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How institutional capital can deliver impact objectives and target stable returns through affordable housing

Pensions for Purpose

26 March 2024

octopusinvestments

A brighter way

Agenda

1. The scale of the need in the UK and the potential for improvement
2. Why affordable housing matters to institutional investors
3. How sustainable investing in the real estate sector can address social and environmental issues

Presented by:



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Head of Octopus Affordable Housing

Affordable Housing

Background, demand and supply



Affordable Housing

Affordable housing includes homes for sale or rent and is for people whose needs are not met by the private market. Affordable housing is a key element of the government's plan to end the housing crisis, tackle homelessness and provide aspiring homeowners with a step onto the housing ladder. The Government's National Planning Policy Framework (NPPF) defines the types of affordable housing as Affordable Housing for Rent and Affordable Housing for Sale.

Source: Homes England – Factsheet 9: What is affordable housing, as of 2 November 2023.



Affordable Housing

Demand

As of 2019, there were 3.37 million households who needed affordable housing in England, who could not access existing affordable housing supply¹

In 2020-21, 52,100 affordable homes were built – approximately a third of the number of homes needed²

There are estimated to be a further approximately 1 million households in England who are housed in the private market but cannot afford to sustain their living costs³

Combined with the cost-of-living crisis this has led to unprecedented levels of housing need throughout England³

It is estimated that 340,000 new homes per year are needed to be built to have any meaningful impact on housing need over a 15-20-year period, of which 151,000 should be affordable³

Affordable Housing

Supply

As of October 2022, there were approximately 4.4 million social/affordable homes in the UK of which 1.6 million are owned by Local Authorities and 2.8 million are owned by Housing Associations (Private Registered Providers)¹

In 2022, 20,000 affordable homes (0.0045%) are owned by profit making entities (for-profit registered providers)²

83% (3.68 million) of these units are low-cost rental accommodation (Social or Affordable Rent)¹

Savills predict that £27 billion will be invested in Affordable Housing by 2027 with profit making entities owning approximately 140,000 affordable homes (approximately 3.00%) in 2027²

The supply of affordable housing increased by 0.7% over 2021 (after deductions for demolitions, sales etc.)¹

Local Authority & Housing Association development capacity is under financial pressure over the medium term due to increased debt rates and required investment in areas such as Building Safety and Zero Carbon¹

22%

Average expected fall in development pipelines from England's' largest registered providers

3

Top 3 barriers to development plans: construction costs; interest rates; and refocusing on existing stock

36%

More than a third of social housing providers say their work towards net zero has slowed in the past 12 months

Timeline

- **1950s** – Local authorities are the primary builders of social housing
- **1960s** – Overall housebuilding peaks
- **1988** – housing Act introduced, giving registered providers of social housing access to private finance
- **1990s** – Onset of sustained period of Large-Scale Voluntary Transfers (LSVTs_ between councils and housing associations. Housing associations overtake councils as primary providers of social housing
- **2008** – Global financial crisis and onset of low interest rate environment. Housing and Regeneration Act opens door to for-profit providers and new forms of private capital
- **2010** – Coalition government slashes housing budget in Spending Review
- **2015** – Government announces 4-year social rent reduction
- **2017** – Grenfell Tower fire
- **2020** – Covid-19 pandemic causes a slowdown in housebuilding
- **2022** – Interest rates begin rising rapidly

Sources: Octopus Real Estate: Closing the Gap, as of August 2023.



Social & Affordable Rent

For households on local authority waiting lists

Typical operating costs

- 20% on Houses
- 25% on Apartments
- Note that Social Rent excludes service charge, Affordable Rent includes it

Customer type

- Incomes from £0 to £30,000 on Council Housing Waiting Lists

Risk mitigation

- LHA, low rent base

Risk areas

- Responsible for repairs, maintenance, major repairs
- Low income-based customers
- Assured tenancy agreement (hard to get possession)
- Limited control over nominations



Shared ownership

Helping households onto the housing ladder

Typical operating costs

- Approximately £250 per annum management fees
- Arrears allowance of approximately 0.50%

Customer type

- First time buyers, typical incomes between £25,000-85,000
- Those who would previously have looked at Help to Buy

Risk mitigation

- Lease to customer, no repairing obligations (except approximately £500 per annum for first ten years), investment protected via second charge (ranking second to mortgage if applicable)

Risk areas

- Sales risk (if units developed)
- Customers exposed to mortgage costs
- Crowded investment market



Intermediate rent

Can be targeted at “Key Workers”

Typical operating costs

- 20% on Houses
- 25% on Apartments
- Approach to Service Charge is variable and depends on grant agreements/s106

Customer type

- Aspiring first time buyers, typical incomes between £25,000-85,000
- Those who would previously have looked at Help to Buy

Risk mitigation

- Flexibility and control on letting, easier to get possession, always cheaper than the market, offers more longevity of tenure than the market

Risk areas

- Market renting risk
- Higher turnover than social/affordable rent
- Rents above LHA so less benefits protection

Note: Rent to buy offers Intermediate Renters the opportunity to become Shared Owners as circumstances allow.
Sources: House of Commons Library: What is Affordable Housing, as of 20 July 2023.



Older Persons Affordable Housing

Extra Care & Sheltered Housing

Net to gross assumptions

- 30% on Rented properties
- Reflecting higher operating costs

Customer type

- Older persons typically with a care package

Risk mitigation

- Specifically designed for client group
- Ensure schemes have a balance of care needs

Risk areas

- Fill up rates slower than other tenures
- Care provided by third party
- Service Charges require careful management
- Older Person Shared Ownership should be treated as fixed equity sale



Origination

Most common origination routes for affordable housing

1.

Partnerships

- Working with RPs and Local Authorities to enable them to deliver more homes
- Partners have the skills to build new homes, but limited financial capacity
- Partners will often manage homes once they are complete

2.

S106

- Homes required to be affordable housing under planning restrictions
- Built by housebuilders and sold to RPs at a discount to reflect restrictions
- Significant source of UK affordable housing supply

3.

Development

- Securing social housing grant so that homes can be developed at a subsidised discount that enables them to be affordable housing
- Requires secure counterparties who can be prudently forward funded

4.

Regeneration

- Investing in areas where existing homes don't maximise the use of the space they occupy, to both refurbish existing homes and build new ones
- Can be complex and take a long time



A brighter way

Our Affordable Housing strategy

Octopus entities

Investing in the people, ideas and industries that aim to change the world

Founded in

2000

More than

200 investment professionals

Private business

60% owned by employees

£13.4bn¹
under management

Octopus financial services entities, including:



Octopus energy entities, including:



Certified



Corporation

All Octopus Investments businesses are certified B Corporations

- Meeting the highest standards of verified social and environmental performance, public transparency and legal accountability.
- Working to redefine success in business by measuring success by more than just profit.
- The interests of employees, customers, communities, environment and shareholders are treated equally.

OUR PEOPLE
ENVIRONMENT
CUSTOMER
COMMUNITY
SHAREHOLDERS

Source: Octopus, as of 31 December 2023.
1 Funds Under Management data includes undrawn commitments, funds under advisory mandates and funds monitored. It also includes funds under the management of Octopus Renewables Limited.

Four investment themes

- 1. Accelerating the delivery of genuinely affordable, quality homes**
by providing a structure that allows for co-investment opportunities and that Housing Associations can trust
- 2. Reducing fuel poverty**
using Octopus's unique energy expertise
- 3. Delivering affordable housing for older people**
as one of the UK's top later-living investors
- 4. Supporting levelling-up across England**
by encouraging Local Authorities and LGPS to invest in their local areas through co-investment opportunities

About our strategy

- Evergreen UK Private REIT
- Targeting resilient, index-linked income, and accompanying capital appreciation, from the acquisition and long-term ownership of a portfolio of general needs and older persons' affordable homes across England:
 - Embedded Registered Provider of Social Housing
 - 'Direct-let' model
 - Housing Association and Local Authority partners managing assets
 - Partnering with Housing Associations and Local Authorities to fund their development pipelines
 - Targeted s.106 acquisitions
 - Forward funding, forward commitment and standing investments
 - No specialist supported housing



Summary

We recognise the UK is not delivering enough energy-efficient, genuinely affordable homes for those that need them

We are accelerating delivery of genuinely affordable, sustainable homes

We know that by providing the sector with access to long-term, patient capital that is responsibly managed, we can help to deliver these homes

We are marrying the development expertise of Housing Associations and Local Authorities with our sustainability-focused goals and our investors private capital, to form a more collaborative and long-term model

We understand the benefits of partnering with investors that share our values and goals to build a portfolio that we can be proud of

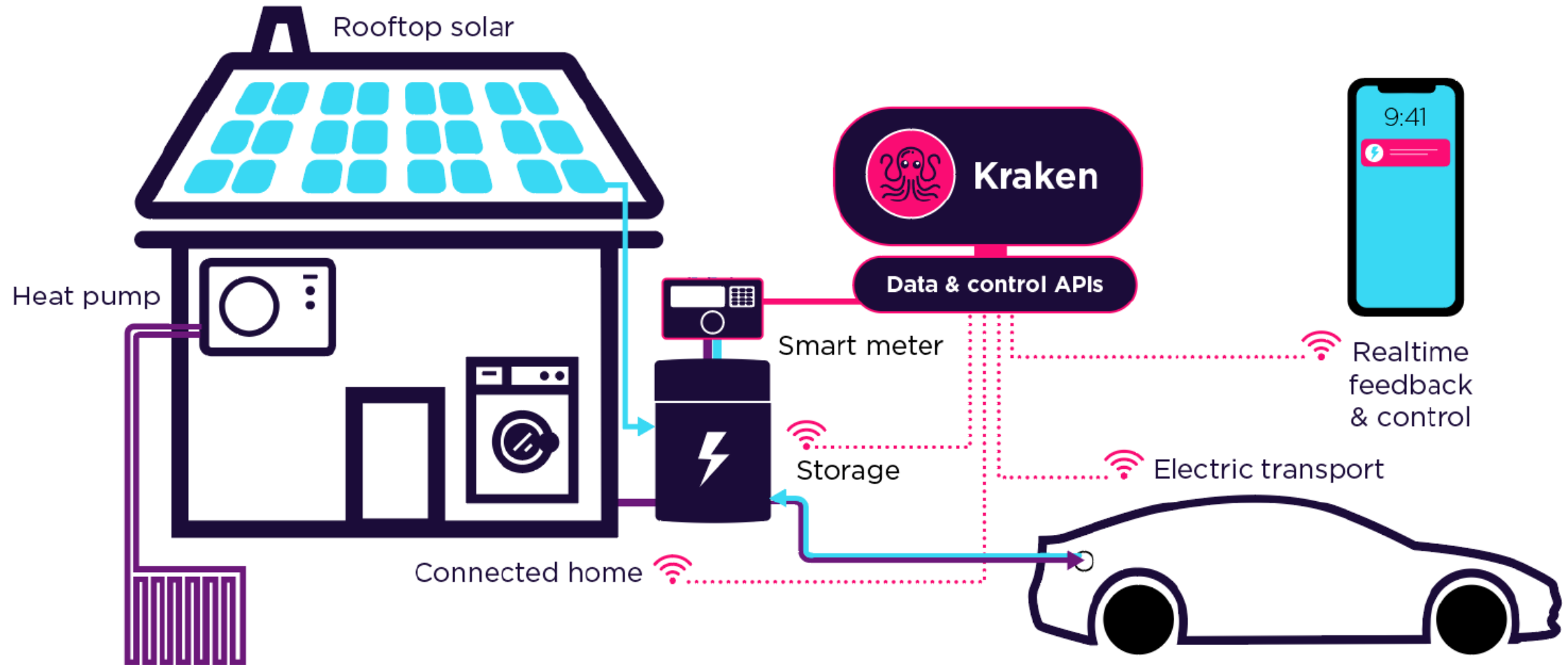
We aim to provide investors with resilient, index-linked income, and accompanying capital appreciation whilst creating value for all stakeholders

The value of an investment can fall as well as rise.
Investors may not get back the full amount they invest.



Net Zero homes

Means all electric and connected homes



Important information

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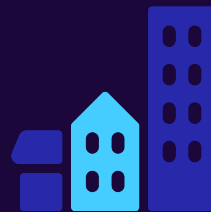
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