NEF Defined Income Scheme:
Building more Rented Homes

Presentation to Highbury group on housing delivery
10.11.14
What is it?

- The NEF Defined Income scheme is a new form of contract between the Local Authority and an RP.
- Instead of specifying a number of subsidised units in a scheme, it specifies a maximum income from the units (the “defined income”).
- The defined income comes from a mix of market and subsidised rent units, and should be a more stable revenue flow for the RP, reducing risk.
- A key difference at the local authority level is that planning permission allows units to flex tenure between subsidised housing and market rent.
- It can be used on whole schemes or S106.
Starting with the Flex Scheme

Financial contribution per house

10 subsidised
£50/week

10 market rent
£100/week

£1500 / week: this is the Defined Income
It will rise with RPI
Excess Income

Market rents go up 20%.
This generates extra money to subsidise more units

13 subsidised
£50/week

7 market rent
£120/week

These 3 units were converted

income of £ 1500 / week
This is the Defined Income
In this example, every subsidised unit doesn’t pay £5 in rent, but it could be any reason. This means that a subsidised unit is converted to market rent to make up the shortfall.

9 subsidised
£45/week

11 market rent
£100/week

£0  500  1000  £1500

Defined Income
Income Risk Reduction

When market rents fall: Flex Income Stability vs without Flex Scheme

- **Weekly Site Income £**
- **% drop in market rents**
- **Defined Income: £1500/wk**

- **Flex site income**
- **Non-Flex site income**

Economics as if people and the planet mattered
Concepts behind the scheme

- More stable income streams are worth more.
- For this reason, a scheme with a Flex contract on it will generate more value.
- This excess value can be used in several ways:
  - Either to subsidise more housing (*inherent additionality*)
  - Or to pay more for the land (*site additionality*)
  - Or a combination of the two
- In addition, an income stream rising with RPI has strong financial benefits (*financial additionality*)
Types of Additionality

We have identified 4 basic types of additionality

- **Inherent additionality** – the direct effect in housing terms of putting the scheme on a particular site.
- **Site additionality** – sites that would not otherwise have come forward that can, if the Flex scheme is used, due to capacity for increased payments.
- **Financial additionality** – improvements in access to index linked finance and capital recycling.
- **Social additionality** – benefits of increased supply, mixed communities, & better quality private rented housing.
Orbit: A case study

- Orbit are targeting building 12,500 homes by 2020
- They are only currently able to finance 9,500 of these using current headroom
- Non-recourse funding like this in an SPV would enable them to access funds to fund the remaining 3,000 homes using cheaper index linked funding
- Potential access into new funds e.g. equity markets via REITS and non-specialist property funds
Pots of Money?

Property Funds

Social Housing

UK PRS

REITS
In the broader context – Asset Allocation

- Bond Market
  - Securitisations
- Pension Funds
- Equity Market
  - REITS
  - Property Funds
Capital Recycling

RP keeps Management Contracts

Builds low risk investment portfolio with RPI linked income stream

Fee Income

Stabilise Income + Sell

RP

Build
Start with some cash

£ 200 million

10 x £20 mil projects, 100 units each

400 social and 600 market rent units

(assuming 40% social)

~The money is lent for 10 years~
The Flex Scheme Refinances

Every 2.5 years

Build → Pay → Sell

In 10 years

RP → Mutual Funds → RP

RP → Mutual Funds → RP

RP → Mutual Funds → RP

RP → Mutual Funds → RP
Impact of capital recycling

£200 million

1 loan for 10 years
- 400 social
- 600 market rent units
  (1,000 units in total)

OR

4 loans for 2 ½ years
- 1600 social
- 2400 market rent units
  (4,000 units in total)
WHAT if we lose social Housing?

400 social
600 market rent units

OR

1600 social
2400 market rent

800 social
3200 market rent
(institutionally managed)

Disaster! HALF social housing is lost!*

*e.g. through a fall in market rents