



Glasgow City Council
Strathclyde Pension Fund Committee

Item 4(c)

1st March 2023

Report by Richard McIndoe, Director of Strathclyde Pension Fund

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**Direct Impact Portfolio (DIP)
Investment Proposal – Places for People Scottish Mid-Market Rent Fund**

Purpose of Report:

To set out a proposal for an investment of £20m within DIP.

Recommendations:

The Committee is asked to **APPROVE** an investment of £20m in Places for People Scottish Mid-Market Rent Fund by DIP.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes No consulted: Yes No

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1 Background

1.1 Portfolio Establishment

In December 2009, the Strathclyde Pension Fund Committee agreed to establish a New Opportunities Portfolio (NOP) with a broad remit to invest in assets for which there was an attractive investment case but to which the current structure did not provide access.

1.2 Review

The NOP strategy has been subject to 3-yearly reviews with the name changing to the Direct Investment Portfolio in 2015. The most recent review was concluded in November 2021. This made no change to the objectives, structure, overall size parameters, risk and return parameters, or governance structure, but did result in an increase in the individual investment size parameters and a further name change to the Direct Impact Portfolio (DIP).

1.3 Implementation Framework

DIP investment proposals are assessed on their own merits within an agreed implementation framework based on SPF's overall risk-return objectives and specific DIP parameters.

The framework agreed at the 2021 review is summarised below.

Direct Impact Portfolio	
Objectives	Primary objective identical to overall SPF investment objective. Secondary objective of adding value through investments with a positive local, economic or ESG (environmental, social, governance) impact.
Strategy & Structure	In line with SPF risk-return framework but focused on the UK and the Equity, Long Term Enhanced Yield and Short Term Enhanced Yield asset categories.
Risk and Return	Portfolio benchmark return of CPI +3% p.a. Individual risk and return objectives for each investment.
Capacity	Target allocation of 5% of total Fund (based on Net Asset Values). Range of 2.5% to 7.5% of total Fund.
Investment Size	Target: £30m to £100m Minimum: £20m Maximum: greater of £250m or 1% of Total Fund Value
Decision Making	3 stage process with review and satisfactory due diligence by officers, followed by a presentation to the Sounding Board before a proposal is taken to Committee for approval subject to completion of legal documentation.
Monitoring	Includes individual investment reports, participation in advisory boards, and a quarterly DIP monitoring report which is reviewed by the Fund's Investment Advisory Panel.
Co-investment	Existing co-investment programme should be extended in order to maximise its effectiveness, subject to development of a detailed proposal

The following proposal has been assessed using this framework and has been reviewed by the SPF Committee Sounding Board.

2 New Investment Proposal

2.1 Key Terms

Name	Places for People (PfP) Scottish Mid-Market Rent Fund
Investment vehicle	Scottish Limited Partnership
Manager	PfP Capital Ltd
Sector	Affordable residential accommodation
Investment objective	To develop an additional c.500 purpose built, affordable residential units for rent in Scotland
Term	c.27 years remaining until October 2049
Target size	£240m (inclusive of a £47.5m Scot Govt loan)
Proposed DIP investment	£20m
Target return	6.2% IRR (Net) / 5.2% Cash Yield

2.2 Investment Summary

The PfP Scottish Mid-Market Rent Fund (SMMR or the fund) was established in 2019 with the support of the Scottish Government (SG) to secure the development of a portfolio of 1,000+ quality, affordable homes for the mid-market rental sector in Scotland’s main cities by March 2021. This was subsequently extended to allow for the effects of the Covid pandemic. The fund also sought to leverage institutional investment capital by targeting index-linked yield and long-term capital growth.

PfP is a “not-for-dividend” organisation with a strong social purpose, which utilises commercial business methods to deliver positive social outcomes.

DIP committed £25m to the fund in 2019 and it has performed well to date, despite the various challenges of the past few years. An additional investment of £20m by DIP is now proposed, which would take the total to £45m.

More information on the Manager is included in **Schedule 1**.

2.3 Investment Rationale

2.3.1 Scottish Affordable Homes Sector

The supply of housing in Scotland remains at historically low levels, with estimates indicating that 23,000 new homes are required each year to meet its housing needs, driven by population growth & smaller average household sizes. New home completion rates however have fallen materially below this level since their peak in 2007 with the balance of completions also increasingly shifting towards the private sector, from the more traditional public sector owners (local authorities & housing associations).

Demand for Mid-Market Rent (MMR or affordable) homes has materially outstripped supply, especially in city locations.

MMR properties are affordable rental homes where rent is set below an area's average private sector rate, to cater for a large section of the Scottish population who face three main challenges:

- being unable to afford private sector rents;
- being unable to save a large deposit for a first-time home purchase;
- not qualifying for social housing because of their income levels.

MMR properties are therefore aimed at this segment of the population who are typically (but not exclusively) aged between 21 & 45; have household income typically between £25k-£35k p.a. and include keyworkers or young professionals who may either be unable to afford to buy, or choose to rent for reasons of flexibility or convenience, but struggle to afford private rents.

2.3.2 Fund Strategy

Prior to the fund's launch, the SG had made a commitment to deliver over 50,000 affordable homes by March 2021. As part of this strategy PfP was selected to establish the SMMR fund with the target of delivering 1,000+ affordable units in Scotland, in developments of up to 150 units, mainly in the major urban areas of Glasgow and Edinburgh.

In support of the fund's objectives, SG provided the fund with a 23-year, low-cost loan of £47.5m (interest only until 2025 and then repaid over the period to 2041) based on a commitment for the fund to be deployed in accordance with the SG's Public Service Obligations which stipulate:

- the target tenant profile;
- the maximum starting rent levels (c. 60%-80% of the average private sector rent for each type/size of home in each region, but based on the SG's Broad Rental Market Area (BRMA) framework on which Local Housing Allowances are set); and
- the maximum annual rent increase, which is limited to CPI.

The fund is subject to the SG's current rent controls, however these were very recently relaxed to allow 3% p.a. increases for private landlords from April 2023.

The SMMR seeks to invest in a diversified portfolio of houses and smaller apartment blocks with the objective of generating long-term income for investors and specifically:

- to identify potential development sites by assessing the target market, location, size, type of housing and affordability;
- to develop new MMR properties in close proximity to similar residential housing stock, in areas of expected population and/or economic growth, and within commuting distance of Scotland's main cities;
- to acquire sites with planning consent on either i) a forward funding basis (90%+ of projects) where the site is acquired pre-construction and the fund finances the construction by the developer; or ii) on a forward commitment basis (10%) where the development is acquired on completion (or "turnkey" basis) without providing funding;
- to develop where there is potential for rents to increase over time.

DIP committed £25m to the fund in late 2019 following a commitment of £10m from Castle Rock Edinvar, PfP Group's inhouse housing association. In 2020, Nationwide Building Society Pension Fund committed £60m, followed by £40m from SNIB.

With total capital of £182.5m (equity £135m / debt £47.5m) the fund has now completed and let 481 units, with a further 590 units under various stages of construction (total 1,071 units) across 9 projects in Glasgow (x3); Edinburgh (x4); Dalkeith & Paisley. The units are managed (marketing, leasing, deposits & maintenance) by Touchstone, PfP's inhouse property management co.

2.4 Risks

The main risks of the proposed investment are considered to be:

- Property Development Risk;
- Site Origination Risk;
- Construction Risk;
- Letting Risk.

A summary of investment specific risks and key mitigants is contained in **Schedule 2**.

2.5 Projected Return

The Fund is targeting a return of 6.2% IRR (Net) and a cash yield of 5.2% p.a.

The target investment return is towards the lower end of the range sought by DIP (the minimum being 5%). For this reason, KPMG were engaged in 2019 to review the fund's financial projections, the target investment return, revenue and cost assumptions and key financial sensitivities, as additional re-assurance that the targeted returns were considered reasonable and achievable. Their report supported the assumptions used by PfP and the fund's projected returns.

As part of their sensitivity analysis, KPMG highlighted the index-linked nature of the potential returns, although more from the perspective of the downside risks of low inflation. The recent relaxation of the rent controls effectively removes the potential erosion (albeit modest) of the fund's projected returns.

2.6 Exit

The fund's original term was 30 years to 2049 (now c.27 years remaining), at the end of which the intention is for the assets to be sold on an affordable homes basis. The nature of the exit will however be determined in consultation with the LPs at the time.

2.7 Fees

The Management Fee is unchanged for the proposed additional commitment to the fund, which in DIP's experience of the affordable housing market is considered to be modestly below the typical market norms. Carried interest provisions additionally do not apply to the fund.

The fee structure for the PfP fund is in line with, or lower than DIP's experience of the affordable housing sector and is therefore considered acceptable.

2.8 ESG and Impact

PfP is a commercial organisation with a strong social purpose, although run on a not-for-dividend basis with all profits reinvested in the business. As one of the largest managers and developers of private and affordable housing in the UK, it aims to be the most socially responsible asset management company in the housing sector.

More information on the Manager's approach to ESG and Impact is included in **Schedule 3**.

2.9 Investment Size and Cash Requirements

SPF Fund value at 31 st December 2022	£26,970m
DIP allocation (target 5% of main fund) NAV	£ 1,349m
Current DIP NAV	£ 1,349m
NAV Range (Lower) 2.5%	£ 675m
NAV Range (Upper) 7.5%	£ 2,023m

2.10 Investment Strategy

The proposed investment falls within the real estate sector and therefore the Fund's long term enhanced yield allocation (LTEY).

Allocations following this investment, based on Fund values at 31st December 2022 and total DIP commitments to real estate, would be as follows:

Real Estate, £ in DIP	£370m
Real Estate, % in DIP	19%
Real Estate in DIP as % of Total Fund	1%
LTEY, % Total Fund (target 20%)	18.4%

3 Policy and Resource Implications

Resource Implications:

Financial: Investment of £20m to be drawn as required. Fee structure is modestly lower than market.

Legal: The investment will be subject to satisfactory completion of due diligence, including review and execution of appropriate legal documentation.

Personnel: None

Procurement: None

Council Strategic Plan: SPF supports the mission: ***to enable staff to deliver essential services in a sustainable, innovative and efficient way for our communities.*** The LGPS is one of the key benefits which enables the Council to recruit and retain staff.

Equality and Socio-Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2021-25? Please specify. Equalities issues are addressed in the Fund's responsible investment policy.

What are the potential equality impacts as a result of this report? No significant impact from this proposal.

Please highlight if the policy/proposal will help address socio-economic disadvantage. The provision of additional affordable housing in the main Scottish conurbations will contribute to addressing the housing shortage for this key demographic group.

Climate Impacts:

Does the proposal support any Climate Plan actions? Please specify: The housing units being developed by the fund will be constructed using the strongest environmental standards possible in respect of materials and energy efficiency.

What are the potential climate impacts as a result of this proposal? As above.

Will the proposal contribute to Glasgow's net zero carbon target? As above.

Privacy and Data Protection Impacts: To be fully provided for in the legal documentation for the proposed investment.

Are there any potential data protection impacts as a result of this report
Y/N N

If Yes, please confirm that a Data Protection Impact Assessment (DPIA) has been carried out

4 Recommendations

The Committee is asked to **APPROVE** an investment of £20m in Places for People Scottish Mid-Market Rent Fund by the Direct Impact Portfolio.

Schedule 1	Investment Manager: Places for People (PfP)
Schedule 2	Investment Specific Risks
Schedule 3	ESG and Impact

Investment Manager: Places for People (PfP)

Places for People (PfP) is one of the UK's largest property & leisure management, development and regeneration businesses which was established in 1965. It is a not-for-dividend organisation with a strong social purpose, which uses business practices to deliver positive social outcomes.

The Group owns or manages 231,000 residential properties, including over 8,600 in Scotland through the group-owned Castle Rock Edinvar Housing Association and operates 100 leisure facilities. The Group has a turnover of £849m and generated operational profit of £209m (2021/22) and has total assets of £5bn. It provides employment & training opportunities to over 11,500 employees; supports new/existing businesses; provides financial products, specialist care & support services and serves over 500,000 UK customers.

The key individual of the PfP SMMR Fund is William Kyle (Fund Director) who is a planning and development surveyor and member of the Royal Institution of Chartered Surveyors. He is experienced in all aspects of land acquisition and planning for residential development. He was previously Development Director at Sigma Capital, where he was responsible for the development of family housing for rent and leading a development team in the origination, assessment and acquisition of suitable development sites. He has also worked for both national volume and luxury regional housebuilders with a focus on the acquisition and planning processes as well as in the asset management of a portfolio of development assets throughout Scotland and Northern England for a major UK bank.

Kyle is supported by Mark Vickery (Director), John Tatham (FD / acting CEO) and the board of PfP Capital comprising 6 other non-executive directors and members of the fund's Investment and Risk & Compliance Committees.

The Board comprises individuals with a combined 180 years of senior experience and includes chairpersons of publicly listed companies, a director of the Institute of Directors, a Managing Director of Deutsche Bank, a member of the Council of Mortgage Lenders and the European Mortgage Finance Agency, fund managers (including Mercury Fund Management) and a Barrister/QC of 32 years' experience.

Investment Specific Risks

Property Development Risk

The construction of more than 90% of the SMMR's developments will be undertaken by the vendors of the sites on a forward funding basis, where the vendor/developer assumes the development risk (mainly planning), albeit with the construction financed by the fund. The remainder of the projects are expected to be acquired on a "turnkey" basis where the fund acquires the property post-completion without providing funding. No planning risk will be assumed under either scenario.

Site Origination Risk

Kyle, as Fund Director, has undoubtedly proven his ability to source a high volume of potential affordable housing sites and has a high level of confidence that he will be able to originate sufficient additional projects to reach the expanded target number of units. The risk of failing to identify or secure sufficient development sites to achieve the 1,500 units targeted is therefore considered low.

Construction Risk

The PfP team has extensive experience in the property development process from site identification, planning, acquisition and construction.

Strong, reputable, national construction contractors will be engaged by the developers on fixed price building contracts (with cost over-runs, delays and liquidated damages risk lying with the contractor), incorporating performance bonds and/or parent company guarantees as applicable, to ensure an appropriate level of financial surety available in the event of contractor failure.

PfP will monitor the construction process and where funding the development will do so in arrears, on a formal development valuation basis.

The risk of contractors failing can never be eliminated. In such a scenario however, the developer would require to replace the contractors using the performance bonds, guarantees, contract retentions and other measures to cover the extra financial costs.

Letting Risk

While most of the developments will be for 100 units or less (maximum 150), the expected demand for affordable housing is such that the risk of not letting the units at the discounted/affordable rates (compared with private rentals in the respective area) is also considered low.

Impact and ESG

Places for People (PfP) delivers affordable homes in thriving communities across the UK. The business consists of complementary companies that are market leaders in placemaking, property investment, development, leisure and management, and have the expertise to create and manage entire communities, providing homes, services, support and infrastructure. They aim to deliver social outcomes and a positive impact on communities by taking a commercial approach with all profits being reinvested into providing additional homes and services.

PfP's strategy is to focus on:

- Increasing the social impact they have on communities;
- Improving the quality of their assets (the group invested £133m in their existing homes in 2021/22 including £9m in energy efficiencies);
- Creating more affordable housing;
- Improving the quality of the service they provide.

They do this by making sure that their "places" (i.e. homes and communities) are economically sustainable, which in turn attracts people for the long term. They build homes which meet the latest environmental standards so that their customers benefit from energy and cost efficiencies.

PfP has been named as a strategic partner of Homes England, who awarded them grant funding £250m in 2021 to deliver 4,400 affordable homes over the following 7 years. They also plan to develop 10,000 mixed tenure homes over the next decade as part of a framework agreement with Countrywide Properties plc.

PfP Capital became signatories to the UN supported Principles for Responsible Investment in 2019 and seek to address the following 6 UN Sustainable Development Goals (SDGs) in particular:

- 1) No Poverty;
- 7) Affordable and Clean Energy;
- 8) Decent Work and Economic Growth;
- 10) Reduced Inequalities;
- 11) Sustainable Cities and Communities;
- 13) Climate Action.

Finally, PfP Capital were lead authors of a submission to the FCA in 2022 by 8 leading real estate industry organisations, on appropriate regulatory metrics for the real estate sector. This aims to adopt tailored and fit for purpose ESG metrics for the UK's sustainability disclosure requirements (SDR) regime, which they hope will become international industry standards.