HM TREASURY

Communities and Local Government

Consultation on reforms to the real estate investment trust (REIT) regime:

A) to explore the potential role social housing REITs could play to support the social housing sector;

and

B) to consider the tax treatment of REITs investing in REITs

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1 Introduction

Subject of the consultation

1.1 On 21March 2012 the Chancellor of the Exchequer announced that the Government will undertake a consultation on Real Estate Investment Trusts (REITs) and in particular: (1) the role REITs can play in supporting the social housing sector; and (2) the tax treatment of REITs investing in REITs.

1.2 This consultation covers both issues. Chapters 2-3 focus on social housing and what role REITs can play; and chapter 4 focuses on REITs investing in REITs.

Policy context

REITs policy

1.3 The UK Real Estate Investment Trust (UK-REITs) regime was launched in January 2007. UK-REITs are tax efficient vehicles for property investment. The UK REITs regime moves the taxation on a property rental business from the REIT to the investor in the REIT.

1.4 Since their launch more than three-quarters of the UK's major listed property companies have joined the UK-REIT regime. To date there are over 20 UK-REITs with a market capitalisation of over £20bn. However, the focus of investment for existing UK-REITs has been in commercial property, with only a few holding some residential property in their portfolio.

1.5 Since 2007, UK-REIT legislation has undergone a number of reforms to help improve the regime. Finance Bill 2012 includes a new series of reforms to help remove barriers to entry to, and investment in, the regime, and to reduce administrative burdens for new and existing UK-REITs. It is proposed that these will come into effect subject to Royal Assent and it is hoped that these reforms, alongside other housing reforms, should encourage greater investment in the residential property sector.

1.6 Looking forward, the Government remains committed to supporting the REIT regime and particularly the role it can play in facilitating institutional investment into the property sector as a whole, as well as the residential sector more specifically.

1.7 Any future reform to the REIT regime, however, needs to be weighed alongside the Government's primary objective of reducing the deficit; and ensuring that the underlying stability of the REIT regime is not weakened and investor interests remain protected.

Social Housing policy

1.8 Affordable social housing is of great importance, both for the millions who live in social homes and for the country as a whole. However, the numbers on social housing waiting lists have increased over the past decade. In England, the number of households on social housing waiting lists rose from 1.04 million in April 1999 to 1.84 million households by April 2011.[1] For

[1] Household waiting list figure is sourced from DCLG Livetable 600

England, Scotland, Wales and Northern Ireland there are now almost five million people waiting for social housing.[2]

1.9 With first time buyers also wanting to get a foot on the housing ladder, more housing for affordable home ownership is needed. The Government, and each of the devolved administrations, are developing and implementing programmes to increase the supply of affordable homes.

1.10 In line with its policy of increasing affordable housing supply, whilst ensuring the most effective use of the existing social housing stock, the Government, and each of the devolved administrations, have four key objectives in encouraging new investors to the sector. These are:

- securing additional private finance to support development of new social housing;
- protecting the taxpayer from additional spending pressures, including on Housing benefit;
- protecting existing social tenants; and
- protecting the investment in the existing social housing stock.

Devolution

1.11 Social housing policy is a devolved issue. This means that England, Scotland, Northern Ireland and Wales can each have different policy objectives and regulatory frameworks in which social housing providers operate.

1.12 REITs, however, are a UK property investment vehicle. As such, any changes made to the legislation apply to the whole of the UK.

1.13 Consequently, it is important to consider how a UK wide vehicle (eg a social housing REIT) could work in a devolved policy space and we would welcome respondents views on the devolution issues raised by this consultation.

Aim of the consultation

1.14 This consultation explores how the REIT regime could be used to meet wider governmental objectives (eg increasing social housing, deficit reduction, etc); whilst also retaining the integrity of the REIT brand.

1.15 For the social housing REIT consultation, this means exploring how REITs could be used to support the social housing sector whilst addressing the four key social housing objectives mentioned above.

1.16 For the REIT investing in REIT consultation, this means exploring what the benefits of introducing investment diversification are for both companies and wider government policies.

Structure of consultation

1.17 The remainder of this consultation document is divided into three sections:

- Chapter 2 – explains the important role that the social housing sector plays in the housing market; its contribution to wider economic and social objectives; the constraints which have arisen in the social housing sector and how this will affect both future demand and supply.

[2] This figure may be an overestimate since multiple applications may be made by individuals to different social housing providers. Figures were not available for Wales.

- Chapter 3 – examines the potential role that REITs could play in the social housing sector and sets out a series of consultation questions for consideration.
- Chapter 4 – examines the potential tax treatment of REITs investing in REITs and the associated costs and benefits; and sets out a series of consultation questions for consideration.

1.18 Finally, chapter 5 summarises the questions raised in this consultation and provides information on how to respond.

Responding to the consultation

1.19 This consultation began with the publication of this document and will last for a period of 12 weeks, closing on 27 June 2012. Information on how to respond to this consultation is provided in Chapter 5.

2 The role of social housing

2.1 The provision of social housing in the UK takes many forms but its basic purpose is to provide accommodation for rent or for sale at sub-market prices to those whose needs are not met by the market.

2.2 In 2011, there were just under 5 million existing social rented homes in the UK. Of these, around 2.7 million were owned by housing associations[1]. The remainder remain in public sector ownership and are owned by local authorities. The table below provides a breakdown of the number of social housing units provided in England and the devolved administrations.

Table 2.A: Total social housing stock (millions)

Country	Total social housing stock	Stock owned by Housing Associations	Stock owned by local authorities/councils
England	4.00	2.32	1.73
Scotland	0.60	0.28	0.32
Wales	0.22	0.13	0.09
Northern Ireland	0.12	0.03	0.09

Source: DCLG and devolved administrations

2.3 In addition to social rented homes, social housing can also be offered for sale. Such sales can be undertaken in a number of ways. Social housing tenants have the right to purchase their existing rented property on discounted terms, whether through Right to Buy or Right to Acquire. Alternatively, social housing properties can be offered for sale on a shared ownership (part buy/part rent) basis.

2.4 Shared ownership schemes enable households, who are unable to purchase a home suitable for their needs on the open market, to get a foot on the housing ladder at a lower initial cost. Shared ownership schemes operate on the basis that purchasers pay a percentage of the market value (from 25 per cent to 75 per cent) for a long lease[2] of a property from a social landlord, and pay rent on the landlord's share or 'equitable interest'. Shared owners may generally purchase further shares (up to 100 per cent) at market value over time. The initial rent charged and annual increase may be capped in order to ensure that the product remains affordable for customers.[3] The ability to acquire additional shares and the basis of rent reviews is normally set out in the shared ownership lease.

Outlook for future demand

2.5 As the UK's population continues to grow, the number of households is set to keep on rising in the years to come. See table below for comparable figures of household growth.

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[1] http://www.communities.gov.uk/housing/housingresearch/housingstatistics/housingstatisticsby/stockincludingvacants/livetables/

[2] Leases tend be for 99 years.

[3] In England, in the case of shared ownership properties currently provided in part with Government funding (see below) the initial rent is capped at 3 per cent of the value of the landlord's share and any annual rent increase is capped at the Retail Price Index plus 0.5 per cent.

Table 2.B: Household growth by country (millions)

Country*	2008	2033	Growth rate (per cent)
England	1.7	27.5	27
Scotland	2.3	2.8	21
Wales	1.3	1.6	25

* *Figures for Northern Ireland were not included in this table because estimations were over a different time period. In 2008 household population was 0.7mn and expected to increase to 0.8mn by 2013 (or 18 per cent).*

Source: DCLG and devolved administrations

2.6 Reforms to the management of the existing social housing stock can help meet these housing needs, but new affordable housing will still be needed, both to provide support when people need it, for as long as they need it, and to help support overall housing growth and the wider economy.

Delivering more social housing

2.7 Housing is a devolved policy, and each of the devolved administrations has their own objectives and approach to delivering new social housing. Government investment continues to play an important role in the supply of new affordable housing. Consequently, funds have been committed across the UK to support investment in new affordable housing.

2.8 The table below provides a summary of how much funds have been committed and the number of new homes expected to be delivered.

Table 2.C: Committed funds and new affordable homes (2011-12 and 2014-15)

Country	Government funds (£ billion)	Number of new affordable homes
England	4.5	170,000
Scotland	1.1	30,000**
Wales	0.27*	Under consultation
Northern Ireland	0.5	8,000

* Indicative level
**Over lifetime of current Scottish Parliament
Source: DCLG and devolved administrations

2.9 The remainder of this chapter summarises the approach to investment and delivery of new supply in England, Northern Ireland, Scotland, and Wales.

England

2.10 The Government's vision for affordable housing was set out in "Laying the Foundations: A Housing Strategy for England"[4]. Investment in affordable housing is an important part of the Government's strategy for meeting the needs and aspirations of a large section of the population. Delivery of new affordable housing has a vital role to play in supporting overall housing supply, and stimulating economic growth, particularly at a time when overall housing supply is at historic lows. Currently, the number of households in England is projected to grow by 232,000 households a year to 2033.[5] In financial year 2009-10, almost 118,000 new houses were completed in England.

[4] Document can be found here: http://www.communities.gov.uk/publications/housing/housingstrategy2011
[5] 2008 Household projects published by DCLG in November 2010. www.communitieis.gov.uk/publications/corporate/statistics/2033household1110

2.11 The Government has committed nearly £4.5 billion investment in new affordable housing over this Spending Review period. A range of different affordable housing options are being supported – from affordable rented housing to affordable home ownership options, such as shared ownership and shared equity schemes. To deliver this, the Government is working with a wide range of partners in both the public and private sectors.

2.12 The current fiscal environment and the need to address the public deficit means that reform and innovation are needed to ensure that investment delivers more for less, maximising delivery and making the best use of constrained capital expenditure.

2.13 The recently introduced Affordable Rent product gives social landlords the flexibility to charge rents of up to 80 per cent of local market levels, on both new properties and a proportion of re-lets, as part of an agreement to build new homes. The rental income and sales receipts from shared ownership properties also help to support the funding of new supply.

2.14 This marks a significant shift in the balance of funding for new affordable housing supply, with a much higher proportion of the cost of delivering each new home coming from private finance, reducing the pressure on funding from the taxpayer. The total funding from providers, including the borrowing capacity generated by conversions to affordable rent, is almost £10 billion.[6] This means more new homes can be delivered for every pound of public capital investment and helps a greater number of households experience the benefits of an affordable rented home.

Box 2.A: Affordable Homes Programme

Under the new Affordable Homes Programme, 146 providers, including housing associations, local authorities, and private developers, will deliver 80,000 new homes for Affordable Rent and Affordable Home Ownership (where this is a local priority) with Government funding of just under £1.8 billion.

Thanks to the positive response to the Affordable Homes Programme, the Government now expects to provide up to 170,000 affordable homes by 2015, compared to the 150,000 originally estimated. This outcome supports economic growth and means that 80,000 jobs will be provided in construction and related trades.

Affordable Rent represents a major shift in the approach to delivering affordable housing. The Department for Communities and Local Government is closely monitoring the roll out of the programme and assessing its longer term implications for the sector and its ability to lever in future private investment.

Consideration is also being given to how the Government can build upon the positive response to the Affordable Homes Programme to drive the delivery of affordable housing to 2015 and beyond, in a constrained fiscal environment. The key principles of the affordable rent model – flexibility, innovation and efficient use of existing assets – will remain the cornerstone of affordable housing provision for the future.

2.15 The Government is keen to stimulate innovation and greater competition by encouraging entry of new providers into the affordable housing sector. The Housing & Regeneration Act 2008 enabled the registration of for-profit providers and a number of companies have already registered, adding to the sector's diversity and potential financial capacity.

[6] HCA internal calculation 2012

2.16 The opening up of the social housing register to for-profit providers, combined with the recent emergence of Affordable Rent and the strength of the wider rental market, has stimulated further interest in social housing registration. As a result, the Social Housing Regulator is in advanced discussions with a number of for- profit bodies who wish to set up a social housing subsidiary.

2.17 The Government is keen to encourage new entrants into the sector and the Social Housing Regulator will work proactively with a range of organisations, advisors, trade bodies and consultants to ensure that the new opportunities are well understood and so to ensure that the potential benefits of greater competition and innovation are realised, whilst ensuring that tenants and taxpayers continue to get a fair deal.

Scotland

2.18 The Scottish Government aims to deliver at least 30,000 affordable homes by 2016. At least 20,000 of these will be for social rent and of these at least 5,000 will be council houses. Increasing the supply of affordable housing is a vital part of Scottish Government efforts in addressing homelessness and affordability issues, and continuing to regenerate Scotland's most deprived neighbourhoods.

2.19 "Homes Fit for the 21st Century, the Scottish Government's housing strategy for the next decade: 2011-2020"[7] set out a commitment to supporting innovation and introducing new sources of funding and new approaches to investment.

2.20 As part of this, the Scottish Government is committed to finding new and innovative ways to fund affordable housing to help those, including young people, on lower incomes. It has developed a range of new approaches involving the financial sector to achieve this. Examples include the National Housing Trust initiative (see box below) which provides affordable homes for below market rent; and shared equity schemes which provide access to low cost home ownership.

Box 2.B: National Housing Trust

The Scottish Government, with support from the Scottish Futures Trust, has developed the National Housing Trust Initiative (NHT), which leverages in private sector funding and council borrowing to support affordable housing. This model uses a Scottish Government guarantee to support council borrowing for collaboration with the private sector.

NHT has been welcomed by both the public and private sectors as a means of boosting the supply of affordable rented homes across Scotland whilst also supporting hundreds of jobs in the construction sector and wider economy. Contracts were signed in 2011 for the construction of over 600 homes across six council areas including Aberdeen, Edinburgh, and the Borders, and a further round of contracts is expected to be signed following completion of the latest procurement round (which is well underway).

The Scottish Government is also working with housing associations and others to evolve the model. Further opportunities to participate in the initiative will therefore be available this year as NHT variants come on stream.

Wales

2.21 The Welsh Government provides support for affordable housing through the Social Housing Grant (SHG) Programme which funds the development of new affordable homes. SHG

[7] Document can be found here: http://www.scotland.gov.uk/Publications/2011/02/03132933/0

is used for a variety of different types of housing provision including different tenures (i.e. social rent, intermediate rent and low cost home ownership) and different types of housing need (e.g. housing for families, older persons) and supported housing for people with specific needs.

2.22 The need to increase supply in the tight fiscal environment has meant that the Welsh Government has had to look at new and innovative ways of funding and delivering affordable housing. One example of this is the "The Welsh Housing Partnership"

Box 2.C: Welsh Housing Partnership

The Welsh Housing Partnership (WHP) has developed an innovative approach to funding housing in Wales and maximises the impact of public funding by drawing on the support and finances of private sector partners.

The project demonstrates alternative ways of bringing new money into the housing sector. This project is financed through a combination of Welsh Government grant funding, a loan from the Principality Building Society and combined financing from the four associations in the Welsh Housing Partnership.

Less public funding is required for this model (around three times less than for traditional affordable housing) and around 150 quality affordable rented homes will be delivered by the WHP to people living in South and North Wales.

Northern Ireland

2.23 The Department for Social Development is committed to providing 8,000 social and affordable homes between 2011-12 and 2014-15. However, in 2010-11 there were approximately 40,000 people on the waiting list in Northern Ireland for social housing, with half of this list already assessed as being in greatest need.

Financing of social housing

2.24 The social housing sector has attracted significant levels of private finance for many years. The social housing sector has traditionally accessed debt finance from two main sources: bank lending and the capital markets. Most housing association debt has come from traditional bank lending, which associations were able to secure at extremely competitive rates, particularly in the years running up to the financial crisis when they often secured long term loans at margins as low as 25-50 basis points above LIBOR.

2.25 The table below provides a summary of existing committed loan facilities and amounts drawn. In total 82 per cent of the existing loan facilities have been drawn down.

Table 2.D: Existing loan facilities by country (£ billion)

Country*	Existing loan facility	Amount drawn down
England	64.1	52.6
Scotland	4	2.9
Wales	2.5	1.5

**Figures were not available for Northern Ireland*

Source: England: English Social Housing Regulator (Oct-Dec 2011); Wales: Global Accounts (31 March 2011); Scotland: Scottish Government (31 March 2011)

2.26 Since the financial crisis, access to long term debt is more restricted. However, the sector continues to need considerable private finance. The latest survey by the English Social Housing Regulator indicates a figure of £4-5 billion over the next 12 months.[8]

2.27 In response to this, associations have increasingly turned to the capital markets for long term debt. In England, for example, around £8 billion has been raised by providers through the capital markets. Furthermore, some associations continue to secure long term fixed rate debt through the bond markets at attractive rates. Most recent housing association bond issues have managed to secure an all- in cost of borrowing of between 5-6 per cent per annum.

2.28 Whilst it has principally been the largest associations who have been able to launch own name issues, smaller associations are also able to access the capital markets through aggregating vehicles such as The Housing Finance Corporation. Increasingly, a two tier borrowing market has emerged in the housing association sector, with bank lending providing shorter term finance and the capital markets providing long term debt.

2.29 Because sub-market social rents make it difficult to finance new development solely with debt finance, provision of new social housing has also been supported by the payment of public capital grants. In England, the housing association sector has received a total of £43 billion historic social housing grant.[9] When social properties are disposed of outside the social sector, this historic grant must be reinvested in new supply.

2.30 However, given the imperative to reduce the deficit, reform has been necessary to ensure that such public investment stretches further, maximising delivery and making the best use of constrained capital expenditure. In England, the new Affordable Rent model has changed the balance of funding for affordable housing supply, with a much greater proportion of the cost of development coming from private rather than public investment. The new model has helped providers unlock financial capacity from their existing asset base by permitting them to charge higher rents on a proportion of their re-lets, providing additional income to service private debt. The total funding from providers, including the borrowing capacity generated by conversions to affordable rent, is almost £10 billion.[10]

2.31 Whilst these options are available, the sector will continue to need to access significant amounts of private finance both to invest in new development and its existing stock. To diversify their sources of finance, and avoid relying too heavily on a limited group of lenders, social housing providers are increasingly exploring other funding mechanisms. Concurrently, the Government is also keen to explore alternative sources of private finance for the affordable housing sector to ensure that the sector can continue to access the funding it needs to deliver new affordable housing and invest in the existing stock.

[8] Tenant Services Authority Quarterly Survey (October- December 2011)

[9] Tenant Services Authority- 2011 Global Accounts of the housing association sector.

[10] HCA internal calculation 2012

Question 1. Does a financial constraint exist for social housing providers? If so, please elaborate.

Question 2. What sources of finance are housing providers currently using to support affordable housing development?

Question 3. What new sources of finance are housing providers exploring to support future development?

Question 4. Does the size of the housing association impact the financing opportunities available to it? If yes, please explain how.

Institutional investment in social housing

2.32 Institutional investors are already active in the social housing sector. Investors such as pension funds and insurance companies primarily invest in the social housing sector through the purchase of public bond issues, both own name issues and bonds issued by an aggregator such as The Housing Finance Corporation. Some investment is also channelled through private placements where a bilateral agreement is entered into between the investor and borrower.

2.33 However, the Government and devolved administrations are keen to encourage more institutional investor participation and believe that the affordable housing sector can offer attractive opportunities. In particular, housing associations can offer an attractive form of investment because they provide a stable, inflation linked income stream from social rents; a large and conservatively valued asset base; and are effectively regulated.

Stable rental income

2.34 In England, the Government has confirmed its commitment to retain the current RPI+0.5 per cent formula for social rent increases for the rest of this Parliament. A large proportion of this income is supported by the payment of housing benefit, with around two thirds of existing social tenants in receipt of housing benefit.

2.35 Whilst the introduction of Universal Credit will bring reforms to the benefit system, designed to support claimants into work, the Government fully recognises the importance of stable rental incomes for social-sector landlords, which allow them to access affordable credit and deliver new homes. The design of the Universal Credit therefore will contain safeguards to help protect social landlords' income streams, and ensure that sufficient support mechanisms are in place for those who need help managing their finances.[11]

2.36 In Wales, the Welsh Government has consulted upon a proposed new policy for social housing rents that would apply to both housing association and local authority landlords. The consultation proposed a rational, transparent and consistent rent framework that reflects the location, type, size and quality of the landlord's dwellings. The consultation also proposed the continuation of the long standing policy that local authority rents and RSL rents should converge progressively and that annual rent increases should be 1 per cent above the rate of inflation. The Welsh Government is currently revising the policy proposals in light of consultation responses and aims to publish the revised policy for implementation in April 2013.

[11] The Department for Work and Pensions is running a series of demonstration projects intended to test a range of mechanisms for protecting landlord income.

2.37 In Northern Ireland a specific rental increase formula does not exist. Instead, housing associations tend to increase their rents in line with the increases set by the Northern Ireland Housing Executive.

2.38 Scotland also does not have a central policy or formula for setting rents. Consequently RSLs set their rental rates according to their own requirements.

Question 5. How attractive is affordable housing as an investment for institutional investors? What, if any, are the barriers?

Conservative asset base value

2.39 The sector also has a large, conservatively valued asset base. In England, the total book value of the social housing assets owned by providers was £109 billion at 31 March 2011.[12] Scotland has a total net social housing asset value of £10.5 billion. For Wales, the housing property value now totals £4.3 billion; and Northern Ireland has a total net asset value of social and affordable housing combined equal to £3.4 billion.

Robust regulatory framework

2.40 Social housing also benefits from a robust regulatory framework. More detail on the regulatory framework in each country in the United Kingdom is set out in annex 1.

[12] Tenant Services Authority 2011 Global Accounts of the housing association sector.

3 What role is there for social housing REITs?

3.1 The UK Real Estate Investment Trust (UK-REITs) regime was launched in January 2007. UK-REITs are tax efficient vehicles for property investment. The UK REITs regime moves the taxation on a property rental business from the REIT to the investor in the REIT.

3.2 Since their launch more than three-quarters of the UK's major listed property companies have joined the UK-REIT regime. To date there are over 20 UK-REITs with a market capitalisation of over £20 billion. However, the focus of investment for existing UK-REITs has been in commercial property, with only a few holding some residential property in their portfolio.

Recent reforms to the regime

3.3 Since its launch in 2007, UK-REIT legislation has undergone a number of reforms to help improve the regime. Most recently, the Government announced reforms to remove barriers to entry to, and investment in, the UK-REITs regime, and to reduce administrative burdens for new and existing UK-REITs.

3.4 These reforms, the most important of which have been summarised in table 5.A below, will be included in Finance Bill 2012. It is proposed that these reforms will come into effect after Royal Asset.

Table 3.A: REIT reforms in Finance Bill 2012[1]

Measure	Explanation
Abolition of the 2 per cent entry charge	The conversion charge will be abolished.
Relaxation of the listing requirement	REITs will be able to be listed on exchanges such as AIM which are considered less burdensome than a full listing.
Temporary relaxation of the regime's non-close company rule	Newly formed REITs will have 3 years to meet the non-close company requirement
Diverse ownership rule	Allows that particular institutional investors will not make a company close for REIT purposes.
Allow cash to be considered a "good" asset for the purposes of the balance of business asset test which ensures that a REIT is primarily a property investment vehicle	The balance of business test will be amended such that cash will be included in the definition of "good asset".
Redefine "finance costs" for the purpose of the profit financing cost ratio which prevents a REIT from over borrowing	"Financing costs" will be defined as interest and interest equivalents paid on borrowing in order to purchase property rental business

3.5 As mentioned above, no solely residential REIT exists in the UK. In large part, this is due to the low yield that this sector generates which is insufficient to attract investors.

[1] Further detail on the specific reforms can be found in the accompany FB12 explanatory notes. See pg 83: http://www.hm-treasury.gov.uk/d/finance_bill2012_en.pdf

3.6 The proposed reforms remove barriers to new firms becoming REITs and ensure the REITs regime offers the correct balance between the stability needed to attract investors without unintentionally hindering good business practice. Consequently, as the rental market strengthens the REIT regime will be better placed to react to market signals thereby facilitating more investment.

Social housing REITs[2]

3.7 As discussed in Chapter 2, social housing providers are beginning to explore new avenues in terms of how they can meet their future financing needs, fund their development ambitions, and subsequently expand the housing supply. One option that stakeholders have started to explore is the role REITs could play in attracting investment into the social housing sector.

Question 6. What role is there for REITs to play in social housing for either low cost rental or affordable home ownership accommodation?

3.8 In the current economic climate, social housing providers are likely to need to diversify their sources of finance. Larger housing associations have increasingly turned to the debt market to issue own name bonds to raise alternative financing. Some have also entered into sale and leaseback schemes with institutional investors, such as pension funds, who buy the properties and then lease them back to the social housing provider. Whilst smaller housing associations are able to access the bond markets through aggregating vehicles such as The Housing Finance Corporation (THFC), it is principally large providers, able to issue own-name bonds that have made most use of the capital markets.

Question 7. In what circumstances might REITs be an attractive means of accessing finance compared to existing financing options?

3.9 As discussed, UK-REITs have not concentrated on private residential property investment because of the low returns achieved due to low rental rates, more voids (i.e. unoccupied rental units), and high management and maintenance costs (as a result of poor economies of scale).

3.10 Investment in social housing is different from investment in other residential rental property because social housing providers are able to achieve economies of scale. Multiple social housing units tend to be clustered in smaller areas, which means that management companies are able to reduce their costs for managing and maintaining their properties.

3.11 Social housing tenures also tend to be longer in comparison to private rental. This means that there is a lower incidence of voids. In England, the void rate for 2010-11 was only 1.78 per cent.[3] And when voids do occur, given the increasing demand for social housing units, they tend to be for shorter periods.

3.12 Rent in the social housing sector, however, is significantly below that charged in the private rental market. In England, the Government has introduced the Affordable Rent programme which, subject to approval, allows a social housing provider to increase their rent up to 80 per cent of the market level as part of an agreement on new supply.

[2] A "social housing REIT" would be a REIT whose property portfolio includes social housing.

[3] Tenant Services Authority 2011 Global Accounts of the Housing Association sector

3.13 A key question is whether the enhanced economies of scale and longer (guaranteed) tenures of the social housing model are sufficient to offset a decrease in rental income and thereby make social housing sufficiently attractive for investors.

Question 8. What would the social housing REIT business model need to look like to generate attractive returns?

Question 9. What level of return would be considered attractive to your investors?

Question 10. What reforms would be needed to enable REITs to support a social housing business model?

Question 11. What benefits and risks should be considered as a consequence of changing the REIT regime?

Question 12. What practical issues that affect implementation should be considered?

3.14 The social housing sector is regulated to ensure that grant funded social housing stock and social housing tenants are protected. Obviously the treatment of for-profit providers will differ across the UK. Details of the regulatory frameworks in each of the devolved administrations are set out in Annex 1.

3.15 In England, the Regulator is committed to enabling the registration of for- profit providers in a way that ensures it delivers its statutory objectives and it is able to manage effectively the risks presented by new types of organisations. In light of this the Regulator intends to review certain aspects of the regulatory framework during 2012, with a view to clarifying the expectations and approach to the regulation of for-profit landlords, as well as considering the impact on not-for-profit landlords where this is relevant. The aim will be to gain deeper understanding, following consultation, of managing the risks and opportunities that for-profit providers generate, and may lead to the Regulator proposing changes to the framework. The Regulator's current expectation is that this consultation will take place in the summer, with the new regime in place by the end of 2012. This new framework would apply to any REIT wishing to register as a for- profit provider of social housing.

3.16 Where relevant, for- profit providers will also need to abide by grant conditions applied by the Homes and Communities Agency (including the requirement to repay social housing grant in line with any contractual arrangements, or, by agreement, to recycle into the provision of new supply) should the Regulator grant consent to the disposal of properties outside the regulated social housing sector.

Question 13. Are there particular social housing regulations that might be affected by the introduction of REITs? If so, please explain.

Question 14. What role should social housing regulators play in regulating REITs in this sector?

3.17 As previously discussed, social housing is a devolved policy. As such, the regulatory framework under which social housing providers operate may differ across the UK. There is, however, an overarching common objective which is to ensure that the supply of social housing remains robust.

Question 15. Given that the REITs regime applies to the UK and social housing is a devolved matter, does this give rise to particular issues that should be considered?

3.18 The Government would welcome stakeholder views on the questions raised in this section. Where possible, please provide evidence to support your response.

4 REITs investing in REITs – a technical measure

4.1 Under the current regime, a REIT is exempt from Corporation Tax on its profits and gains from its property rental business. A REIT is required to distribute profits and gains by way of a Property Income Distribution (PID). A PID is treated in the hands of investors as income from property and taxed accordingly.

4.2 If a REIT invests in another REIT then the PID income received by the investor REIT is taxed as income from property on which the main rate of Corporation Tax will be paid and the PID is not treated as part of the investor REIT's tax exempt property rental business. Consequently, a REIT investing in a REIT is subject to tax on the PID and can pay this taxed income out as an ordinary dividend – not a PID. For example, a pension fund will receive a dividend after corporation tax has been paid on the income giving rise to the dividend, even though the pension fund may not pay taxes itself.

Rationale for considering this measure

4.3 In Budget 2011 the Chancellor of the Exchequer announced that a package of REIT reforms would be introduced to address both barriers to entry and investment for new and existing REITs; and to promote good business practice for existing and future REITs. Subsequently an informal consultation was held to discuss how to implement these reforms.

4.4 During this informal consultation, a number of stakeholders suggested that the REIT regime should be modified so that a PID received by an investing REIT is considered to be part of the investing REIT's tax exempt property rental business and so not subject to the main rate of Corporation Tax.

4.5 The justification for making the amendments is that it would not only change the tax suffered by investors in REITs that invest in other REITs but also facilitate greater investment diversification as they are able to take a stake in a wider investment pool.

Question 16. Is there a need for REITs to invest in REITs? Please explain.

Question 17. How would this measure be beneficial to your investment model? Please provide evidence to support your answer.

Question 18. How do you think this measure will help the government to achieve its wider objectives (e.g. encouraging further investment in the property sector)? Please explain.

Question 19. What practical issues that affect implementation should be considered, including avoidance risk?

Question 20. How can these issues be addressed?

4.6 Introducing this measure would be a fundamental change to policy, since it would mean moving away from limiting REIT activity to direct investment in bricks and mortar. The Government is keen to ensure that the credibility of the REIT regime remains intact and that investors are protected. Therefore, any change in policy needs to be weighed against potential risks to the regime, including the introduction of additional complexity.

Question 21. What risks to the REIT regime could arise from allowing REITs to invest in REITs? How can these risks be minimised?

Question 22. What risks to the wider governmental objectives could arise? How can these risks be minimised?

4.7 Again, the Government would welcome stakeholder views on the questions raised in this section. Where possible, please provide evidence to support your response.

5 Responding to the consultation

Issues for consideration

5.1 This document sets out the importance of the social housing sector in meeting demands within the housing sector as well its contribution to the wider economy. Looking forward, demand for social housing accommodation is likely to increase; however, existing constraints may impact the ability of social housing providers to increase their supply. The Government is interested in exploring whether a social housing REIT could address the existing constraints and help support social housing providers' development plans. The Government would be interested in evidence and views on the issues set out in this consultation with respect to social housing REITs.

5.2 The Government is also interested in views on potential technical REIT regime changes to facilitate REITs investing in REITs. As set out earlier, the motivation behind this measure is to enable existing REITs to diversify their investment portfolio.

Social housing REITs

5.3 Chapter 2 and 3 ask a series of questions relating to constraints that exist within the social housing sector; and whether a social housing REIT might be able to address these constraints thereby bolstering future supply of social housing units. Below is a recap of the questions that the Government has raised.

- Does a financial constraint exist for social housing providers? If so, please elaborate.
- What sources of finance are housing providers currently using to support affordable housing development?
- What new sources of finance are housing providers exploring to support future development?
- Does the size of the housing association impact the financing opportunities available to it? If yes, please explain.
- How attractive is affordable housing as an investment for institutional investors? What, if any, are the barriers?
- What role is there for REITs to play in social housing for either low cost rental or affordable home ownership accommodation?
- In what circumstances might REITs be an attractive means of accessing finance compared to existing financing options?
- What would the social housing REIT business model look like to generate attractive returns?
- What level of return would be considered attractive to your investors?
- What reforms would be needed to enable REITs to support a social housing model?

- What benefits and risks should be considered as a consequence of changing the REIT regime?
- What practical issues that affect implementation should be considered?
- Are there particular social housing regulations that might be affected by the introduction of REITs? If so, please explain.
- What role should social housing regulators play in regulating REITs in this sector?
- Given that the/ REITs regime applies to the UK and social housing is a devolved matter, are there particular issues that should be considered?

REITs investing in REITs

5.4 Chapter 4 sets out the logic behind (and potential implications of) amending the tax treatment of REITs investing in REITs. The questions raised in this chapter are recapped below.

- Is there a need for REITs to invest in REITs? Please explain.
- How would this measure be beneficial to your investment model? Please provide evidence to support your answer.
- How do you think this measure will help the government to achieve its wider objectives (e.g. encouraging further investment in the property sector)? Please explain.
- What practical issues that affect implementation should be considered, including avoidance risk?
- How can these issues be addressed?
- What risks to the REIT regime could arise from allowing REITs to invest in REITs? How can these risks be minimised?
- What risks to the wider governmental objectives could arise? How can these risks be minimised?

Other comments

5.5 In addition to the specific questions set out above, the Government would welcome any other comments relating to specifically, to social housing REITs or REITs investing in REITs.

Responding to the consultation

5.6 This consultation began with the publication of this document and will last for a period of 12 weeks, closing on 27 June 2012. This formal consultation represents part of a wider process of discussion and engagement with stakeholders.

5.7 Comments on the specific questions raised in the consultation are welcomed. Where possible stakeholders are encouraged to provide evidence to support specific points. Stakeholders do not need to respond to all of the questions in the consultation and should feel free to limit their response to those questions that are of particular relevance to them.

5.8 Responses should be sent by email if possible to:

REITS.Consultation@hmtreasury.gsi.gov.uk

Or by post to:

REITs consultation
Property Tax Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

5.9 This document can be found on the website of HM Treasury (www.hm-treasury.gov.uk). When responding, please state whether you are responding as an individual or as part of an organisation. If responding on behalf of a larger organisation please make it clear who the organisation represents and, where applicable, how the members' views were assembled.

Consultation disclosure

5.10 All written responses may be made public on the Treasury's website unless the author specifically requests otherwise in writing.

5.11 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regime. These are primarily the Freedom of Information Act (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004.

5.12 If you would like the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as being confidential. If we receive a request for disclosure of information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

5.13 In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response.

5.14 Subject to the previous two paragraphs, if you wish part (but not all) of your response to remain confidential, please supply two versions - one for publication on the website with the confidential information deleted, and another confidential version for use by the Treasury.

5.15 Any FOIA queries should be sent by email to:

Public.enquiries@hmtreasury.gsi.gov.uk

Or by post to:

Correspondence and Enquiry Unit
Freedom of Information Section
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Code of practice for written consultation

5.16 This consultation is being conducted in line with the Code of Practice for written consultation, which sets down the following criteria:

- Formal consultation should take place at a stage when there is scope to influence the policy outcome;
- Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible;

- Consultation document should be clear about the consultation process, what is being proposed, the scope of influence and the expected costs and benefits of the proposals;

- Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach;

- Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained;

- Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation; and

- Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

5.17 If you feel that this consultation does not fulfil these criteria, please contact:

Giles.Thomson@hmtreasury.gsi.gov.uk

Or by post:

Giles Thomson
Property Tax Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Next steps

5.18 As stated above, this consultation began with the publication of this document and will last for a period of 12 weeks, closing on 22nd June 2012. After the consultation period has closed, the Government will consider the responses to the consultation.

5.19 In line with the Code of Practice for written consultations the Government will publish a summary of responses to the consultation.

A Social housing regulatory frameworks

A.1 This annex provides further detail of the social housing regulatory frameworks in England, Scotland, Wales and Northern Ireland.

Social housing – a devolved policy

A.2 As already mentioned, housing policy in the UK is devolved. Scotland, Wales and Northern Ireland are each responsible for housing policy, with the UK Government retaining responsibility for housing policy in England.

A.3 This means that each administration has its own, distinct policy on the management and delivery of social housing. In particular, each administration has a separate framework for the regulation of registered social landlords. This chapter summarises key aspects of the regulatory framework in England, Scotland, Wales and Northern Ireland.

A.4 This annex uses the term registered social landlords (RSLs) as a generic term for non- state regulated providers of social housing. In England, this term has been replaced by the term Private Registered Providers, but the term RSL remains in usage in other parts of the United Kingdom.

Regulating social housing providers

England

A.5 In England, the Localism Act 2011 reformed the system of regulation for Private Registered Providers of social housing (PRPs). The Act abolished the previous independent regulator, the Tenant Services Authority (TSA), transferring regulation functions to a new Regulation Committee of the Homes and Communities Agency (HCA). The HCA Regulation Committee took over the statutory functions of the Social Housing Regulator on 1 April 2012.

A.6 A new regulatory framework also came into force in England on 1 April 2012. The revised regulatory framework can be found at http://www.tenantservicesauthority.org/show/nav.15065.

A.7 The Regulator's role as the economic regulator of Private Registered Providers of Social Housing (PRPs) will remain largely unchanged. This includes a proactive role on standards relating to governance and viability, rents and value for money. The Regulator will engage with PRPs to obtain assurance that these standards are being met. However, it will also have an expanded role on value for money in Private Registered Providers.

A.8 The principal changes relate to consumer regulation. Registered providers will still be required to meet the relevant standards. But the Government is creating a new landscape for the way tenants' problems with housing services are addressed. From April 2012, the regulator will have a 'backstop' role in consumer matters limited to setting the service delivery standards and acting only where it considers there is risk of serious detriment (or harm) to tenants or potential tenants. Instead there will be a stronger emphasis on local accountability mechanisms, including routine scrutiny by tenants and a formal role for local representatives (tenants' panels, MPs and elected councillors) in the complaints process.

A.9 The 2008 Housing and Regeneration Act enabled the entry of 'for profit' organisations into the social housing sector and the government has made clear in its recent Housing Strategy that it sees an important role for these organisations in delivering its vision for housing.

A.10 The Regulator is committed to enabling the registration of for- profit providers in a way that ensures it delivers its statutory objectives and it is able to effectively manage the risks presented by new types of organisations. In light of this the Regulator intends to review certain aspects of the regulatory framework during 2012, with a view to clarifying the expectations and approach to the regulation of for-profit landlords, as well as considering the impact on not-for-profit landlords where this is relevant. The aim will be to gain deeper understanding, following consultation, of managing the risks and opportunities that for-profit providers generate, and may lead to the Regulator proposing changes to the framework. The regulator's current expectation is that this consultation will take place in the summer, with the new regime in place by the end of 2012.

A.11 Where relevant, for- profit providers will also need to abide by grant conditions applied by the Homes and Communities Agency (including the requirement to repay social housing grant in line with any contractual arrangements, or, by agreement, to recycle into the provision of new supply) should the Regulator grant consent to the disposal of properties outside the regulated social housing sector.

Scotland

A.12 As of 1 April 2012, The Housing (Scotland) Act 2010 passes the responsibility for the regulation of social landlords from Scottish Ministers to the new, independent Scottish Housing Regulator. A new regulatory framework in Scotland has been set out which is risk-based and proportionate, focuses on promoting good service outcomes, effective governance and sustained financial health in social landlords.

A.13 The Regulator will identify the risks to their regulatory objective. In general terms, the following are likely to be the main risks:

- poor outcomes for tenants and other service users;
- poor stock quality and investment failures;
- poor financial performance and management; and
- poor governance.

A.14 The Regulator's functions include monitoring, assessing and reporting on the financial well-being and governance standards of registered social landlords (RSLs) and, if necessary, intervening in these areas with RSLs. The Regulator has a direct interest in how housing associations and co-operative borrow money and otherwise fund themselves in the market. The Scottish Government expects this interest to include new funding models which may emerge, like REITs, and which landlords may wish to make use of.

A.15 To see the Scottish Housing Regulator's recently published Regulatory Framework Document please use the following link: http://newregulator.scottishhousingregulator.gov.uk/sites/default/files/files/Regulatory%20Framework%20Document(1).pdf

Wales

A.16 The delivery outcomes reflect the Welsh Government's commitment to citizen-centred principles of governance and better services for people who use them and are set out as follows:

- Part A: Governance, and financial management outcomes.
- Part B: Landlord services – how we deliver efficient and effective landlord services.

A.17 The Welsh Ministers expect housing associations to achieve delivery outcomes. However, it is for an association to decide locally, working with tenants and other service users, how it will achieve those outcomes.

A.18 The Welsh Ministers regulate housing associations. A Regulation Team has been established within the Housing Directorate to undertake regulation activity on their behalf.

A.19 A new Regulatory Framework for Housing Associations Registered in Wales was published in December 2011 (see www.wales.gov.uk/housing to access this document).

A.20 All housing associations are expected to carry out a regular self assessment which evaluates their performance on service delivery, governance, and finance, and proposes improvement action. The Welsh Ministers expect housing associations to publish their self assessments in a way that is readily accessible to tenants. Self assessment is the core evidence used in the regulatory assessment. A robust, evidence based, challenging self assessment is thus an important element of the Regulatory Framework.

A.21 Each year, the Welsh Ministers will produce a Housing Association Regulatory Assessment for each association. The Assessment forms the basis of a published report. Associations are expected to inform tenants and service users of its publication via their usual channels of communication.

A.22 The financial element of the regulatory assessment is undertaken between September and March and culminates in a financial viability judgement. This is the only formal judgement. The judgement is issued to each housing association at the end of March each year.

A.23 There are three categories of financial judgement: "pass", "pass with closer regulatory monitoring", or "fail".

A.24 Where a judgement of "fail" applies, the Welsh Ministers will have already been working closely with the association to address the underlying issues. Where the judgement is "pass with closer regulatory monitoring", the Welsh Ministers are of the view that additional work and/or scrutiny, is required to provide stronger assurance on financial viability.

A.25 The remainder of the regulatory assessment is undertaken on an annual cycle. The timing for an individual housing association is agreed with the Welsh Ministers.

A.26 For governance and service delivery, there are no formal judgements. The annual regulatory assessment report on each association provides:

- An assessment of the level of regulatory involvement required over the forthcoming year; that is: "low", "medium" or "high".
- A brief, robust, narrative evaluation of governance and service delivery focussed on outcomes for tenants, service users and communities, and tailored to local circumstances.

A.27 It is anticipated that, given their very clear commitment to providing quality homes and services, housing associations will act voluntarily to address any matters of concern identified through regulatory activity. However, should this not be the case, the Welsh Ministers have the powers to intervene, to require appropriate action to be taken. These powers are contained in the Housing Act 1996, as amended by the Housing (Wales) Measure 2011.

A.28 The Regulatory Board for Wales is an advisory board set up by the Welsh Government to oversee the operation of the Framework. It also reports on the way in which the Regulation Team of the Welsh Government carries out its work. The Chair of the Board is independent of government and organisations that operate in the field of housing. One of the members of the

Board is also independent. Other members of the Board are representatives from a variety of organisations.

- Community Housing Cymru: the representative body for housing associations.
- Welsh Local Government Association: the representative body for local authorities.
- Welsh Tenants' Federation: the representative body for tenants.
- Tenant Participation Advisory Service Cymru: the leading tenant participation body.
- Council for Mortgage Lenders: representing the lenders to housing associations.

A.29 The Welsh Government will provide the Board with an annual report on its activity. The Board will then submit a report to the Welsh Ministers on the performance of housing associations and on the regulatory function of the Welsh Government.

A.30 In addition, the Regulatory Board for Wales, which is an advisory board set up by the Welsh Government, works with the Tenant' Advisory Panel[1] to ensure that tenants' views, their concerns and their interests are reflected in the Board's work, thus helping to ensure that tenants are at the heart of the Regulatory Framework.

A.31 Members of the Panel actively seek the views of tenants across Wales by attending local and national events, meetings and conferences. This enables as many tenants as possible to be involved which, in turn, helps form a fuller picture of tenants' views.

Northern Ireland

A.32 There are approximately 120,000 social houses in Northern Ireland. Around 90,000 of these are managed by the Northern Ireland Housing Executive, which was established as a Public Corporation in 1971. The Housing Executive, however, does not contribute to the New Build programme.

A.33 The Department for Social Development, as the sponsoring Department has appropriate arrangements in place to monitor the performance of the Housing Executive as an Arms Length Body. Under the Housing (Northern Ireland) Order 1992 (Article 25), the Department has a number of powers such as:

- to remove a member of a Committee of an Association;
- to appoint a member of the committee;
- to order any bank or other person who holds money or securities on behalf of the Housing Association not to part with the money or securities without approval of the Department; and
- to restrict the transactions or payments in the administration of an HA without approval of the Department.

A.34 The above powers are only available after the Department has commenced the Inquiry process- that is, has appointed an independent expert to conduct an inquiry into the affairs of any registered Housing Association.

A.35 The balance of the social housing stock is managed by Registered Housing Associations (currently 31 in number). These Associations are also responsible for the delivery of the New Build programme.

[1] The Panel comprises fifteen housing association tenants from across Wales.

A.36 The Department is the Regulatory Authority and is responsible for establishing the Regulatory Standards and the Inspection Programme for the Registered Housing Associations.

A.37 With regard to regulatory changes, the Department will be seeking additional powers under future housing legislation to take action in advance of the Inquiry process. These powers will be akin to those of the English Regulator and would enable the Regulator to effect changes to the management teams and/or Board membership. Or impose financial penalties.

A.38 The Department will also review the standards with the aim of increasing the role of tenants' participation in determining objectives and targets set by the Association.

HM Treasury contacts

This document can be found in full on our website: http://www.hm-treasury.gov.uk

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