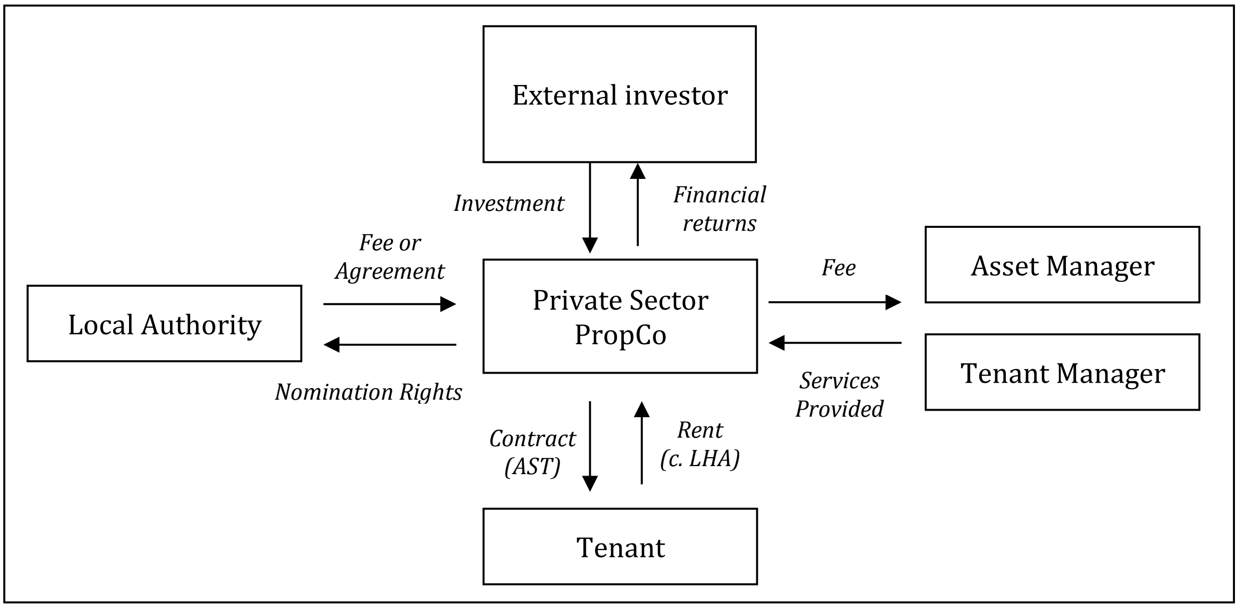
- Given the company is 100% owned by the local authority all borrowing associated with the company would be classified as public sector debt, and as such schemes of this kind could lead to increased public borrowing and therefore be unlikely to attract central government support..
- Since the debt would be classified as public sector debt, this approach is only open to those local authorities that have sufficient borrowing capacity and willingness to use some of it for this purpose.
- Local authorities take on the greatest amount of financial risk in this approach. This risk can be potentially shared through the use of long term contracts with asset and tenant managers. Additionally by exercising control over the company and ultimate ownership of the properties, local authorities have the ability to respond to risks as they evolve. In return for taking on this risk, local authorities benefit in the long term from any surpluses generated by the company and any long run appreciation in property values.

State Aid remains a potential consideration if the local authority provides a grant, loan, service, guarantee or property to the company not at market terms. An existing State Aid exemption exists for undertakings entrusted with the operations of services of general economic interest. The SGEI exemption incorporates the provision of social housing or housing at sub-market rental levels (broadly defined as up to 80% of market rent), but could not be used if some properties are rented at market rates. While the exemption relates to new supply of social housing, the conversion of street property from market to sub-market rent potentially meets the classification of new supply.

**<u>Structure B: Wholly owned Private Sector Company</u>**

An alternative to the local authority led model involves the property portfolio being acquired and let by a private sector provider, including the possibility of this role being undertaken by a registered provider. The private sector PropCo would potentially manage properties itself, or contract with separate asset and tenant managers. PropCo may seek investment from third party investors, or use its own resources. In this structure the local authority would not make any investment, although it might look to secure access to the properties through entering into a long term nomination agreement, potentially with a specific void guarantee.

**Exhibit 3: Summary wholly owned Private Sector Company led investment model**




**Advantages:**

- The source of funding would be at the discretion of the private provider. Debt associated with the PropCo would be classified to the private sector, provided that the local authority does not enter into a long term lease that could potentially be viewed as either a finance lease or providing the local authority with control.
- EU procurement rules would not generally apply. However they may apply if a local authority enters into a contract for goods, services or works from the private provider, which under certain conditions could include nomination rights or guarantees.
- Financial risk of the structure sits with external investors and private sector providers. However to help reduce risks investors may look to local authorities for some form of guarantee. This guarantee could be in the form of a nomination right to place tenants in the property, or more explicit void or rental guarantees. The stronger the form of financial guarantee, the greater the risk which is being passed back to the local authority.
- If the PropCo were a registered provider, it would be possible under the current benefit regime to access the higher temporary accommodation level of rental income for homelessness prevention, rather than local housing allowance, improving initial scheme viability.

**Disadvantages**

- Cost of finance may be more expensive than that achieved by local authority, as private provider credit risk viewed as higher than that of local authority by external investors, or unable to access finance at rates as low as Public Works Loan Board.
- Local authorities would have the least amount of control over the properties out of the three structures presented and depending on the terms of the nomination agreement in place, the private sector provider may have the ability to decide to use properties for an

alternative use (e.g. switch to market rent if market rental levels rose in the area), or sell properties to realise capital gains.

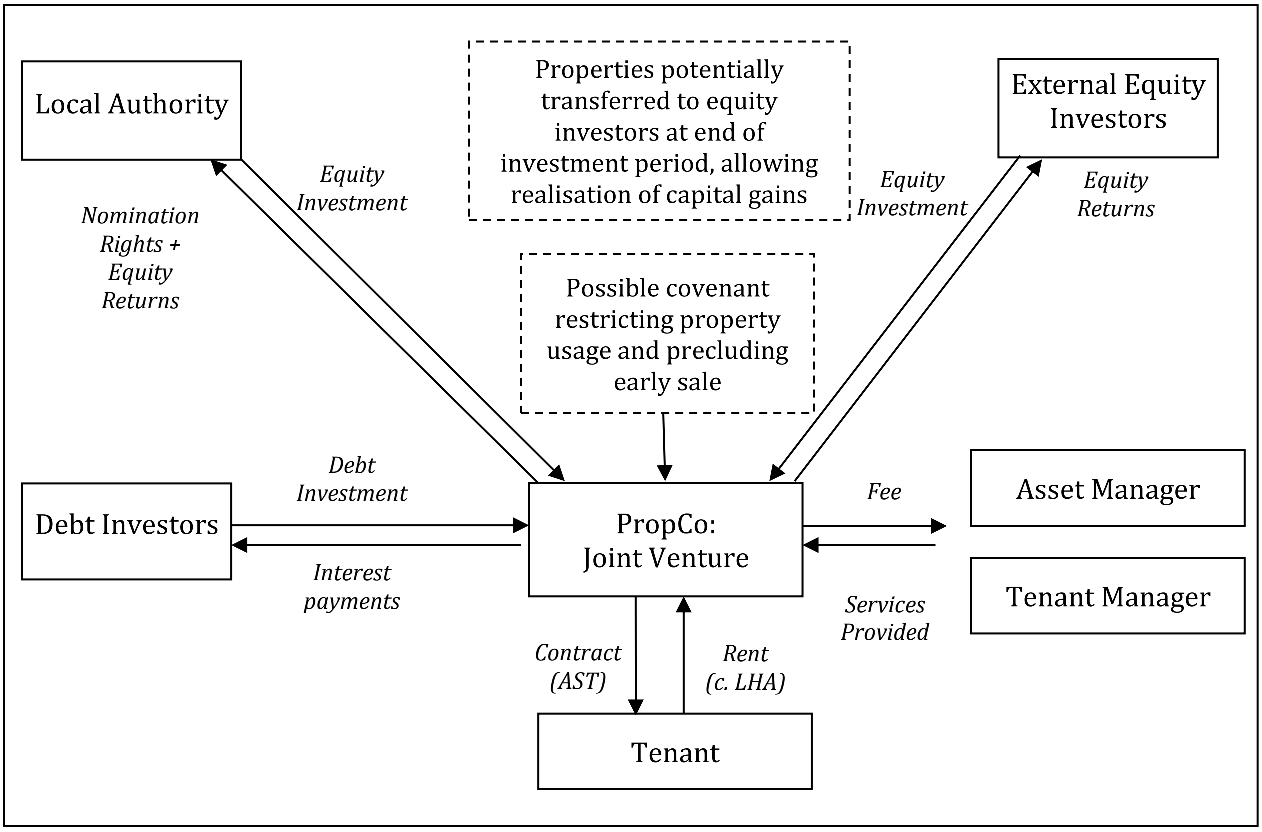
- Given the rental level would be by definition below market levels, the financial return to investors would be expected to below that which could be achieved by renting properties at market rents. Consequently without some form of risk sharing - potentially achieved through a local authority or central government guarantee, profit maximising investors are unlikely to view as attractive. However conversations with some private sector providers with explicit social missions (two registered providers in particular) have indicated that return levels could be acceptable and they would be interested in looking to establish structures of this type.

State Aid would remain a consideration if the local authority provided sub-market funding or guarantees to the private sector provider.

**Structure C: Public-Private Joint Venture**

An alternative model involves a new joint venture being formed between a local authority and private sector partners, including external equity investors. Properties are held in a joint venture PropCo with a view to achieve a specified aim - alleviation and prevention of homelessness for a defined period.

**Exhibit 4: Summary joint venture model**



**Advantages:**

- Debt is potentially classified to the private sector. The classification of debt would depend on the assessment of "control of general corporate policy". If the local authority has ownership of more than 50% of equity in the joint venture, or is deemed to have control over it, then any debt in the joint venture would be classified to the public sector. With a deadlock 50:50 equity structure between a local authority and private sector providers, then an application of ESA10 in 2014 would suggest that 50% of any debt would be classified to the public sector. If the local authority has less than 50% equity in the joint venture, and does not have control through any additional rights, then any debt would be classified to the private sector.
- Risk would be shared between private sector partners and the local authority. Similarly, any long term reward arising from capital appreciation and surpluses generated by PropCo would be shared. Meetings with private providers have highlighted that this model is viewed as particularly attractive as their interests would be closely aligned with those of the local authority in this structure.
- Local authorities would have a higher degree of influence and control than in the wholly owned private sector model (structure B), helping ensure that the properties are continued to be used for the original purpose of homelessness prevention and alleviation.

**Disadvantages:**

- Equity investment would need to be sourced from both the local authority and external equity investors. The scale of the initial equity could be potentially relatively limited, although low levels of equity would increase the risk to debt holders and increase the cost of debt finance. Debt could be jointly sourced, or entirely from the private sector.
- In setting up the joint venture company, the presence of a private interest will likely require the local authority to carry out a procurement exercise in accordance with Contract Procedure Rules, and in particular the Public Contract Regulations 2006.
- External investors may also require local authority to enter into contractual nomination rights or provide additional guarantees. However given the joint ownership and potential alignment of risks between local authority and investor, this is potentially less likely to be needed than in Structure B – the private provider model.

State Aid would continue to remain a consideration as per previous structures.

## Financial Model

The following section outlines the financial model which has been developed as part of the project. The tables below are based on figures developed with the London Borough of Enfield, based on existing property management and maintenance costs. It should be highlighted that while it is possible to draw wider conclusions over viability, and to use a standard model template for alternative geographic areas, the breakdown of investment, income and cost estimates will be dependent on local geographic market conditions, and therefore the absolute figures should not be viewed as directly comparable or representative. Furthermore, while the example is based on the creation of a portfolio constructed by acquiring existing street property, it could be easily adapted for new build, although time scales for implementation would be likely to be substantially longer.[4] It should be noted that analysis conducted as part of this project indicated potentially financial viable schemes in three out of the four local authority partner areas.

The financial model includes the following assumptions:

- 100 unit portfolio acquired by PropCo, focusing on acquiring properties in the lower quartile of the market. Properties acquired on a pepper-potted basis across target area (within local authority boundaries).
- PropCo pays for all fees for acquisition, potentially using professional search and acquisition agent. Total initial outlay of £18.7m.
- Renovation work completed to bring property up to an agreed standard, with Decent Homes viewed as a minimum. Properties furnished to a standard equivalent to the private rented sector, rather than that of social housing - principally major appliances and floor coverings. A further £1.5m spent in total across the portfolio, bringing total capital investment of £20.1m.
- Properties let to households who are at risk of homelessness or those currently in temporary accommodation, through an assured short hold tenancy (AST). Local authority potentially has nomination rights to the properties.
- Rent is set at levels equal to or below local housing allowance, to ensure that the properties represent a suitable offer. Gross annual rental receipts of £1.37m based on LHA levels – gross rent is defined on basis of occupancy for 52 weeks a year with voids and bad debt dealt with separately later). This corresponds to a gross yield of 6.8%.
- Asset manager is responsible for maintaining properties. Costs cover routine and responsive maintenance, major repairs, insurance, gas safety, ground rent and other service charges.
- Provision is made for bad debt to reflect some potential non -payment by tenants - 4.5% based on local market experience with target tenant group.
- Void provision reflects properties un-occupied for period of time between tenancies – assumed at 3.5% of gross rent.
- PropCo operating costs principally reflect salaries and on-costs of individuals responsible for acting as tenant and asset managers, as well as costs for rent collection systems, accounting and audit.

[4] Price would be equal to the acquisition price from developer, or if self-developing, total costs would include, among other costs: a) land costs; b) build costs; c) a developer margin; d) additional infrastructure costs; e) planning and consultancy costs; f) Section 106 costs; and g) fittings and appliances. Renovation costs would be lower, reflecting new build automatically meeting appropriate standards. Most other costs associated with the project would remain similar. However, maintenance costs could potentially be revised downwards, as could provision for major repairs, reflecting life cycle considerations.

- Net operating income yield in steady state of 4.4% - this reflects pre-tax, pre-finance return to capital invested.

### Exhibit 5: Summary of Financial Model - London Borough of Enfield Example

| | Total | Average Per Unit | Per Unit Per Annum | Per Unit Per Week |
|---|---|---|---|---|
| **CAPITAL EXPENDITURE** | | | | |
| **Property purchase cost** | | | | |
| Total no. properties | 100 | 1 | | |
| Property cost | £18,300,000 | £183,000 | | |
| Stamp duty and land tax | £182,642 | £1,826 | | |
| Legal fees | £75,000 | £750 | | |
| Survey fees | £100,000 | £1,000 | | |
| Other acquisition costs | £3,000 | £30 | | |
| **Total purchase price (incl. fees)** | **£18,660,642** | **£186,606** | | |
| | | | | |
| **Initial renovation costs** | | | | |
| Preliminary / monitoring fees | £100,000 | £1,000 | | |
| Cost of renovation work (incl. VAT) | £928,500 | £9,285 | | |
| White Goods / other furnishing (incl. VAT) | £300,000 | £3,000 | | |
| Contingency (%) | | 10% | | |
| Contingency (£) | £132,850 | £1,329 | | |
| **Total renovation costs** | **£1,461,350** | **£14,614** | | |
| | | | | |
| **Total property acquisition cost (incl. fees and renovation)** | **£20,121,992** | **£201,220** | | |
| | | | | |
| **INCOME** | | | | |
| **Rental income** | | | | |
| **Annual gross rent** | **£1,374,175** | | £13,742 | £264 |
| **Gross yield** | **6.8%** | | | |

| | Total | Average Per Unit | Per Unit Per Annum | Per Unit Per Week |
|---|---|---|---|---|
| **GROSS TO NET YIELD BREAKDOWN** | | | | |
| **Rental income** | | | | |
| **Annual gross rent** | **£1,374,175** | | £13,742 | £264 |
| **Gross yield** | **6.8%** | | | |
| | | | | |
| | **(total per annum)** | | | |
| Routine Responsive Maintenance Costs | £50,000 | | £500 | £10 |
| Insurance Costs per unit per annum | £15,000 | | £150 | £3 |
| Gas Safety | £10,000 | | £100 | £2 |
| Ground Rent | £1,000 | | £10 | £0 |
| Service Charges | £45,000 | | £450 | £9 |
| Relet Costs | £50,000 | | £500 | £10 |
| Major Repairs Provision (0.5% of asset value p.a) | £100,000 | | £1,000 | £19 |
| Provison for voids (3.5% of gross rental income) | £48,000 | | £480 | £9 |
| Provision for bad debts (4.5% of gross rental income) | £62,000 | | £620 | £12 |
| **Net Rent** | **£993,175** | | **£9,932** | **£191** |
| **Net Yield (pre set up costs and asset management)** | **4.9%** | | **4.9%** | |
| | | | | |
| Steady state PropCo operating costs (asset + tenant managers, insurance, accounting and audit) | £115,000 | | | |
| **Net Operating Income** | **£878,175** | | £8,782 | £169 |
| **Net Operating Income Yield (pre-tax)** | **4.4%** | | | |

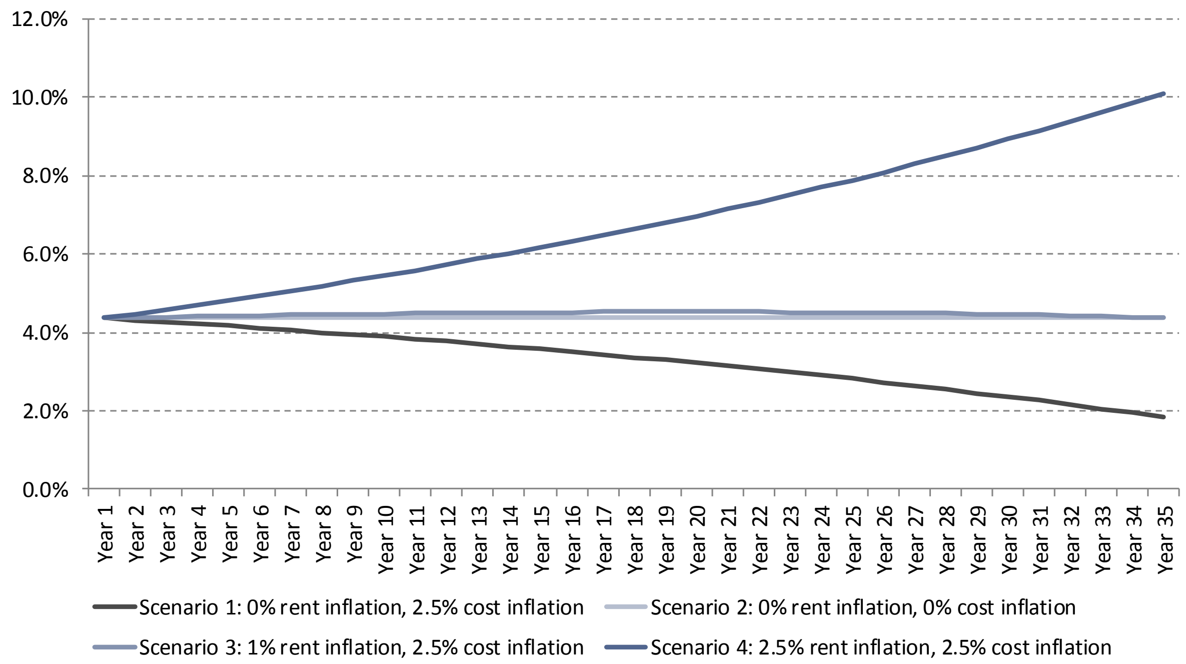
**Evolution of net operating income yield over time**

The evolution of the net operating income yield over time is dependent on a number of assumptions. The two key assumptions are;
1) the rate that rent increases over time;
2) the rate at which costs increase (primarily repair and maintenance and PropCo operating costs).

Exhibit 6 illustrates the evolution of steady state net operating income over time under four nominal inflation scenarios[5], and for simplicity ignores impact of set up costs

1. In the most conservative case, nominal rents are unchanged over a 35 year period, but costs increase with long run inflation of 2.5%. Net operating income falls from 4.4% to 1.8% at the end of 35 years, with an average across the period of 3.3%.
2. Rent and costs are unchanged - net operating income remains constant at 4.4%.
3. Rent increases at 1.0% p.a. and costs increase by 2.5% p.a. - net operating income varies between 4.4% and 4.5% over the 35 years, with the relatively low increase in rent sufficient to compensate for the greater increases in costs, as the scheme begins with rental income significantly higher than costs.
4. Rent and costs both increase at 2.5% p.a. The increase in rent is more than sufficient to cover the increases in costs, and as a consequence the net operating income increases from 4.4% to 10.1% at the end of 35 years.

**Exhibit 6: Net operating income yield over time, under range of inflation scenarios**




The total return to an investor in PropCo includes both the cumulative net operating income and any changes in the value of the underlying property assets. Assuming 2.5% p.a. capital growth, 1.0% p.a.[6] rental inflation and 2.5% cost inflation p.a. the total pre-tax investor return

[5] For the purposes of this analysis, the start up phase is ignored
[6] 1% rental inflation has been used to reflect the planned increases in LHA for 2014/15.

would be 5.7% p.a. over a 35 year period.[7] While this level may be acceptable for a local authority or a social investor[8] this level is unlikely to meet the minimum hurdle rates of external institutional investors to fully fund PropCo without some additional risk sharing.

Exhibit 7 provides a sensitivity table to this return for higher rates of rental inflation and capital growth - for example, if rental inflation was 2.0% p.a. then the total investor return would improve by 80bp from 5.7% p.a. to 6.5% p.a.

**Exhibit 7: Total investor return of 5.7% assuming 1% rental inflation p.a. and 2.5% capital growth**

**Total Pre-Tax Investor Return (IRR) - % p.a.**

| | | **Rental Inflation (p.a.)** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 0.0% | 0.5% | 1.0% | 1.5% | 2.0% | 2.5% | 3.0% | 3.5% | 4.0% |
| **Capital Growth (p.a.)** | 0.0% | 3.5% | 3.9% | 4.4% | 5.0% | 5.5% | 6.0% | 6.6% | 7.1% | 7.7% |
| | 0.5% | 3.8% | 4.2% | 4.7% | 5.2% | 5.7% | 6.2% | 6.7% | 7.2% | 7.8% |
| | 1.0% | 4.1% | 4.5% | 4.9% | 5.4% | 5.9% | 6.3% | 6.8% | 7.4% | 7.9% |
| | 1.5% | 4.4% | 4.8% | 5.2% | 5.6% | 6.1% | 6.5% | 7.0% | 7.5% | 8.0% |
| | 2.0% | 4.7% | 5.1% | 5.5% | 5.9% | 6.3% | 6.7% | 7.2% | 7.6% | 8.1% |
| | 2.5% | 5.1% | 5.4% | 5.7% | 6.1% | 6.5% | 6.9% | 7.4% | 7.8% | 8.3% |
| | 3.0% | 5.4% | 5.7% | 6.0% | 6.4% | 6.7% | 7.1% | 7.5% | 8.0% | 8.4% |
| | 3.5% | 5.7% | 6.0% | 6.3% | 6.6% | 7.0% | 7.4% | 7.7% | 8.1% | 8.6% |
| | 4.0% | 6.0% | 6.3% | 6.6% | 6.9% | 7.2% | 7.6% | 8.0% | 8.3% | 8.7% |

*Notes: 2.5% p.a. cost inflation, 35 year investment period, returns shown pre-tax.*

## Financial Returns Sensitivity

The following section outlines a summary of the sensitivity of the financial model to key assumptions. The analysis presented considers variables in isolation and it should be noted that the impact of more than one variable change is not necessarily equal to the sum of the individual impacts. A fully flexible financial model is available with this report.It should also be noted that all total investor returns are calculated over a 35 year time horizon, assuming 1% p.a. rental inflation and 2.5% p.a. capital growth.

**Exhibit 8: Sensitivity of net operating income yield and total investor return to change in initial property purchase price**

| **Change in property purchase price** | **0.0%** | **2.5%** | **5.0%** | **7.5%** | **10.0%** | **15.0%** | **20.0%** | **25.0%** |
|---|---|---|---|---|---|---|---|---|
| Net Operating Income | 4.4% | 4.3% | 4.2% | 4.1% | 4.0% | 3.8% | 3.6% | 3.5% |
| Total Investor Return | 5.7% | 5.7% | 5.6% | 5.5% | 5.4% | 5.3% | 5.1% | 5.0% |

[7] A 35 year investment period has been assumed to allow for the potential of annuity investment and to model inflation relative to long term forecasts. It is noted that the existing Affordable Homes and Private Rental Sector guarantee schemes offer guarantees for up to 30 years. The impact of a different length investment horizon is dependent on the inflation assumptions used for capital, rents and costs. It is not possible to infer that a shorter investment horizon would have either a positive or negative impact on returns without explicit modelling.

[8] A local authority may find this return acceptable, particularly if there are additional savings arising from lower spending on temporary accommodation. A social investor is viewed for the purposes of this report as one who would be willing to accept a lower financial return in compensation for delivering a positive social impact.

### Exhibit 9: Sensitivity of net operating income yield and total investor return to change in initial rental level

| Change in rental level (gross rent) | -10.0% | -7.5% | -5.0% | -2.5% | 0.0% | 2.5% | 5.0% | 7.5% | 10.0% |
|---|---|---|---|---|---|---|---|---|---|
| Net Operating Income | 3.7% | 3.9% | 4.1% | 4.2% | 4.4% | 4.5% | 4.7% | 4.8% | 5.0% |
| Total Investor Return | 5.2% | 5.3% | 5.5% | 5.6% | 5.7% | 5.9% | 6.0% | 6.2% | 6.3% |

### Exhibit 10: Sensitivity of net operating income yield and total investor return to bad debt and void percentages

| Change in void and bad debt level | 6.0% | 8.0% | 10.0% | 12.0% | 14.0% | 16.0% | 18.0% | 20.0% | 22.0% |
|---|---|---|---|---|---|---|---|---|---|
| Net Operating Income | 4.5% | 4.4% | 4.2% | 4.1% | 4.0% | 3.8% | 3.7% | 3.5% | 3.4% |
| Total Investor Return | 5.9% | 5.7% | 5.6% | 5.5% | 5.4% | 5.3% | 5.1% | 5.0% | 4.9% |

### Exhibit 11: Sensitivity of net operating income yield and total investor return to change tenant and asset management costs

| Change in asset and tenant management costs (maintenance, insurance, ground rents and service chage, relet costs, major repairs and other PropCo costs) | -15.0% | -10.0% | -5.0% | 0.0% | 5.0% | 10.0% | 15.0% | 20.0% | 25.0% |
|---|---|---|---|---|---|---|---|---|---|
| Net Operating Income | 4.7% | 4.6% | 4.5% | 4.4% | 4.3% | 4.2% | 4.1% | 4.0% | 3.9% |
| Total Investor Return | 6.0% | 5.9% | 5.8% | 5.7% | 5.7% | 5.6% | 5.5% | 5.4% | 5.3% |

## Options to Improve Financial Viability

A number of potential options are available to improve financial viability of the scheme, and therefore attract external investment. These can be focused on increasing the return (through higher rents or tax incentives), reducing the upfront investment cost (through grants), or reducing financing costs (through a debt guarantee). Of the four options outlined below we believe that the use of a guarantee would have the smallest impact on public sector debt, and the greatest opportunity to be used in a targeted manner to address this pressing social issue.

**Exhibit 12: Overview of options to improve financial viability**

| Option | Discussion |
|---|---|
| 1. Increase Local Housing Allowance | • Increase would need to be targeted to avoid wider impact on other LHA recipients<br>• Increases public sector borrowing – although lower initially than funding the full capital cost through grants<br>• Distributional considerations, given households receiving LHA would potentially receive different incomes based on historical circumstance rather than current assessed need |
| 2. Grant programme | • Reduces upfront funding costs to improve financial return<br>• Increase in public sector debt equivalent to size of total grant<br>• Potentially distorts housing market if provided as direct grant<br>• Would need to fit with existing affordable housing funding, and risk of duplication of funding streams<br>• State Aid implications if provided to private sector<br>• For new build could be achieved through the inclusion of land already owned by the local authority – principally as long term equity investment |
| 3. Debt guarantee | • Guarantee debt investment, lowering interest costs and improving return to equity investors – potential to leverage in external finance<br>• Potential to use existing guarantees infrastructure (affordable housing guarantee)<br>• Potentially limited impact on public sector debt |
| 4. Tax incentive for investment | • Tax incentive for investment in property schemes, improving return to investor<br>• Could be structured around equity investment only, to ensure link to risk taking aspect of investment.<br>• Potential to provide relief by expanding qualifying investments under Enterprise Investment Scheme rules, or introduce as part of Social Investment Tax relief regime given explicit social purpose<br>• Restrictions would need to be applied to allow investment only in qualifying vehicles, to ensure deliver social impact<br>• Relief would need to be linked to a minimum holding period<br>• Potentially significant upfront impact on public sector debt through lower tax receipts, but could be equivalent to (implicit) |

cost of guarantee over life of scheme

## Business Case 1: Central Government Guarantee Scheme

As outlined in the financial model, the total investor return is unlikely to be sufficiently high to attract external institutional investment which would meet the whole of PropCo's investment requirements. Furthermore, any profit maximising private sector provider considering acquiring a portfolio of rental property is likely to concentrate on properties let at market rents, since these will typically give a higher return than letting at Local Housing Allowance rates, given the higher rental income. The combination of these two factors means that without some form of government support, the supply of properties available for homeless families is unlikely to increase.

**Improving equity returns through leverage**
There are multiple ways in which any given investment can be financed. The simplest financial structure would be one which draws investment from both debt and equity investors. It should be noted that the financial structure does not increase the overall pre-tax return of the project; it instead rewards different types of investor for the respective risks they take.

Under the base case, the total investor return is 5.7% p.a. This is equivalent to the situation in Exhibit 13 where there is no debt (leverage), as the scheme is fully financed through equity.

For an investment proposition as described in the financial model, assuming leverage of around 40%[9] it is estimated that the interest rate required by debt investors would be in the region of around 200-300bp above gilts[10]. Taking a mid-point of 6% (35 year gilt rate of 3.5%[11] + 250bp spread) then the equity investor return would actually fall to 5.4%, highlighting the limited benefits of using leverage in this instance.

However if debt could be accessed at a lower rate (as would be the case if a guarantee on principal and interest payments was made available), then the equity return would increase - for example 4% interest rate and 40% leverage would improve the equity return to 6.5%. Furthermore a lower interest rate would allow a higher level of leverage to be prudently taken, as measured by the interest coverage (net operating income/interest payment). Increasing leverage to 80% at a 4.0% interest rate would improve the return to equity investors to 8.8%; a 310bp improvement relative to the original scenario and based on investor feedback potentially significant enough to attract private sector equity investors.

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[9] This level of gearing is consistent with average gearing of UK and US listed Real Estate Investment Trusts (REITS) of around 30-40%
[10] It is quite possible that the spread would be higher than this level reflecting the uncertainties perceived by investors as a result of an investment scheme being a first time issuer. This assumes that there is no local or central government guarantee.
[11] Pricing based on 13th January 2014, reference 4.25% Treasury Gilt 2049

**Exhibit 13: Equity return to investors can be improved with addition of leverage (fixed rate debt) but only if interest rate is sufficiently low**

**Total Pre-Tax Equity Investor Return (IRR) - % p.a.**

| | | **Leverage (debt/total investment)** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 0% | 10% | 20% | 30% | 40% | 50% | 60% | 70% | 80% |
| **Interest rate** | 3.5% | 5.7% | 5.9% | 6.1% | 6.4% | 6.7% | 7.2% | 7.8% | 8.6% | 10.0% |
| **on debt** | 3.8% | 5.7% | 5.9% | 6.1% | 6.3% | 6.6% | 7.0% | 7.5% | 8.2% | 9.4% |
| | 4.0% | 5.7% | 5.9% | 6.0% | 6.2% | 6.5% | 6.8% | 7.2% | 7.8% | 8.8% |
| | 4.5% | 5.7% | 5.8% | 6.0% | 6.1% | 6.2% | 6.5% | 6.7% | 7.1% | 7.7% |
| | 5.0% | 5.7% | 5.8% | 5.9% | 5.9% | 6.0% | 6.1% | 6.3% | 6.4% | 6.7% |
| | 5.5% | 5.7% | 5.8% | 5.8% | 5.8% | 5.8% | 5.8% | 5.8% | 5.8% | 5.8% |
| | 6.0% | 5.7% | 5.7% | 5.7% | 5.6% | 5.5% | 5.4% | 5.3% | 5.2% | 5.0% |
| | 6.5% | 5.7% | 5.7% | 5.6% | 5.4% | 5.3% | 5.1% | 4.9% | 4.6% | 4.2% |
| | 7.0% | 5.7% | 5.6% | 5.5% | 5.3% | 5.1% | 4.8% | 4.5% | 4.1% | 3.6% |

## Role of a government guarantee scheme

An appropriately constructed Government guarantees scheme has the potential to reduce the interest rate required on debt investments into schemes of this kind, by providing an explicit guarantee to the interest and principal payments to debt investors, significantly reducing the risk they are taking. The affordable housing guarantee programme, for example, is able to offer borrowers access to loans at rates of 3.9% over a 30 year term[12] for reasonably high levels of leverage[13]. Not only would a guarantee improve overall viability, but it would potentially make investing, through either debt or equity, more attractive to private sector partners, resulting in a net smaller impact on public sector debt than the alternative option of local authorities investing directly. Furthermore, the ability to borrow at interest rates below that available through the Public Works Loan Board would also improve overall value for money.

Exhibit 14 illustrates how a scheme could potentially be structured.

- Private sector debt investors invest in FundCo or in projects via an aggregator
- Government guarantee given to private sector debt investors, either by guaranteeing the debt of an aggregating vehicle or funding company, or by providing a guarantee directly to individual investors. The guarantee would be tied to assets being used for a specific social purpose - prevention and alleviation of homelessness, and provides a guarantee over both interest and principal.
- The guarantee allows borrowing up-to a suitably high level of leverage relative to open market vacant possession valuation. This could be as high as 80% if consistent with existing guarantee schemes.
- PropCo draws down debt from FundCo (FundCo potentially invests in multiple PropCo)
- FundCo has first fixed charge over the approved assets of PropCo, and assets must meet required loan to value and interest cover ratios
- Individual PropCo formed for different geographic areas, potentially crossing more than one local authority.

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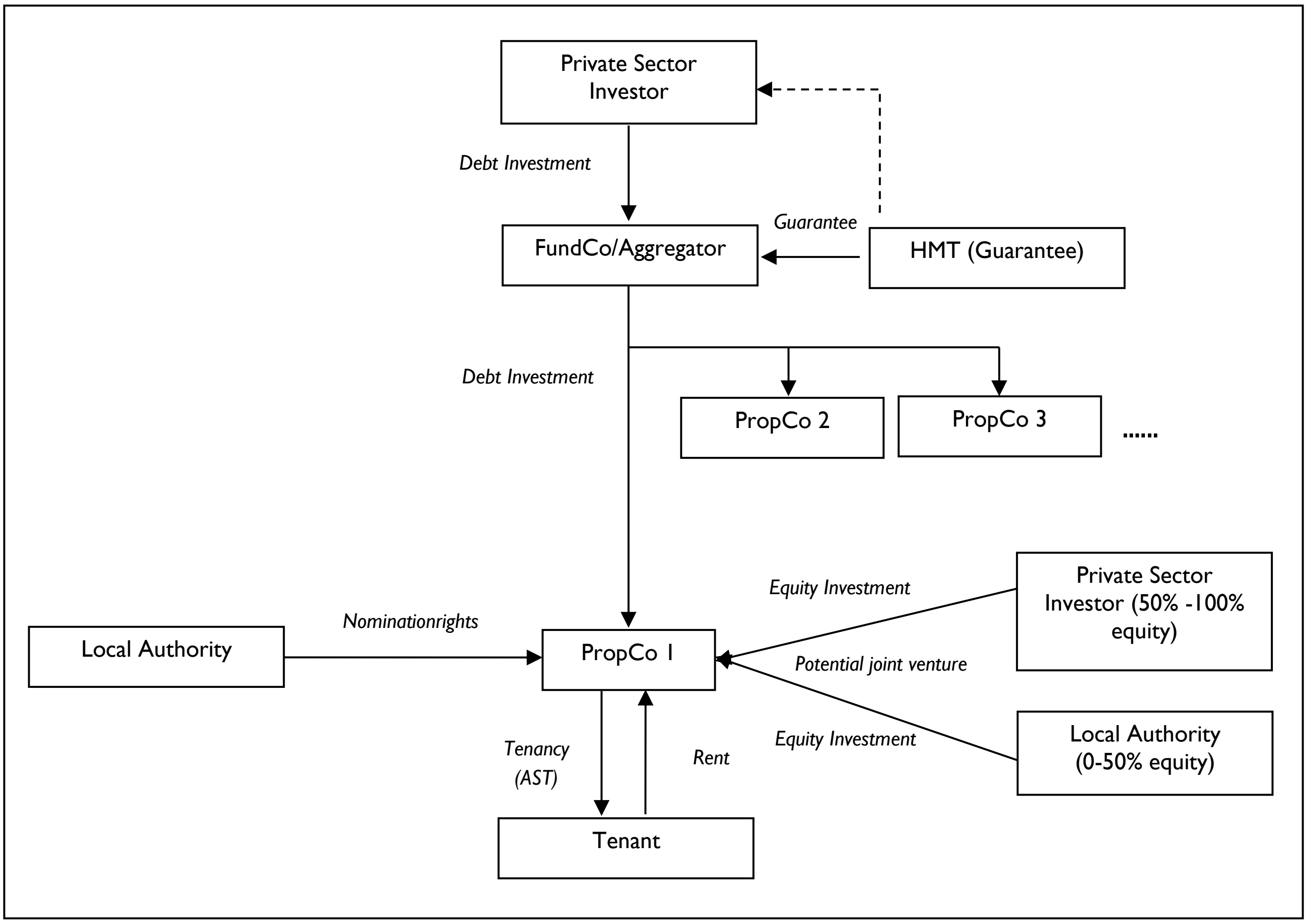
12 Inside Housing 10th January 2014 reported that pricing on the affordable housing guarantee was 40bp above gilts, a rate of around 3.9% on a 30 year term.
13 The Private Rental Sector guarantee scheme offers leverage of up to 80% subject to a 1.2x interest cover. The Affordable Housing guarantee offers leverage to levels such that property security value is not less than 115% of the loan at all times, with valuation based on an EUV-SH basis. This equates to a leverage ratio of 87%, but relative to EUV-SH valuation, which is likely to be lower than open market vacant possession valuation.

- PropCo receives equity investment from private sector investor, with potential for local authorities or other public sector organisations being minority investors alongside the private sector through a joint venture. Restrictions would be placed on public sector investment to ensure that debt issued by PropCo would be classified to the private sector
- PropCo owns property assets, which are rented to tenants at rents which are at or close to local housing allowance
- Local Authority has nomination rights to properties.

**Exhibit 14: Government guarantee model**




**£600m guarantee could support 10% of homeless households out of temporary accommodation.** A £600m guarantee, if successfully drawn down and used to provide leverage at 70%, would potentially stimulate £860m in investment in social housing. Using an average property price of £150,000[14] this would equate to 5,700 homes or approximately 10% of the current number of homeless households accommodated in temporary accommodation.

[14] £150,000 average property price used to reflect likely concentration on 2 and 3 bed properties and that investment likely to be concentrated in lower quartile end of property market

**Summary Advantages**

- Reduces increase in public sector debt relative to local authorities directly investing
- Improves financial viability of schemes, helping to deliver potentially larger impact
- Offers potential for better financing rates than market or even PWLB (local authority direct approach)
- Efficiencies and economies of scale in terms of attracting funding, compared to individual local authority guarantees
- Potentially able to use existing infrastructure
- Targeted approach which is able to ensure and maximise social impact, and does not have to commit to continued new support in an environment where market conditions have changed
- Opportunity to deliver step change in provision of accommodation for homeless households

While it would be possible for local authorities to provide guarantees themselves, there are additional benefits from a centrally administered scheme:

- Pooling of risk across local authorities through a central guarantee may benefit from diversification
- Some local authorities may find it difficult to enter into directly into a guarantee due to local factors and the long term nature of that arrangement
- Diseconomies of scale in the negotiation of a range of guarantees whose terms may vary on a case by case basis
- Credit enhancement of a central guarantee may be stronger than a local authority backed one, leading to lower cost of finance.

**State Aid considerations**

A key consideration for any guarantee scheme will be whether or not the guarantee is exempt from State Aid. Risk sharing should normally be compensated by an appropriate premium. Whether a guarantee constitutes State Aid therefore depends on the premium received for that guarantee[15]. If the guarantee was priced with reference to the market rate for an equivalent loan, potentially there would be no State Aid. From an investor perspective, if a guarantee is priced with reference to market rates, the advantage is limited, as the effective interest cost is unchanged. While the guarantee may be able to reduce transaction costs by increasing the supply and availability of debt finance, this does not seem to be the most significant hurdle to attracting investment in this instance. From an equity investor's perspective, if faced with an equivalent cost of debt to that which could be achieved without the guarantee, the impact on returns and overall viability is limited.

Consequently for a guarantee to stimulate activity and an increase in supply of accommodation for homeless families, it would need to reduce the interest rate relative to the market rate.

Social housing falls under a general interest objective since it addresses a fundamental right - access to housing. It therefore belongs to the State Aid category of Services of General Economic Interest - irrespective of whether provided by public or private undertakings - which if in compliance with Commission Decision of 20 December 2011 on the application of Article

[15] State Aid considerations in relation to guarantees are covered by Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, Official Journal of the European Union (2008/C 115/02, 20.6.2008)

106.2, results in no requirement for notification of State Aid under Article 108. As a consequence it would seem possible, subject to formal legal advice, to set a guarantee fee significantly below the market rate, thereby reducing the interest cost of the debt investment, and materially improving the equity investor returns.

An important consideration therefore would be to confirm the definition of social housing for the purposes of this scheme. The use of the affordable housing definition of social housing (rents of no more than 80% of market rent) would potentially mean that certain geographic areas would not be able to participate given the closeness between social housing rent levels, local housing allowance and market rents. Given the target tenant group are individuals and households in recognised need, who are being currently failed by the market (inadequate supply of homes at acceptable rent levels), and that the definition of social housing is a national decision, it would also be worth considering the potential to introduce more flexibility to the level of rents required relative to market rent, whilst still being classified as social housing. Additionally, the SGEI exemption considers the provision of new supply of social housing. Initial legal advice has suggested that the conversion of existing property from market rent to sub-market rent would be classified as increasing the supply of social housing, although this would need to be formally confirmed.

**Classification of borrowing**
In the case of fully private ownership then the debt investment would not be classified to the public sector, provided that the aggregator/FundCo does not represent a public sector organisation. In the event that an aggregator/FundCo were a public sector body, it would be preferable for the guarantee to be made directly to the investor, who would then invest directly in PropCo.

In the case of a joint venture between public sector and private sector investors there are a number of scenarios:

- If the public sector represents a minority equity investor, and has no additional rights of control, such as veto power or priority rewards, and bears no additional risk, then 100% of any borrowings of the joint venture would be classified as private sector debt.
- If, however, additional rights of control are present, and these are deemed sufficiently powerful to give the public sector control, then 100% of any borrowing would be classified to the public sector. If the joint venture is 50:50 and private and public sector are in deadlock, then 100% of any joint venture debt will currently be classified to the private sector by default. If the public sector has additional controls or rights above the private sector partner, then debt would be classified to the public sector. It is worth noting that the application of ESA10 (European System of Accounts) in 2014 will change this position - a 50:50 deadlock joint venture operating in the market will see the 50% public sector share of the borrowings of the venture be allocated to the public sector balance sheet.

The provision of a guarantee would likely need to be recognised on the public sector balance sheet. The size of the liability recognised would be dependent on the severity and likelihood of losses associated with the provision of the guarantee, and would be linked therefore to the final scheme rules. Potentially partially offsetting this would be any income associated with a fee for the provision of the guarantee.

**Implementation**
Given the presence of two existing housing guarantees schemes (Affordable Housing and Private Rented Sector) there would significant benefits to using the established infrastructure

(due diligence, credit committees, documentation) to launch an additional guarantee, potentially through modifying existing scheme rules or adding a new variant. Given the target group and terms on which the housing is provided, it seems that this would sit most closely with the Affordable Housing guarantees scheme.

**Additional considerations**

It is within the power of local authorities to offer guarantees to investors for individual projects. However, there are advantages to a central guarantee in terms of standardised processes and terms and conditions, pooling and diversification of risks across projects, and better perceived strength of the guarantee leading to improved pricing of debt investment.

Given the targeted nature of support in a local authority, relatively small investment sizes would be helpful in allowing a range of different private sector organisations to develop schemes. A minimum draw down size of £5m would seem reasonable in trading off inclusivity with a desire to ensure schemes are managed efficiently and at an appropriate scale. It would also be worth considering the opportunity to allow the staggering of draw-downs, as this would help improve the efficiency with which capital is deployed and positively support overall financial viability and investor returns.

**Risks of guarantee being called**

Interest cover is defined as the ratio of net operating income relative to interest cost payable on debt. A figure of less than 1.0x indicates that a property portfolio would have insufficient income after costs to meet the interest payments of the debt used to help fund the portfolio. In this situation, if the debt was guaranteed, debt investors would look to the provider of the guarantee to make up the shortfall.

Exhibit 15 highlights the interest coverage delivered under the financial model for a range of leverage and interest rates. As reference, the Private Rental Sector Guarantee requires interest coverage of 1.2x - the equivalent figures are shaded in grey in Exhibit 15. With a suitable low interest rate sufficiently high levels of leverage are achievable; e.g. with an interest rate of 4.0% (close to the Affordable Housing Guarantee rate for 30 years) interest cover is still 1.4x at 80% leverage. The potential to set initial leverage and interest cover restrictions should also help reduce the likelihood that a guarantee would be called upon.

**Exhibit 15: Interest cover of more than 1.2x achievable with suitable low interest rate**

**Minimum Interest coverage (post set up)**

| | | Leverage (debt/total investment) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 0% | 10% | 20% | 30% | 40% | 50% | 60% | 70% | 80% |
| **Interest rate** | 3.5% | n.a. | 12.5x | 6.2x | 4.2x | 3.1x | 2.5x | 2.1x | 1.8x | 1.6x |
| | 3.8% | n.a. | 11.7x | 5.8x | 3.9x | 2.9x | 2.3x | 1.9x | 1.7x | 1.5x |
| | 4.0% | n.a. | 10.9x | 5.5x | 3.6x | 2.7x | 2.2x | 1.8x | 1.6x | 1.4x |
| | 4.5% | n.a. | 9.7x | 4.9x | 3.2x | 2.4x | 1.9x | 1.6x | 1.4x | 1.2x |
| | 5.0% | n.a. | 8.7x | 4.4x | 2.9x | 2.2x | 1.7x | 1.5x | 1.2x | 1.1x |
| | 5.5% | n.a. | 7.9x | 4.0x | 2.6x | 2.0x | 1.6x | 1.3x | 1.1x | 1.0x |
| | 6.0% | n.a. | 7.3x | 3.6x | 2.4x | 1.8x | 1.5x | 1.2x | 1.0x | 0.9x |
| | 6.5% | n.a. | 6.7x | 3.4x | 2.2x | 1.7x | 1.3x | 1.1x | 1.0x | 0.8x |
| | 7.0% | n.a. | 6.2x | 3.1x | 2.1x | 1.6x | 1.2x | 1.0x | 0.9x | 0.8x |

*Notes: 1.0% p.a. rent inflation, 2.5% cost inflation, 35 year investment period*

**Additional risks associated with operation of guarantee scheme**
The following section provides a summary of the impact of variation in some of the key variables in the financial model, and the implication that these would have in terms of investors making a claim on the guarantee scheme.

For the purposes of comparison the impacts are considered in relation to the base case financial model outlined above, and for a number of different interest coverage scenarios. It should be noted that the following considers the impact of variables in isolation - a combination of the change in more than one variable may have a more or less significant impact that purely the combination of the each variable in isolation.

It should be noted also that these sensitivities consider the impact without any compensating action. Given properties are let at local housing allowance rates, which are typically below market rent levels, one mitigation is to move part or all of a portfolio from LHA to market rent, although there would be potential State Aid considerations associated with this.

Separately the ultimate cost to government from any guarantee which is called upon would depend on how the guarantee is structured. It would be possible, for example, to structure a guarantee in a way that if called PropCo automatically provides a counter-indemnity, such as a second charge over the properties, which means at the end of the life of the scheme, if a guarantee has been called, properties are sold to repay debt investors and anything left over goes first to repay the guarantee provider for any payments they have made, and then the residual is paid to equity investors.

Decline in rental level
A decline in the rental level that a property can be let at, potentially due to a change in the benefit level that could be claimed by tenants, all other things being equal, will lead to a reduction in the net operating income, net of the impact of lower void costs[16].

Exhibit 16 provides a sensitivity of interest coverage ratio to falls in gross rental income. For example:

- If the initial interest cover was 1.2x, gross rents would need to fall by more than 10% in absolute terms, all else being equal, before a guarantee would be called.
- If the initial interest cover was 1.5x, then a decline of over 20% would be required before the guarantee would be called upon.

**Exhibit 16: Sensitivity of interest cover to changes in rent**

[16] Voids are typically based on percentage of time (and therefore a percentage of gross income) that a property is empty, the impact of a lower rental level, leads to a lower void cost in absolute terms.

**Change in gross rental income**

| % change in gross rent | 0.0% | -2.5% | -5.0% | -7.5% | -10.0% | -12.5% | -15.0% | -17.5% | -20.0% | -22.5% | -25.0% |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Interest cover** | 1.20x | 1.15x | 1.11x | 1.06x | 1.02x | 0.97x | 0.93x | 0.88x | 0.84x | 0.79x | 0.75x |
| | 1.30x | 1.25x | 1.20x | 1.15x | 1.10x | 1.05x | 1.01x | 0.96x | 0.91x | 0.86x | 0.81x |
| | 1.40x | 1.35x | 1.29x | 1.24x | 1.19x | 1.14x | 1.08x | 1.03x | 0.98x | 0.92x | 0.87x |
| | 1.50x | 1.44x | 1.39x | 1.33x | 1.27x | 1.22x | 1.16x | 1.10x | 1.05x | 0.99x | 0.93x |
| | 1.60x | 1.54x | 1.48x | 1.42x | 1.36x | 1.30x | 1.24x | 1.18x | 1.12x | 1.06x | 1.00x |
| | 1.70x | 1.64x | 1.57x | 1.51x | 1.44x | 1.38x | 1.31x | 1.25x | 1.19x | 1.12x | 1.06x |
| | 1.80x | 1.73x | 1.66x | 1.60x | 1.53x | 1.46x | 1.39x | 1.32x | 1.26x | 1.19x | 1.12x |
| | 1.90x | 1.83x | 1.76x | 1.68x | 1.61x | 1.54x | 1.47x | 1.40x | 1.33x | 1.25x | 1.18x |
| | 2.00x | 1.92x | 1.85x | 1.77x | 1.70x | 1.62x | 1.55x | 1.47x | 1.40x | 1.32x | 1.24x |

Increase in voids and unrecoverable bad debts

An alternative scenario potentially sees the rent levels unchanged, but for some reason the properties take longer to let, resulting in a longer void period. Alternatively, the level of bad debts may increase due to tenants' inability to pay their rent. The financial model assumes voids of 3.5% of gross rent and bad debts of 4.5% of gross rent; meaning in total 8% of potential gross rental income is not collected. These figures are potentially conservative relative to private rented sector equivalent figures.[17]

- If initial interest cover was 1.2x, then voids and bad debts would have to increase from 8% to 20% before any debt guarantee would be called upon by investors.
- If the initial interest cover was 1.5x then voids and bad debts would need to increase to more than 25% before debt investors would call on the guarantee scheme.

## Exhibit 17: Sensitivity of interest cover to change in voids and bad debts

**Change in voids and bad debts**

| Void and bad debt rate | 8.0% | 10.0% | 12.5% | 15.0% | 17.5% | 20.0% | 22.5% | 25.0% | 27.5% | 30.0% | 32.5% |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Interest cover** | 1.20x | 1.16x | 1.12x | 1.07x | 1.02x | 0.97x | 0.93x | 0.88x | 0.83x | 0.79x | 0.74x |
| | 1.30x | 1.26x | 1.21x | 1.16x | 1.11x | 1.06x | 1.01x | 0.95x | 0.90x | 0.85x | 0.80x |
| | 1.40x | 1.36x | 1.30x | 1.25x | 1.19x | 1.14x | 1.08x | 1.03x | 0.97x | 0.92x | 0.86x |
| | 1.50x | 1.45x | 1.39x | 1.34x | 1.28x | 1.22x | 1.16x | 1.10x | 1.04x | 0.98x | 0.92x |
| | 1.60x | 1.55x | 1.49x | 1.42x | 1.36x | 1.30x | 1.24x | 1.17x | 1.11x | 1.05x | 0.99x |
| | 1.70x | 1.65x | 1.58x | 1.51x | 1.45x | 1.38x | 1.31x | 1.25x | 1.18x | 1.11x | 1.05x |
| | 1.80x | 1.74x | 1.67x | 1.60x | 1.53x | 1.46x | 1.39x | 1.32x | 1.25x | 1.18x | 1.11x |
| | 1.90x | 1.84x | 1.77x | 1.69x | 1.62x | 1.54x | 1.47x | 1.39x | 1.32x | 1.25x | 1.17x |
| | 2.00x | 1.94x | 1.86x | 1.78x | 1.70x | 1.62x | 1.55x | 1.47x | 1.39x | 1.31x | 1.23x |

Increases in property and tenant management costs

There are a number of costs which are associated with managing and maintaining property to a good standard. These include responsive maintenance costs for dealing with tenant repairs, major repairs linked to life cycle considerations of the property, insurance, annual gas safety inspections, service charges and ground rents for leasehold properties, and costs associated with re-letting properties, as well as costs associated with staff undertaking tenant and asset management duties and those associated with running a property investment vehicle. In the financial model these in total come to around 28% of gross rent. A substantial increase, if not

[17] Large scale private rented sector property managers have indicated that void levels in private rented sector are typically in the range of 3.0-3.5%, a figure supported by the IPD residential property benchmarks. However, given the below market rent levels and the ability to enter into nomination agreements with local authorities to place tenants, feedback indicated that this figure could be improved upon if well managed. Similarly, bad debt levels in the private rented sector are typically lower than 4.5%. This in part reflects that most private sector tenants pay a deposit, which is used to cover any rental shortfall. Given the target tenant group may not pay an initial deposit and not all local authorities will pay one on their behalf, a higher level has been assumed for the purposes of the financial model.

compensated by movements in rent, would reduce net operating income. Exhibit 18 provides a sensitivity table to an uncompensated cost increase.

- If interest cover was 1.2x then costs would need to increase by more than 35% before the guarantee scheme were called upon.
- If interest cover was 1.5x then these costs would need to increase by around 75% before interest cover fell below 1.0x.

**Exhibit 18: Sensitivity of interest cover to change in property and tenant management costs**

**Change in costs:**
**(maintenance, insurance, ground rents and service chage, relet costs, major repairs and other PropCo costs)**

| Increase in costs | 0.0% | 5.0% | 10.0% | 15.0% | 20.0% | 25.0% | 30.0% | 40.0% | 50.0% | 60.0% | 70.0% |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Interest cover | 1.20x | 1.17x | 1.15x | 1.12x | 1.09x | 1.07x | 1.04x | 0.99x | 0.94x | 0.88x | 0.83x |
| | 1.30x | 1.27x | 1.24x | 1.21x | 1.19x | 1.16x | 1.13x | 1.07x | 1.01x | 0.96x | 0.90x |
| | 1.40x | 1.37x | 1.34x | 1.31x | 1.28x | 1.25x | 1.22x | 1.15x | 1.09x | 1.03x | 0.97x |
| | 1.50x | 1.47x | 1.43x | 1.40x | 1.37x | 1.34x | 1.30x | 1.24x | 1.17x | 1.10x | 1.04x |
| | 1.60x | 1.56x | 1.53x | 1.49x | 1.46x | 1.42x | 1.39x | 1.32x | 1.25x | 1.18x | 1.11x |
| | 1.70x | 1.66x | 1.63x | 1.59x | 1.55x | 1.51x | 1.48x | 1.40x | 1.33x | 1.25x | 1.18x |
| | 1.80x | 1.76x | 1.72x | 1.68x | 1.64x | 1.60x | 1.56x | 1.48x | 1.40x | 1.33x | 1.25x |
| | 1.90x | 1.86x | 1.82x | 1.77x | 1.73x | 1.69x | 1.65x | 1.57x | 1.48x | 1.40x | 1.32x |
| | 2.00x | 1.96x | 1.91x | 1.87x | 1.82x | 1.78x | 1.74x | 1.65x | 1.56x | 1.47x | 1.38x |

Decline in property values

So far this section has considered the scenarios which impact the on-going income of the scheme and therefore lead to the guarantee being called upon to cover shortfalls on interest payments to debt investors. Any guarantee scheme would also need to consider the maximum loan to value ratio which would be acceptable. If property prices fell significantly in nominal terms over the length of maturity of the loan, then the value of the assets would no longer exceed the value of the loan outstanding. In this scenario the debt guarantee would be called upon to compensate for the loss of initial loan value. Exhibit 19 provides a sensitivity analysis to declines in property values.

- If the original loan to value was 80%, then debt investors would have funded 80% of the original property value. If property values fell by more than 20% over the length of the borrowing, then the final value of properties would not be sufficient to repay the borrowing.
- If the loan to value was initially 60%, then property prices would need to fall by 40% in nominal terms for the guarantee to be called.

**Exhibit 19: Sensitivity of loan to value ratio to changes in property prices**

**Change in property value**

| | 0.0% | -2.5% | -5.0% | -7.5% | -10.0% | -15.0% | -20.0% | -25.0% | -30.0% | -35.0% | -40.0% |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Loan to Value | 80% | 82% | 84% | 86% | 89% | 94% | 100% | 107% | 114% | 123% | 133% |
| | 75% | 77% | 79% | 81% | 83% | 88% | 94% | 100% | 107% | 115% | 125% |
| | 70% | 72% | 74% | 76% | 78% | 82% | 88% | 93% | 100% | 108% | 117% |
| | 65% | 67% | 68% | 70% | 72% | 76% | 81% | 87% | 93% | 100% | 108% |
| | 60% | 62% | 63% | 65% | 67% | 71% | 75% | 80% | 86% | 92% | 100% |
| | 55% | 56% | 58% | 59% | 61% | 65% | 69% | 73% | 79% | 85% | 92% |
| | 50% | 51% | 53% | 54% | 56% | 59% | 63% | 67% | 71% | 77% | 83% |
| | 45% | 46% | 47% | 49% | 50% | 53% | 56% | 60% | 64% | 69% | 75% |
| | 40% | 41% | 42% | 43% | 44% | 47% | 50% | 53% | 57% | 62% | 67% |

## Business Case 2 - Advisory Intermediary Supporting Local Authorities

Based on the experience of working with pathfinder local authority, the responses to a survey completed during a seminar held with a number of local authorities[18], and one-to-one meetings with a number of private sector providers[19] there is clear evidence of need and demand among local authorities for additional advisory support in looking at ways to increase the supply of private rented sector accommodation for homeless households.

The key roles that this advisory intermediary would need to play include:

- Needs assessment in terms of potential demand for housing
- Viability assessment, both in terms of financial viability, and in relation to wider impacts on local housing market
- Financial model development and analysis and quantification of financial risks
- Assumptions testing
- Structuring options advice
- Advice around key procurement, state aid, and legal considerations
- Advice around potential governance arrangements
- Review of alternative funding options
- Support through democratic process to cabinet decision

While local authorities are free to commission support from existing external organisations, there would be several advantages to the formation of a central intermediary whose purpose was to provide advice and expertise for local authorities in this area. The advantages include:

- Clarity of purpose, with ability to set up clear measurable (SMART) objectives in terms of number of local authorities supported, and able to demonstrate success
- Saves "reinventing" deal structures and allows communication of good practice and precedents elsewhere
- Early stage structuring and informal legal support can be provided, reducing requirements and costs of external advice, and helping to streamline decision making process
- Gives local authorities confidence to enter into housing funding deals
- Provides a central point with which investors can engage, thereby helping to facilitate access to external funding sources
- Potential for wider learning and application of expertise to be levered to other projects within DCLG

A central team could sit either within or outside DCLG, but strong, clear endorsement from DCLG would be critical to maximising impact.

**Costing:**
Assuming a first year target of working with 10 local authorities, then initial year 1 budget for the intermediary would be around £400,000.

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[18] DCLG hosted a seminar on 4th November 2013, which was attended by housing and finance representatives from around 25 local authorities. A number of presentations were made covering the wider context, project background, the options available to local authorities and some of the legal issues, from representatives of DCLG, Social Finance and Trowers and Hamlin. At the end of the event a questionnaire was circulated, asking participants a number of questions. A summary of the feedback is included as Appendix Two to this report.

[19] The summary of these interviews is included as a Appendix One

This estimate is based on an analysis of the actual costs of direct support provided to one of the pathfinder local authorities (London Borough of Enfield) by Social Finance over the last six months as part of the overall project – these costs total approximately £50,000. This cost is based on actual salary rates, with an allowance for NI and other on-costs, and central overheads, with no allowance for surplus or profit.[20] The figure excludes time spent working with the other three local authorities and in activities for DCLG directly. Social Finance estimates a potential 20% learning curve would be possible if a second authority was to engage on the same basis, with some potential for further efficiency gains if projects were repeated multiple (10+) times in the subsequent year.

**Exhibit 20: Estimated costs of advisory support to local authorities**

| **Single LA advisory support (first project)** | | |
|---|---|---|
| Direct salary costs pro-rated for time spent | | £32,500 |
| Employer NI and contribution to pension and benefits | 23.4% | £7,605 |
| On costs (premises, IT, central overheads) | 30.0% | £9,750 |
| | | |
| Estimated cost associated with support to LA | | £49,855 |
| **Full cost recover** | | **£49,855** |
| | | |
| Learning curve repeat project | | 20% |
| **Estimated full cost - authority 2** | | **£39,884** |
| | | |
| Learning curve efficiency gain 10 projects | | 20% |
| **Estimated full cost - authority 11** | | **£31,907** |

**Funding:**
The costs of an advisory intermediary could be paid for centrally by DCLG, potentially with some element of payment by results, based on successful submission of a Local Authority cabinet report. Alternatively costs could be shared with local authorities, either on mandate for support or successful implementation. Upfront cost sharing with local authorities would be preferable as this would help to ensure the interests and motivations of local authorities applying for support were appropriately aligned. Given the significant number of external risk factors impacting upon the potential success development of a business case (market conditions, political, funding conditions), a full payment by results programme would be likely viewed as highly risky by any provider and therefore unlikely to provide value for money to the commissioner.

One potential option would be for the central intermediary to receive a flat fee on engagement with a local authority, equal to the cost of the support and fully paid for by the local authority. On successful submission of a business case for approval, DCLG would make a success payment to be shared between the local authority and the intermediary - for example 60% of the costs, of which 50% would be paid to the LA and 10% to the intermediary. This would incentivise both LA and central intermediary to develop a successful business case, and would mean DCLG would only make payments in the event of a successful business case being developed.

[20] This figure equates to an all-inclusive day rate of around £350.

There is also a case for any fee for advisory support to be structured with a mid-project decision break point. Experience of working with the four local authority pathfinders has highlighted that in some areas after conducting detailed market analysis and financial modelling a scheme is not financially viable without significant grant support[21]. In these circumstances, which cannot always be determined in advance, it would seem sensible to have the option to end the engagement, and limit the resource expenditure by the local authority.

The argument for DCLG to support an implementation phase post the development of a successful business case is less strong, as costs of implementation support should be factored into the financial model.

**Commissioning:**
Given the costs associated with establishing a new organisation specifically for this purpose, it would seem more cost effective to engage an existing organisation. There are a number of options which could be considered.

There are precedents for an advisory role sitting within, or closely aligned to government e.g. Partnerships UK, PRS Taskforce, Local Partnerships. There could be potential to utilise one of these existing organisations to undertake this activity.

Alternatively DCLG could look to procure a new partner. This could be achieved through a public procurement approach, and given the scale of any contract; it would be likely that a full procurement process would be required. Given the nature of the services and support required, it would seem likely that procurement of these services would fit within the existing ConsultancyOne Framework developed by the Government Procurement Service.

It would also be critical that if an external organisation were commissioned to act as an advisory intermediary, this organisation would have a clear alignment of interests with participating local authorities, and that potential conflicts of interest were appropriately managed.

[21] The need for grant support may not prevent a local authority wanting to proceed. For authorities where the cost of temporary accommodation substantially exceeds the income received through housing benefit, there is a case to provide some element of grant support on the basis of an invest-to-save programme.

## Appendix One: Feedback From Private Sector Providers

DCLG and Social Finance conducted a number of meetings with potential private sector providers through this project, including registered providers, potential investors, and tenant and asset managers. In particular, these included a series of one-to-one meetings during the later stages of the project to discuss the various options identified, gain feedback on these, and establish the level of interest across the three main activities (acting as investor, PropCo and asset/tenant manager). The providers met with included representative from Grainger, Kier Group, Mears Group, Mill Group, Notting Hill Housing Trust and Thames Valley Homes, organisations with a strong existing track record in property investment, asset management, tenant management and development. The following provides a summary of the key feedback provided in these meetings.

**Endorsement of models presented and costs in financial model**
There was recognition that the three different structures presented represented, at a high level, a summary of key options available. It was noted that there are a number of potential derivatives of each model, although these were not viewed as materially different. There was strong endorsement that the costs presented in the financial model accurately reflect real world figures, and that there would be potential to improve on some aspects of the costs with careful management. It was noted that the renovation costs reflect work being done on existing previously occupied property, and would be different from the costs of bring un-occupied empty property back into use. [22]

**Providers willing and able to undertake all the key roles identified**
A number of potential roles for private sector providers were outlined in the various models presented. These included sourcing and acquiring portfolio of properties, letting, tenant management, asset management, and sourcing or providing investment. In combination, the private sector providers met indicated that they would either be willing to undertake each of the roles outlined, or were aware of a number of organisations who would be.

**Returns too low for profit focused private investor**
The returns illustrated in the base case financial model were viewed as too low for private investors to view as attractive, given the perceived level of risk. It was highlighted that the precise investor return requirements depends on the type of investor, and in particular the level of risk the investor is taking. It was also stressed that even if an investment proposition meets the risk adjusted return requirements of an investor, given competition for investment, it would be critical that the investment case was clearly articulated. However it was felt that equity returns of 8-9% and above, with a government guarantee to debt, would be potentially attractive to private investors.

For organisations with an explicit social mission (particularly registered providers), the return levels demonstrated were viewed as potentially sufficient to make investing attractive, given

[22] One registered provider noted that their initial spending on renovation for an equivalent scheme was substantially higher in absolute terms - a further meeting was held to discuss this in detail. The key drivers of the difference were 1) a focus on larger properties and exclusively on houses, which together would typically cost more to renovate 2) additional spending on energy-efficiency measures for the benefit of tenants 3) pulling forward of preventative maintenance to reduce spending at a later stage. On a like for like basis, allowing for the differences in property mix, energy efficiency level, and timing of preventative maintenance the costs presented were viewed as comparable and not substantially different.

the explicit objectives of homelessness prevention and alleviation. It was highlighted that a net operating income of around 5% typically acted as a hurdle rate reflecting the cost of capital for these organisations, but it was noted that a lower level would be acceptable in initial years if there was potential to achieve an average of 5% over the life of the investment.

**Debt guarantee would be helpful if sufficiently robust**
A debt guarantee was viewed as potentially helpful, but the extent that it was viewed as critical was dependent in part on the private sector partners' own access to capital. It was highlighted that large registered providers are, in many cases, able to access capital markets at costs which are on a par with or marginally cheaper than that available via the affordable housing guarantee scheme, when considered on a comparable basis. Private sector providers without immediate access to capital or who only look to make equity investments viewed a guarantee scheme as having significant potential in stimulating additional investment.

**Partnership key to achieving success**
Feedback across the three main structures indicated a preference among private sector providers for models which saw an alignment of interests between the private sector and the local authority, with particular interest in models which see local authorities share directly in the risks and rewards. The role that a local authority might play could range from providing nomination rights, through to void guarantees, or potential rent or debt guarantees. Nominations were viewed as helpful by providers in terms of minimising voids, and it was not expected that a local authority would enter into either a rent or debt guarantee unless it also had control over PropCo.

**Central advisory could help address local authorities bottleneck**
Private sector providers indicated that the types of model discussed were not only of interest but under the right conditions were also viable. Given the relative complexity of schemes, particularly in terms of procurement and State Aid, and the local nature which, to an extent, limits the size of each scheme, providers viewed local authorities as critical for instigating early stage feasibility analysis and discussions. This was a view that was echoed even by those private sector providers who are already in discussions with local authorities to develop schemes similar to those outlined. There was consensus that a central intermediary who could help support and advise local authorities in developing projects would offer significant value.

# Appendix Two: Feedback from Local Authority Seminar

**Introduction**

DCLG and Social Finance held a conference in London on November 4th to inform local authorities about the project and to gauge levels of interest in schemes of this kind. The half day event included presentations from DCLG (background), Social Finance (financial model and structuring options) and Trowers and Hamlin (legal considerations). A questionnaire was handed out to all attendees and the responses used to inform our on-going work on the project.

A total of 40 local authorities were invited to attend the seminar. These were selected by DCLG to ensure a diverse mix of rural and urban regions from across England and Wales. Approximately 40 delegates attended, representing around 25 local authorities. 17 survey responses were received representing at least 14 different local authorities[23].

The survey consisted of 24 questions and provided both qualitative and quantitative data. Themes explored included:

- Current and anticipated future homelessness situation;
- Ability of local authorities to access PRS accommodation on behalf of homeless households;
- Attitudes towards the use of investment to increase the supply of PRS accommodation;
- Preferable investment characteristics

Please note that given that not all respondents answered all questions, the total number of responses varies between questions.

**<u>KEY FINDINGS</u>**

1. **Demand for homelessness support is growing**
    - 16 out of 17 respondents reported that the demand for homelessness prevention and support had increased over the past 12 months – 13 of these said it had increased significantly, and 12 expected it to increase significantly over the next 1-3 years.

2. **Costs associated with dealing with homelessness are rising**
    - 12 out of 17 respondents reported that the financial position of their Temporary Accommodation budget had declined over the past 12 months, and 14 expected it to decline over the next 1-3 years.
    - 15 said rental levels demanded by private sector landlords (either as Temporary Accommodation or to discharge a duty) had increased over the past 12 months, and the same number said their ability to access PRS accommodation had declined over the same period.

3. **There is considerable interest in using investment to increase the supply of PRS accommodation available for homeless households**
    - 12 out of 17 respondents said they were either very or extremely interested before the seminar in using investment to increase the supply of PRS

[23] Respondents were given the option of including contact information. 14 of the 17 responses completed this section, each representing a separate local authority.

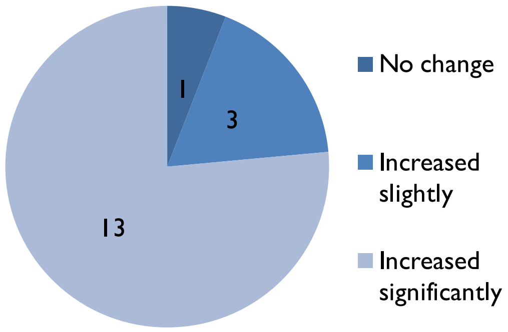
accommodation for homeless households at LHA level rents – 13 said they were more interested after the seminar.
- The most popular investment period for this purpose was 20-30 years.

4. **The most valuable role which a central intermediary could play would be provision of advisory services**
    - If a central intermediary could provide only one role, 9 out of 17 respondents said that this role should be advisory based, though there was also considerable interest in possible corporate finance and aggregator functions.

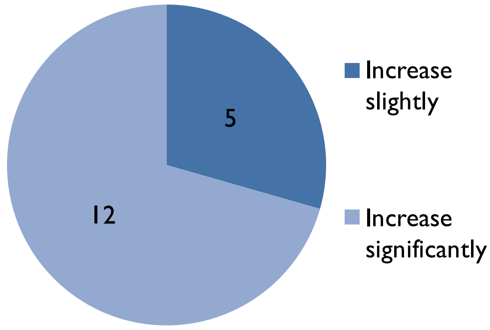
5. **A central intermediary has the potential to deliver a range of potential benefits**
    - 10 out of 15 respondents felt a central intermediary had the potential to increase the supply of PRS accommodation available for homelessness prevention and support
    - 9 out of 15 respondents felt a central intermediary had the potential to increase the supply of PRS accommodation available for homelessness prevention and support
    - 11 out of 15 respondents felt a central intermediary had the potential to increase the value for money of PRS accommodation available for homelessness prevention and support

## Full Survey Response

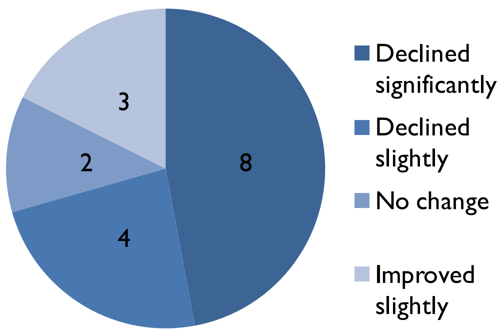
Question 1: How has demand for homelessness prevention and support changed over the last 12 months?*



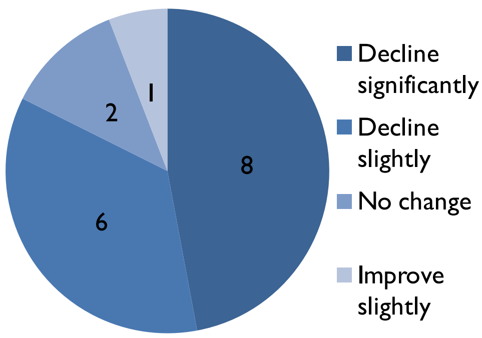

Question 2: How do you expect demand for homelessness prevention and support to change over the near term (next 1- 3 years)?*



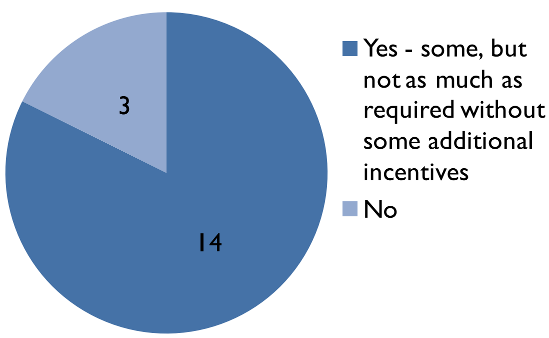

Question 3: How has the financial position of the temporary accommodation budget changed over the last 12 months?*



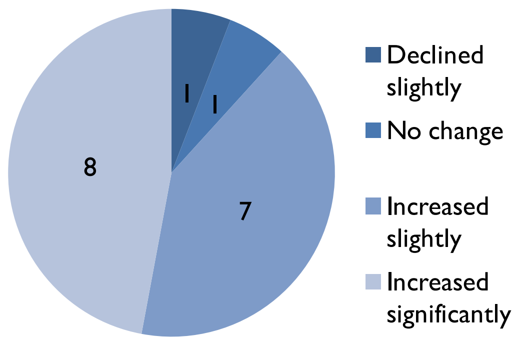

Question 4: How do you expect the financial position of the temporary accommodation budget to change in the near term (next 1-3 years)?*



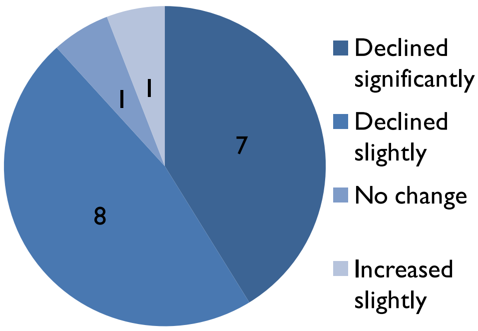

Question 6: How have rental levels for private rented sector accommodation being demanded by landlords (either as Temporary Accommodation or to discharge a duty) changed over the last 12 months?*



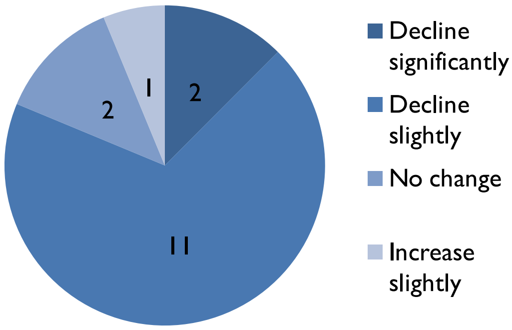

Question 5: Are you still able to enter into new or renewed contracts for temporary accommodation with landlords at rates which are equal to or less than Local Housing Allowance levels (inclusive of any additional landlord incentives)?*



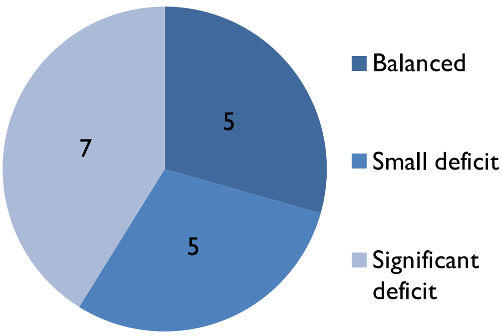
Question 7: How has the ability to access private rented sector accommodation on behalf of homeless households (either as Temporary Accommodation or to discharge a duty) changed over the last 12 months?*



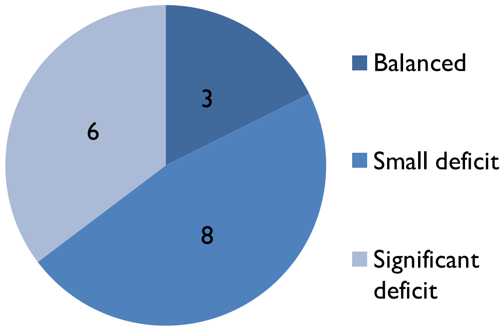

Question 8: What is your expectation on the ability to access private rented sector accommodation on behalf of homeless households (either as Temporary Accommodation or to discharge a duty) in the near future (1-3 years)?*




Question 9: What is the current financial position of your Temporary Accommodation budget for 2013/14?*

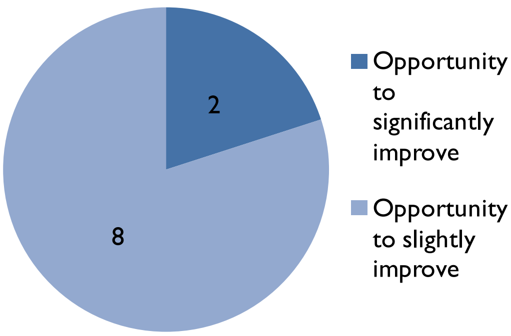



Question 10: What is your expectation of the financial position of your Temporary Accommodation budget over the next three years?*

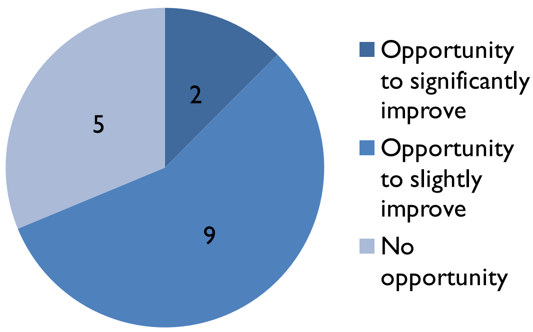



Question 11: Regarding the offer currently available through the private rented sector (PRS) market at or close to LHA rates, how do you see opportunities in each of the following areas?

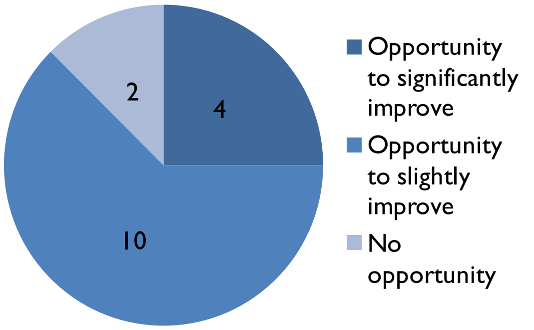
A: Improve tenant security - through longer Assured Short-hold Tenancies*



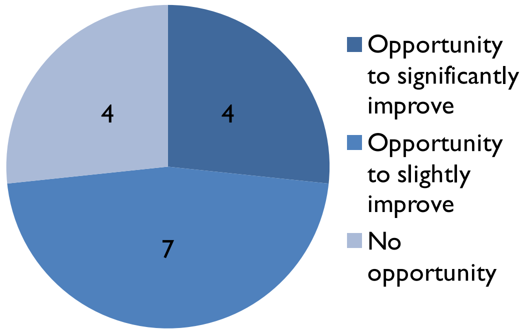

B: Improve standard of accommodation



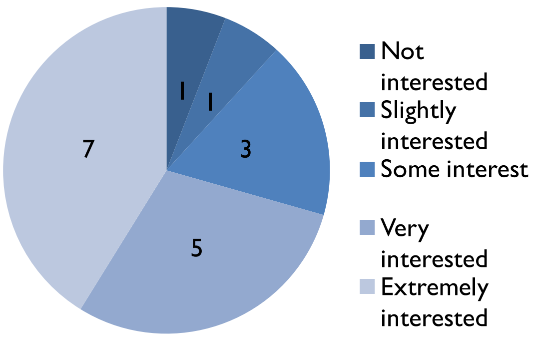
C: Improve management of accommodation



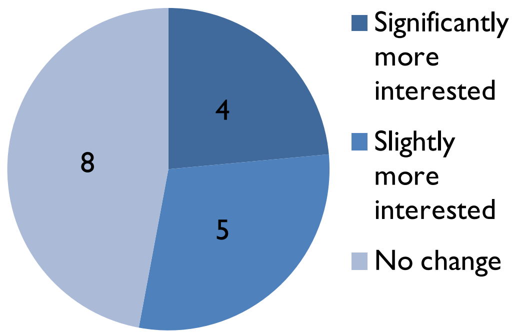

D: Improve value for money vs. current provision




Question 12: Before today's seminar how interested were you in looking at using investment (internal or external) to increase the supply of PRS accommodation for homeless households at LHA level rents?

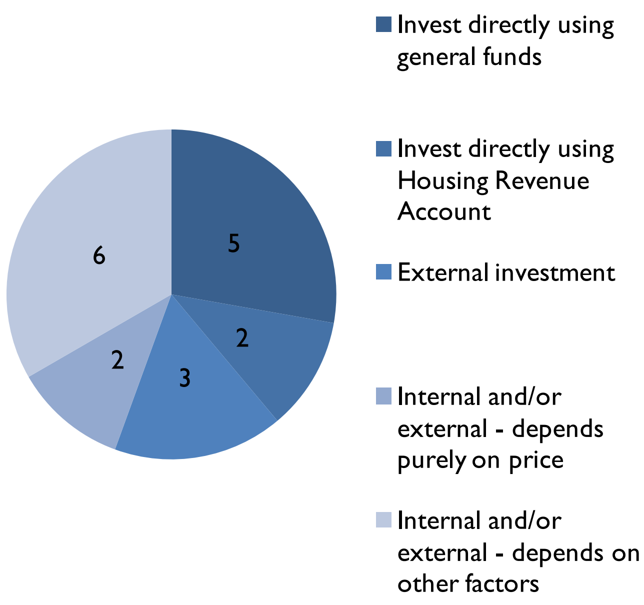



Question 13: After today's seminar how interested are you in looking at investment (internal or external) to increasing the supply of PRS accommodation for homeless households at LHA level rents?*

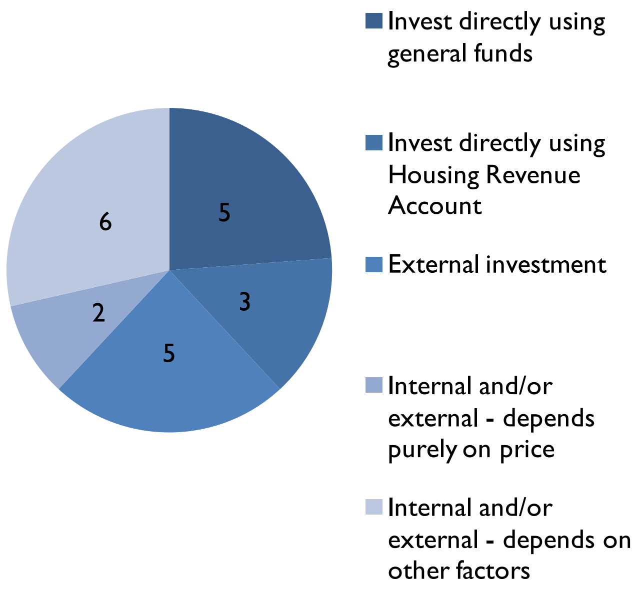



Question 14: In order to increase the supply of PRS accommodation for homeless households, are you interested in any of the following? Please select all that apply.

Question 15: If you were to consider developing a portfolio through buying existing street properties, how would you most likely look to fund it?

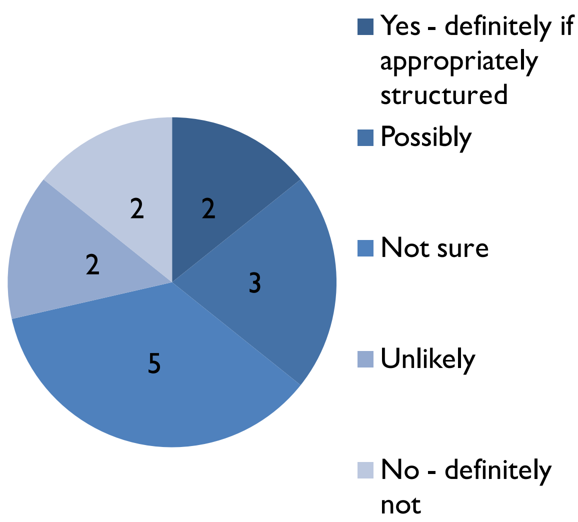



Question 16: If you were to consider developing a portfolio of new build properties, how would you most likely look to fund it?

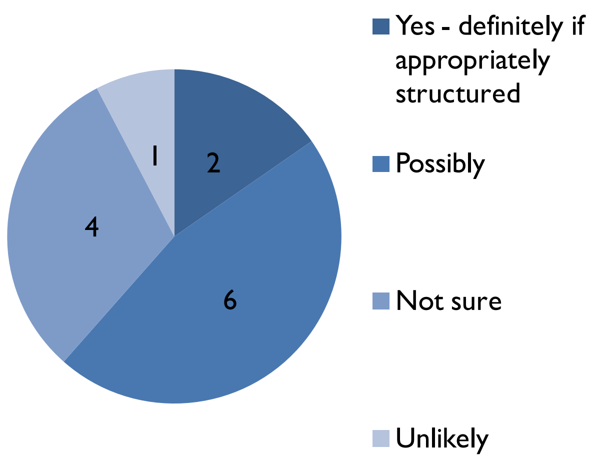



Question 17: If you were looking to fund a scheme with an external investor, would you consider providing some form of guarantee to the investor:

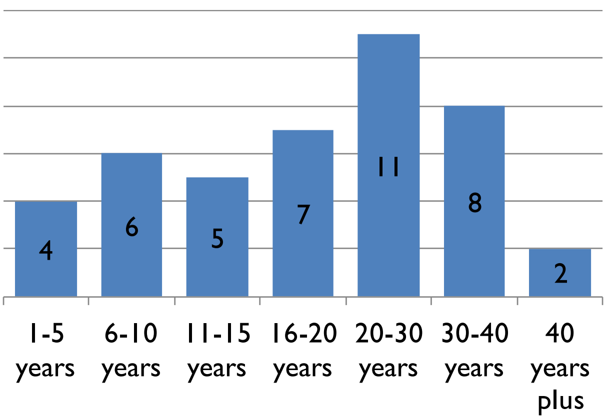
A: Operational guarantees such as priority nominations or voids?



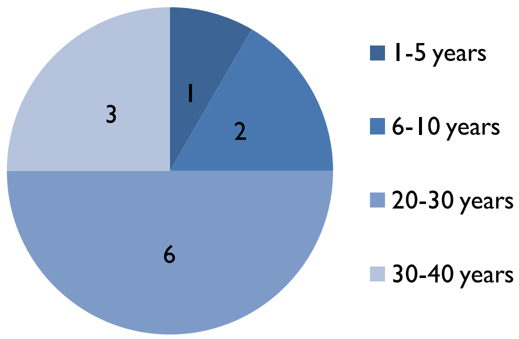

B: Financial guarantees such as an interest or capital guarantees?*



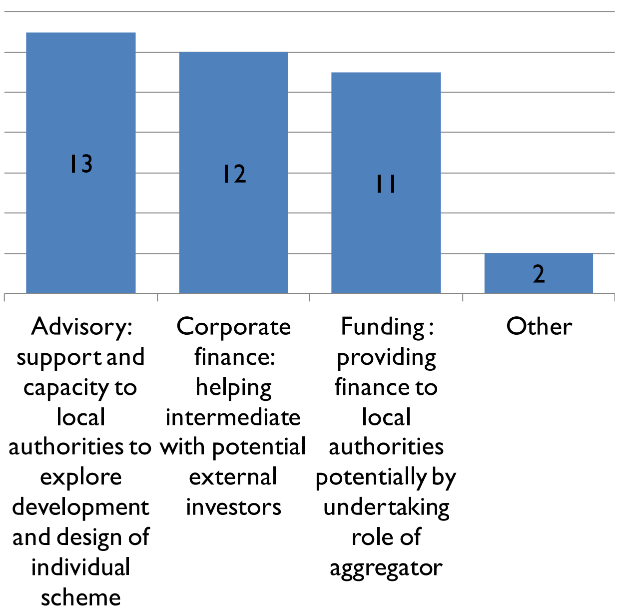
Question 18: Which investment lengths would your local authority consider as acceptable if investing directly or indirectly in a property portfolio? Please select all that apply.



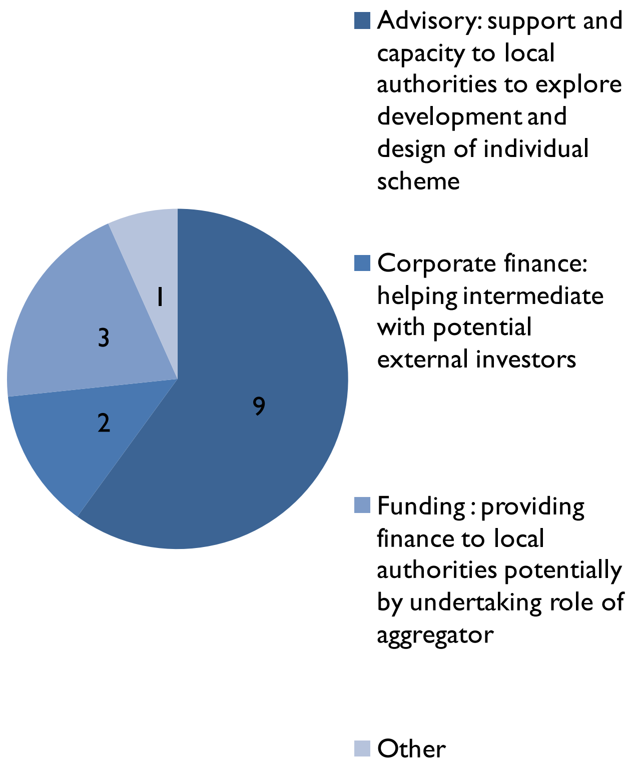

Question 19: Which investment length would be viewed as preferable?*




Question 20: Which roles do you think a central intermediary should undertake to support local authorities looking to attract institutional investment in this area? Please select all that apply?

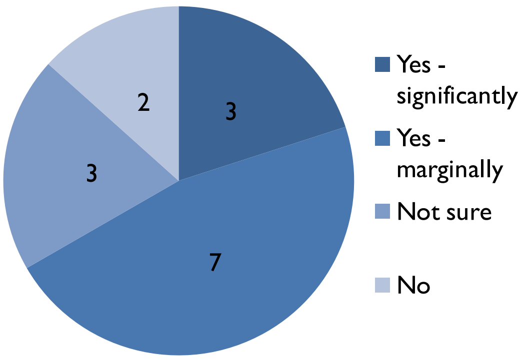



Question 21: If a central intermediary could provide just one role, which would be most helpful?

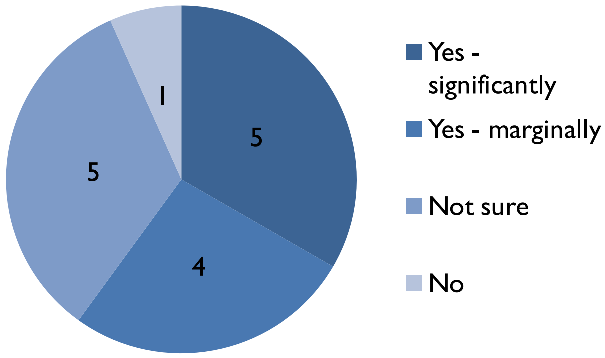


Question 22: One potential scenario would be the establishment of a central intermediary which would be able to offer private sector landlords of a sufficient scale access to cheap borrowing. In return landlords would be required to make properties available to local authorities at LHA rates for a fixed period (for example ten years), and properties, tenancy agreements and management would need to meet pre-defined standards.

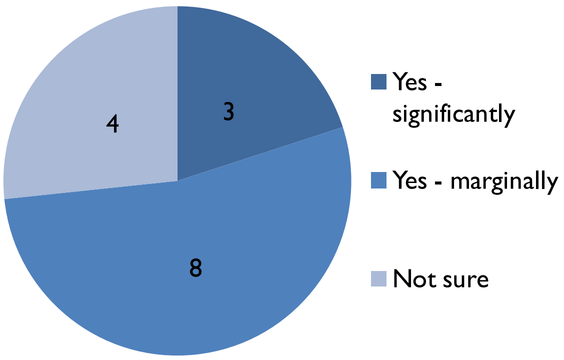
A: Do you feel that such an intermediary would have the potential to deliver an increase in the supply of PRS accommodation available?



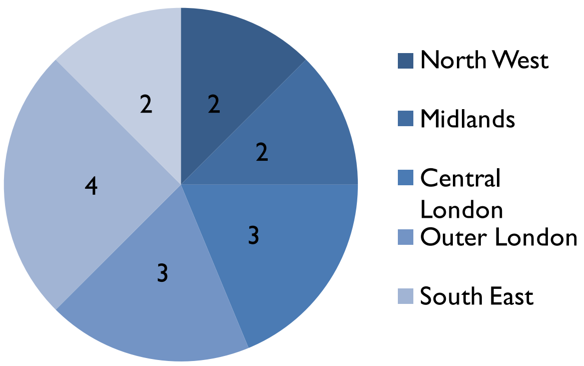

B: Do you feel that such an intermediary would have the potential to drive an increase in the quality of available PRS accommodation?



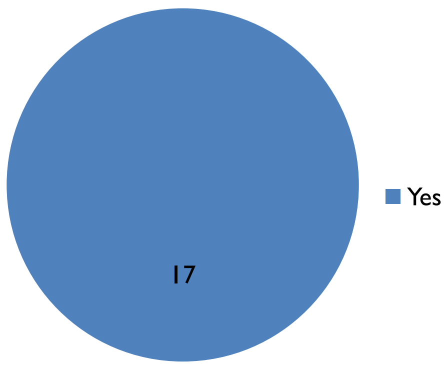

C: Do you feel that such an intermediary would have the potential to help improve value for money of available PRS accommodation?*




Question 23: What is the geographic location of your Local Authority?*




Question 24: Have you found today's seminar useful?



**Feedback Questionnaire** **4th November 2013**

Many thanks for taking the time to attend today's seminar. It would be greatly appreciated if you would take a further few minutes to complete the following questions. Your feedback will be extremely helpful in shaping the direction of work over the coming months and maximising the benefits of this project to the widest possible audience.

Please answer each question with regards to your own local authority and based on your personal experience. Please circle each answer which best applies. All answers will be treated in confidence. We will aim to circulate aggregated responses to everyone attending if a meaningful sample is collected.

**1. How has demand for homelessness prevention and support changed over the last 12 months:**
A. Declined significantly
B. Declined slightly
C. No change
D. Increased slightly
E. Increased significantly

**2. How do you expect demand for homelessness prevention and support to change over the near term (next 1- 3 years)?**
A. Decline significantly
B. Decline slightly
C. No change
D. Increase slightly
E. Increase significantly

**3. How has the financial position of the temporary accommodation budget changed over the last 12 months?**
A. Declined significantly
B. Declined slightly
C. No change
D. Improved slightly
E. Improved significantly

**4. How do you expect the financial position of the temporary accommodation budget to change in the near term (next 1-3 years)?**
A. Decline significantly
B. Decline slightly
C. No change
D. Improve slightly
E. Improve significantly

**5. Are you still able to enter into new or renewed contracts for temporary accommodation with landlords at rates which are equal or less than Local Housing Allowance levels (inclusive of any additional landlord incentives)?**
A. Yes - sufficient for demand
B. Yes - some, but not as much as require without some additional incentives
C. No

**6. How have rental levels for private rented sector accommodation being demanded by landlords (either as Temporary Accommodation or to discharge a duty) changed over the last 12 months?**
A. Declined significantly
B. Declined slightly
C. No change
D. Increased slightly
E. Increased significantly

**7. How has the ability to access private rented sector accommodation on behalf of homeless households (either as Temporary Accommodation or to discharge a duty) changed over the last 12 months?**
A. Declined significantly
B. Declined slightly
C. No change
D. Increased slightly
E. Increased significantly

**8. What is your expectation on the ability to access private rented sector accommodation on behalf of homeless households (either as Temporary Accommodation or to discharge a duty) in the near future (1-3 years)?**
A. Decline significantly
B. Decline slightly
C. No change
D. Increase slightly
E. Increase significantly

**9. What is the current financial position of your Temporary Accommodation budget for 2013/14?**
A. Significant surplus
B. Small surplus
C. Balanced
D. Small deficit
E. Significant deficit

**10. What is your expectation of the financial position of your Temporary Accommodation budget over the next three years?**
A. Significant surplus
B. Small surplus
C. Balanced
D. Small deficit
E. Significant deficit

**11. Regarding the offer currently available through the private rented sector (PRS) market at or close to LHA rates, how do you see opportunities in each of the following areas?**

**11.1 Improve tenant security - through longer Assured Short-hold Tenancies**
A. Opportunity to significantly improve
B. Opportunity to slightly improve
C. No opportunity

**11.2 Improve standard of accommodation**
A. Opportunity to significantly improve
B. Opportunity to slightly improve
C. No opportunity

**11.3 Improve management of accommodation**
A. Opportunity to significantly improve
B. Opportunity to slightly improve
C. No opportunity

**11.4 Improve value for money vs. current provision**
A. Opportunity to significantly improve
B. Opportunity to slightly improve
C. No opportunity

**12. Before today's seminar how interested were you in looking at using investment (internal or external) to increase the supply of PRS accommodation for homeless households at LHA level rents?**
A. Not interested
B. Slightly interested
C. Some interest
D. Very interested
E. Extremely interested

**13. After today's seminar how interested are you in looking at investment (internal or external) to increasing the supply of PRS accommodation for homeless households at LHA level rents?**
A.  Significantly more interested
B.  Slightly more interested
C. No change
D. Slightly less interested
E. Significantly less interested

**14. In order to increase the supply of PRS accommodation for homeless households; are you interested in any of the following?  Please circle all that apply**
A. Buying existing street property
B. Leasing existing street property - leases of 3 years or under
C. Leasing existing street property - leases of 4-10 years
D. Buying new build from external developers
E. Investing directly in developing own new build

**15 If you were to consider developing a portfolio of buying existing street properties - how would you most likely look to fund it?**
A. Invest directly using general funds/Public Works Loan Board
B. Invest directly using Housing Revenue Account
C. External investment
D. Internal and/or external - depends purely on price
E. Internal and/or external - depends on other factors

**16 If you were to consider developing a portfolio of new build properties - how would you most likely look to fund it?**

A. Invest directly using general funds/Public Works Loan Board
B. Invest directly using Housing Revenue Account
C. External investment
D. Internal and/or external - depends purely on price
E. Internal and/or external - depends on other factors

**17. If you were looking to fund a scheme with an external investor, would you consider providing some form of guarantee to the investor?**

**17. 1 Operational guarantees such as priority nominations or voids?**

A. Yes - definitely if appropriately structured
B. Possibly
C. Not sure
D. Unlikely
E. No - definitely not

**17.2 Financial guarantees such as an interest or capital guarantees?**

A. Yes - definitely if appropriately structured
B. Possibly
C. Not sure
D. Unlikely
E. No - definitely not

**18. Which investment lengths would your local authority consider as acceptable if investing directly or indirectly in a property portfolio? - circle all that apply.**

A. 1-5 years
B. 6-10 years
C. 11-15 years
D. 16-20 years
E. 20-30 years
F. 30-40 years
G. 40 years plus

**19. Which investment length would be viewed as preferable?**

A. 1-5 years
B. 6-10 years
C. 11-15 years
D. 16-20 years
E. 20-30 years
F. 30-40 years
G. 40 years plus

**<u>20. Which roles do you think a central intermediary should undertake to support local authorities looking to attract institutional investment in this area? - circle all that apply.</u>**

A. Advisory: support and capacity to local authorities to explore development and design of individual scheme
B. Corporate finance: helping intermediate with potential external investors
C. Funding: providing finance to local authorities potentially by undertaking role of aggregator
D. Other. Please describe

**<u>21. If a central intermediary could provide just one role, which would be most helpful?</u>**

A. Advisory: support and capacity to local authorities to explore development and design of individual schemes
B. Corporate finance: helping intermediate with potential external investors
C. Funding: providing finance to local authorities potentially by undertaking role of aggregator
D. Other. Please describe

**22. One potential scenario would be the establishment of a central intermediary which would be able to offer private sector landlords of a sufficient scale access to cheap borrowing. In return landlords would be required to make properties available to local authorities at LHA rates for a fixed period (for example ten years), and properties, tenancy agreements and management would need to meet pre-defined standards.**

**<u>22.1 Do you feel that such an intermediary would have the potential to deliver an increasein the supply of PRS accommodation available?</u>**

A. Yes - significantly
B. Yes - marginally
C. Not sure
D. No

**<u>22.2 Do you feel that such an intermediary would have the potential to drive an increasein the quality of available PRS accommodation?</u>**

A. Yes - significantly
B. Yes - marginally
C. Not sure
D. No

**<u>22.3 Do you feel that such an intermediary would have the potential to help improve value for money of available PRS accommodation?</u>**

A. Yes - significantly
B. Yes - marginally
C. Not sure
D. No

**23. Geographic location of Local Authority:**
A. Scotland
B. Wales
C. North East
D. North West
E. Midlands
F. Central London
G. Outer London
H. South East
I. South West

**24. Have you found today's seminar useful?**
A. Yes
B. No
C. Undecided

If you have any other comments please feel free to include them here:

## Authors

**Nick Salisbury, Director**
Nick is a successful and respected property banker, who, after a career with Barclays, is now using his knowledge and business expertise for a wider social benefit. This carries a specific focus on housing, regeneration and social business. He has a portfolio of varied non-executive and advisory roles where he brings added value from his banking and property background and is working with Social Finance on a consultancy basis, looking particularly at housing and related projects. Nick is an independent Board Member of Homes for London and has joined the boards of two housing associations, Home Group and Assettrust. He is also a trustee of the Oasis Charitable Trust. Nick was a member of the Montague Review, examining the Barriers to Institutional Investment in the Private Rented Sector.

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**Tim Rothery, Associate Director**
Tim is an Associate Director, having joined the team in November 2011. His work is focused around housing, but having also experience of projects focused on vulnerable children, criminal justice, and unemployment. Most recently Tim has been working with a number of local authorities looking at ways of increasing their supply of good quality affordable accommodation for homeless households. Tim was also involved in working with six housing partners on a project to explore the potential to attract institutional investment into the private rented sector, with a particular focus on meeting the need of low-to-middle income households. Tim previously worked at Goldman Sachs for seven years, where he was a Vice President in the Global Investment Research department in London, most recently leading the European Capital Goods Research team. Tim is a Chartered Financial Analyst, and holds an MPhil in Economics from Oxford, and a BA in Economics from Cambridge.

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**Gopi Shah, Associate**
Gopi joined Social Finance in June 2013. Prior to joining Social Finance, Gopi worked at the Clinton Development Initiative, created by the Clinton Foundation with the mission to catalyse sustainable economic growth in Sub-Saharan Africa focusing on agricultural interventions. Gopi started her career in the Capital Markets division at Goldman Sachs where she worked on asset and liability management for UK Pension Schemes. Gopi holds a Masters in Public Administration in International Finance and Development from Columbia University and the London School of Economics, and has a BSc in Economics and Politics from the University of Warwick.

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**Douglas Hull, Analyst**
Doug joined Social Finance in September 2013. He has worked on projects across a number of social issues, including children's services, youth unemployment, homelessness and housing. Through this he has worked closely with social sector organisations, investors, local authorities and a number of central government departments. Doug moved to Social Finance from Charity Finance Group, where he participated in the Charityworks Graduate Management Programme. At CFG he carried out research and policy work in a range of areas, including leading the umbrella body's engagement with the social investment tax relief consultation. Doug holds a BA in Geography from Cambridge University, where he also founded an overseas volunteering society.

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