

## **Will housing associations be the first to launch a residential REIT?**

*David Levenson reports on the housing association REIT consortium Property People January '07*

Real estate investment trusts (REITS) have arrived and by all measures have been well received. Nine listed property groups converted to REIT status on D-Day (January 1st), including such famous blue chip names as British Land, Hammerson, Land Securities and Slough Estates. Their decisions herald a new dawn for large and small property investors throughout the UK.

Amongst an exclusive field of runners and riders competing to bring the first residential property REIT to the market is a consortium of housing associations, (code-named 'HA-REIT'). Members of HA-REIT, such as Affinity, Catalyst, Genesis and Thames Valley may not yet be household names, however such organisations hold portfolios valued on an open market basis which would be envied by many of the listed PropCos (property companies).

**REITS the background** A REIT is a tax efficient investment vehicle which can be held by institutional and private investors, and can invest in any category of commercial or residential property. The only significant operating restrictions are that 75% of the REIT's assets must be held in income yielding properties and at least 90% of the REIT's net taxable income must be distributed. Therefore REITs would not be suitable for outright property developers.

A common feature of the REITs established to date is that they are predominantly based upon commercial portfolios, comprising retail, office and industrial property. This is hardly surprising as there are few listed companies which are dedicated to residential investors. The investment property databank (IPD) index includes residential property alongside farms and certain leisure properties, with a weighting of just 3 per cent.

Traditionally, institutional investors have shunned residential property for reasons that had more to do with reputation than returns. With the advent of the Buy-to-Let market in the mid-1990's, the result of a sustained property boom underpinned by low interest rates, investors started to take residential property more seriously, however the corporation tax regime was still regarded as a major disincentive. With residential property cementing its status as a buoyant capital and income yielding asset, cue the arrival of REITs.

**What is a housing association?** Most people when asked about housing associations or registered social landlords (RSLs), to use their official status, can identify them as not-for-profit or public interest organisations which provide social housing. Like council housing, social housing can only be made available to those people in society who are seriously economically disadvantaged; usually the homeless, the unemployed and the elderly or disabled who are subsisting on benefits.

RSLs receive government funding and regulation, but are nevertheless independent organisations which borrow commercial debt to finance their activities. Over the past 18 years, RSLs have borrowed in excess of £30 billion which is now comparable with the amount of public subsidy provided to the sector; prior to 1988, virtually all housing association activities were 100 per cent subsidised. The advent of large scale voluntary transfer (LSVT) of council housing to RSLs in the early 1990's has boosted the sector which collectively owns more than two million homes or just under 7 per cent of the housing stock in England. This is projected to rise to around 10 per cent within 10 years.

**How do housing associations fit into the REIT story?** These days, RSLs are no longer exclusively involved in providing social housing. The term 'affordability gap' is on the lips of everyone from government ministers and property developers, to media pundits. This denotes the extent to which prospective homemakers, whether buying or renting, find that they cannot afford the property and location that best suits their circumstances.

It was the RSL sector which successfully pioneered new models of home ownership in the 1990s, such as shared ownership, which government have recently acknowledged with the introduction of models, such as the first time buyer initiative. Similarly RSLs have been in the vanguard of supplying housing for key workers, such as NHS staff, student accommodation for our universities, residential care homes and retirement villages. A number of RSLs have built up their own market rent portfolios, an outcome of their core development activities, as a means of creating more capacity to support the provision of more affordable housing. This is four-square in line with government's expectations of the sector.

These asset classes are highly appropriate for REITs as they provide secure inflation-proof rental yields, with capital appreciation. RSLs are well governed, professionally managed and properly regulated organisations as befit the custodians of public funding. The banking sector and debt capital markets have derived great confidence from the RSL sector, numbering some 1,500 organisations, which has yet to record a single default. As property managers, the leading RSLs are highly regarded and HA-REIT's investors can be assured that their investments will be well safeguarded.

Every time an RSL sells a property, it must obtain consent from its regulator, the Housing Corporation (Section 9 consent). Consents are not lightly given and HA-REIT, whose properties will be managed by RSLs, is virtually assured of securing the regulator's consent, which affords an element of exclusivity.

For investors, the key constraint has been how to access the residential market at volumes which make the costs of entry viable. There are few residential portfolios which are suitable (assuming they were to be made available) and even then, ongoing supply of stock is not guaranteed. Housing associations can readily solve this problem – they have substantial development pipelines of open market as well as affordable properties which will enable the initial seed portfolio projected at £250 m to grow to £1 b and beyond within 3 years.

**How will HA-REIT work?** Like the other REITs which have been converted from property companies, HA-REIT will be listed on the London Stock Exchange and will be financed by institutional and private investors. HA-REIT will have some special features which clearly identify its origins. The properties will be supplied by the housing association sector and the majority of these will continue to be managed by the RSLs which previously owned them. The money raised by the RSLs from sales to HA-REIT will be used to finance much needed new affordable housing. Housing associations are adept at making their resources go further – typically the sale of one property will gear the construction of two new affordable homes.

HA-REIT will be managed as a separate entity, and while the RSLs can invest in HA-REIT, for example by taking part of the consideration from property sales in shares, they will not have a controlling interest and the board and management of HA-REIT will be independent of the RSLs and the sector as a whole. This ensures that while

the RSL property managers continue to provide services to their tenants, the board and the REIT manager can get on with serving the interests of shareholders.

Finally, REITs may not revolutionise how we invest in residential property, but they will come to represent a valuable new outlet for the long term supply of affordable as well as market rented housing. In this respect REITs and housing associations make very good bed-fellows.

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