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ESG considerations for social housing

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Main responsibilities

Mikhaila is responsible for conducting in-depth research reviews on ESG high-risk transactions, and for supporting the investment committees and debt origination teams in making balanced decisions using financial and non-financial information. She also leads on Real Assets ESG research and contributes to the ESG investment and origination strategy and produces sectoral and thematic papers to develop and improve AIRA's ESG investment views and supports ESG integration across the desks.

Experience and qualifications

Mikhaila previously worked in Aviva Investors' RFP team as an ESG and Multi-asset & Macro specialist. She also completed a secondment in the Sustainable Outcomes team, producing company deep dives and analysis for one of Aviva Investors' Climate Transition strategies. Prior to joining Aviva Investors, Mikhaila held senior sales positions at LGIM and Schroders.

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Introduction

Many environmental, social and governance factors are linked and should not be tackled in isolation. Considering climate impact and nature when dealing with social issues is efficient and effective.

However, this paper focuses on the social aspect of social housing to highlight the opportunities and risks within the sector – risks that can arise as the unintended consequences of private investment or that are not immediately obvious.

Read this paper to understand:

- Why the UK faces a social housing crisis
- The ESG investment case for social housing
- How to best approach financial, social and reputational risks

Social housing: A different kind of crisis

The UK is in a housing crisis. The problem has been exacerbated by the COVID-19 pandemic and its impact on workforce availability, as well as the lack of construction materials. There are not nearly enough new homes being built to meet demand as the nation's population grows.

However, an important distinction must be made between the broader housing deficit – the lack of available homes across all tenures and types – and the related but separate housing crisis impacting the poorest and most vulnerable members of society, namely the lack of social rent homes.

In the UK, as home ownership rates have declined, there has been an increase in the number of households renting from registered providers (RPs), and over one million households are on local authority waiting lists for social homes.[1]

145,000
Annual number of new social homes needed in England

To try and address the general housing deficit, in 2017 the UK government targeted new home completions to reach 300,000 per annum (p.a.) by 2025,[2] but current data suggests completions will fall short.

Simply increasing the supply of housing will not address the problem or benefit members of society most in need. Crucially, the undersupply of social rent housing urgently needs to be addressed.

However, the UK government has focused more on low-cost home ownership (for example, through the Help-to-Buy and Shared Ownership schemes) and 'affordable rent', rather than investing in social rental housing. In 2020, 29,000 social homes were sold or demolished and less than 7,000 built.[3] Since 1991, there has been an average annual net loss of 24,000 social homes in England due to government policy and the lack of grants to subsidise social homes.

Some estimates indicate 145,000 social and affordable-rented homes are required annually to meet current and future demand over the next 15 years.[4] Current annual completions for all social/affordable tenures are just under 60,000.[5]

1. 'Social housing deficit', Shelter England, 2022.
2. Nick Colley and Jane Fear, 'Is there an investment case for social and affordable housing in the UK', Impact Investing Institute, October 2021.
3. 'Social housing deficit', Shelter England, 2022.
4. Capital grant required to meet social housing need in England 2021-2031, National Housing Federation, June 2021.
5. Nick Colley and Jane Fear, 'Is there an investment case for social and affordable housing in the UK', Impact Investing Institute, October 2021.

Figure 1 shows the supply of affordable housing completions by tenure in England from 1991-92 to 2019-20, and highlights the sharp decline in social rented accommodation.[6]

Figure 1. **Social/affordable home net additions by tenure, England**

Note: Prior to 2014/15, shared ownership was included within residential unit completions by source.
Source: Impact Investing Institute, 2021.[7]

The ESG investment case for social housing

Social housing investments deliver significant positive societal impacts, particularly for low- to middle-income households. When done well, investment in this sector can support governments' affordable housing programmes and targets by delivering housing to disadvantaged or vulnerable groups, individuals and households.

The UK's housing deficit is concentrated within these groups, driven by average house prices rising by more than 260 per cent in real terms since 1997 compared to 68 per cent for wages.[8] In fact, full-time workers paid on average nearly eight times their annual salary to purchase a home in 2018, compared to 3.5 times in the early 1990s.[9] The affordability, availability and quality of market rental properties is a well-documented issue. Yet for a lot of people, private rental accommodation is their only option. This can lead to 'rent traps', whereby high rents significantly reduce the amount tenants can save towards buying their own home.

6. 'Affordable housing supply: April 2020 to March 2021, England', Department for Levelling Up, Housing & Communities, November 18, 2021.
7. Nick Colley and Jane Fear, 'Is there an investment case for social and affordable housing in the UK?', Impact Investing Institute, October 2021.
8. 'The astonishing relationship between wages and property prices', Ogilvy & Sneyd, October 15, 2018.
9. 'Housing affordability in England and Wales: 2019', Office for National Statistics, March 19, 2020.

New social housing is an alternative for the increasing number of people squeezed out of buying, who may also struggle to afford or find good quality market rental properties. Specialist housing, transitional supported housing and social rented accommodation have the potential to address these issues.

Social housing investment could also have a multiplier effect. For example, as the investment consultant Redington highlighted in a recent article,[10] an individual who achieves housing stability through affordable accommodation may be more likely to gain employment (although this is somewhat subjective and hard to measure).

Housing associations are generally effective in supporting residents, too. During the COVID-19 pandemic, many housing providers were proactive in ensuring tenants knew how to claim benefits and navigate the Universal Credit system. They also offered guidance and support around managing rental payments and broader finances.

Underlying risks

As with other sectors that can have material positive impacts, social housing is not without risk. Despite being well regulated, there are several risks specific to social housing in the UK. These include:

- Stakeholder impacts
- Financial risks (arrears, voids, regulated rent setting)
- Affordability and viability in changing regulatory environments
- Anti-social behaviour and health and safety

Some issues, such as landlord neglect or negligence, have been well documented by groups like the Social Housing Action Campaign[11] and other grassroots organisations. Together, these highlight structural issues that, if ignored, could undermine the sector's ability to have a positive social impact. It is crucial the quality of operators is assessed through due diligence, with ESG considerations fully examined.

It should be stressed the UK regulatory regime and governance structures for social housing, including the requirement to have independent non-executive directors on boards, are designed to mitigate and manage these risks. However, investors should still conduct their own due diligence.

Our focus in this paper is on the general needs social and affordable housing (GNA) category – homes for those who cannot afford to rent or buy on the open market, including low-income families. More specifically, we are looking at 'social rented' housing, which typically accounts for 35-50 per cent of a household's net income. The social considerations in this sector will help distinguish between straightforward investment in residential and social outcomes-based investment.

New social housing is an alternative for the increasing number of people squeezed out of buying

10. 'The case for social housing', Redington, June 28, 2021.
11. Social Housing Action Campaign, 2022.

Below, we elaborate on the key areas of consideration for ESG due diligence. While on the surface these may sound like governance issues, each one is directly linked to social factors or has direct social implications.

Stakeholder impacts

The residents and tenants consultation undertaken for the UK government's white paper on social housing in 2018[12,13] received numerous reports of safety and quality concerns. Residents reported they were not listened to or treated with respect by landlords, with some handling complaints slowly or poorly or ignoring them all together.

Many, if not all, of the largest UK housing associations have at some point been accused or found to have not met their legal obligations, including the most basic standard of ensuring accommodation is fit to live in.[14] Governance errors and issues are not exclusive to non-profit housing associations or the social-rented sector though, concerns have also been raised around errors made by private-sector landlords and for-profit housing associations, resulting in unjustifiably high fees and distress to residents.

> Housing quality in the social rented sector has vastly improved over the last 20 years

It should be noted, however, that housing quality in the social rented sector has vastly improved over the last 20 years, with the help of the Decent Homes Standard and private investment. Housing and landlord quality is also generally of a much higher standard than we see in private landlord alternatives.

Nevertheless, negative stakeholder outcomes resulting from poor governance, controls or oversight could expose investors to significant reputational risk.

- It is crucial housing providers must have property management teams to liaise with residents, handle complaints appropriately and efficiently, and ensure residents feel safe, secure and listened to. Attention should be paid to the track record of the management team and its governance structure and controls.
- To demonstrate commitment to the wellbeing, satisfaction of and engagement with tenants, housing providers should be also encouraged to join relevant organisations or charters, such as the Together with Tenants Charter or National Housing Federation.
- From a health and safety perspective, investors funding a project or development can request proof of project compliance with the relevant regulatory and/or jurisdictional requirements. Compliance with appropriate health, safety and quality standards must be proven and relevant building certificates obtained. Examples include the Decent Homes Standard (DHS), and the requirement for cladding certificates for new high-rise developments.
- Proof of adherence to relevant town planning and development regulations and document stipulations can also form part of an investor's assessment. For private placements, compliance with DHS and regulatory oversight should be examined.

12. Ministry of Housing, Communities & Local Government, 'A new deal for social housing', GOV.UK, November 17, 2020.
13. Ministry of Housing, Communities & Local Government, 'The charter for social housing residents: Social housing white paper', GOV.UK, January 22, 2021.
14. 'William Ford, Housing disrepair scandal in South London', Osbornes Law, August 19, 2021.

Assessment biases within the system

There is an additional reputational risk regarding the systems and categorisation methods used within the local authority nominations process when assessing candidates' suitability for social housing. This is established by local councils and can, it has been argued, result in exclusionary practices that create inequitable outcomes for ethnic minority applicants.[15]

Research by the Human City Institute (2017) indicated the level of housing stress in Black, Asian and minority ethnic communities (BAME) is much higher than for in white communities. Homelessness has grown massively in BAME communities, from 18 per cent to 36 per cent in the last two decades – double the proportion of ethnic minorities in the population as a whole. BAME households are more likely to wait longer for a housing offer, be offered poorer quality homes, and flats rather than houses.

36%

rise in homelessness amongst BAME communities during the last two decades

Investors are limited as to what action could be taken to improve outcomes for applicants, as local councils still control the waiting lists. However, investors working with non-profit housing providers or associations may be able to engage with these parties on their tenant base, to encourage equal or broader representation among, for example, tenant committees and groups. This would at least give some assurance to all tenant groups they have a voice.

Financial risks

Due to the nature of social and affordable housing in the UK, housing associations and investors are vulnerable to arrears among tenants and void periods (vacant properties). This applies to non-profit and for-profit housing providers, although non-profits are likely to be more significantly impacted.

Some housing associations make use of vacant properties to provide housing for vulnerable people who need to move urgently. We saw this during the pandemic when several associations made vacant stock available for rough sleepers. Some providers also tried to relieve pressure on the NHS and social care services by preparing properties for hospital discharge.[16]

> Initiatives such as energy efficiency improvements can have a significant positive impact on void periods and rent arrears

Typically, though, void properties pose challenges to housing associations as they incur surplus overheads and lost revenue. Robust due diligence is required to assess initiatives or opportunities that could mitigate these risks. For example, it has been suggested initiatives such as energy efficiency improvements can have a positive impact on void periods and rent arrears due to social and wellbeing benefits associated with such activities.[17]

15. Kevin Gulliver, 'Racial discrimination in UK housing has a long history and deep roots', LSE, October 12, 2017.
16. How housing associations are using voids during the coronavirus crisis',National Housing Federation, May 1, 2020.
17. 'Managing void properties in social housing', Inenco, 2022.

Regulated rent setting is another consideration for housing associations, particularly in the UK where inflation has surged recently. In September each year, the annual Consumer Price Index (CPI) figure is used to establish the limit on annual rent increases for social housing to ensure rent remains within 35-50 per cent of a household's net income.

The UK saw CPI increase by 9.9 per cent in the 12 months to August 2022,[18] having hit 10.1 per cent in July, the highest level since 1982. But in 2022 and 2023, the maximum amount social rents can be increased by (as per the rent cap) is 4.1 per cent.[19]

While this is negative from a credit perspective, it is likely registered providers with good operating margins will not be impacted too greatly. It is also worth noting a lot of the debt housing providers have is fixed rate. Consequently, this key cost base would not rise in this scenario. For many providers, their credit ratings would likely be unchanged, and the social factors and issues outlined above would not have a material financial impact.

For investors, managing and monitoring the financial considerations outlined above are of great importance. Attention must be paid to governance and social risk mitigation initiatives.

Affordability and viability

What is driving the lack of delivery of social rent housing? As outlined above, government policy has led to a focus on affordable home ownership and rental schemes. This has resulted in a phasing out of social rent housing provision as grants are currently not available to support public investment.

Further challenges have arisen from build cost inflation, which is putting pressure on the viability and delivery of new housing stock. This will likely adversely impact affordability, particularly when higher inflation and interests rates are taken into account.

Housing associations need to maintain profitability to deliver on requirements

Maintaining assets, meeting changing health and safety standards and one-off expenses can also have big implications for net operating margins and requires adequate funding. Housing associations also need to maintain profitability to deliver on these requirements. Budget needs to be set aside to maintain existing stock, build new stock, and ensure all homes meet evolving regulatory standards, particularly regarding energy efficiency, safety and sustainability. Due to the lack of government support in recent years, this has been increasingly problematic for the delivery of new social rented accommodation.

Additionally, investors must be mindful of potential regulatory changes. Project revenues and cashflows can be affected by changes in housing and wider government policy, including changes to benefit systems. The Benefit Cap, for instance, is already problematic for social rented homes in high-rent regions and/or affordable-rent tenures, as a higher proportion of rent revenue might need to be sourced from tenants' employment income.

The UK government has also set a target for social housing providers to attain the minimum energy performance certificate rating of 'C' for rented properties by 2035, or 2030 for 'fuel-poor' households.

18. 'Consumer price inflation, UK: May 2022', Office for National Statistics, May to August, and June to September, 2022.
19. Regulator of Social Housing, 'Limit on annual rent increases 2022-23 (from April 2022)', GOV.UK, November 15, 2021.

This will require significant investment from housing associations and non-profit providers; hence, private capital is playing an increasingly important role in the delivery of social rented homes.

Likewise, the Government's Fire Safety Act,[20] and confusion around the responsibilities and liabilities of property managers and owners following its introduction, has added further pressure to the sector.

The risks of further government intervention in this sector need to be considered. While budgeting for the above may pose challenges for housing associations and their investors/partners, it is important to note that regulations and activities are beneficial to tenants in terms of the quality of their homes and wellbeing.

Anti-social behaviour and health and safety

The social rented sector requires resource-intensive day-to-day management of the assets and/or tenancies. Staffing shortages and overwork can pose challenges to meeting these requirements. In some cases, there are risks to staff associated with lone working and low pay.

Social rent housing, more than other residential or affordable rented properties, can be particularly subject to anti-social behaviour and crime. This is particularly the case in developments isolated from surrounding communities, or when developments are clustered together on the outskirts of a town or city. It is critical to have good property management teams so those in social housing can live free from fear of crime, drugs and anti-social behaviour.

Private capital is playing an increasingly important role in the delivery of social rented homes

However, while dependent on the local context, new projects have the potential to deliver positive local impacts, such as job creation and greater footfall for local businesses, owing to an increased number of residents. Such projects could also incentivise local investment in infrastructure, such as public transport/cycle routes or green spaces. Housing stability and security can also enable individuals to access employment opportunities.

Investors must pay particular attention to the track record of social housing providers/associations when it comes to managing risk. As stated previously, housing providers must have effective property management teams so that residents feel safe, secure and listened to.

Additionally, for investors seeking to achieve an increased level of social benefit and/or are working with registered housing associations, there is potential, within certain types of investment, to further serve the community and tenants by providing training and education workshops, community centres, and community outreach activities or partnerships.

20. Home Office, 'Fire Safety Act 2021', GOV.UK, May 18, 2022.

Beyond risk mitigation

What can investors do to increase the delivery of social outcomes in social housing investments?

While this sector offers opportunities for sustainability- or social-linked loans or social frameworks, these can only be effective drivers for change if careful consideration is given to specific sustainability criteria and targets. Loans should be linked directly to advancing impact objectives using external frameworks or criteria such as the Sustainability Reporting Standard (SRS) for Social Housing.[21]

The SRS was launched in November 2020 by the ESG Social Housing Working Group, comprising 18 banks and investors, housing associations, service providers and impact investing organisations. The Standard provides a voluntary reporting framework for housing providers to report on their ESG performance. It was designed to make it easier for lenders and investors to assess the ESG performance of housing providers and identify ESG risks as well as opportunities to create positive social and environmental outcomes.

Best practice means setting out transparent social goals from the outset of a project and delivering on those through design, procurement, construction, operation and decommissioning. Although there are still likely to be trade-offs, giving careful attention to the human impact of developments is an essential part of the process.

Best practice means setting out transparent social goals from the outset of a project

Investors should be able to track and monitor the proceeds of projects to ensure there is clarity on who the end beneficiaries are. It should be noted, however, the concept of social-linked loans is not as widely established as sustainability-linked loans and data availability can be an issue.

Impact investing could also offer a potential route to safeguarding against some of the sector's downside risks, helping investors move away from simply considering ESG issues through a financial lens to instead assess projects from a real economy and outcomes perspective.

Social housing strategies can target a range of social impact opportunities or focus on specific themes by attempting to solve a particular social problem, such as child services. For example, social housing investments can potentially be aligned to the UN Sustainable Development Goals (SDGs) in Figure 2.

21. 'The Sustainability Reporting Standard for Social Housing: the final report of the ESG Social Housing Working Group', The Good Economy, November 2020.

Figure 2. **UN SDGs**

SDG 1: No poverty

SDG 10: Reduced Inequalities

SDG 3: Good health and wellbeing

SDG 11: Sustainable cities and communities

SDG 8: Decent work and economic growth

Source: Aviva Investors, August 2022.

If projects are established under a social framework, it should be possible to track the number of people who benefit by monitoring relevant KPIs.

Alongside financial due diligence and ESG risk mitigation, investors can increasingly focus on the social value-add. However, there must be more attention on delivering real and measurable social outcomes.

It is time to start thinking about this collectively as an industry. Monitoring and measuring social impact could be the next step for asset managers, not just for social housing but across all sectors and industries.

Key takeaways

- Social housing has a vital role to play in providing affordable housing for those most in need. Investments in this area can deliver significant positive social impact.
- Robust due diligence is required to manage financial, social and reputational risks.
- For investors with a specific social outcome or social value focus, investments should distinguish between those that address the broader UK housing deficit and those specifically aiming to increase supply in the area that most urgently needs it – social rent housing.

Key risks

Investment risk

The value of an investment and any income from it can go down as well as up and can fluctuate in response to changes in currency and exchange rates. Investors may not get back the original amount invested.

Illiquidity risk

Where funds are invested in real estate / infrastructure and illiquid private assets, you may not be able to switch or cash in your investment when you want because real estate in the fund may not always be readily saleable. If this is the case we may defer your request to switch or cash in your units.

Valuation risk

Investors should bear in mind that the valuation of real estate / infrastructure is generally a matter of valuers' opinion rather than fact.

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