

The background of the slide features a large, faint, light blue outline of the City of Vancouver coat of arms. The crest includes a crown at the top with four maple leaves, a shield with a cross and a ship, and a banner at the bottom with the motto 'CITY OF VANCOUVER'.

## **AGENDA ITEM**

**9**

# **HEARTHSTONE SOCIAL AND AFFORDABLE HOUSING MANDATE**

**FALKIRK COUNCIL**

**Subject: HEARTHSTONE SOCIAL AND AFFORDABLE HOUSING MANDATE**  
**Meeting: JOINT MEETING OF PENSION COMMITTEE AND PENSION BOARD**  
**Date: 11 MARCH 2016**  
**Author: DIRECTOR OF CORPORATE AND HOUSING SERVICES**

**1. INTRODUCTION**

- 1.1 This report updates the Pensions Committee and Pension Board with matters relating to the Fund's investment in Social and Affordable Housing with Hearthstone Investments.

**2. BACKGROUND**

- 2.1 In 2014, the Pensions Committee agreed to make a £30m investment in Hearthstone's Housing Fund for Scotland in order to fund new Social and Affordable Housing. The investment was made on the basis of £15m being allocated to social housing and £15m to affordable housing.
- 2.2 The Fund's return objective is RPI + 2%. In order to deliver the new property units, Hearthstone has been working in partnership with Castle Rock Edinvar, the Edinburgh based Housing Association who are part of the Places for People Group.
- 2.3 The £15m earmarked for social housing has, to date, been invested in successive short term debt instruments with the Places for People Group. In return, the Fund has received the commitment from the Group that they would invest £15m in Social Housing in the Clackmannanshire, Falkirk and Stirling areas.
- 2.4 The Social Housing Programme is now well advanced and involves the construction of 195 units across the pension fund area as follows:

| Area             | Site       | Number of Units |
|------------------|------------|-----------------|
| Clackmannanshire | Sauchie    | 39              |
| Falkirk          | Bellsdyke  | 62              |
|                  | Overton    | 34              |
| Stirling         | Durieshill | 60              |
| TOTAL            |            | 195             |

- 2.5 As a result of the Falkirk Fund's investment, financial support was also made available from the Scottish Government allowing the final Social Housing Programme to be worth £25m. All units are expected to be completed in 2017.

2.6 Turning to the affordable housing part of the investment, the following purchases have been made by Hearthstone:

|                        |   |              |
|------------------------|---|--------------|
| 17 Units in Bo'ness    | - | £1.8m        |
| 16 Units in Rutherglen | - | £1.6m        |
| 18 Units in Aberdeen   | - | <u>£4.5m</u> |
|                        |   | <u>£7.9m</u> |

The balance of the initial allocation (£7.1m) is still to be deployed.

### **3. LATEST DEVELOPMENTS**

3.1 Changes to government policy on social and affordable housing provision have led the Places for People Group to restructure their Medium Term Bond Issuance Programme. As a result, the debt instruments originally used to support the Social Housing Programme have been repaid. This does not however impact on the £25m Social Housing Programme which continues to move forward with the full commitment of the Places for People Group.

3.2 The Group have now re-launched their latest bond issuance programme, and the Fund can therefore resume its original purpose and secure a 10 year bond, which is expected to yield around 3% p.a. (i.e. below the target return for the Fund). Hearthstone have intimated that as the Social Housing Programme has been secured, there is an alternative for the Falkirk Fund – still involving the Places for People Group - which may deliver superior returns and which the Committee may wish to consider.

3.3 The proposal is for Hearthstone to use the £15m to acquire further affordable housing assets and then lease them back to the Places for People Group. Hearthstone estimates that this approach would yield around 6% (net of fees) based on the rental stream and the capital growth of the properties over the term of the lease. The properties acquired would be:

- New Build (unless exceptional market conditions dictated otherwise)
- Located in Scotland
- Leased for between 7 and 9 years (the remaining life of the Housing Fund for Scotland)
- Leased to inflate at CPI +0.5%
- Capable of being sold or re-let on expiry of the lease
- Sourced by Hearthstone and managed by the Places for People Group.

3.4 It is recognised that in order to deliver the £15m tranche of social housing Castle Rock Edinvar needed there to be financial support from the Scottish Government. This was ultimately provided through the Scottish Government's Innovative Financing Unit, taking account of future social housing allocations to Clackmannanshire, Falkirk and Stirling Councils. It is unlikely that this financial support would be available again in the near future should the Committee wish to use the £15m to provide a further round of social housing provision. Anecdotal evidence also indicates that other asset managers who are seeking to invest in social housing are experiencing difficulty in deploying the capital into the market.

### **4. RISK PROFILE**

4.1 The risk profile of physical property is clearly different to that of a bond from a regulated body such as the Places for People Group. It is the Hearthstone view however that the additional yield that can be achieved by entering into a leasehold arrangement is adequate compensation for the additional risk to capital, particularly given the fact that the investment will be secured against the underlying property assets.

- 4.2 The main risk is one of timing should a significant market downturn occur at the same time as the expiry of the lease to Places for People's group (and the expected exit date of the fund). This could be mitigated by extending the lifetime of the investment, phasing the subsequent sale of assets, or by re-letting the assets. Further mitigation of the risk could come the fact that the housing assets would be ungeared and geographically diversified across Scotland.

## **5. ADVISOR VIEW**

- 5.1 Hymans Robertson, the Fund's investment adviser, has been consulted regarding the options and are supportive of the purchase and leaseback proposal.

## **6. CONCLUSION**

- 6.1 The Places for People Group have completed the re-structuring of their bond issuance programme. The Falkirk Fund can choose to secure a 10 year bond from the Group as originally envisaged or it could update the mandate to allow Hearthstone to secure a further £15m in affordable assets on a purchase and lease back arrangement with Places for People.
- 6.2 Should the Committee agree to the purchase and lease option, the number of houses created by the fund's investment will increase, as previously the fund was limited to c. 200 homes from the Social Housing Programme plus the units generated from the £15m on affordable housing provision. It would now be generating the 200 homes from the Social Housing Programme, plus £30m of affordable housing.
- 6.3 The proposal from Hearthstone seeks to recycle the initial capital investment that has facilitated the development of Social Housing. The proposal offers the potential to deliver a superior return for the Fund with risk being at a tolerable level, particularly in light of the overall scale of the investment relative to the Fund as a whole. Importantly, the proposal would not affect the ongoing Social Housing Programme and affordable housing component as agreed in the original mandate.

## **7. RECOMMENDATIONS**

- 7.1 The Pensions Committee and Pension Board are asked to note the developments surrounding the Social and Affordable Housing mandate.
- 7.2 The Pensions Committee is asked to determine whether £15m of the investment should continue to be invested in the debt programme of the Places for People Group or used to acquire new affordable housing units with a view to these being leased back to the Group.

**Director of Corporate and Housing Services**

**Date: 1 March 2016**

**Contact Officer: Alastair McGirr**

### **LIST OF BACKGROUND PAPERS**

NIL