Section Three

Focus on social housing.

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Many of the announcements in the recent Spending Review such as establishing a National Housing Bank, providing £39 billion in affordable housing support and agreeing a 10 year social rent settlement were widely welcomed in the housing sector for bringing greater clarity and stability for investors. However, to accelerate the delivery of affordable homes Housing Associations (HAs) will need to raise an additional estimated £100 billion[1] in private funding. This is difficult in the current environment when borrowing costs are high, there are multiple demands on HA funds and many HAs are reaching the limits of their borrowing capacity.

HAs plan and invest for the long term. This means they are more sensitive to fluctuating gilt yields than many borrowers. When rates were low, they borrowed significantly. Higher-for-longer yields means that fewer HAs are coming to the capital markets for borrowing and those that do, are borrowing for shorter terms.

This is perhaps a more urgent issue than has been acknowledged. There are about 1.3 million households on the waiting list for social housing today, and we need to increase the annual number of affordable homes by about 100,000 a year to meet demand.

PIC has invested more than £3 billion in social housing over more than a decade and we have seen periods of significant demand, but never so few investable opportunities within the sector. The secure, long-term cashflows that these types of investments produce allow us to match our future pension payments over coming decades.

The sector faces other serious issues which prevents them from building new homes: namely retrofitting existing properties for both fire safety and energy efficiency. However, the Bank of England's ("BoE's") Quantitative Tightening ("QT") programme is perhaps rather surprisingly playing a role in further suppressing the amount of social and affordable homes being built in the UK.

The impact of QE

After the BoE started its Quantitative Easing ("QE") programme in 2009, borrowing costs plummeted. With gilt yields and therefore borrowing costs at historic lows, the amount of investment by institutional investors shot up, over and above the funding by banks. This took a lot of pressure off the public purse.

As shown in figures six and seven, since 2019 there has generally been consistent investment flows into the social housing sector – where bank funding has been more limited, for example in the first three quarters of 2020/21 – a period when banks were focussed on other forms of lending to support the economy during COVID – insurers picked up the slack, and maintained investment flows into the sector.

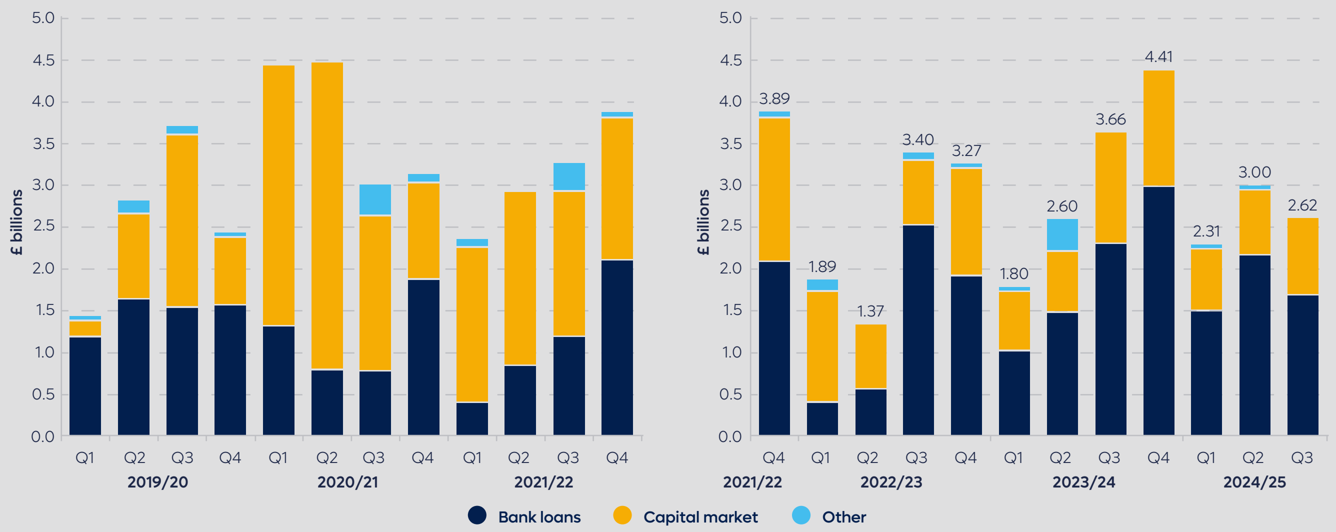
The Housing Finance Corporation Limited is a non-profit organisation that issues long-term bonds in the Sterling capital markets and on-lends the proceeds to HAs to boost affordable housing supply. They state that "there has been a marked shift towards capital markets funding through facilities such as bonds and private placements, particularly after the banks pulled back from long-term lending to the sector following the 2008/9 financial crisis."[2]

PIC research found that as of December 2018 HAs had agreed total borrowing facilities of £95.4 billion, of which £59.8 billion (63%) were bank loans, so institutional investors, such as life insurers, were funding the £35 billion gap.[3] S&P project that total agreed social housing debt in the UK will increase to £120 billion by 2026.[4] Banks would not be able to fund this by themselves, and as figure seven shows, funding has indeed decreased as lending by institutional investors has tailed off.

[1] £100 billion in private funding, New AHP could deliver 500,000 affordable homes over next decade with additional £100bn in private finance
[2] The Housing Finance Corporation (THFC), Private finance in the social housing sector: how we got here, September 2022
[3] Regulator of Social Housing, Quarterly survey for Q3 October to December 2018 and Pension Insurance Corporation, Filling the £35bn funding gap. How insurance capital helps fund social housing in the UK, January 2020
[4] Inside Housing, Sector's debt pile to hit £120bn by 2026, says S&P, March 2024

Focus on social housing. Cont.

Figures Six and Seven: New Facilities agreed – 2019 – 2024/25



Why has funding decreased?

Since QT was announced at the end of 2021, and gilt yields subsequently began to rise, the demand for funding by institutional investors – and their risk-adjusted appetite for investing in the sector – has dropped substantially.

The National Bureau of Economic Research ("NBER") assess the impact of QT on Gilt yields at between 44-70 bps, taking the lower estimate, it is reasonable to suggest the impact of QT on borrowing costs at around 50 bps.

The additional 50bps on borrowing costs cannot be passed on to customers as social rents are regulated. When coupled with the requirement to spend cash on existing stock, this means fewer social homes are being built.[5] The Regulator of Social Housing Sector Risk Profile report revealed that "providers forecast building 300,000 homes over the next five years, 12% lower than forecast a year ago [2023 forecasts]."[6]

HAs borrow at a small margin above gilt yields. With long term interest rates significantly higher than they have been in recent years, and the expectation that rates will remain high for a long time, borrowing from institutional investors at durations of up to 30 years is now an unattractive option for social housing providers. This means they are borrowing less and borrowing for much shorter periods, typically between 5 and 10 years.

HAs set their plans over the long term and therefore higher yields means lower HA borrowing either to build new houses, or to refinance their existing borrowing. In October 2024, the Regulator of Social Housing released its Sector Risk Profile Report which warned that the sectors weakening financial position "continues to intensify."[7]

It found that in 2023/24 the sectors' debt servicing cost exceeded its earnings for the first time since 2009.[8]

Weakening outlook for the sector could mean that even if rates do decline – for example through the ending of QT – the sector remains unattractive due to its higher risk profile.

This is important because institutional investors like PIC, which ideally lend for very long durations as they seek to match future pension payments over the next 30-50 years, are consequently sensitive to sector risk, especially when markets are expensive, as they are today.

The yield available to investors above the risk-free rate, known as the credit spread, is historically tight. For bonds with a duration more than 10 years it is the lowest we have seen since 2007. This means that in our view, most assets are overpriced, and this is certainly the case when you are seeking to hold the bond for 30 years or more, across multiple economic cycles.

So, whilst HAs believe it is expensive to borrow now, institutional investors believe it's expensive (and risky) to lend.

This situation is compounded by the impact of QT, which has not been well documented so far, but it is clearly a contributing factor to the slowdown in the number of social homes that are being built. Taking up to 50bps off the cost of borrowing would have a real impact on the ability, and desire, of housing associations to bring more projects to market, and in the ability of the Government to achieve its target of building 1.5 million homes over the course of this parliament.

[5] Building Cost Information Service, **Latest UK housing starts and completions figures**, April 2025
[6] Regulator of Social Housing, **Sector Risk Profile**, October 2024
[7] Housing Today, **Regulator warns of 'little margin for error' as housing associations' debt servicing costs exceed net earnings**, October 2024
[8] Housing Today, **Regulator warns of 'little margin for error' as housing associations' debt servicing costs exceed net earnings**, October 2024