DCLG consultation

Increasing the borrowing capacity of stock transfer housing associations

CIH response

May 2015

Emailed to: lsvt.valuation@communities.gsi.gov.uk

Introduction

1. The Chartered Institute of Housing (CIH) is the independent voice for housing and the home of professional standards. Our goal is simple – to provide housing professionals with the advice, support and knowledge they need to be brilliant. CIH is a registered charity and not-for-profit organisation. We have a diverse and growing membership working in both the public and private sectors, in 20 countries on five continents across the world. Further information is available at: www.cih.org

2. CIH welcomes the opportunity to comment on the consultation proposals to increase the borrowing capacity of stock transfer housing associations. There is a housing crisis that requires urgent action, in terms of increasing the development of housing across all tenures, including a growing need for many more affordable homes. This is highlighted by the percentage of in work households that require help with rental costs which has increased to 22% of the total.[i] So measures that enable housing organisations to provide increased funding through best use of their assets can make a valuable contribution at a time of ongoing public funding constraints.

3. CIH supports interventions that can enable stock transfer housing associations to increase their borrowing capacity to meet their ambitions to provide more and better homes for their local communities, where this is done with a robust approach to risk management, and responds to local needs. We believe that there are appropriate mechanisms to protect the interests of the tenants of these associations, such as the regulatory role of the Homes and Communities Agency (HCA) and its powers over disposals (which would remain even if section 133, under consideration in the consultation paper, is removed). The housing association sector is one that has successfully managed its businesses and potential risks, with a strong financial track record, and we welcome the paper's consideration of how to address constraints on their capacity.

Q1. What are the main constraints on the stock transfer providers' financial capacity in the period after transfer?

4. The purpose and focus of stock transfer associations in the earliest stages is financing the purchase and improvement of the stock, meeting the obligations set out in the process of stock transfer to existing tenants. Financial capacity is limited by the high level of debt taken on, the costs of major repairs programmes, and therefore lack of reserves in the early period after transfer. The

consequences of section 133, giving guarantees to retain homes as social stock, means that lenders reflect the restriction this puts on their freedom of action in the case of a default, in the valuation process. This contributes to the use of existing use social housing valuation, as compared to mainstream housing associations' typical valuation (market value subject to tenancies). There is also the need for organisations to establish a track record on effective business management and repayment, particularly where the transfer organisation is a new entity rather than part of an existing group structure.

Q2. How do these change as the provider matures and passes peak debt?

5. As transfer obligations are met, organisations can look to build up reserves and diversify their business. In many cases, as well as benefitting from increased property values, future costs, particularly for maintenance, can be reduced due to the level of improvements made. Often, as organisations approach peak debt, they are already looking at how they can utilise their resources to develop new homes. This ambition is constrained by the level of available security (due to the valuation measure) and other lending restrictions, such the requirement for the lender to approve business plans annually and agree any variations. Several members reported the difficulty they experience in conversations with lenders, in developing new lending agreements that support this transition from the initial business plan to a more diverse role. This is more so following the financial crisis of 2007-8, and the requirements on lenders to ensure liquidity, which has made many lenders more risk averse.

Q3. What are the main reasons why lenders prefer a lower value for transferred stock?

6. The asset base provided as security for loans is the 'backstop' for lenders; measures that limit their ability to realise those assets easily in case of a default increase the level of risk in their calculations and the pricing of loans. Section 133 Housing Act 1988 is one of those limitations, in that it restricts how homes transferred to an LSVT organisation can be disposed of. It is a factor in the valuation measure for LSVTs being the lower existing use social housing, compared to market use subject to tenancies common for traditional housing associations. This means LSVT stock is valued at 30-40% of market value compared to 60% for traditional housing associations under the market value subject to tenancies.

7. Section 133 aimed at securing the future of homes transferred by limiting any disposals. However, the HCA has powers over the disposal of social housing stock under section 172 of the Housing and Regeneration Act 2008, and through its regulatory role and its requirement to protect social housing stock and public investment. Arguably therefore, as LSVT associations mature and demonstrate

their capacity and reliability to manage debt and meet the requirements of lending covenants, there is less need for the additional security of section 133, and its removal could support increased flexibility in negotiations between associations and lenders. Not all transfer associations would necessarily seek to change their borrowing agreements particularly where these were pre-financial crisis (and often on more generous terms) but it is a measure that would enable such flexibility where appropriate.

8. It may be appropriate that, in the case of future stock transfers, section 133 should still be applied for a transitional period, whilst the association meets the transfer obligations and develops its track record and relationship with lenders, although this may not be necessary where an existing association is the transfer recipient.

Q4. Following a transfer of stock, what could encourage lenders to release security for the raising of finance at an earlier stage?

9. Measures that support stock transfer associations to service their debt and demonstrate their reliability in meeting lending obligations will give additional assurance to lenders, such as reduced costs for development through subsidy or guarantees, and certainty over ongoing income streams. These are important considerations, alongside the removal of restrictions such as section 133. Where stock transfer organisations are part of larger group structures, the track record of repayment and governance arrangements could encourage greater flexibility, although responses from our members are varied on how well such arrangements help negotiations with lenders.

Q5. What would lenders need in order to be comfortable with a higher valuation?

10. Lenders are already familiar with the higher valuation measure of market value subject to tenancies, as this is used for traditional housing associations. Therefore lenders would apply the same principles to their lending decisions, using a different but still familiar methodology. Additional measures that reduce the risk for lenders would also enable them to accept a higher valuation, such as security of the asset base and income streams of organisations. This was raised by respondents in the context of the extension to Right to Buy and changes to social security measures which may increase lenders' concerns and reduce the potential benefit of removing section 133.

Q6. What would encourage lenders to allow stock portfolios to be broken down into optimised lot sizes to attract valuation premiums?

11. Stock transfer organisations and lenders would consider this potential approach to increase valuations, but many were concerned that it would increase costs overall and therefore not provide the increased capacity that the

government and transfer organisations are seeking. It may be a productive approach for some organisations as they diversify their activities.

Q7. What are the main reasons why surveyors value transferred stock at a lower percentage of market value?

12. At initial valuation on transfer, stock condition leads to lower valuations, but overall, the approach to valuation taken by surveyors is set by the lenders' requirements.

Q8. What scope is there for changes to the assessment approach to result in increased property values?

13. Changing the assessment approach and enabling stock transfer associations to use market value subject to tenancies, in line with traditional housing associations, means a significant increase in potential borrowing capacity, typically from 30-40% of market value to 60%. Not all organisations may choose to use this; however, it gives increased opportunity to address the pressing need for new homes in locations of high demand. The NHF has provided several examples in its briefing for the spending review (November 2014).

Q9. What steps could the government take to unlock additional financial capacity amongst stock transfer providers?

14. Either the removal of section 133, or the development of a general consent by HCA, in line with that offered regarding section 172 of the Housing and Regeneration Act 2008, would address the issue that is the main concern of this paper. Many stock transfer organisations are at a stage where this would enable them to lever in significant extra funding which could deliver more new homes.

15. However, it is not the only measure that government could take to increase the lending capacity of stock transfer associations, or to provide assurance to lenders in order to support higher valuations. Measures to provide certainty for the associations' long term asset base, and their ongoing income streams would all contribute. Other measures could help to mitigate risks, such as:

- Increased grant levels
- Use of guarantee schemes to support increased lending focused on development of new homes
- The provision of discounted public land to reduce development costs

Q10. What would be the possible implications for tenants from any change?

16. Tenants have assured tenancies that provide significant protection. The sector has no significant history of default, and the role of the HCA itself provides additional support, and the opportunity to intervene in cases of concern. The HCA

also has powers over the disposal of stock. Taken together, all provide protection for existing tenants in terms of security of tenure for existing tenants. The proposed change to valuation assessments, alongside others that could support increased borrowing capacity, provides opportunities for more new homes and therefore benefits for potential future tenants currently on waiting lists or without an alternative option to private rent.

17. For further information please contact:

Sarah Davis, Senior Policy and Practice Officer, 024 7685 1793.

[i] NHF (2014), Broken market, broken dreams