

# CREATING HOMES - a new way forward

## 1. Introduction

The shortage of housing in the UK continues to worsen as house building slows and population increases; various solutions are being discussed. The UK needs to enable affordability and serve both need and aspiration, whilst continuing to care for the environment. A pluralistic approach should be followed; existing methods must be improved, and new ways found.

This paper advocates an innovative approach to the provision of mixed tenure homes, adopted by the Tirion Group to develop two large pilot projects on brownfield sites in South Wales. Half the homes built are available to rent at affordable rates, including a proportion at social rents. Loan assistance was provided, but no grants were necessary.

These developments are nearing completion and are outstandingly successful. Lessons have been learnt which can be applied to future projects to improve pace of delivery and reduce costs further. There is an opportunity to create thousands more affordable homes without the high cost of government support currently being experienced.

An independent report has been commissioned jointly by Welsh Government and Tirion to review the way the methodology might be utilised to deliver more homes in Wales. This paper is provided in advance of the formal review in order to facilitate progress and add clarity.



## 2. The Problem

This is a time of national house building gloom. Construction and finance costs have increased dramatically, and government subsidies are unsustainable. New house building has slowed to a fraction of projected need and are not meeting government targets. The ever-growing population compounds the differential between supply and demand.

The market for existing housing is displaying signs of life, but new construction remains sluggish due to the combined effect of inflated construction and finance costs.

In the meantime, private sector housing for rent is becoming scarce and more expensive, caused partly by a cocktail of adverse tax policy, interest rates, and targeted regulation. Rents in some parts of South Wales have risen by more than 30% in 3 years. The public social and affordable housing sector is also in retreat; constrained by cuts in government spending.

The consequences are significant. Lives are blighted and unfulfilled; and beneath the surface there is evidence of even more worrying trends, including social discontent, mental illness, drug use, and the time bomb effect of a lower birth rate.

This all sounds quite depressing but sometimes it takes a crisis to unblock minds and drive solutions.

### **3. The Challenge**

Tirion was conceived as an experimental solution by Welsh Government for re-purposing two large industrial contaminated sites, with abnormally high development costs, that were not feasible for the private or social sectors to develop without substantial government grants.

The new venture was set the challenge of delivering over 1300 homes, with 50% for sale and 50% for affordable rent. Some full market rent homes were permitted, matched by a similar proportion of social housing. A high-quality development was sought, with an excellent living environment complying with all Welsh Government standards.

Start-up loans were provided, but otherwise all abnormal costs were to be met without grant assistance (a combined £50m subsidy might otherwise have been required to develop these sites with similar requirements).



### **4. The Middle Way**

The concept, based on an idea by the Principality Building Society, was to set up the Tirion group as a not-for-profit, arm's length bridge between the public and private sectors, utilizing an innovative investment package.

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A target customer group was (and is) working people seeking a good home, who are unable to afford, or do not wish to be burdened with, a deposit and mortgage. The solution devised offered a compromise between home ownership and renting through provision of an aspirational, well-designed environment; and a stable long-term home managed by a supportive landlord. The estates are tenure blind; owned homes are mixed with rented homes seamlessly. Tirion collaborated with WG and formed beneficial partnerships with commercial house builders and RSL's.

Completed projects have attracted a wide variety of tenants and owners with different circumstances and backgrounds. Community cohesion is excellent, as demonstrated by resident satisfaction surveys. Flexibility and mobility are also offered. Families may upsize or downsize within the same large development; there are already examples of this. Residents can also move to a different location more easily because they don't have a property to sell.

Another target customer group, albeit smaller, could be elderly downsizers, or equity releasers; because an attractive environment and community is provided, without the penalty of stamp duty, or concerns about quality of life. This group could release more large family homes on to the market.

## 5. Methodology

New companies were set up for each project to enable flexibility. Repayable loans were provided to remediate the sites. No other assistance was required or provided. Tirion set out with no equity, and repayable debt only. Primary success factors are:

- 5.1 Tirion was set up as a not-for-profit community benefit society, enabling substantial savings compared with commercial companies who seek profits of 20% or more.
- 5.2 Long-term, 50-year, finance and debt repayment were planned at the outset; via the UK gilt market. This funding method generally facilitates a low rate of return over a long period, based on very low risk of default.
- 5.3 Tirion will retain ownership and manage the site and tenancies over the 50-year period. This yields both financial and qualitative advantages.
- 5.4 'Affordable housing' was defined as homes rented for 80% of open market rates.
- 5.5 A stepped repayment of debt over the term was agreed based on CPI movements. 70% of rental income is used for debt servicing, with the balance used for management and maintenance.
- 5.6 Successful completion of site remediation and the planning permission process delivered enhanced value, which in turn enabled the procurement of short-term construction finance and sale of part of the land to generate equity.
- 5.7 Phased construction and handovers allowed tenanted homes to be transferred as investments to the long-term funder. Properties were transferred between inter-group companies to ensure VAT recovery. A 'warehouse' financing stage was introduced between completion of construction and transfers to investors.
- 5.8 A proportion of the site was sold in the market competitively to a house builder which constructed and sold up to 50% of the homes. Maximum value was obtained, because the commercial partner was de-risked; free of section 106 and other obligations. Maximum affordable housing was delivered because, the commercial partner was unable to reduce this obligation through claims of unviability.

- 5.9 Private sector efficiency and innovation was blended with public sector altruism. This is a more subtle and sophisticated point; but the absence of profit drivers, coupled with commercial sector mindsets and freedoms, delivered substantial gains. Cost control of the contract sums was exemplary.

Tirion recruited a mix of skills including commercial acumen and innovative minds. It was set up with a lean executive team supported by a carefully selected Non-Executive Board (NED's). It benefitted from low overheads and on-tap access to a panel of experts.

This was not a PFI process because the commercial middleman and the profit motive were removed. Outcomes have been outstandingly successful. Loans are being fully re-paid. The methods employed could be used again as a partial solution to the current housing crisis, in collaboration with others.

## 6. Comparison with Traditional Procurement

- 6.1 Government generally provides social and affordable housing grant (SHG) via lump sums to providers (usually RSL's) who are responsible for outcomes. Typically, 58% of ACG (Acceptable Cost Guidance) is provided, but recently grant needs have increased, due to rising costs. Whilst this is clear and simple, it is very expensive, and opportunity to utilise government collateral combined with entrepreneurial skill, to maximise home building, is lost.
- 6.2 The pilot projects required no grant at all. In different circumstances with a tenure mix requiring more homes at social rent, some financial assistance would have been required. However, analysis demonstrates that based on an apples v apples comparison, the Tirion model delivers around double the number of social and affordable homes per £ spent by Government, compared with traditional methods.
- 6.3 Tirion projects are tenure blind with a strong focus on place-making and community cohesion. The 50-year management and finance model ensures enduring quality, because customer appeal must be maintained over the 50-year term. Short-term planning practised by other delivery vehicles risks diminishing quality and resident wellbeing.
- 6.4 Site wide management over the long term facilitates – sustainable drainage, low carbon technologies, site wide sprinkler mains, shared facilities, community enterprise, and many other advantages.

## 7. Increasing Funding for Housing

The formula described, aims at raising around 85% of long-term funding from the city investment market; mainly pension funds whose index linked obligations to their pensioners mirrors growth in rental income. The funding market described seeks large scale investments. This methodology can be designed to provide 'off balance sheet' access to substantial funds government doesn't otherwise have, and an income stream to repay it, without call on tax revenues. At times of financial constraint, this a life changing route to new housing.

## 8. The Zero Carbon objective

The pilot projects were designed with a pathway to zero carbon enabled by the design. Boilers may simply be swapped for heat pumps; pipes & radiators are sized for lower temperatures, tank cupboards are provided, solar panels and batteries are enabled; etc. etc.

Future projects may be zero carbon from the outset, because technology costs may be amortised and managed over the 50-year management term, rather than normal commercial payback timescales. Furthermore, long term planning makes it possible to self-generate zero carbon energy at lower cost than conventional grid energy. Specialist industry partners recognise this and are offering long term equipment leasing arrangements that will reduce energy bills to residents and/or reduce construction costs. Alternative green loans are also being considered.

## 9. Equity Sharing

As described, LTV is initially created through the project preparation period. The equity proportion owned by the community benefit society (Tirion) then grows through the term and reaches 100% in year 50. Typically, equity owned is around 35% by year 10, fuelled by property price inflation. This growing equity can be made available to fund other housing projects; or can accrue to the public sector partner; and/or can be used to devise a community endowment scheme, managed by trustees for the benefit the estate environments, communities, and some long-term residents in need of particular assistance.



## 10. Obstacles and Mitigation

Delivery of 'the challenge' described, was not without its problems. Obstacles were devised by sceptics, planners, lenders, and lawyers. But persistence was rewarded.

The financial methodology outlined above, coupled with the bare finances of a new company, led to complex security provisions, delays, and legal agreements. A closer public-private sector partnership utilizing the power of low-risk government collateral could by-pass these problems.

A proliferation of new legal agreements led to delays and additional cost; but templates now exist and can be re-cycled to mitigate these problems in future, along with firmer client and clearer client instructions.

The projects were delayed by prolonged planning application periods of more than 2 years. Whilst this is typical for large complex projects in the UK process, improvements in the planning system could improve this. Ideally a special fast track route could be introduced for projects that deliver particular societal benefits. This might involve the appointment of project champions within the planning authority, charged with coordinating parallel working across departments, including the introduction of case conferences to accelerate determination.

Gilt market financing delivers attractive rates in very low risk scenarios. Long term rental income at affordable rates satisfies this criterion. Nevertheless, gilt rates vary significantly across economic cycles; in times of economic gloom, they worsen. This means that the timing of re-financing needs to be optimised, either by good, advanced planning and forecasting; or by an ability to prolong the warehousing period when essential to avoid exit to poor rates. This can be enabled by the public/private sector partnership.

## 11. Discussion & Conclusions

There are many moving parts and many levels. Money, land, and regulation are the biggest obstacles. The methodology described helps unblock the money problem and deliver much needed homes faster and better. Qualitative comparisons are also favourable; evidenced by exemplar placemaking, community cohesion. Long term ownership and management delivers unique advantages.

Self-generation of low carbon energy, at lower long term cost than grid energy, is proposed for all future projects. An opportunity also exists for communities to share the benefits of long-term equity growth.

The pilot projects have demonstrated that;

- Acceptance of a small (negligible) risk enables the delivery of many more, high quality, affordable homes, than traditional methods; which are based on zero tolerance of risk.
- A greater degree of government participation yields significant additional benefits.

Tirion is able to assist with both these points, through partnerships and provision of excellent resource and expertise; without the hassle and obligations involved with recruiting suitable staff and executives.

The middle way advocated should be mixed with social and commercial providers in blended partnerships. The lead developer role should be considered in light of Tirions success at procuring the commercial builder/developer in a subsidiary role through a competitive market testing process.

New projects, utilising the pension fund finance advocated, should ideally be applied to large scale developments to attract the best investment opportunities. Some large developable sites are available. New site proposals may need to navigate the time consuming LDP and planning processes which can be more than a 5-year journey in the UK. This paper has not addressed planning issues in detail but measures to speed planning processes should be introduced if house building problems are to be addressed effectively. Projects which deliver clear societal benefit could be fast tracked.



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Other issues not covered here include measures to reduce construction costs, and the design conundrum created by overheating of lightweight highly insulated homes in summer.

- MMC has the potential to reduce costs but is currently faltering; solutions require component standardisation and industry confidence that orders will be forthcoming.
- The Mill project in Cardiff has included a successful experiment, utilizing ground water to cool rooms without resort to refrigeration.

These and other solutions are discussed in separate papers.

Whilst the pilot projects described have delivered outstanding outcomes; timing has an over-riding impact on success factors. 'Key variables' are construction cost, rental income, and the cost of long-term finance. In the current economic cycle, some regions have experienced rent increases of more than 30% in 3 years; construction costs have increased by more than double this rate since the pre-covid years; interest rates have increased by more than 500%. This cocktail has curtailed new house building starts substantially.

Whilst these key market variables will re-balance over time, the difference between affordable rent and achievable market rent will present a hangover problem for many years to come. There is an urgent need to address efficient, innovative solutions, and processes.

The methodology described is most effective if the timing of exit to the gilt market is optimised. Within the spectrum of economic cycles, we are currently in a trough. This is the ideal time to commence a new project journey(s) because the construction industry is hungry for work and if commenced soon, completion should hit the financial markets near a crest.

Project preparation and management resource is available. More specialist charitable SMEs can be created.

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