SOCIETY OF CHARTERED SURVEYORS IRELAND

Social Housing Funding Model

SUBMISSION

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Contents

This report was produced by the Society of Chartered Surveyors Ireland (SCSI) in conjunction with Cleary McCabe & Associates

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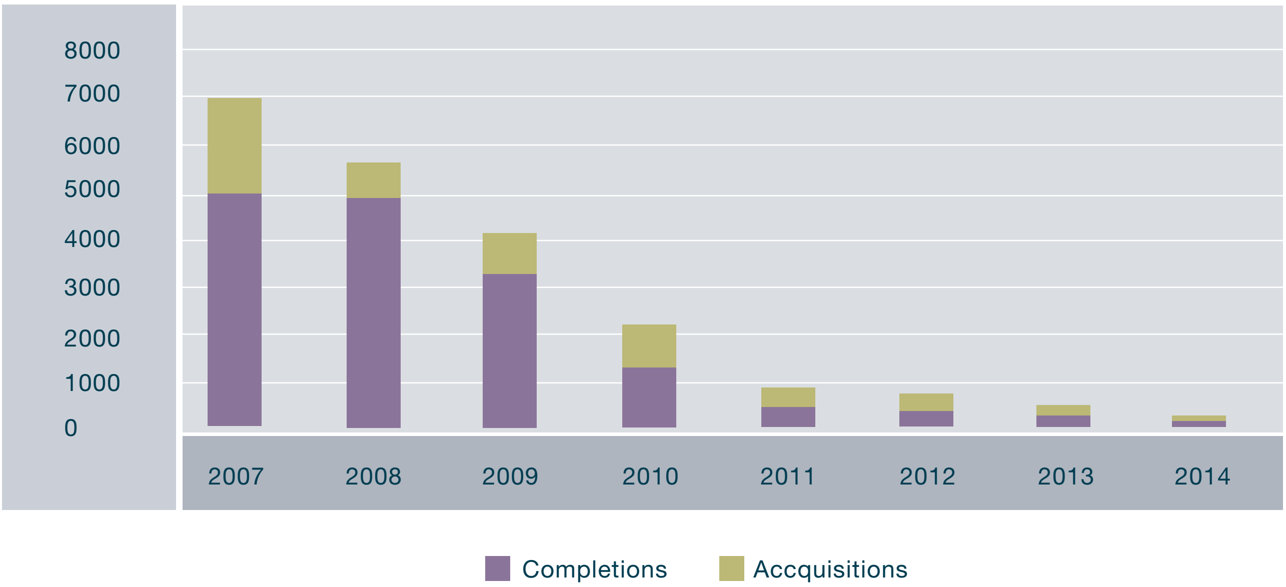
Introduction

The Society of Chartered Surveyors Ireland (SCSI) has commissioned this report to focus on potential funding models for social housing as a means of increasing the supply of social housing in the context of the estimated 89,000 people in need of some form of social housing support.

The report examines an existing green field site in the ownership of Dublin City Council at Cherry Orchard, Dublin 10. The basis of this report is to assist in addressing the supply issues in respect of the social housing crisis within the Dublin area.

Due to the rapid and severe deterioration in the public finances since 2007, the capital budget for constructing (or acquiring) units has been significantly reduced. Unsurprisingly, the reduction in the capital budget for social housing has resulted in a dramatic decline in the provision of social housing units by local authorities which is evident from Figure 1.

Figure 1: Provision of Local Authority Housing 2007-2014



Source: Department of the Environment, Community and Local Government

Social Housing Investment Programme

The most significant public capital housing investment package since 2011 was announced in Budget 2015 and subsequently published in the Social Housing Strategy (SHS) in November 2014 in an effort to begin to address the crisis in the social housing sector. The key issues are the increasing homelessness problem, the high number of households on the social housing waiting lists, last estimated at around 90,000 as of May 2013 and increasing rents in the private sector, which are crowding out tenants who depend on assistance with their rent payments from the State. The fundamental problem has been the lack of new building in the public sector since the financial crisis. Consequently the SHS contains a capital investment programme of over €2.2 billion for social housing provision for the next three years. Including the provision for current expenditure, the total investment is €3.8 billion by 2020. This investment will comprise the following:

- Over €1.5 billion of Exchequer investment by 2017, including €435 million in 2015, €500 million in 2016 and €600 million in 2017.
- Public Private Partnerships (PPP) will be used to invest €300 million in the delivery of around 1,500 social housing units by 2017.
- An off-balance sheet financial vehicle will provide at least €400 million from 2015 onwards to approved housing bodies. The funds are expected to come from the sale of State assets, which is expected to leverage private finance and provide for at least 2,000 housing units over the period 2016 to 2018.

Overall, the large-scale investment in social housing is expected to fund the provision of over 35,000 new social housing units by 2020. The investment package will involve a combination of new build, acquisitions and leased properties. The projected level of delivery over the period to 2020 is set out in the SHS, based on the total spend of €3.8 billion. These units represent units leased, acquired and newly built over the period, but a detailed breakdown is not provided. The estimated breakdown on an annual basis is set out in Table 1.

In addition it is noted that NAMA established a Special Purpose Vehicle to expedite social housing delivery. This Special Purpose Vehicle, National Asset Residential Property Services Limited ("NARPS") -operates by acquiring residential units from NAMA debtors and receivers and leases them directly to approved housing bodies. By end-2014, over 400 units were delivered under this initiative and, on the assumption that local authorities and approved housing bodies confirm their intention to buy or lease the properties, NAMA expects that a further 600-700 houses and apartments will be taken up by local authorities and housing bodies via NARPS in 2015.

The Society of Chartered Surveyors Ireland has produced this report to provide an assessment of potential partnership approaches to the delivery of social housing. A viability assessment and a scoring template which can be used by local authorities to evaluate partnership proposals is also provided.

This report focuses on a new build model at Cherry Orchard in Dublin as being part of a variety of solutions being proposed.

Table 1: Total Social Housing Units to be Built, Acquired and Leased to 2020

	2015-2020	2015	2016	2017	2018	2019	2020
Projected Social Housing Units							
Total	**35,000**						
Capital (Table 1 of SHS)		2,386	2,386	2,711	2,400	1,145	1,145
Current (Table 1 of SHS)		3,000	4,114	4,286	3,600	4,000	4,400
Total	**35,573***	**5,386**	**6,500**	**6,997**	**6,000**	**5,145**	**5,545**

*The total sums to 35, 573 as per Table 1 of SHS. The annual provisions are DKM estimates.
Source: Social Housing Strategy to 2020, December 2014.

Social Housing Funding Model with Worked Examples

The purpose of the new funding model is to meet the need for more social housing through the construction of new units by way of PPP. The methodology being proposed is to create a structure that will attract professional and institutional investors into the sector to deliver a quality product while removing the significant capital funding costs from local authorities. In addition it is envisaged that the funding provided by professional investors will ensure that quality and standards are met as with any professional developer operating in an advanced development market (i.e. meeting the proper building regulations, delivering a good mix and quality scheme, etc.).

The proposals being considered are for the local authority to partner in a structure with a promoter/developer/contractor. Under this scenario, the local authority will offer up the land and the developer/promoter will provide the working capital, manage the design and construction process and deliver a quality fit for purpose social housing scheme within a set timeframe. The models under consideration should allow the developer/funder to then sell the completed investment to a third party such as a REIT or pension fund. The REIT or pension fund will hold the properties for a significant period of time and seek a moderate level of return based on the difference between the rental income achieved on the housing units and the cost of managing same.

The concept is not new in that many social housing entities and charitable organisations going back over 100 years have worked to such a model. However, in an Irish scenario there are some issues to be considered particularly in terms of:

1. **The source of rental income and long term investor returns.** The more secure and certain the rental income the lower the long term funding costs, in that a pension fund will accept a low level of annual return if the rental income is secure or close to secure as a government bond. Certainty of rental income and certainty of rental duration will affect the viability of the scheme.

2. **The management of the completed development.** Certainty around the operation and the management of the completed development is extremely important. The quality and track record of the housing association or estate manager will be a significant factor in the risk profile of any potential bidder.

3. **Construction quality and track record of delivery.** The track record and capacity of the bidding entity to physically build and complete the appropriate number of units within the timescale required and to an acceptable level of specification will be a vital element of the project. This will determine the bidder's ability to access cheap sources of credit for the period of construction, as short term funding costs will reflect the track record and anticipated duration to complete the scheme.

4. **Land value as an input cost.** In the viability analysis undertaken in this report the site/land is applied at a zero value. It should be noted that historically a number of social housing projects were based on developments where the lands were in the control of institutions or held by trusts. In the majority of cases the land was supplied at no cost. It may have been that the land remained within that trust, however the actual input cost of the land was not factored into the viability studies.

The starting point for the worked example in this report is a site located at Cherry Orchard, Dublin 10. Plus Architecture were commissioned to carry out a design feasibility study to establish the quantity of residential accommodation that could be placed on this site subject to planning permission. Two financial viability studies were then undertaken using the Plus Architecture design and accommodation schedule. The first viability study is based on the market value of the site as a private residential scheme and the second study assumes a social housing model where all the units are rented. The worked examples are high level only and should be used to provide some guidelines for further consideration.

Worked Example - Dublin city council site located at Cherry Orchard, Dublin 10

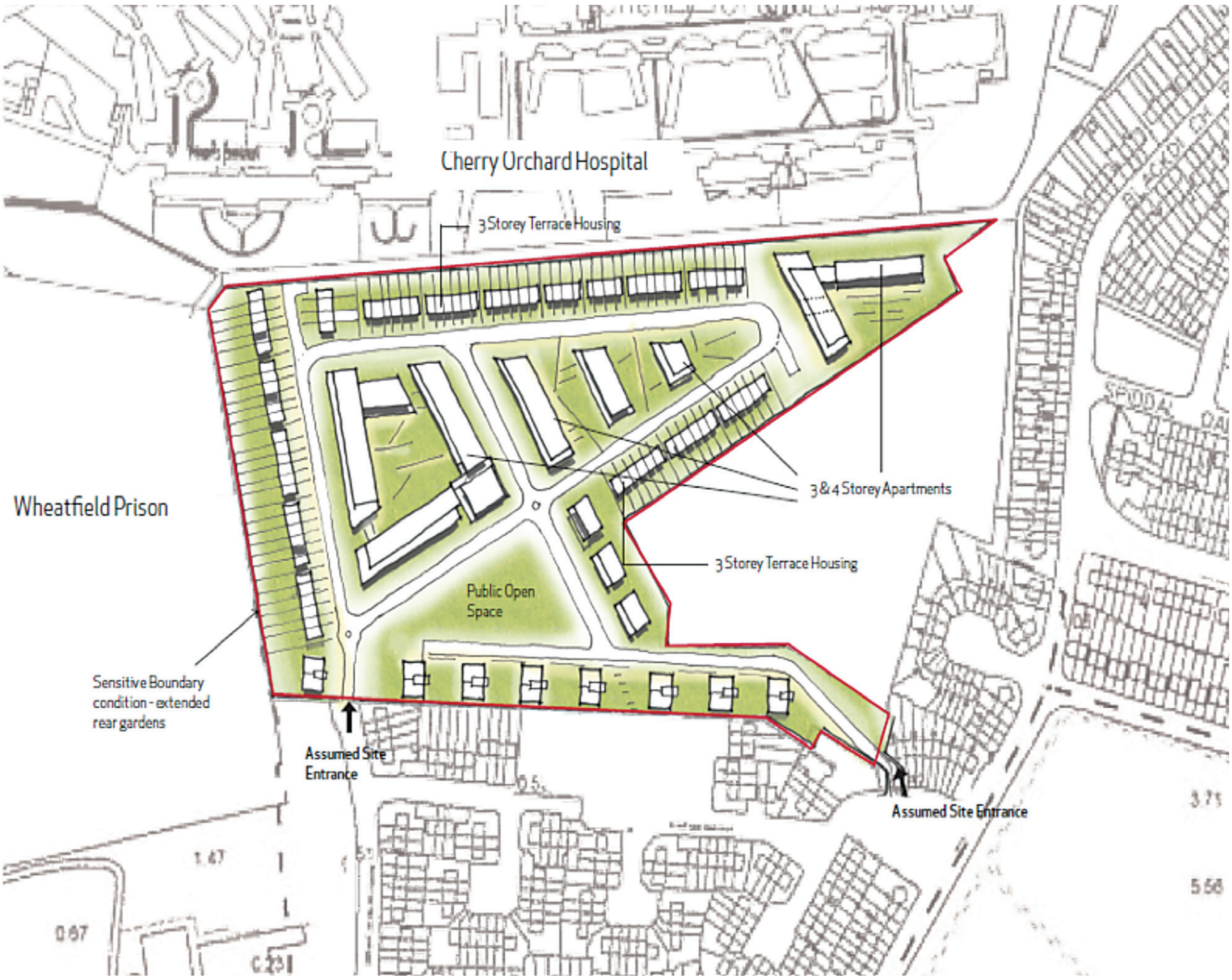
The site is located in Cherry Orchard, Dublin 10. The boundaries of the site are Cherry Orchard Hospital to the north, Wheatfield Prison to the west and existing local authority housing to the south and east.

The site is approximately 20 acres/8.09 hectares.

Plus Architecture produced an indicative site layout and accommodation schedule based on the site plan below and this equates to the following indicative schedule.

Table 2: Accommodation Schedule

Accomodation type	1-Bed	2-Bed	3-Bed	Semi-D	3 Storey Terraced	Total
No of units	110	220	16	16	88	450



Viability Study Methodology

The Plus Architecture accommodation schedule and typical layout is then tested in two viability models:

a. Viability Study 1 as a private development scheme i.e. where the development is constructed, marketed and sold at market rates.

b. Viability Study 2 assumes social housing across all of the completed units. When the scheme is completed and occupied it will produce an annual rent that can be pre-sold to a REIT or pension fund for a set term, possibly 20/30 years, depending on returns.

Table 3: Viability Study 1: Market Sale of Units

1.0	**Revenue**				
	Type	**Units**	**Unit Gross SP**	**Sales Value**	
	1-Bed Apartment	110	€99,000	€9,594,714	
	2-Bed Apartment	220	€160,000	€31,013,216	
	3-Bed Apartment	16	€230,000	€3,242,291	
	Semi-D	16	€250,000	€3,524,229	
	Terraced	88	€240,000	€18,607,930	
	Car Parking	0	-	€0	
	Gross Development Value			**€65,982,380**	
2.0	**Costs**				
2.1	**Build Costs**				
	(Demolition, Site Clearance, Landscaping & Planting, Roads, etc.)			-	
	Build Costs			€63,650,000	KSN Order of Magnitude costs currently €67m reduced by 5% based on value engineering
	Work re Boundaries			-	
	Contingency	3.00%		€1,909,500	
	Professional Fees	8.00%		€5,244,760	
	Total Build Costs			**€70,804,260**	
2.2	**Disposal Cost/Marketing**	%	Basis	**€329,912**	
2.3	**Local Authority Contributions**	450	€9,500	€4,275,000	
2.4	**Total Costs before funding, land and profit**			**€75,409,172**	
2.5	**Funding Cost of construction**	Annual Rate:	5%	**£3,540,213**	
2.6	**Cost including Funding Cost**			**€78,949,385**	
3.0	**Surplus/(Deficit)**			**(€12,967,005)**	
4.0	**Less Profit being % GDV**	13.00%		**€8,577,709**	
5.0	**Surplus / (Deficit) before site purchase**			**(€21,544,714)**	

Cherry Orchard (All figures are exclusive of VAT)

Summary of Inputs and Outcomes from Viability Study 1

Inputs

1.0 Revenue. This is a summary of the total sales revenue based on market rates for houses in this location and figures are net of VAT. The sales prices are based on asking prices within the area.

2.0 Costs

2.1 Build Costs. The construction costs are based on Kerrigan Sheanon Newman (KSN), Quantity Surveyor's Order of Magnitude costs for the Plus Architecture indicative site layout. It is assumed that it will be possible to achieve a 15% reduction in the order of magnitude costs by way of value engineering. Professional fees and contingencies are standard within the industry.

2.2 Disposal Fees. These are standard within the industry.

2.3 Local authority contributions. These are assumed based on standard local authority levies for similar schemes.

2.4 Funding costs. It is assumed that funding costs of 5% can be procured on the market based on short term loans. However, this may be understated and higher funding costs may be required. Also developers must usually provide collateral in the form of title to the site to be held against the loan.

3.0 Developer's profit at 13% of GDV. Private developers seek somewhere between 15%-20% of the gross development value as a potential profit given the risk exposure.

4.0 Surplus/deficit. This is based on a simple viability model created in this report. It is apparent that the project produces a deficit and so there is no market value for the residential use.

Outcomes

The outcome is that the site is not commercially viable as a private residential site. Other uses may be more appropriate for this site (data centre, hospital, etc.) however these are not for consideration for the purposes of this report. Therefore in any proposed residential development scenario the land will have to be inputted at no value/cost. In fact the land may actually have to be subsidised in terms of funding being spent by the local authority to provide access to the site and site servicing. As with all private residential developments the site cost is ultimately a proportion of the completed housing sale price. Therefore based on the low sales prices for housing units in this location, coupled with the anticipated construction costs, the site is not viable for an open market private residential use.

Table 4: Viability Study 2: Socially Rented and Acquired to be held by Long Term Fund(s)

1.0	**Revenue**				
	Type	**Units**	**Monthly**	**Annual**	
1.1			**Rent**	**Rent**	
	1-Bed Apartment	110	€750	€990,000	
	2-Bed Apartment	220	€1,000	€2,640,000	
	3-Bed Apartment	16	€1,200	€230,400	
	Semi-D	16	€1,200	€230,400	
	Terraced	88	€1,200	€1,267,200	
	Less				
1.2	Service Charge	450	€1,000	(€450,000)	
1.3	Asset Management Fee	5%	€5,358,000	(€267,900)	
1.4	**Net Annual Rent**			**€4,640,100**	
2.0	**Costs**				
2.1	**Build Costs**				
	(Site Clearance, Landscaping & Planting, Roads, etc.)			-	
	Build Costs			€63,650,000	KSN Order of Magnitude costs
	Abnormal Site Conditions			-	currently €67m reduced by 5% based
	Work re Boundaries			-	on value engineering
	Contingency	3.00%		€1,909,500	
	Professional Fees	10.00%		€6,555,950	
	Total Build Costs			**€72,115,450**	
2.3	**Local Authority Contributions**			**€0**	
	Contributions/Levies			-	
2.4	**Costs Subtotal**			**€72,115,450**	
2.5	**Funding Cost**		5%	**€3,605,773**	
	To be funded	€72,115,450	24	**€3,605,773**	
2.6	**Cost including Funding Cost**			**€75,721,223**	
3.0	**Add Profit being a % of construction costs**	10.00%	€72,115,450	**€7,211,545**	
4.0	**Land**			€0	
5.0	**Total cost of Development**			**€82,932,768**	
	Net Annual Rent			**€4,640,100**	
6.0	**Annual Return %**			**5.60%**	

(Note VAT and all other taxes are excluded from this study

Summary of Inputs and Outcomes from Viability Study 2.

Inputs

1.0 Revenue/rents.

1.1 Rents. Rents set out in this section are based on the published rates for social housing. It should be noted that if rents are guaranteed it will increase the attractiveness of the completed investment for any purchaser/funder. Also note no assumption for voids has been allowed and this may further reduce the quantum of rental income by possibly 8% per annum.

1.2 Service charges. The service charge is assumed as €1,000 per unit on average. However, this should be examined and assessed in more detail. The amount of service charges being provided will affect the quality of the scheme. Any under allowance of service charges may affect the long term maintenance and upkeep of the properties which will affect their value over the lifetime of the project.

1.3 Asset management fee. This is assumed as 5%, however this may be quite low for the purposes of commercial analysis. Again this will have to be looked at and assessed in greater detail, however this is not analysed any further in this report.

1.4 Net annual rent. The net annual rent is the amount available to service the investment returns of any potential purchaser/funder. For the purposes of this simple viability model we have excluded any void periods, bad debts and taxation issues.

2.0 Costs

2.1 Build Costs. The construction costs are based on Kerrigan Sheanon Newman (KSN), Quantity Surveyor's Order of Magnitude costs for the Plus Architecture indicative site layout. It is assumed that it will be possible to achieve a 15% reduction in the order of magnitude costs by way of value engineering. Professional fees and contingencies are standard within the industry.

2.2 Local authority contributions. These are assumed as zero for social housing schemes.

2.3 Funding costs. It is assumed that funding costs of 5% can be procured on the market based on short term loans. However, this may be understated and higher funding costs may be required. Again any developer must provide collateral in the form of title to the site to be held against the loan. The 5% short term funding costs per annum assumes that 50% of the construction costs is the extent of what's being funded at any stage in that the units will be completed and occupied as soon as possible so that there should be no more than half of the entire scheme under construction at any stage.

3.0 Developer's profit. It has been assumed in this scenario that a profit at a reduced rate of 10% of construction costs can be applied. This is on the basis that the ultimate purchaser of the completed scheme is a pension fund or equivalent funder and the precontracted sale therefore reduces the risk to the developer.

4.0 Land. The land has been assumed and applied at no cost or value.

5.0 Total development costs. Total development costs reflect the construction, planning and funding costs required to bring the scheme to fruition.

6.0 Annual returns. A 5.60% net annual return is projected to be available to any funder. This figure is arrived at by expressing the net rental income as a percentage of total overall development costs (i.e. (€4,640,103/€82,932,768) x 100). The 5.60% return is at levels considered appropriate by pension funds and some REITs. It is in excess of the income stream available for government bonds and a number of investors will view social housing rents as a proxy for government bonds.

Outcomes

Viability Study 2 provides a high level financial study as to how to extract the optimum use for the Cherry Orchard site as a social housing location. The most sustainable planning position may be to have the location mixed as part social and part private rental for key workers. This will require proactive and ongoing management by a quality housing association. In fact such precedents already exist in Dublin. However, while this is preferable from a sustainable planning perspective a mixture of tenures (i.e. non-social housing rents and therefore no certainty of income) may affect the funding that will be available for that element of the scheme. In addition the local authority has to consider whether they will convey their interest in the land/site to the chosen PPP partner. This will be an important consideration as any return being sought by a REIT or pension fund will include an interest rate and also pay down on the amount of capital invested.

Summary and Recommendations

Based on the viability analysis undertaken in this report we have established that the market value for the site as a private residential project is a negative figure. Therefore it is unlikely to be considered as an appropriate private residential site in the short to medium term.

We have established the potential for development of a funding model for a socially rented scheme on the site. However this social housing model assumes a guaranteed income stream and a set quantum of rent. It has also been established that the local authority should input the land into the project at no cost. In addition it is suggested that the items listed below should be focused upon by the local authority in determining the most appropriate bid for the site on the basis of the PPP process. By focusing on these key headings this will introduce a consistency into the assessment of the various PPP bids. The key points to note are:

1. **Income stream/rental income**
   How certain is the rental income? Will it be guaranteed for 20/30 years? Will there be a guaranteed rental floor and also will the rent be linked to the CPI? A sensitivity analysis can be run in terms of the various rental options and this will assist in considering the best return.

2. **Construction cost inputs**
   This should be focused on specifications, densities and building standards appropriate for the site. All of which will affect the economic viability of the scheme.

3. **Short term funding costs**
   The capacity of the proposed bidder to access short term funding costs need to be considered. If the proposed bidder has access to lower cost short term funding this is of benefit. However if the private sector model can only access higher cost short term funding this may negate the benefits of a PPP process.

4. **Developer's profit**
   This needs to be considered in terms of what is an appropriate level of developers profit for the risk being undertaken. A speculative developer seeks up to 25% return on investment, however the profit margin may be significantly less if the builder/developer is certain as to the end users capacity to buy out all the units. If a pension fund has agreed to forward purchase the completed scheme then the developer's profit of 8-10% of construction costs should be considered appropriate.

5. **Land**
   Based on Viability Study 1 the land is at a negative value. In Viability Study 2 the land is considered as a zero input cost. As we have seen in Viability Study 2, land input costs are zero and yet the returns are still marginal. It may be that the local authority will also seek to attribute a value to the land at the outset but not charge this up front to the project. This will allow the local authority to possibly convert the land input cost to a percentage ownership of the completed development. This ownership may be converted back to a monetary sum or ownership at some future date. A model for a subsequent buyback option for the completed scheme can also be set in place however this is not the subject of this report.

6. **Service charges**
   The local authority also needs to consider what the appropriate level of service charge to be applied is. This affects the net rent/income stream and revenue term certain listed in point 1 above. If the service charge is understated this may lead to cutting of corners in the estate management of the scheme and the ultimate deterioration of the units. If overstated this may lead to a transfer of income to the management company and an erosion of the net return to the long term investor.

7. **Long term funding returns**
   This needs to be analysed on the basis of what a long term funder is willing to bid for a term certain income of 25-30 years for a social housing model. As many funders would effectively view this as a proxy for a government bond and given that government bonds are trading at quite a low rate it may be possible to attract a number of potential bidders.

In summary the Cherry Orchard site is likely one of the least attractive sites given that it has no value as a private residential project based on the viability studies undertaken in this report. However there is a potential opportunity for a planning gain by creating a social and private key worker rental model all contained within an appropriately managed development. Again in this scenario it should be stated that the local authority's expectations on land should be at a zero value input.

The report also sets out various templates that can be applied to the assessment of a PPP project for social housing on the site at Cherry Orchard. It allows the local authority to gain a further understanding of the valuation metrics and funding methodologies that will be applied by any potential bidder.

In addition a suggested template for scoring the key headings in the PPP process is attached in Appendix 1. This is offered as a guide to providing the local authority with a mechanism to score and weigh the key points of any potential bid. It is not an exhaustive list but merely a guide as to the prioritising of the key inputs for any PPP process for the funding of social housing.

Appendix 1 - PPP Scoring Template

Entity	Income/ Revenue Assessment	Construction Costs	Short Term Funding	Developer's Profit	Land Assumptions	Service Charge	Long Term Funding Returns	Total

Scoring Scale : 1 = Not market norm or industry standard - 10 = above industry norms or industry standard

Appendix 2 - Summary of Social Housing Rents 17 June 2013

Social Housing

New Maximum Monthly Rent limits (Effective from 17th June 2013)

County	Single Shared	Couple Shared	Single	Couple	Couple/One Parent Family 1 Child	Couple/One Parent Family 2 Children	Couple/One Parent Family 3 Children
Dublin - Fingal	€300	€350	€520	€700	€850	€900	€950
Dublin – Not Fingal	€350	€400	€520	€750	€950	€975	€1,000

Area	1 Bedroom Apt	2 Bedroom Apt	3 Bedroom House
Ballyfermot	€750	€1,000	€1,200
Blanchardstown	€850	€1,100	€1,350
City Centre	€950	€1,200	€1,300
Drimnagh	€1,000	€1,200	€1,350
Lucan	€1,000	€1,200	€1,300
Tallaght	€875	€1,100	€1,375

Examples:

1 Bed/Ballyfermot Cedarbrook Walk - €750	**2 Bed/Ballyfermot** Cherryorchard Apartment - €1,000	**3 Bed House/Ballyfermot** Decies Road - €1,200
1 Bed/Blanchardstown Villa Blanchard - €€850	**2 Bed/Blanchardstown** Waterville Terrace - €1,100	**3 Bed/Blanchardstown** Warrens Town Drive - €1,350
1 Bed/City Centre Gardiner St Upper - €950	**2 Bed/City Centre** Gregg Court - €1,200	**3 Bed/City Centre** St. James Ave - €1,300
1 Bed/Drimnagh Drimnagh Rd - €1,000	**2 Bed/Drimnagh** Lansdowne Hall - €1,200	**3 Bed/Drimnagh** Clonmacnoise Road - €1,350
1 Bed/Lucan College Gate Way - €1,100	**2 Bed/Lucan** Larkfield Sq - €1,200	**3 Bed/Lucan** Sarsfield Prk - €1,300
1 Bed/Tallaght Bellevue, Cookstown - €875	**2 Bed/Tallaght** Marlfield Lawn - €1,100	**3 Bed/Tallaght** ParkhillGreen - €1,375

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