



Value ‘stripping’: Affordable housing, institutional investment, and the political economy of municipal debt

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Abstract

In this commentary, I examine the role of institutional investors in affordable housing production in England, reflecting and expanding on the papers in this special issue on the governance of residential investment. Drawing on my research on the politics of municipal debt and local authority housebuilding in London, I provide a snapshot of the key regulatory changes that have enabled insurance companies, pension funds, and other institutional investors to extract profits from social and affordable housing. I also explore the politics and relations of power that underpin this transformed environment through a discussion of investors’ lobbying activities, and through an analysis of ‘income strip deals’, long-term leasing agreements between investors and local authorities that have gained popularity in recent years. In line with the authors in this issue, I argue that to grasp the recent wave of institutional investment in public housing, we need to pay attention to the narrative framings through which the promise of patient capital is enacted and legitimised, and to the range of regulatory actions mobilised to support and maintain the flow of value to renters.

Keywords

Affordable housing, financialisation, governance, institutional investment, municipal debt

Introduction

One of the shortcomings of the burgeoning scholarship on the financialisation of housing and of urban development is the tendency to treat investment in the built environment in overly abstract and homogeneous terms (Ashton and Christophers, 2020; Özogul and Taşan-Kok, 2020). The literature on urban financialisation has also paid less attention to the question of regulation and to the relationship between investors and various parts of the state apparatus. The four authors in this special issue have made a salient and impressive contribution to

filling this gap by illuminating the range of actors, discourses, and forces at work in the governance of housing investment in the United Kingdom, in Amsterdam, and in Israel (Brill et al., 2022; Geva and Rosen, 2022; Stirling et al., 2022; Taşan-Kok et al., 2021).

Taking as their focus the Build to Rent market in London, Brill et al. (2022) unravel the material and

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discursive strategies through which state institutions and policy networks support patient capital (in this case pension and sovereign wealth funds). Building on the insights of state theory, they suggest that the relationship between investors and housing systems is best understood as one of co-evolution. They discuss, for example, the way in which policy makers' 'hubristic' visions of population and property growth help create an environment of certainty for investors while reproducing the narrative of a crisis of housing supply (Brill et al., 2022:7). Ultimately, this growing interdependence between planning systems and investors necessitates forms of action organised around longer time horizons (Jessop, 2016)—what Brill et al. (2022) call 'patient planning'—to resolve, at least provisionally, the inherent contradiction between the profit expectations of investors and the goals of housing policy.

The recent wave of institutional investment in residential markets in the United Kingdom also needs to be understood as part of a much longer policy trajectory, as Stirling, Gallent, and Purves (2022) suggest. In their study of the post-war origins of housing financialisation, Stirling et al. (2022) trace the evolution of the state's discursive construction of housing as an asset and argue that housing policy has always been a central feature of British macro-economic governance. Critically, they link the post-2010 focus on increasing housing supply to the state's attempt to support a mode of growth based on asset price inflation. Housing supply policies—from institutional investment in residential property, to the construction of affordable homes through densification—work well within a low-interest rate and highly leveraged political economy precisely because they do not fundamentally challenge 'the status of housing as an asset' (Stirling et al., 2022: 15).

In this commentary, I complement and expand on the work of authors in this special issue to explore why and how institutional investors have begun investing in social housing¹ in England, and develop two points that are central to my ongoing research on the politics of municipal housing debt in London. First, I show how the financialisation of social housing by patient capital investors has been enabled by ongoing austerity, by the fragmentation of the system of social housing provision, and by the maintenance

of a policy and monetary environment that is favourable to the interests of rentier capital (Christophers, 2020). My second point is that, if we are to make sense of the way in which policy is developed in mutual constitution with investment flows as argued by Brill et al. (2022), we need to pay attention to the way in which power flows through this transformed regulatory landscape. I develop this argument through a discussion of the impact of investors' lobbying activity on different institutional arms of the state, and through an exploration of the politics of 'income strip deals; long-term leasing arrangements between investors and local authorities. My findings are based on an analysis of policy, news, and industry documents, and on insights from interviews conducted between 2017 and 2021 as part of my research on local authority housing companies in London.

The entry of institutional investors in affordable housing provision

The history of social housing finance in England can be read as an interplay between public and private finance: from the social homes built by the financier and philanthropists of the 19th century, to the rise of council housing in 1919 and the emergence of the Public Works Loan Board as a lender to local authorities, to the emergence of state-subsidised, non-profit housing associations from the 1980s onwards, and the use of the Private Finance Initiative (PFI) in the 2000s.

The fragmentation of affordable housing governance was greatly intensified in the period of austerity after 2010, deepening the structural linkages between public sector, non-profit, and for-profit providers of housing, and the sources of debt finance underpinning these models. One of the major developments of this period has been the revival of local authorities as producers of housing following the introduction of the self-financing regime in 2012, which redistributed historic debt to councils and allowed them to borrow against their rental revenue to build new homes. Under conditions of devolved austerity and in light of enduring debt limitations (local authority borrowing for housing was capped until 2018), many local authorities began setting up

arm's length housing companies to build a mix of market, sub-market, and social homes, and to generate a revenue stream to make up for unprecedented cuts to their revenue support grants (Beswick and Penny, 2018; Bloom, 2020; Christophers, 2019b; Morphet and Clifford, 2021; Penny, 2022).

Concurrently, a series of factors facilitated the *direct* involvement of patient capital investors in the realm of social housing (Bloom, 2020; Wijburg and Waldron, 2020). Indeed, the links between patient capital and social housing are not new; whether in the form of bond-financing or bank-issued loans, private finance has long played a role in the funding structure of housing associations (Wainwright and Manville, 2017). One of the changes that is slowly unfolding now is that patient capital investors are attempting to invest equity capital (rather than debt finance) directly into affordable and social housing, by partnering with housebuilders, housing associations and local authorities (Delahunty, 2022; Gladwell, 2018). This shift has been underpinned by a number of regulatory changes.

First, the Housing and Regeneration Act of 2008 made it possible for private investors and developers to register as 'for-profit' providers of social housing. The aim was to encourage competition between housing associations and private sector providers by making some grant funding available to the latter, and to provide social housing tenants with greater 'choice' (Jarvis, 2018; Victory and Malpass, 2011). Second, austerity accelerated the commodification and assetisation of social housing in the period after 2010, as housing associations were encouraged to raise rents and build more homes for market rent and sale to counter deep cuts to government subsidies. Changes in the system of rent-setting have in turn led to a proliferation of not-so-affordable sub-market tenures, or 'products' as referred to by housing professionals (Interview, 2017, August 10; Penny, 2022). Set against this policy background, and in the context of an expansionary monetary environment, social housing has become an increasingly attractive asset class for investors looking for a guaranteed stream of stable, indexed-linked returns (Wijburg and Waldron, 2020).

Although homes built by for-profit providers including institutional investors currently make up

only a very small proportion of affordable housing, the number of such companies is growing. By 2022, the number of companies registered with the Regulator of Social Housing in England had doubled in size, from 25 in 2015 to over 50 at the time of writing (Delahunty, 2022). *Legal and General* (L&G), the British multinational financial services and asset management company, represents the biggest such investor, with plans to build over 3000 homes a year, half of which would be let at subsidised affordable rents (Delahunty, 2022).

Power, politics, and the promise of patient capital investment

To understand how the discursive and material interests of patient capital investors have co-evolved with those of state institutions (Brill et al., 2022), we need to appreciate the power of corporate lobbying and its differential impact on various parts of the state apparatus. Consider, for example, a recent report published by L&G and BPF, the *British Property Federation*, to support institutional investment in affordable housing (Century and Parmar, 2022). The authors of the report call for central government to create a 'level playing field' between not-for-profit and for-profit providers of affordable housing and to agree on a long-term rent settlement (the policy which regulates increases in social housing rents); the latter would provide investors with greater certainty by reducing the amount of private equity finance required, increasing the value of affordable housing, and reducing the level of subsidy needed per home (Century and Parmar, 2022: 9).

The argument advanced by L&G and the BPF reproduces the narrative that the housing crisis is one of supply (Brill et al., 2022): the undersupply of affordable homes will continue without investment from institutional investors to fill the gap in funding, the authors contend (Century and Parmar, 2022). If this discursive strategy aims to better align the temporal horizons and profit expectations of patient capital with those of the state (Ashton et al., 2016; Jessop, 2016), the status of institutional investors in Britain's political economy also speaks to the 'revolving door' between financial and real estate interests, and the central state (Christophers, 2019a).

Perhaps then it should not come as a surprise that a former director at L&G was hired to work for Theresa May's policy unit in 2016 before returning to the financial giant, or indeed, that the 2012 *Review of the barriers to institutional investment in private rented homes* was written by Sir Adrian Montague, who as Beswick et al. (2016) incisively note, led the government's PFI programme in the 1990s and is now chair of the insurance company Aviva.

At the level of the local state, the relationship between private lenders and local authorities is more asymmetrical in nature, reflecting the way in which different institutional arms of the state are vulnerable to varying degrees of corporate lobbying and capture (Jessop, 2000). While local government in England is not subject to US-style bond market discipline, as the Treasury retains a monopoly status as lender of last resort to local authorities (Sbragia, 1996), the links between private financial markets and local authorities have periodically intensified, from the Hammersmith and Fulham swaps fiasco of the 1980s (Tickell, 1998) to the LOBO loan scandal which saw local authorities take out derivative-embedded loans from commercial banks in the run-up and aftermath of the Global Financial Crisis of 2007–2008. More recently, a number of councils have entered into long-term contractual agreements with institutional investors known as 'income strip deals'. Under these arrangements, investors buy and lease back a public asset for a period of 30–50 years, after which the local authority can re-purchase the property for a nominal amount.

Accounts from local state actors provide a glimpse of the asymmetrical relationship between patient capital investors and local government. During my research on local housing companies in London, an interviewee talked about being approached by patient capital investors 'with bags of money [. . .] trying to find ways to fund the council's ambitions' while another explained how councils received considerable attention from institutional investors and sovereign wealth funds looking for a guaranteed rental stream (Interview, 2018, June 28; Interview, 2018, August 14; see also Marss, 2019a). Indeed, institutional investors have successfully established new avenues for investment in local

authority housing. In 2019, the London Borough of Croydon signed an income strip lease with L&G for the provision of homes for residents previously residing in emergency accommodation, and the London Boroughs of Bromley and Newham signed similar deals with insurance company *Pension Insurance Corporation plc* (PIC) in 2021 and 2022, respectively.²

Income strip leases sustain the fiction that patient capital investment can help resolve crises in affordable housing and municipal indebtedness. As seen in lawyers' websites and in investors and councils' press releases, income strips promise local authorities the opportunity to generate an income stream³ to make up for cuts to their budgets, while retaining future ownership of their assets, as long, that is, as they do not default on their inflation-linked payments. Conversely, income strip deals offer institutional investors a stable source of income to meet their pension and insurance commitments, without being exposed to the underlying value of the asset (hence the ability to 'strip' income). As a form of finance that does not rely on government grants, long-term leases with investors are presented as a way of addressing the United Kingdom's housing crisis and as an example of 'inclusive capitalism' (Legal & General, 2019).

Yet these optimistic narratives about the future belie the way in which various institutions of the state implicitly subsidise the extraction of rent from affordable housing (Brill et al., 2022; Weber, 2021). Take, for instance, the case of the London Borough of Croydon. In 2019, the council drew on its cheap borrowing powers from the Treasury to acquire 167 properties from the open market before selling them to L&G. The properties were then leased back to the council's arm's length company, *Croydon Affordable Homes*. This acquisition strategy was agreed in advance between the council and the institutional investor (Ward, 2019), illustrating the way in which the governance of investment involves the mobilisation of state capacities (Dutta, 2019) towards 'co-managing' the capture of rents from public assets (Ashton et al., 2016: 1396). Critically, the rental income collected by L&G is supported by Housing Benefit, the government subsidy to help low-income tenants cover the cost of rent.

In turn, long-term leases with institutional investors expose renters to the risk of eviction as tenants are insecure; the deals also raise the very real possibility, particularly under conditions of rising inflation, of local authorities defaulting on their loans to investors and of losing further control over the ownership and management of affordable housing (Interview, 2019, July 24). Finally, income strips also reproduce an uneven geography of extraction, as investors target lower-value areas where the level of government subsidy to renters is high relative to the cost of acquiring and refurbishing properties (Marss, 2019b).

Conclusion

To conclude, I want to suggest that Britain's austere and debt-led political economy has produced an increasingly splintered regulatory landscape in which institutional investors are working with and alongside local authorities to 'strip' value from social housing through the capture of subsidised rents. If the entry of institutional investors in social housing provision is illustrative of the enduring function of housing as an asset in British policy as argued by Stirling *et al.* (2022), my research also substantiates Brill *et al.*'s (2022) claim that the needs and interests of policy makers and patient capital investors are co-constituted. This interdependence between investors and institutions is necessarily asymmetrical, I have stressed, particularly at the local scale where leasing arrangements with pension funds and insurance companies expose local authorities and tenants to a series of long-term risks. Combined, these findings suggest that if we are to understand how and why residential investment is governed in the way that it is, we need to pay attention to the multi-scalar entanglements that characterise the relationship between investment flows and housing policy, and to the range of discourses and powers mobilised by state actors and investors in the process of market-making.

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Notes

1. Social housing in England is state-subsidised affordable housing, historically provided by either housing associations or local authorities. Rents are generally set at 30 to 40 percent of local market rents. Social housing sits under the umbrella of 'affordable housing', which includes a range of tenures such as Affordable Rent, which can be up to 80 percent of local market rents.
2. See Beswick and Penny (2018) for a discussion of the London Borough of Barking and Dagenham's deal with institutional investor *Long Harbour*.
3. Local authorities can generate a surplus by sub-leasing the properties to tenants at a rate higher than the payments made to investors, which are initially set at below market rates.

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