Brandon Lewis: “Make every pound go further”

New minister calls for more creativity and innovation

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Maximise capacity but contemplate the worst

The balance sheets of many housing associations were already strong before they received a further boost from the combination of low interest rates, relatively high rent increases and increases in asset values of the past few years. There is also broad political support both for increasing the volume of the delivery of new homes, especially affordable homes, and for greater engagement with residents to increase their participation in society and quality of life. If housing associations are to maximise their contribution to these goals, they need a clear understanding of their financial exposure and capacity under relatively normal conditions, as well as an appreciation of their vulnerability to stress scenarios, in which clear and rapid decision making may be needed to maintain viability.

A starting point for this exercise is to calculate the headroom against your loan covenants over the medium term, with allowance made for risk volatility (“a bad year”) and for unforeseen risks. The board should decide what proportion of the free capacity can be used and the division of investment between creating new assets, improving existing assets or giving social support to residents and the wider community in accordance with organisational priorities. One advantage of spending on social programmes is that, in the event that the organisation comes under financial pressure due to an adverse scenario, this expenditure can be stopped quite quickly. The reputational risk associated with such a decision can be managed by committing to projects only over a relatively short timescale.

It is worth emphasising that your financial capacity is not fixed but may be increased in a number of ways. As reported in this issue, Genesis and Circle Housing have achieved significant savings through reducing the number of contractors, cutting staff numbers and rationalising offices. Many associations are now taking a more commercial approach to asset management, considering whether each of their units could deliver more value if used for market renting or shared ownership or perhaps if the property was sold and the proceeds reinvested in a new home built to more modern standards. We should add that the products for which your properties are used must be appropriate to the customer. With some housing associations in London finding that the Affordable Rent product is not suitable for people in acute housing need, it may be necessary to use up some financial capacity by charging a lower rent in order to produce the social benefit of a sustainable tenancy, with residents better able to take on low paid employment.

In previous HRS Reviews, we have set out our ideas on mainstream and stress scenarios applicable to the sector. Aspects of two of our stress scenarios, The Bubble Bursts and The Divide Deepens, have been identified recently. In relation to the former, very high price rises in London over the past year are now combined with a less positive market sentiment, leading to fears that prices may begin to fall in the capital in the near future. The housing boom in the south east has generated a strong demand for labour and materials, with some housing associations and developers in the north and west of England reporting difficulties both in retaining bricklayers and sourcing bricks. We continue to advise that you should make prudent assumptions about sales values in your development appraisals and have in place contingency plans in case sales are delayed. Your exposure to the housing market should be limited by your capacity to maintain viability in a scenario in which sales are both significantly delayed and at much lower levels than expected.

In addition to a scenario driven by economic problems, we also need to consider the potential for adverse changes in government policy towards the sector. We are in a position to benefit from the Conservatives’ philosophy of transferring assets from the public sector to “the community” but is also at risk from their desire to transfer these asset to individuals through the Right to Buy programme. For LSVTs, the potential for assets to be lost has been increased following recent increases both in the percentage and the maximum financial value of discounts, as well as a reduction in the qualifying period. For all associations, there is a potential future risk that these greater incentives could be extended to the Right to Acquire, which relates to housing association properties built with public subsidy. It would be prudent to model the effect of such a change on your financial plans.
Leadership, Governance and Strategy

Public support for new housebuilding is increasing according to research published by the DCLG on 26th July. In 2013, 16% more people supported new homes being built in their local area than opposed it, compared with 18% more opposition than support in 2010.

As reported in HRS Review 57, Brandon Lewis has replaced Kris Hopkins as housing minister. Mr Lewis told Inside Housing that housing associations should “be more creative and innovative” and “think how we can make every pound go further to deliver more affordable homes,” while the decision that Mr Hopkins should retain responsibility for homelessness, separating it from the housing brief, was criticised by organisations providing housing and support to homeless people.

The government’s approach is to encourage a move from public to community or private ownership of housing, as well as a shift in the commissioning of services from central to local government. One of Mr Hopkins’ last acts as housing minister was to announce the creation of a £100 million fund to support the transfer of housing from local authorities to housing associations or other landlords. The fund will be available from next April to write off the debt associated with the stock to enable transfer to take place, subject to the support of tenants and evidence that the transfer would provide value for money.

On 5th August, the DCLG announced that Right to Buy discounts would increase in line with the Consumer Price Index, while the maximum discount for houses increased from 60% to 70%, which was already the level for flats. The maximum discount is now £77,000 except in London where it is £102,700. Under the Deregulation Act, the qualifying period had been cut from five to three years.

Meanwhile, the DWP is reportedly planning to commission research into the costs of supported housing to underpin its proposals, first set out in a consultation document in 2011, to devolve the funding for these services to local authorities. The CIH fears that these plans could lead to further funding cuts.

A further matter on which the government may need to make some decisions concerns the rents being charged on new housing association lettings, owing to the conflict between the government wanting more volume at higher rents and local authorities wanting a product that can help to house their homeless families. As the G15 group of London housing associations called on the DCLG to provide guidance on this issue, Affinity Sutton announced plans to set rent levels on the basis of income, rather than based on the property market, possibly as a percentage of the London living wage. Chief Executive Keith Exford told Inside Housing that councils tended to nominate the same people to Affordable Rent units as they had done to social housing properties at around 30% of the market rent, making it much more likely that the tenancy would fail.

As well as addressing the rents to be charged, associations must consider the suitability of their assets and whether they would generate more value through an alternative use. Writing in Social Housing, Neil Hadden of Genesis Housing Association (pictured) said the sector should take a more commercial approach to asset management, providing homes that are fit for the future, meeting the aspirations as well as their expectations of customers. Both Genesis and Circle Housing have developed asset management models, enabling them to consider potential alternative uses for their stock, including market rent, sale or disposal.

It is good to see that the public is now behind what research has been telling us for some time, that a step change is needed in housing supply to meet the needs of the population. Housing associations have already shown much creativity and innovation to support their share of this delivery despite large reductions in the level of capital subsidy. Social housing development is now cross-subsidised through sales, market renting and commercial activities, while organisations are working together to share costs, risks and expertise.

The direction of the current government carries both opportunities and threats to the sector. Further funding to support stock transfers could help associations to enlarge group structures and spread their central overheads over a larger number of units. However, an increase in the incentives for Right to Buy has the potential to erode the asset base of LSVTs, as well as reducing the overall stock of affordable housing. The transfer of responsibility for funding supported housing to a cash-limited budget held by the local authority could put further financial pressure on these services. These potential changes should be modelled in financial plans and appropriate strategy changes considered.
All associations should consider whether the rents charged for each of their rental products are affordable to the target group and have processes in place to ensure that properties are not let to households that would not find them affordable. This will require a discussion with local authorities to ensure that nominations are appropriate to the target group for the property.

We expect associations to be taking a much more active approach to asset management, having a broad plan in place for each neighbourhood and taking decisions as properties become void as to whether to relet on the same basis, change the tenure or dispose on the open market. There should be clear targets for improving the economic performance and social value of the stock, monitored by the Board.

Part of this social value will relate to the cost of heating the home. It may be better to dispose of older properties that are hard to heat and replace them with those built to modern standards. For the remaining units, the amount of fuel used can be cut by improving insulation while the unit cost can be reduced through the use of subsidised micro-generation (PV panels, air source heat pumps etc.) as well as through using economies of scale to negotiate a better rate from suppliers.
The increasing dependence on sales was illustrated by data from Inside Housing, which showed that, over the last two years, there had been a threefold increase in the number of homes built by housing associations for open market sale. Market sale accounted for more than half of the development output of both Genesis Housing Group and One Housing Group in 2013/14.

In 2012/13, the total surplus on sales was £637 million, accounting for 39% of the aggregate net surplus of 130 housing associations in a study by Social Housing. This consisted of £115 million from first-tranche sales of shared ownership properties, £127 million from “non-social housing development activities” and £396 million from sales of existing assets, which includes staircasing.

The strong housing market enabled the G15 group of London-based housing associations to reach an aggregate surplus of £1 billion, as house prices in the capital rose by 17% during the year. However, Robert Grundy of Savills told Inside Housing that “There is a need to be slightly careful about how long surpluses like this can be delivered in a market that can go down as well as up.”

As associations become involved in larger and more risky development and regeneration activities, there is an increasing use of joint ventures to share risk and to maintain separation of these activities from subsidised assets. The benefits of this approach were set out in Social Housing by Paul Buckland of Devonshires. Partnerships with private developers enable associations to benefit from their sales and marketing expertise while involving local authorities can provide access to low-cost finance from the Public Works Loans Board. Both parties may also possess substantial land banks.

Joint ventures are typically used as the vehicle to deliver PFI schemes, with five of such schemes involving housing associations having been signed off in the past year (see box). The two most recent schemes to reach financial close were Kent Excellent Homes for All, which has contracted West Kent Housing Association to provide housing management services to 238 homes for 25 years and the extra-care scheme in Stoke-on-Trent, which will be delivered by the Sapphire Extra Care Consortium, in which Manchester & District Housing Association has a 25% share.

A more unusual type of joint venture involved the ownership, by Circle Housing and investment firm Traderisks, of a portfolio of 1,023 private rented properties, £127 million from “non-social housing development activities” and £396 million from sales of existing assets, which includes staircasing.

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A common form of diversification for housing associations is to provide services under contract to local authorities, including housing-related support and homelessness/housing advice services. In August, it was reported that Aspire Housing had declined to bid for the housing advice service in Newcastle-under-Lyme, which it had run for five years, because it was no longer prepared to subsidise the service from its own reserves. The association said that it was reviewing all of its contracts with local authorities, with the requirement to produce a quantifiable social and/or commercial return, while it was also taking into account the potential cost of exiting the contracts before submitting tenders.

The government has been changing the basis of a number of its contracts, including those relating to its Work Programme aimed at getting people back into employment to “payment by results.” These are high risk for the contractor, since there is no guarantee of funding although significant expenditure may be incurred. In August, Bromford Support, once a strong backer of the scheme announced that it was to end its involvement with the Work Programme by April 2015. It said that its participation was unviable because prime contractors were creaming off the referrals most likely to get employment, leaving lower-tier contractors like Bromford to work with people with complex support needs, with a much lower chance of success.

Achieving value for money is vital to generate financial capacity, as well as being an important regulatory requirement. Two large associations have recently generated significant savings, the majority of which came from changes to procurement. Genesis Housing Association saved £19 million per year by signing long-term exclusive deals with single contractors for repairs and maintenance, legal and professional services (£12 million), reducing staff numbers by 120 (£2.5 million) and rationalising offices (£2.5 million). Circle Housing saved £5.3 million through reducing its maintenance contracts from 200 to just six, although customer satisfaction fell from 83% to 66% before recovering once contracts were embedded. During 2013/14 it also reduced the number of finance directors from eleven to four and launched a transformation plan aimed at saving £25 million per year.

A key decision that boards may need to take is whether to pursue legal action when in dispute with a third party. On 28th July, Stratford-on-Avon Council agreed to pay Heart of England Housing Association £3.6 million in an out-of-court settlement for failing to disclose details of noise insulation problems at a number of properties prior to stock transfer in 1996, which had caused the Association to incur additional costs. On 13th August, Mr Justice Bean ruled against Midland Heart and its Chief Executive, Ruth Cooke, who had sued the owners of the Sunday Mirror for defamation, after a story about a private landlord mentioned the association and Ms Cooke’s salary. The fact that the paper had printed an apology was taken into account in the ruling.

In a wider issue affecting reputation, there is a risk that stakeholders and the wider public will misunderstand the large surpluses generated recently in the sector. In an Inside Housing editorial, Martin Hilditch observed that associations should make it clear that the surpluses help “to attract investment, develop homes and invest in communities, among other things.” Urging the sector to embrace social media, Nick Atkin of Halton Housing Trust warned against “boring, staid, corporate glossy messages” from the communications team to deliver this message.
Welfare Reform

Of the welfare reform measures implemented to date, the most controversial change and the one having the most impact has been the bedroom tax. The policy continues to be the subject of legal challenges, of which one achieved some success during the last quarter. On 9th July, upper tribunal judge Mark Rowland ruled that a woman should not have had her benefit cut by Eastleigh Borough Council because she needs her spare bedroom for an overnight carer, even though the help she requires for her asthma condition was only required on a minority of nights. The Council said it would not appeal and would abide by the decision, although the number of people that might benefit from it is expected to be small.

While the Conservatives remain solidly behind the policy, the Liberal Democrats have shifted their position, as revealed by the Chief Secretary to the Treasury, Danny Alexander, who said on 17th July that the party now only supported the measure for those who had turned down a suitable offer of alternative accommodation. In response the Labour Party announced plans to force a vote on the issue during the autumn, saying that the change of policy would be meaningless unless the Liberal Democrats voted with them.

One of the expected impacts of the bedroom tax was that social landlords would find it more difficult to let larger properties, leading to an increase in voids. However, according to a survey of 67 social landlords by Inside Housing, the number of void properties on 1st July was 8,878, down by 9.7% on the 9,829 reported in July 2013. The average time to let an empty property fell from 25.3 calendar days in 2013 to 24.2 days in 2014, while the average percentage of homes empty fell from 1.22% in 2013 to 1.15% this year.

An aspect of welfare reform that has had an impact on fewer households than the bedroom tax to date is the overall benefit cap, but this might change following reports that the Conservative manifesto might include a commitment to reduce the overall benefit cap from £26,000 to around £18,000.

While the sector appears to have coped well to maintain and even improve arrears and voids since the introduction of the initial reforms, the risks associated with rent collection are expected to increase significantly as Universal Credit is introduced, along with payment to tenant as the default treatment of housing costs. Following the completion of a nine-month pilot involving 52 residents receiving their housing benefit rather than it being paid to the landlord, City West Housing Trust reported that it had achieved a rent collection rate of 99.18%. However the additional staff time involved increased management costs per unit from £178.94 to £754.88, which would be “unsustainable in the long term” if applied to all of City West’s tenants The Trust recommends that landlords move prompt-paying tenants onto direct payments early to free up resources to deal with more difficult payers.

A problem that has been identified among the areas that have begun to switch claimants onto Universal Credit, is that landlords do not know whether their tenants are receiving this benefit. To tackle this, a pilot exercise is planned involving Golden Gates Housing Trust in Warrington, under which tenants claiming Universal Credit would be asked to take a form to their landlord to verify their housing costs or to give consent for the Job Centre to contact the landlord. This will enable the Trust to provide appropriate support to ensure that rent is paid on time.
The economy

GDP Growth and Inflation

The Second Estimate of GDP, released by the ONS on 15th August, reported an increase in UK economic output of 0.8% in the second quarter of 2014, rising 0.2% above its 2008 peak.

According to Output in the Construction Industry, June and Q2 2014, released by the ONS on 8th August, there was zero growth in construction output between the first and second quarters of 2014, 4.8% higher than in the Q2 2013. Although housing output increased by 3.5% in the last quarter, “other new work [...] remained relatively weak in level terms and has recovered very little of the output lost during the economic downturn.”

Looking forward, the median of HM Treasury’s comparison of independent forecasts for August predicts growth of 3.1% in 2014, up from 2.9% three months previously, reducing to 2.5% in 2015 and 2.4% for the following three years.

The rate of CPI inflation has been unstable recently, averaging 1.7% over the last four months. The median prediction from the HM Treasury document is for CPI to be at 1.7% at the end of this year (down by 0.1% on April’s forecast), rising to 2.0% next year and 2.1% for the following three years.

The housing market

The six house price indices that we track show significant gains over the past year, although the market is now starting to cool. According to the standardised indices, which track the change in the value of a typical home, the increase varied from 6.4% on the Land Registry index, up from 5.6% three months ago, to 10.6% on the Nationwide House Price Index, down from 10.9% in April. Price increases are very much driven by London, which, according to the Land Registry’s figures, saw an increase of 16.4% in the year to June to £437,608, compared with a 13.8% increase in the year to March. The lowest annual rate of growth and the lowest prices were in the North East, where prices rose by 0.8% to £98,555.

The LSL / Acadametrics index of mean house prices, covering England & Wales in the year to July, shows a 9.9% rise, while the ONS index for England in the year to June shows an 10.2% increase. The ONS data shows once again the strongest performing market to be London (+19.3%), while the slowest growth was in the North East at +4.4%.

Looking forward, the latest RICS UK Residential Market Survey reported that at the national level, buyer demand had stabilised and sales growth moderated, although “price momentum for the time being remains firm.” Indicators in the capital were “going into reverse” with the balance of surveyors reporting a price rise
The rise in construction company liquidations in the first quarter of the year is a reminder that there is an ongoing risk from the financial failure of contractors. For the development activity, this could result in the delay in completing a scheme, possibly resulting in loss of Affordable Homes Programme Grant, in addition to the extra cost of employing a new contractor to finish the work. For ongoing repairs and maintenance, the failure of a contractor, particularly given the move towards single contractors covering large areas, could leave the association unable to meet its repair responsibilities. Associations should continue to monitor the financial health of their main contractors and to have in place contingency plans enabling a replacement firm to take over in a short time scale.

Business viability

According to the UK Labour Market Bulletin issued by the ONS on 13th August 2014, in the three months to June 2014, unemployment fell by 132,000 compared with the previous quarter to 2.08 million (6.4%). In July, 1.01 million people claimed Job Seekers Allowance, down from 1.12 million in April. However, average total pay including bonuses fell by 0.2% over the year to June to £477 per week, having risen by 1.7% in the year to March. CPI inflation in June was 1.9%.

The employment market continues to demonstrate an unusual position with unemployment falling but, at the same time, wage rates increasing by less than inflation. This position is finally expected to unwind next year. In the mean time you should continue to plan prudently for wage inflation and to consider whether further support should be made available to residents, both to help unemployed people to find work and to assist those in low-paid and / or part-time jobs to find more remunerative and stable positions.

down from 50% in May to 30% in June and 10% in July. **HM Treasury’s median forecast** is for prices to rise by 8.9% in 2014 (up from 8.0% in May), falling back to 5.6% in 2015, 4.9% in 2016, 4.3% in 2017 and 4.1% in 2018.

Figures published by the Bank of England on 29th July report mortgage approvals rising from 62,007 in May to 67,196 in June, after five successive months of falls. The number of approvals had previously peaked at 76,214 in January.

According to the Halifax Housing Market Confidence Tracker, the net percentage of those thinking it would be a good time to sell was +25 whereas the net percentage thinking it would be a good time to buy was +5, the first time since the inception of the poll that sentiment was in favour of selling rather than buying.

The Council of Mortgage Lenders reports that the percentage of mortgages in arrears by 2.5% or more declined from 1.24% in March to 1.18% in June, while there were 5,400 repossessions in Q2 2014 compared with 7,600 in Q2 2013. In June, **28,600 loans were made to first-time buyers** (up by 19% over June last year) to a total value of £4.2 billion, while average loan-to-value ratios remained at 80%. Gross mortgage lending rose from £16.7 billion in July 2013 to £19.1 billion in July 2014.

Business viability

There were 3,461 compulsory liquidations and creditors’ voluntary liquidations in England and Wales in the second quarter of 2014 (on a seasonally adjusted basis). This was down by 6.9% on the previous quarter and by 15.1% over the year. However, the construction sector saw 171 company liquidations in Q1 2014, compared with 117 in the previous quarter and 205 in Q1 2013.

Employment

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Using the median figures from HM Treasury’s latest range of independent forecasts, average earnings are predicted to rise by 1.6% in 2014, down from 2.2% in May’s forecast, and 2.7% in 2015. According to the same source, claimant unemployment is predicted to be 1.0 million at the end of 2014, down from 1.1 million forecast three months ago, falling to 0.9 million next year.
While short-term interest rates are creeping up slowly in the expectation that the Bank of England will raise the base rate early next year, medium- and long-term rates remain very low by historic standards and have fallen over the last quarter. Housing associations, regarded as long-term stable businesses should have access to 30-year money at below 5% per annum.

The precise margin charged on any new finance will depend on your ability to convince lenders / investors of the quality of your stock and of your management. The counterparty will also be interested in the extent of the security you are able to offer and whether the loan benefits from a guarantee from the government. Capital market transactions tend to be large so they will need to be combined with shorter-term revolving credit facilities from the banking sector to manage the peaks and troughs in cash requirements.

For the first time since the base rate was reduced to 0.5% in March 2009, the vote of the Monetary Policy Committee was split, with two members voting in favour of an increase of 0.25% but the remaining seven voting to maintain the current position, with the base rate at 0.5%. The market expectation is still for rates to begin to rise in the first quarter of 2015, reaching 2.5% by the middle of 2017.

The low probability of a rise in the base rate during the next three months is illustrated by the 3-month LIBOR rate, which, according to global-rates.com, crept up from 0.531% at the beginning of June to 0.554% on 1st July and 0.560% at the start of August. On 22nd August, it stood at 0.564%.

According to the Financial Times, on 22nd August, the ten-year swap rate was 2.57%, down from 2.70% at the beginning of the month and 2.84% on 1st July. On the same, the ten-year gilt yield was 2.40%, while the 30-year gilt yield, on which the pricing of many housing sector bonds is based, was 3.09%. These figures compared with 2.56% and 3.29% a month earlier.

In terms of the sources of finance, the margins applied by the banks to new loans in the sector fell by 0.5% between January and August, due to increased competition and reductions in funding costs. A further increase in the competition to supply funds to the sector is expected through plans by Denmark’s Danske Bank, currently the largest lender to housing associations in Northern Ireland, to begin lending to English housing associations this autumn. However banks generally remained unwilling to offer loans of terms of longer than ten years.

Longer term funding is however available from the capital markets, which continue to display a strong appetite for exposure to the sector. According to Brave New World, a report by JLL into institutional investment in the sector, investors are seeking long-term partners with high levels of interest cover, while the choice as to whether to invest will depend both on the quality of the stock and the quality of the management. Investors are keen to enter into inflation-based leaseback deals, which would be most attractive to medium-sized associations, according to the report.

Speaking at the CIH Conference in June, Richard Stonehouse of Jones Lang LaSalle said that he expected lease funding to “follow a similar growth trajectory” to bond finance over the next few years. However, Howard Webb of Capita pointed out that there was much cheap long-term funding available from the capital markets, while index-linked finance was not attractive to landlords because there was only certainty on rent increases for the next ten years. Meanwhile, the existing 35-year £20 million index-linked student housing leaseback deal with Legal & General, inherited by Sanctuary Housing Group when it took over Cosmopolitan, has been renegotiated on more favourable terms.

Another possible funding route is via debt facilities with insurance companies rather than banks. During July, Legal & General agreed three such loans with housing associations, with a total value of £105 million. The loan to Rooftop Housing Group is notable both because the association was able to use its extra care village in Gloucester as security and because the drawdown will be staggered, with the first £25 million to be drawn down on 31st October this year and the remaining £15 million in tranches of £5 million by 31st August next year.
This approach, together with the use of private placements, has seen more use over recent months than traditional bond issues. This is of concern to Adrian Bell of Canaccord Genuity, who told Inside Housing that the increasing number of private placements with higher credit spreads was reducing demand from investors for public bonds, increasing the price of publicly listed bonds by around 5 basis points. This was because investors could “just pick off the less sophisticated players when they go for a private deal.” Once again, Howard Webb of Capita put the case for the opposition, saying that it might be right to pay slightly more for a private placement if the amount of money required is less than would be required for a public bond or because of a requirement to structure the deal in a particular way.

One such transaction was completed between M&G Investments and One Vision Housing on 4th August, with a £40 million private placement, which took M&G’s investment in UK social housing to more than £4 billion.

One of the requirements for offering a public bond issue is for the borrower to obtain a public credit rating. Two of the ratings agencies have commented on the sector during the last quarter. On 26th June, Moody’s issued a report commenting on Altair’s recommendations following the failure of Cosmopolitan. The paper is supportive of most of these recommendations but raises some concerns about the proposed extension of the moratorium period in the event of a default from 28 to 56 days. This, it says, “would create a longer period of uncertainty for lenders.” It welcomed the requirement for an enhanced requirement for information on assets to be provided to the HCA and highlighted a number of factors mentioned in the report which it considers to be a current credit concern in the sector, including:

- Off balance sheet liabilities
- Non-core activities
- Over-ambitious development programmes
- Complex group structures
- The relationship between registered and unregistered parts of a group.

On 15th July, Fitch Ratings said that it would review the sector outlook for social housing in England before the end of the year, with a move from a negative to a stable outlook in prospect. The agency, which currently gives a two-notch uplift for the presence of the regulator, described the proposed changes to the HCA’s Regulatory Framework as “a positive development.”

Finally, there has been concern about the impact on loan covenants arising from the change in accounting policies contained in the new SORP, which is expected to be introduced on 1st April 2015, particularly in relation to impairment. In a Social Housing article, Jack Stephen, Chair of the SORP Working Party, said that the new SORP sets out indicators of possible impairment and it is only necessary to calculate an impairment charge if one of these indicators is satisfied. The new approach to valuation takes into account a unit’s service potential, which may be calculated by reference to the depreciated replacement cost of the asset, rather than on future cashflows. There is also greater flexibility around the definition of cash-generating units, which is the level at which impairment is calculated. Mr Stephen advised associations to begin negotiations with their lenders before the start of the new financial year and that lenders would expect to see the association’s long-term financial plan produced on the new basis.
Development and Growth

Those associations participating in the 2015/18 Affordable Homes Programme (AHP) now know the extent to which their bids have been accepted, although their commitments may be increased over the life of the programme through continuous market engagement. This round has been noticeable for the transfer of resources from large housing associations towards smaller players and a local authority sector rising from the ashes.

Close scrutiny of progress with the existing Programme should be maintained to ensure that all commitments are delivered before the “drop-dead date” of 31st March 2015. Further development opportunities that arise over the next three years could be put forward to take up the large part of the AHP that remains unallocated or considered for funding through other means. Where property values are higher, using part of a scheme for sales to cross-subsidise the affordable element is a viable proposition, provided that you have access to the appropriate sales and marketing expertise.

Your development strategy should also consider the extent to which you plan to use off-site manufacture on your future schemes. An increased commitment to this approach could improve the bidding position of the association with the HCA, which wishes to increase its use, especially in the continuous market engagement phase of the programme.
The planning system is a major constraint on the overall volume of housing delivery in this country, while also supporting the creation of new affordable housing through Section 106 agreements. If an association considers developing for market rent to be part of its role, it could be well placed to take advantage of any shift in the requirements of these “planning gain” agreements in this direction. It is worth emphasising that market rent is a different product from social housing, requiring an approach to quality and customer service that enables the association to compete with other landlords and enhance its reputation.

We can expect to see increasing competition to the sector going forward, both from private developers and from local authorities, although both of these could provide opportunities in terms of management contracts or development partnerships. You should maintain a dialogue with all key players to maximise your opportunities in this mixed economy.

On 13th June, the Chancellor George Osborne and the Mayor of London Boris Johnson announced the planned creation of twenty housing zones in the capital, in which “all unnecessary planning restrictions” would be removed from brownfield land to accelerate the construction of new homes. £400 million of funding will be made available (jointly from the GLA and from central government) to provide up to 50,000 new homes. Applications have since been submitted by the London Boroughs of Enfield and Haringey for development along the Lee Valley.

Speaking at the CIH Conference in June, Nigel Wilson of Legal & General called for changes to the planning system to boost housing development, such as allowing more Compulsory Purchase Orders and unlocking greenbelt areas. A report by Andrew Heywood published by the Smith Institute in July recommended that local planning authorities and developers should work together more co-operatively. This included early engagement between the parties before a planning application was submitted and work to reduce the delays and complexity associated with the Community Infrastructure Levy and Section 106 agreements.

In June, Fizzy Living, a market rent landlord partly owned by Thames Valley Housing Association, called for a relaxation of Section 106 requirements where the homes were intended for letting rather than sale, to enable build-to-rent developers to compete with build-for-sale developers for land. This approach was followed by Wandsworth Council, when it granted permission for a 510-unit development in Nine Elms, which is to include 114 homes of private rented housing, in addition to 76 affordable homes and £10 million towards the cost of further affordable housing.

As evidenced by the rising proportion of Affordable Homes Programme funding allocated to local authorities, the government is encouraging councils to play a greater role in the creation of new affordable housing. Graham Duncan of the DCLG told the NHF Development conference on 7th July that the government expects to see council house building increase “considerably” and encouraged those who do not have the ability to build themselves to partner with housing associations or house builders. On 8th July, Sir Michael Lyons, chair of the Labour Party’s review of housebuilding, told the Local Government Association conference: “We need to get local government back in the business of housebuilding.”

The interim report from the review by Natalie Elphicke and Keith House, published by the DCLG on 31st July, said that local authorities should be “centre stage” in supporting housing supply, which could be delivered through partnerships with the private and public sectors, such as local housing vehicles.

There is also competition for affordable housing from the private sector, with Kier Group announcing on 14th July that it intends to develop its own affordable housing, with funding for the developments based on the anticipated rental stream.

Changes in land use may support an increase in housebuilding, illustrated by an announcement by Tesco that it plans to release sufficient land originally planned for stores for 4,000 homes across the UK. This was in response to a change in customer shopping habits, including an increase in on-line shopping.

An increase in affordable housing could be brought about through the use of Low Income Housing Tax Credits, according to a report by Vic O’Brien of GreenSquare for the Winston Churchill Memorial Trust. The system, prevalent in the US involves investors receiving a tax credit, enabling them to make a return, provided that the homes are made available for low-cost renting for thirty years.
Many of the decisions that housing associations must take are for the long term, with implications well beyond the term of office of board members and the length of employment of the staff involved. This places an increased onus on those taking the decision to base it upon the best available information and to consider the difficulty and cost of withdrawing from the commitment at a later date. This applies both to the involvement in development and regeneration and to the methods of funding that involvement. Board members must understand the risks of the activity and the capacity of the organisation to manage them and withstand them should they occur before commitment.

You should consider putting in place an appropriate model to assist in maximising the potential of your assets. The complexity should be in proportion to the size of the business, the opportunities available and the threats it faces. It should also provide key data to enable the association to demonstrate return on assets in its Value for Money statement.

Regulation

As reported in HRS Review 56, the HCA published a report by Altair into the near collapse of Cosmopolitan Housing Group on 17th June. In response, the DCLG said it would consider whether any changes of legislation were needed to improve the effectiveness of the regulator when an organisation is in financial distress, while the HCA said that it would accept the report in full, including the recommendations. Matthew Bailes of the HCA told Social Housing that a failure to provide asset and liability information on a timely basis was likely to lead to a regulatory downgrade. In its Corporate Plan published in July, the HCA said it would develop templates to be used by the regulator to help to dispose of assets quickly to other associations during a moratorium period, before the lenders gained access to their security.

In an article in Inside Housing, Carl Brown made five recommendations for associations, to avoid following in the footsteps of Cosmopolitan Housing Group:

- A better quality of information should be provided to Boards to support decision making
- Boards must be confident enough to challenge the proposals of executives
- Plans should be adjusted if planning assumptions prove to be incorrect
- The formation of a “rescue squad” to take over ailing associations at short notice
- Complex funding arrangements should be avoided or kept to a minimum.

The consultation on a new regulatory framework closed on 19th August. The proposals include a requirement for stress testing, which should be “a key business tool that registered providers use in order to test whether their current and future business strategy is appropriate and the necessary risk mitigations are in place.”

One of the requirements of the new framework is for associations to hold an asset register, the requirements for which were described by Mervyn Jones of Savills in Social Housing. These included identifying all obligations arising from leases, supporting asset management decisions at unit and “place” level and assisting in the use of assets as loan security in a timely and effective way.

A further requirement that boards should provide assurance to the regulator that they have adhered to all relevant law was criticised because it was difficult for boards to ascertain that this was the case, particularly if involved in a legal dispute. Trowers & Hamlins lobbied for the wording to be changed for associations to “have regard to” the law or to report any non-adherence having an adverse impact.

Under the proposals, specific consent would be required from the HCA for:

- On-lending to unregistered or profit-making group members
- Finance not to be used for social housing purposes
- Finance raised on an index-linked basis
- Providers with unregistered parents
- Lending between associations not in the same group

Jonathan Walters told Social Housing that this was to enable the regulator to seek assurance that associations were managing the risks of these deals appropriately, not to prevent them from taking place. Associations are already required to obtain consent from the HCA for leaseback deals, of which eight were approved between April 2012 and June this year.

More positively for the sector, the proposed introduction of regulatory fees has been delayed until at least April 2016, after ministers failed to sign off the proposals in time for them to be introduced next year.
Regulatory Judgements

The HCA has issued 24 Regulatory Judgements in the last three months, of which six involved a change in the rating from the previous report. Only one of these constituted a downgrade, which was that issued in respect of Tuntum Housing Association on 30th July, in which its ratings for Governance and Viability were downgraded to G3 and V2 respectively. The trigger for the downgrade was a proposal by Tuntum to acquire and renovate a former local authority tower block, containing 129 flats. When the concerns of the regulator about the increase in the association’s risk profile and the complexity of the acquisition and funding arrangements were not adequately addressed by the association, it concluded that there were significant weaknesses in its growth strategy, financial planning and risk management, along with inadequate board scrutiny and challenge. The regulator had also not received sufficient assurance in relation to board skills, succession planning and structured renewal to support its greater risk appetite.

In relation to Viability, Tuntum “needs to ensure that it has a robust and prudent business planning and control framework” and “to strengthen its risk management to ensure that risks to the delivery of its financial plans are adequately identified and mitigated.” In particular, it was criticised for planning to use its overdraft facility to fund the acquisition of the tower block, while waiting for long-term funding to become available.

The only association to receive an upgrade to its Viability rating was BPHA which had scaled back its development programme since the last Judgement and put in place appropriate exit strategies to mitigate its housing market exposure, to be given a V1 rating. It had also restructured its derivative portfolio to reduce its mark-to-market exposure. In relation to Governance, which remained at G2, the regulator remains concerned that board pay is not proportionate to the organisation’s size or complexity, nor linked to the performance of specific duties.

Four associations received a governance upgrade from G2 to G1: Great Places Housing Group, Pierhead Housing Association, Cambridge Housing Society and the Peabody Trust. The main areas that had been addressed by the associations were:

- Board recruitment, succession, induction, appraisal, training and development
- The effectiveness of governance structures, including sub-committees
- Strategic and financial planning, taking account of the additional risks introduced through mergers
- Internal controls (including those to meet regulatory requirements)
- Strengthening the executive team and the role of the company secretary.

A further regulatory downgrade is expected in the near future after Aldwyck Housing Group was placed on the HCA’s watch list in July for a possible downgrade of its Governance rating. This followed a failure of governance that had taken place in August 2013 and was subsequently identified by Aldwyck. A spokesperson for the association told Inside Housing that “the group’s board and executive are co-operating fully with the regulator in their review.”
Mergers

- Wolverhampton-based Heantun Housing Association became a member of the Accord Group in June (see HRS Review 56).
- In July, Aldwyck Housing Group and Paradigm Housing Group announced that they were involved in preliminary discussions about a merger with the aims of improving service delivery, increasing the number of new homes in the area and providing greater value for money for customers. Previous merger discussions between the two organisations had been called off in November 2012 due to “prohibitive funding costs.”
- In July, Jephson Housing association and Raglan Housing Association submitted a merger application to the HCA. The business case for the merger identified potential savings of £5.8 million per year, producing the capacity for an additional 1,272 homes.
- On 13th August, north-eastern regional group Isos Housing announced that the regulator had given approval for Cestria Community Housing to become part of the Group. The merger, which is set to take place on 1st October, is expected to generate £6 million of savings in the first five years, plus £2 million per year thereafter.

Executive comings and goings

- In June, Sara Thakkar, Chief Executive of Wandle Housing Association, resigned her position for undisclosed reasons, following an internal investigation. Asset Investment Director, Alan Townshend, was appointed as Interim Chief Executive.
- On 18th July, Matthew Fox resigned as Chief Executive of Viridian Housing with immediate effect, while Matt Cooney, currently Chief Executive of Asra Housing Group was named as Chief Executive Designate for the VA Housing Group to be established through the merger of the two organisations.
- In July, Plus Dane appointed Barbara Spicer, currently interim chief executive at the Skills Funding Agency, as Chief Executive, in succession to Ken Perry who had resigned following a downgrade to the association’s Governance rating last August.