FINANCING CO-OPERATIVE & MUTUAL HOUSING

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In the short term it is necessary to provide impetus to the development of co-operative and mutual housing which cannot be realised through piecemeal small projects which lack a co-ordinated approach to raising finance. This could be done by a single aggregated solution which would aim to raise an initial bank facility of around £250 million, with a longer term bond refinancing; which would allow recycling of the initial facility.

The finance would be raised through a central warehouse (which could be an existing conduit or lead housing association) that would take charges over current, unrestricted assets and be repayed through social rental cashflows; due diligence and monitoring would be undertaken by the central warehousing organisation.

Development would be undertaken by existing developing housing associations or private developers with a demonstrable commitment to co-operative and mutual housing. Schemes will need to be supported by partner local authorities; possibly contributing public land (where they could retain freehold ownership and grant long leases to the developer associations) to ensure the affordability of the housing developed. Homes and Communities Agency grant, New Homes Bonus and Right to Buy Receipts could also be applied where available.

In developing new schemes with units for open market sale it is assumed the risk of any open market sale units is taken by the developer and that the funding requirement therefore relates to an ongoing affordable housing provision. Development risks could be underwritten by the developer, either via a construction / cost overrun guarantee or via funding the development and transferring ownership on completion.

The schemes developed would then be managed by a local co-operative or mutual housing organisation; this would be dependent on the local organisation gaining CCH Accreditation[3].

An expression of interest has been developed by the team implementing the recommendations of ‘Bringing Democracy Home’ that will be distributed to identify partner local authorities and housing associations.

In the long term it may be desirable to create a new special purpose conduit (SPC) or utilise an existing one to provide an on-going financing warehouse that would on lend to developer organisations. It may be possible that any public money that is invested goes in as a first loss tranche. The SPC would batch schemes using bank debt which would be financed long term by bond issues (possibly with differing time periods) to institutional investors and individual member investors.

3 Confederation of Co-operative Housing – The CCH Accreditation Framework for Housing Co-operatives – 2010

2 FINANCING CO-OPERATIVE AND MUTUAL HOUSING

Financing Co-operative and Mutual Housing is presented by the Finance Group to the team implementing the recommendations of the final report of the Commission on Co-operative and Mutual Housing, as well as potential statutory, development and investment partners.

'Bringing Democracy Home' highlighted the need for consideration of the role that co-operative and mutual housing could play in national housing strategy and drew the following conclusion regarding financing co-operative and mutual housing:

'Government, through the Homes and Communities Agency (which now incorporates the regulatory functions of the Tenant Services Authority), should support the development of new and innovative funding mechanisms for co-operative and mutual housing in concert with the co-operative and mutual housing sector and the wider co-operative movement.'

We have analysed existing financial models for developing co-operative and mutual housing and identified routes and models for the financing of future schemes and would expect that our work will contribute to the development of a programme of new co-operative and mutual housing developments.

This report examines the current financing of social housing and contrasts it with other European countries (chapter 3), highlights some key issues that may affect the current financing model (chapter 4), outlines existing and new models for financing co-operative and mutual housing in England (chapter 5) and draws on examples from 3 European countries (chapter 6) before exploring warehousing solutions to deliver volume development of new co-operative and mutual housing schemes through partnership working with local authorities and developing housing associations (chapter 7).

Co-operative and mutual housing

Co-operative and mutual housing takes a variety of different forms within the current housing market, although the recent past has concentrated schemes in the social housing sector.

What marks out co-operative and mutual housing as different from other forms of institutional, social and private housing is residents' membership of the housing organisation. This membership entitles them to vote on decisions affecting their homes and gives them a greater level of control over the management of their homes and lives than traditional forms of rental or leasehold ownership housing. Co-operative and mutual forms of housing are particularly ideal at shaping place and creating better outcomes for residents, such as:

(a) mutually supportive communities being established, where residents know that they have friends and neighbours who will look out for them – a tapestry of human interaction that characterises the sector

(b) mutual support has helped members of co-operative and mutual housing organisations who started out with broken lives start to reshape themselves, get skills, get into work, move on in their lives

(c) ordinary people in co-operative and mutual housing organisations who want to do things to tackle climate change, volunteer as school governors, or participate in various other community activities

(d) co-operative and mutual housing organisations set up in neighbourhoods affected by a lack of trust and lack of community, starting to transform them, helping residents feel like they are part of something

Co-operative and mutual housing is relevant to the current social and political environment and may have the potential to offer much to the new Coalition Government's localism and Big Society agenda and to the emerging Community Right to Build.

Development models

The current co-operative and mutual housing sector includes ownership co-operatives, management co-operatives, co-housing projects and community land trusts[4] ; although this list does not preclude the creation of new models.

The Commission on Co-operative and Mutual Housing was keen for local authorities and communities to have a wide range of tenure models to consider that enable them to match local demands and priorities (the decision over 'what is developed where' should be taken at a local level); the tenure models could include the following:

(a) Rented properties with rent levels set at the redefined affordable rate (80% of market rent)
(b) Rented properties at variable rent levels set according to tenants' incomes
(c) Mutual housing schemes at variable rent levels (including open market levels)
(d) Mutual home ownership and equity sharing mortgage schemes with variable equity stakes (these schemes should be structured to ensure access to mortgages to purchasers)
(e) Mutual retirement schemes (either at full rental or ownership or a mix of both)
(f) Mixed schemes of rental and leasehold ownership
(g) Schemes that include elements of commercial, office and retail space

4 A full assessment of existing models was undertaken for the Commission on Co-operative and Mutual Housing by CURS – R. Rowlands – Forging Mutual Futures: Co-operative and Mutual Housing in Practice: History & Potential - 2009

3 CURRENT FINANCING OF SOCIAL HOUSING

Financing housing association development

The financing of social housing by housing associations has been through two key sources, debt and grant. The housing association sector has raised £58 billion through debt financing to date. This comprises facilities from the banking sector (c£50bn) and bonds issued either by individual associations or through conduits (such as The Housing Finance Corporation).

From the late 1990s to 2006, virtually all new debt was raised through bank lending; 85% being loaned from just 5 banks as shown in Table 1.

Bank	Loan Book (£ billion)
Lloyds Group	13.6
Barclays	10.7
Nationwide	9.3
Santander	8.2
Royal Bank of Scotland	8.0
Total	49.8

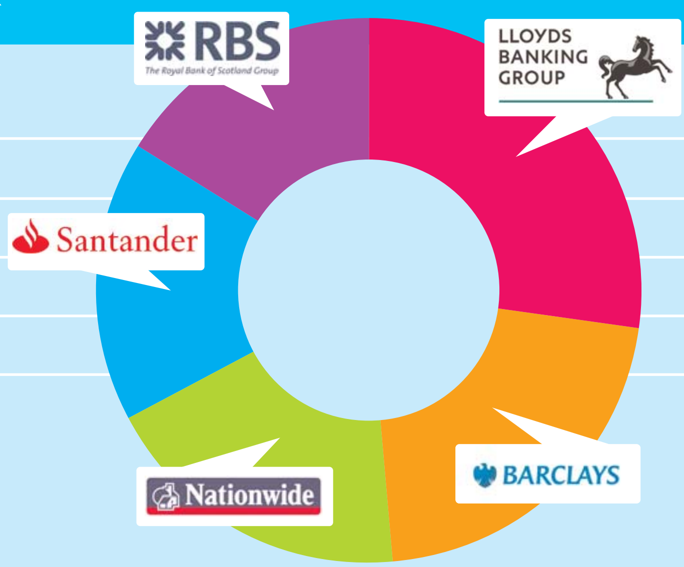

Table 1: The 5 large loan books to housing associations
Source: Tenant Services Authority – Private Finance Strategy - 2010

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It is important to prove creditworthiness to lending institutions. A number of large housing associations have decided to obtain credit agency ratings in order to issue bonds in their own name or otherwise demonstrate creditworthiness; this provides publicised scrutiny of the association and its financial model. Table 2 details current bond issues from the housing association sector.

Issuer	Coupon (%)	Maturity	Spread to LIBOR (%)	Rating
Affinity Sutton	5.981	2038	1.20	Aa2
Circle Anglia	7.250	2038	1.38	Aa3
Genesis	6.064	2039	1.48	A1
L & Q	5.500	2040	1.21	Aa2 / AA-
Hyde	5.125	2040	1.18	Aa2
Notting Hill	5.250	2042	1.22	Aa3
Sanctuary	6.697	2039	1.18	Aa2 / AA-
Harbour Funding	5.280	2034	1.10	Aa3 / AA- / AA
Haven (37)	8.125	2037	0.96	Aa3 / AA- / AA
HAF	8.250	2027	0.84	Aaa / AAA
HSL	8.375	2019	1.08	NA
RSL (Fin)	6.625	2038	0.92	AA- / Aa3
THFC (Indexed)	5.650 (real)	2020	-	NA
THFC No 1	5.125	2037	1.27	AA-
THFC No 2	6.350	2039	1.26	A+

Table 2: Social housing bond issues
Source: Evolution Securities – 8th October 2010

Recent bank lending trends have been away from long term loan financing, unless there is a repricing mechanism at say year 5 or 10. Having fallen from a peak of 250 basis points (bps) after Lehman's demise, spreads are now trending up to 150bps – 200 bps for longer maturities (20 years), where available. Currently institutional investors have a surplus of liquidity which is driving their appetite for medium and long term debt at increasingly aggressive margins.

The overall balance sheet for the housing association sector is stable and healthy with adjusted net leverage at 41.58%, interest cover is tighter (standing at an aggregated 113.1% for traditional housing associations)[5]; it should be noted that there are significantly differing levels across sub-sectors (the existing ownership housing co-operative sector is much less geared than sectors that have developed significant numbers of new properties over the last 20 years). The Tenant Services Authority estimates that there is £25 – 30 billion in available funding capacity to 2013 – 14 and currently a debt capacity of £2.9 billion[6], based on free cashflow available to service debt.

The Housing Finance Corporation

The Housing Finance Corporation (THFC) is an aggregating funder for housing associations with a credit rating of A+ / A-1. It is an Industrial & Provident Society that is controlled by a strong board with banking, financial and commercial experience.

The key components of its activities are:

- THFC acts as principal and borrows in its own name. It on-lends immediately; only to Registered Providers
- Funds borrowed are on-lent on similar interest and repayment terms thus ensuring that it is protected against interest rate risk
- THFC makes its own credit assessment of potential borrowers
- THFC's loans are fully secured and it is required to maintain historically conservatively set covenants
- Investors benefit equally from a floating charge over THFC's assets; primarily its secured loans to housing associations and its reserves
- THFC takes out a combination of fixed and floating charges over housing association assets in respect of loans
- Asset cover requirements are underpinned by a conservative valuation methodology; loan security must be valued at 150% of the loan secured.[7]

5 Tenant Services Authority – 2009 Global Accounts of Housing Associations – March 2010
6 Tenant Services Authority – Private Finance Strategy – 2010
7 The Housing Finance Corporation – Investing in Social Housing – May 2010

Financing social housing – a European perspective

Across Europe there is a range of debt financing models used to develop social housing; these are outlined in Table 3.

Country	Model	Brief outline
Ireland	**Public grants**	Centrally funded grants to approved providers for construction, statutory financial intermediary provides low interest loans for land acquisition, interest financed by central government, limited grants from local authorities.
England	**Debt & grant**	Debt finance raised against future rental cashflows (effectively supported by Housing Benefit) coupled with capital grant as well as discounted land and development contributions under "section 106" provisions.
France	**Savings scheme**	Tax free household savings scheme (CDC) finances off market loans to HLM providers alongside state and local subsidies, tax incentives and other loans. Land provided by local authorities and development contributions.
Austria	**Structured finance**	Long term low interest public loans and grants, combined with commercial loans raised via HCC Bonds and developer / tenant equity sustains tightly regulated form of cost rent limited profit housing. Promotion supported by municipal land policy and land banking.
Switzerland	**Co-operative finance**	Commercial loans, loans from a bond issuing co-operative, revolving loans, and own equity and supported by municipal urban policy and land banking. A liberal rent policy allows landlords to raise rents to recover costs, including changing financing costs.
Netherlands	**Revolving fund**	Replaced direct loans and subsidies with guaranteed capital market loans and rent assistance. Dutch Guarantee Fund (WSW) and Central Fund (CFV) provide security and assist to reduce financing costs. Associations are free to determine own investment strategy, asset base and surpluses intended to be used as a revolving fund to achieve social tasks.
Germany	**Tax privileged**	Federal government has withdrawn from direct supply support and shifted towards demand side subsidies. Municipalities develop their own programs and housing companies are private entities, with a variety of shareholders. Private investment in social housing is promoted via tax concessions. Rents and eligibility depends on level and duration of public subsidy.
Sweden	**Capital market**	Corporate tax exempt municipal housing companies have always been financed by capital market loans which were sometimes backed by municipal guarantees, grants as well the Ministry of Housing's own resources. In the past interest rates subsidies were provided by the central government but these have ceased.

Table 3: Funding strategies for social housing across Europe
Source: CECHODAS Housing Europe – Financing Social Housing after the Financial Crisis – January 2010

In England, debt is levered against a mix of grant and demand side subsidy (through Housing Benefit). Where debt has been guaranteed by the government (eg Switzerland and Netherlands) there is a marginal benefit in terms of pricing (in the Netherlands 50 - 70bps).

Rent setting

Charging rents at below market levels has been a key component of social housing and recent policy had focused on equalising rents across the various social landlords that operate at a local level. The Rent Influencing Regime structured social housing rents around property size and value and local income levels. Average social housing rents have increased over the last 20 years; between 1990 and 1999 real rent increased by over 30% in England[8], a trend that has continued since the turn of the millennium. It should be noted that social housing rents have been effectively constrained by the Rent Influencing Regime and the needs based approach to allocations.

These real rent increases have contributed to the increasing cost of Housing Benefit to the taxpayer, although by far the biggest contributor has been the increase in Housing Benefit paid to tenants in the private rented sector[9] which has increased because of the lack of availability of housing in the affordable social rented sector and rates of Local Housing Allowance (particularly in areas of high demand).

There are various different models for pricing social housing to new and existing tenants that operate across Europe as outlined in Table 4.

The Council for Mortgage Lenders note that: ‘There is a need to explore more fully the interaction between rent and Housing Benefit. Many in the housing sector see greater flexibility in rents as providing not only a more tailored rental offer but also helping to increase the capacity of housing associations to provide more. The value of this to the Government in terms of increasing private investment in new homes needs to be taken into account as part of the work going forward on welfare reform.’[10]

There is a significant opportunity to bridge the funding gap for new developments created by reduced (or no) grant if rent levels are allowed to be set proportionate to market rents or by allowing organisations the flexibility to set rents in line with tenants’ incomes (it should be noted that schemes should not be structured to rely too heavily on higher income tenants); set alongside land subsidies from local authorities.

The Comprehensive Spending Review announced on 20th October 2010 and the publication of its consultation on the future of social housing[11] signal the Government’s intention to explore a more flexible approach to rent setting, creating the ability to develop new affordable housing at rates around 80% of market rents.

8 Joseph Rowntree Foundation – Social Market or Safety Net – 2002
9 Chartered Institute of Housing & Building Societies Association – Wilcox – UK Housing Review 2009/10 – 2010
10 Council of Mortgage Lenders – 21st Century Welfare: Response to the Department for Work and Pensions Consultation – 2010
11 Local Decisions – A Fairer Future for Social Housing: Department for Communities and Local Government – November 2010

Country	Model	On entry	Income exeeds limit?
Austria	Cost-based	**Yes**	Rent unchanged
Denmark	Cost-based, 3.4% of building cost + bank charges	**No**	N/A
Germany	In some regions rents vary with household income	**Yes**	The municipality has the right to raise the rent for people above the limits. However rarely done, as it drives people with social capacity out of social housing estates.
France	Central government decrees maximum rents (vary by region). Cost based related to estate or owner	**Yes**	Tenant should pay small supplement (does not always happen in practice)
Sweden	Set by annual negotiation between landlords and tenants	**No**	N/A
Netherlands	Rent based on utility value of dwelling and target household income level	**Yes**	Rent unchanged
Hungary	Set by local authorities	**Yes**	Unclear
Ireland	Tenants pay % of income in rent	**Yes**	Rent rises
England	Rent Influencing Regime based on local earnings and the dwelling price	**No**	N/A

Table 4: Social housing rents in Europe
Source: London School of Economics – Social Housing in Europe – July 2007

There are a number of key risks around setting rents for the new intermediate tenure at up to 80% of market rents; whilst creating significant additional capacity in high value areas it does not work in many low value areas. There also remain some uncertainties around the Housing Benefit status of these new higher rents. There is a significant risk that rents will be subject to the Local Housing Allowance framework and where they exceed the Local Housing Allowance level, benefit payments will be capped. In addition there is no clarity about whether the maximum benefit caps for individuals and couples / families will still apply.

4 CHALLENGES TO THE CURRENT FINANCING MODEL

Investing in social housing

Housing associations are seen by investors as a low risk, attractive investment primarily due to them being regulated (and therefore being covered by a wider implicit government support) and non-profit distributing with long-term, stable, predictable cash flows underpinned by the Housing Benefit system and the Rent Influencing Regime.

All 3 of these key planks (regulation, Housing Benefits and rent setting) if amended in such a way as to negatively affect stability and predictability could have a significant impact on investors' risk appetite and therefore affect the cost of financing schemes.

The Housing Benefit system is once again under the spotlight since the election of the Coalition Government. Critics of the current system point to three key features:

(a) Those in receipt of Housing Benefit make no contribution to rent below a certain income level
(b) Those in receipt of Housing Benefit are insulated from rent rises
(c) The taper creates a poverty trap that acts as a disincentive for people to seek employment

The Government has recently published proposals through its 21st Century Welfare paper[12]. Concerns within the financial sector at these proposals are highlighted by the response of the Council of Mortgage Lenders:

'The proposals as set out in the consultation if applied to the payment of Housing Benefit will result in a loss of confidence and appetite for lending to and investment in the sector. This will end the existing highly effective public / private model for funding affordable housing. Increasingly reliance has been placed on investment through the capital markets as well as established bank lending to deliver new affordable housing for rent and home ownership. The concern is that the welfare reform proposals as set out could fundamentally alter the availability of capital market investment and further restrict bank lending for this market.'[13]

The regulation of housing associations has been the subject of a recent review with the key components of governance and financial viability (along with the regulation of the services provided) set to be transferred from the Tenant Services Authority to the Homes and Communities Agency by April 2012[14]; how the onset of Tenant Panels will impact on the future of regulation will be key to the success of the new regulatory approach.

Changes to the regulation of the financial sector

The financial crisis of 2008 has brought under the spotlight how banks and other financial institutions are regulated and has highlighted the shortfalls of the Basel 2 arrangements[15]. The Basel 2 Pillars of minimum capital requirements, the supervisory review process and market discipline failed to prevent the near collapse of the international banking sector.

12 Department for Work and Pensions – 21st Century Welfare – 2010
13 Council of Mortgage Lenders – 21st Century Welfare: Response to the Department of Work and Pensions Consultation
14 Department for Communities and Local Government – Review of Social Housing Regulation – October 2010