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*Practice Group:*  
*Real Estate*

## The Politics of Property: Delivery of affordable homes in the United Kingdom. A new model.

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### Background to affordable housing needs

England and Wales has a population of 56.2m.<sup>1</sup> It is divided into 348 municipal authorities. 33 of these are in London and serve an estimated population of 8.2m.<sup>2</sup> Figures regarding housing needs in London are provided individually by the municipal authorities rather than on a London wide basis.

Taking London as an example of the size and extent of the problem, there have been influential studies published on the housing needs of the capital city by the London School of Economics.<sup>3</sup> Their 2011 report suggests that 32,250 homes are required annually between 2011 and 2021 with 43% in East London where capacity is greatest and regeneration is necessary to support economic growth.

For the five years from 2007-2011 the number of houses built by the municipalities (including Housing Associations) never exceeded 8,000 in any one year.<sup>4</sup>

### Solutions to the housing shortfall

It is clear that the municipalities and Housing Associations cannot be expected to solve the affordable housing shortfall on their own, particularly in London. Additionally, central government will not meet this need in the current fiscal squeeze.

According to Stephen Norris, former Conservative minister, "The best way to get the construction industry moving today, helping to move people off benefits and into work while helping solve our shameful housing crisis, is to make the banks we own provide the retail finance and let the developers do what they do best - turning brown field sites into real houses."<sup>5</sup>

Nevertheless, developers are struggling to deliver the shortfall because of the challenges in obtaining debt finance from the banks.

However, all is not lost. There are a considerable number of private funds, life funds, sovereign wealth funds and others who have the balance sheet strength, commercial imagination and delivery skills to work with developers, contractors and forward thinking municipalities who realise that self-help is the only realistic solution to this serious problem.

Public Private Partnerships or P3s are a workable delivery model which shifts risk and responsibility to where it can best be met. They are already well established in Europe and Canada, and with the US currently grappling with how to address more than \$2 trillion of infrastructure need, this is a tool worthy of careful study and implementation.

<sup>1</sup> Office of National Statistics 2011 Lexus.

<sup>2</sup> www.London.gov.uk

<sup>3</sup> Christine Whitehead, The Case for Public Investment in Affordable Housing in London 2011

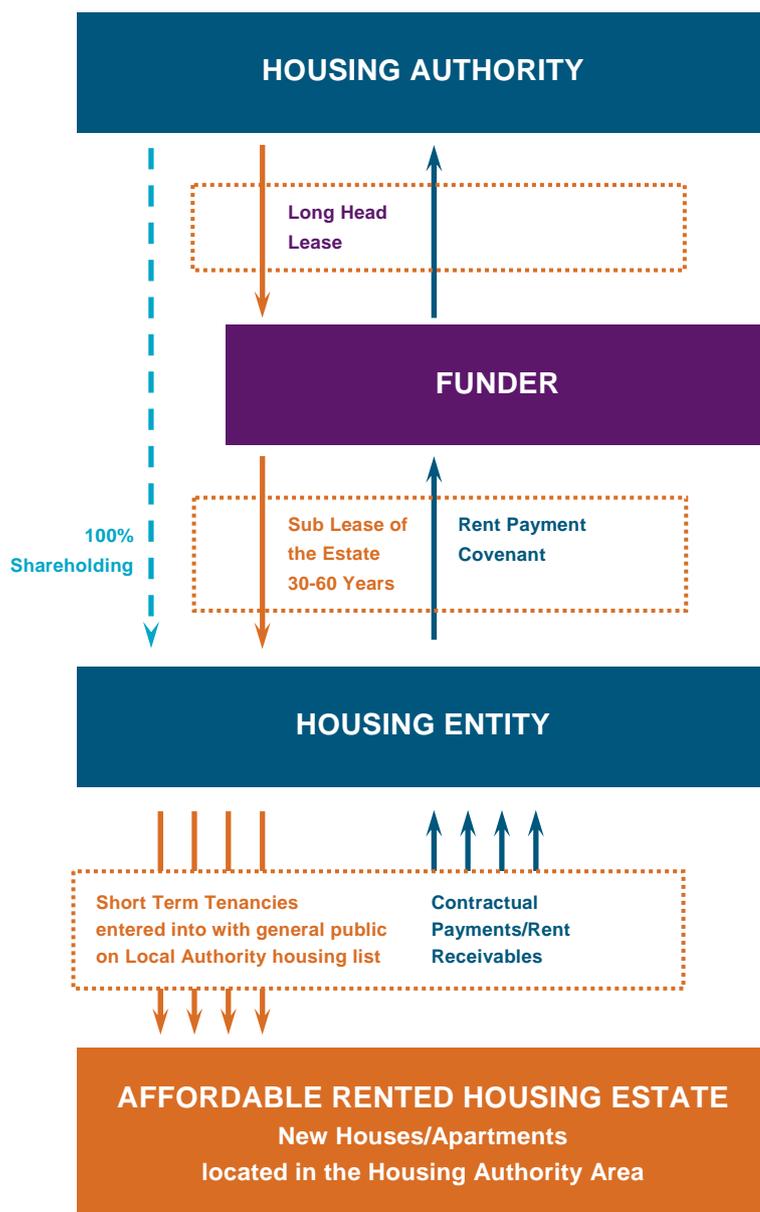
<sup>4</sup> www.communities.gov.uk

<sup>5</sup> Steven Norris, former Conservative Minister and London Mayoral Candidate, Property Week 2.11.2012

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### Our affordable housing model

K&L Gates has developed and executed a unique public/private housing model that allows municipal authorities to deliver high quality affordable housing in their neighbourhoods.



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The diagram provides an introductory overview of a deliverable model where:

- The Housing Authority owns land which needs to be regenerated to provide new affordable homes.
- The project Housing Entity would be established as a limited liability partnership and 100% of the equity would be owned by the Housing Authority.
- The Housing Authority grants a long head lease of the land at an agreed rent to the Funder, in return for providing project funding to build the houses.
- In turn the Funder grants a sub lease of the land for 30-60 years at an agreed rent to the Housing Entity, the rent reflecting the amortised unit cost including repair over the agreed term.
- The land would then be regenerated during, say, the next 2-5 years with the construction of a pre-set number of new houses/apartments in agreed phases using the finance provided by the Funder. Any surplus rent over and above what was needed to service the Funder's rent and pay for maintenance and a sinking fund, would be paid back to the Housing Authority as rent under the Head Lease. Upon completion, the Housing Entity would operate a business letting the homes on tenancies to people on the local authority's housing waiting list. This can be outsourced to the Housing Authority or they can select a delivery partner.

### Key underlying aims of the structure

- **Affordable housing** - To provide the Housing Authority with new off balance sheet quality affordable homes which can be let at affordable rents. The levels of rent are set by the Housing Authority on tenancies (affordable rented) to people on their housing waiting lists at rents which are between 50%-80% of open market rents and which generate sufficient funds to pay the investor in full. The financial model enables the Housing Authority to pay for proper ongoing repair and maintenance and to provide an income stream (the excess) to the Housing Authority, all without the Housing Authority having to deploy any of its financial resources.
- **Bespoke investment tailored to a long term business** - To provide the Funder with an AAA Status investment generating a yield at a rate over a long term with a profile which fits the Funder's treasury and asset management approach to its liabilities.
- **Scalability** - To provide a structure which satisfies the requirements of the key parties and which can be replicated to provide the above results to those parties in respect of other areas of land.
- Establishing the best term of the funding so the homes can be delivered at nil cash outlay to the Housing Authority. The robustness of the model means the cost of funds is very competitive.
- Dealing with any instances if and when any tenants of the properties can purchase the house/flat from the Housing Entity at a discount under 'right to acquire' or 'right to buy' legislation.
- Funding the construction phase and allocating risk during the build period.

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### Conclusions

Using this model, the first scheme in London has been completed and almost 500 quality new homes are currently being built. The model, designed to meet need in London, would easily be applied to meet needs for affordable housing elsewhere in the UK. Residential housing remains an attractive asset class, and municipalities are in a position to capitalise on this by adopting a structure that attracts external private sector investment.

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