Introduction to Housing Association Finance (capital)

June 2020

Ridley Court, a development in Penrith, Cumbria, by Impact Housing Association.

Introduction

This briefing paper considers the capital aspects of housing association finance in England. We have also published briefing papers on the revenue and technical aspects that may be of interest to readers.

Capital Expenditure

Accountants define capital expenditure as being on items that give a benefit and retain their value over several years. There is also an accountancy concept called ‘materiality’ that excludes items of small value from the definition. Capital expenditure in the private and public sectors is often financed by loan, firstly because resources are often not available ‘up front’ to finance it, and secondly so as to spread the cost of the capital expenditure across all the years during which the benefit is experienced.

The definition of capital expenditure in Housing Associations follows the GAAP (Generally Agreed Accounting Practice) definition. Examples of capital expenditure include:
- Constructing or acquiring a new dwelling unit
- Upgrading the rent category of an existing dwelling through improvement
- Reducing future maintenance costs through major repairs or renewals
- Extending the economic life of a dwelling through major repairs and renewals

Housing Associations value their housing based on Historic Cost or 'Existing Use Value for Social Housing'. 'Existing Use Value for Social Housing' is defined as the lower of replacement cost or the recoverable amount. Replacement cost is what it would cost to replace the dwelling. The recoverable amount is what it is thought another Housing Association would pay to buy the dwelling. It is usually calculated by taking the market value and reducing it by a proportion called the 'social discount'. This recognises the fact that they hold their assets for a social purpose rather than a commercial one.

Dwellings owned by Housing Associations are treated as tangible assets rather than investment assets and so are usually depreciated over an assumed life of sixty years. However, the cost of land and the part of the scheme that is funded by grant is not depreciated.

Housing Associations sometimes reduce the value of their housing assets in the balance sheet because of 'impairment'. Impairment is where it is thought that the actual value of a dwelling is lower than the 'book' value that is calculated by depreciating the original cost. In these cases the value is reduced as appropriate. Situations that may cause impairment include:

- Changes in the demand for housing
- Adverse statutory or regulatory changes
- Current or anticipated deficits on the income and expenditure account
- Changes in expectations making a building functionally obsolete (for example, sheltered schemes with shared facilities)

Decent Homes Standard

The government's Decent Homes Standard applies to Local Authorities and Housing Associations. However, it is seen as a basic standard and most social landlords aspire to provide a higher standard for their tenants. A decent home is defined as one that:

- Is above the current statutory minimum standard for housing
- Is in a reasonable state of repair
- Has reasonably modern facilities and services
  - Kitchens less than twenty years old
  - Bathrooms less than thirty years old
- Provides a reasonable degree of thermal comfort

Sources of Capital Finance

Housing Associations have access to several sources of capital finance as shown below:

- Accumulated reserves / Revenue Income
- Social Housing Grants – National Affordable Housing Programme
- Private Loans
- Capital contributions
- Asset sales

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Statement of Financial Position (Balance Sheet)

The balance sheet shown below is taken from the aggregate of all Housing Association accounts with over 1,000 homes for 2018/19:

	£bn
Fixed Assets	
Housing at cost & valuation	150.8
Other	3.2
Investment properties	6.2
Other investments	1.9
Total	162.0
Current Assets	
Properties for sale	7.1
Debtors	2.0
Cash and short-term investments	7.3
Other	1.5
Total	18.0
Current Liabilities	
Short-term loans	1.9
Deferred Capital Grant	1.4
Other (inc. overdraft)	5.8
Total	8.0
Net Current Assets	9.9
Total Assets less Current Liabilities	171.9

	£bn
Long-Term Creditors and Provisions	
Long-Term Loans	74.5
Finance leases	0.6
Deferred Capital Grant	36.6
Other creditors	4.4
Provisions	4.0
Total	120.0
Reserves	
Income & Expenditure	40.6
Designated & Restricted Reserves	-0.6
Revaluation Reserves	11.9
Total	51.9
Total Loans, Provisions & Reserves	171.9

It is not surprising that housing associations' fixed assets consist mainly of housing. Housing is either valued at cost or at valuation. If a valuation results in an increase in value, the gain in value is shown on the balance sheet by adding to the revaluation reserve. Other fixed assets include operational properties such as offices and depots as well as investment properties and other long-term investments.

Current assets include cash and other assets that should be converted into cash within a year. These include properties for sale, debtors and short-term investments. Current liabilities are liabilities that fall due to be paid within a year including short-term loans, deferred capital grants (grants received but due to be applied in the following year) and overdrafts. Most housing associations manage their finances so that current assets exceed current liabilities as this means that cash is likely to be available to meet liabilities as they fall due.

Long-term creditors and provisions include long-term loans that are taken out principally to fund the construction and acquisition of new dwellings. They also include grants received to fund the construction and acquisition of new dwellings. Some capital is also financed by finance leases. Provisions are sums of money set aside to meet specific future liabilities.

There are three types of reserves. The income & expenditure reserve represents surpluses on the income & expenditure account that have accumulated over the years. Designated and restricted reserves are set aside for specific purposes. The revaluation reserve records increases in the value of assets that have arisen because of increased valuations (see above).

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The financial position of housing associations in 2019 can be summarised as follows:

- Strong balance sheet and continuing investment
- £12.1billion invested in new supply (up 12% on the year)
- £13.5billion of new loan facilities
- £27billion undrawn facilities
- £33billion of future capital commitments (up 15% on the year)

During the four years between March 2015 and March 2019 Housing Associations' have increased the value of their housing assets by £7.8billion from £164.1billion to £171.9billion – an increase of 4.8%. This increased value was funded as follows:

	£bn
Fixed Assets	
Housing at cost & valuation	5.7
Other	0.1
Investment properties	0.6
Other investments	0.2
Total	6.6
Current Assets	
Properties for sale	1.7
Debtors	0.1 -
Cash and short-term investments	0.3
Other	0.1 -
Total	1.8
Current Liabilities	
Short-term loans	0.2
Deferred Capital Grant	0.0
Other (inc. overdraft)	0.2
Total	0.4
Net Current Assets	1.2
Total Assets less Current Liabilities	7.8

	£bn
Long-Term Creditors and Provisions	
Long-Term Loans	4.4
Finance leases	0.0
Deferred Capital Grant	0.9
Other creditors	0.7 -
Provisions	0.8
Total	5.4
Reserves	
Income & Expenditure	2.6
Designated & Restricted Reserves	0.1
Revaluation Reserves	0.3 -
Total	2.4
Total Loans, Provisions & Reserves	7.8

In effect, the increased housing has been funded as follows:

	£billion
Long-term loans	4.4
Increased accumulated surpluses	2.4
Grants	0.9
Other variations	0.1
Total	7.8

Issues that affect housing associations include:

- The government focus on home ownership encourages associations to build homes for full or shared ownership
- Less external funding for community investment means reduced activity or cross-subsidy from housing activities

- Housing benefit restrictions could make extra care elderly schemes less affordable to people on benefits

Example Balance Sheet

The balance sheet of the example Housing Association is shown below:

	£,000
Housing Properties	174,590
Less Depreciation	19,318
	155,273
Other Fixed Assets	1,163
	156,435
Cash	2,586
Debtors	1,336
Current Assets	3,922
Creditors	5,064
Net Current Liabilities	1,142
Total Assets less Current Liabilities	155,293

	£,000
Long-Term Creditors	63,086
Capital Grant	83,738
Sub-Total	146,824
Revenue Reserves	8,469
Long-Term Creditors and Reserves	155,292

The balance sheet includes the same items as are shown above. Unusually, this housing association has net current liabilities but can meet its liabilities as they fall due because it has unused overdraft facilities.

Accumulated Reserves

Housing Associations retain their revenue surpluses in reserves. These can be spent either on enhanced services or investment in new affordable housing. Housing Associations effectively set up ‘sinking funds’ including ‘designated reserves’ that are earmarked by the Board for specific purposes and ‘restricted reserves’ that have external restrictions (for example, because of the requirements of a funder). Reserves are often misunderstood in that they are seen as resources that are unused. In fact, housing associations use their reserves to finance their assets (mainly housing) and only a proportion are held as cash.

Housing Associations have accumulated reserves of £52billion. It is often suggested that these could be used to fund new build. However, the reserves are already used to support assets. The question is whether cash-backed reserves could be used to fund new build

National Affordable Housing Programme

Social Housing Grant is distributed to Housing Associations by Homes England and the Greater London Authority through the National Affordable Housing Programme.

Social Housing Grant is a subsidy that enables the Housing Association to develop properties and then to let them at below market rents. The Regulatory Code requires that a Housing Association carry out an appraisal exercise prior to applying for Social Housing Grant and as part of this the Housing Association needs to assess the whole-life costs and benefits of a proposed development. Social Housing Grant:

- Covers a proportion of total scheme costs (balance is funded internally or privately)
- Is set as predetermined amount for each scheme

- Covered all the costs of a scheme before 1989 but since then there has been 'mixed funding'

Standard assumptions for development strategies are that:

- Social Housing Grant (where available) will fund up to 30% of development costs
- Surplus of rent income over management, maintenance and major repairs costs will fund borrowing
- Borrowing and Social Housing Grant will be insufficient to meet all development costs
- Additional subsidy is required from:
  - Housing Association reserves
  - Market sales or rents
  - Contributions from partners

One housing association has funded its development as follows:

	£million
Housing	133.0
Capital Grants	78.4
Long-Term Loans	47.0
Accumulated Surplus	4.9 *
Other	2.7
Total	133.0

* The accumulated surplus is different to the cash balances

The association's future strategy is influenced by:

- Grants being now very limited
- 'Gearing' prevents borrowing more than 67% of capital grants and accumulated surplus (£55.6million is therefore the limit). They therefore need to raise the gearing or remove it as a constraint.
- The continued appetite for development
- The capacity to build surpluses to fund development

Shared Ownership and Affordable Homes Programme 2016-21

The Shared Ownership and Affordable Homes Programme 2016 to 2021 is intended to increase the supply of new shared ownership and affordable homes in England by March 2021. Published in April 2016 by the Homes and Communities Agency (now Homes England) it makes £4.7billion of funding available to increase the supply of new shared ownership and affordable homes.

In the foreword, Greg Clark MP, then Secretary of State for Communities and Local Government wrote:

"A Shared Ownership home allows the purchaser to buy a share in the equity while paying rent on the non-purchased share. For many people, this is a chance they didn't have before to get on to the housing ladder – and to go on to purchase further slices of equity. Since 2011, nearly 41,000 affordable homes have been made available through Shared Ownership. Recognising the level of public demand, we want to greatly expand supply."

The affordable housing programme for 2016 to 2021 was announced in January 2017. Most of the resources in the programme are for low-cost home ownership and there were some resources for affordable rent although there were none for social housing.

The £4.7billion of capital grant is intended to provide:

- 135,000 homes for Help to Buy: Shared Ownership;
- 10,000 homes for Rent to Buy; and
- 8,000 homes for supported and older people's rental accommodation.

However, other than a 5% share of the funding available for specialist accommodation there is no provision for housing for rent. According to the Royal Institute of British Architects this:

"Marks the end of an era for the social housing sector and a decisive government shift towards support for home ownership."

Local authorities, housing associations and private providers can all access grants under the government's affordable housing programme that contribute towards the cost of new development. This programme is administered by the Greater London Authority in London and by Homes England in other parts of England.

Housing associations in England outside London that continue building for rent now must rely on partnership funding or private development finance. However, in London where the Greater London Authority manages the scheme, building for rent continues to be supported.

Further funds are being allocated by Homes England through a process of continuous market engagement.

Homes for Londoners

London Mayor Sadiq Khan (Labour) has secured £3.15billion in government funds to help start building at least 90,000 affordable homes by 2021. This is intended to help Londoners who would otherwise struggle to rent or buy. It's part of 'Homes for Londoners', the Mayor's work to tackle London's housing crisis. The Mayor and Government have agreed at least 58,500 of this will be a combination of London Living Rent and shared ownership.

Homes funded in this programme are expected to be primarily composed of three affordable products. The types of affordable homes the Mayor is funding include:

- London Affordable Rent - for people on low incomes
- London Living Rent - helping Londoners on average incomes save for a deposit to buy their first home
- London Shared Ownership - for people who want to buy but can't afford the open market

Other products may be funded under the Mayor's programme where they are genuinely affordable to Londoners. They may also be funded by providers' own resources or secured through the planning system. Existing pipeline schemes may have affordable housing tenures fixed already, in which case there will be some flexibility during the transitional period.

The Greater London Authority funds affordable housing through three different routes:

- The Approved Provider route, with a single set grant rate for London Affordable Rent at or below the benchmarks, and a different set grant rate for both London Living Rent and London Shared Ownership;
- The Developer-led route, with a single set grant rate to increase the level of affordable homes provided on section 106 sites;
- Negotiated grant rates mainly for supported and specialised housing, and for London Affordable Rent at levels above the benchmarks.

The allocation to London represents 67% of the allocation for England as a whole, compared with the 40% that was allocated to London during the previous round. Of the £3.15billion that has been allocated; £2.171billion is available for the Mayor's Homes for Londoners 2016-21 programme; £579million is required for affordable allocations that had already been made; and £400million has been allocated to the Housing Zones Programme.

An Example of Development without Grant

Impact Housing has built a scheme of fifteen units in the village of Grasmere in Cumbria for Social and Affordable Rents. The land is in the grounds of the local Youth Hostel and the Youth Hostel Association will recycle the proceeds of sale into upgrading the facilities for visitors.

The mix of properties includes two-bed maisonettes, two and three bed houses and a two-bed bungalow, all for people with a local connection to Grasmere.

The scheme, that cost £1.7million to build, received Planning Permission following a long consultation period. Impact worked in partnership with the Lake District National Park to design the scheme and a very successful open evening was held in the village hall, where the plans were displayed. There was a good turnout from local people interested in the proposals and from prospective tenants.

The scheme was built without Government funding, the first in a new Impact Housing non-grant model'. It started on site in summer 2012 with a completion date in early 2013.

The Lakeland Housing Trust purchased two units for affordable rent. This assisted with the funding of the scheme, alongside £60,000 from South Lakeland District Council. The balance was raised by Impact Housing and paid back through rents.

The scheme is attractive and incorporates design priorities highlighted by existing tenants. These include: Parking; Private outdoor space; Drying areas; Good storage levels. All properties will have low running costs because of a range of energy saving measures: Easy to operate central heating; Low water use appliances; High levels of insulation.

The properties have photovoltaic solar panels installed, with feed in tariffs ensuring lower running costs for tenants.

Treasury Management

Treasury Management is the activity of managing the Housing Association's cash flows so that the Housing Association remains in funds and can afford to meet its liabilities as they fall due. Specifically, Treasury Management:

- Provides the financial resources necessary for the Housing Association to achieve its purposes
- Manages the associated risks (organisational and financial) that might threaten its ability to achieve these objectives
- Manages the financial assets in a way that ensures that they maintain their value.
- Manages the financial liabilities in a way that ensures that they remain affordable

A Housing Association agrees a Treasury Policy Statement that includes:

- The limits of the approved treasury management activity
- How the financial management strategy is formulated
- The approved methods of raising capital finance
- Approved sources of finance
- Policy on interest rate exposure

- Policy on external cash managers
- Delegated powers
- Review and reporting arrangements

The success of the cash management strategy depends on balancing the need to optimise the position on paying or receiving interest with the need to have sufficient funds available to finance transactions. Housing Associations normally borrow at a margin over a reference rate such as the London Inter Bank Offer Rate (LIBOR).

Private Loans

Private loans are a major source of finance. Usually loans are long-term at fixed rates of interest. Housing Associations typically borrow £6billion a year from the private sector, with 80% being provided by banks and building societies. Total loans outstanding were £74.5billion on 31st March 2011. Usually loans are long-term at fixed rates of interest. In planning and managing their loans Housing Associations pursue a mix of objectives including:

- Cheapness – low interest rates
- Certainty – fixed interest rates
- Coherence – matching of cash flow with debt servicing
- Renewability – seeking options to extend loans
- Redeemability – seeking options to cancel loans
- Security – seeking a balanced portfolio in terms of loan types and terms

In negotiating loans Housing Associations consider their legal and managerial competence including powers to borrow, ability to service debt and the relationship of new loans to loans already outstanding. Lenders usually seek 'covenants' – that is, conditions regarding the financial performance of the Housing Association. Housing Associations also consider matters including collateral and cover ratios – the links between assets and income flows, the relationship between fixed and floating charges and the interest cover ratio.

Loan covenants related to gearing are common in the loan agreements of traditional housing associations. It is calculated in several different ways. All calculations measure the proportion of debt to equity in a provider's financial structure. A common definition is to measure loans as a proportion of the sum of grant and reserves. Most loan agreements that use this definition set a maximum gearing level of between 60% and 80%.

Loans Since 2008

Bank lending is still fragile as a result of the banking crisis of 2008. However, nothing has fundamentally changed in the housing association sector. There is still government support, regulation and robust cash flows; and banks have not made losses in the sector. However, this has not stopped banks from leaving and re-entering the housing association market. Those banks that remain in the market though have increased their margins and are looking to renegotiate loans.

The problem that the banks have with housing association loans is the rate of interest. Before 2008, most housing association loans were at rates of interest only 0.4% above the London Interbank Offer Rate whereas banks are now looking to charge interest at about 1.5% above this rate. This is still below the level of interest on most commercial loans. This is influencing the ability of housing associations to afford loans for developments and improvements.

Banks have moved from long-term loans to short-term loans. Banks will generally now only lend for a five- or ten-year term and insist on re-pricing options even when they are willing to lend for a longer term. Most housing association loans are currently long-term. However, large housing associations with large debt portfolios can cope with shorter term loans. This method of financing is especially problematic for stock transfer associations as they are looking for a large loan to fund a long-term project.

In assessing the credit worthiness of a housing association, a bank will pay attention to governance. The nature of the Board and Executive team play a big part in the bank's analysis of a housing association. This affects the credit rating and the price. The quality and robustness of the business plan and its assumptions and sensitivities are also factors, as are the quality of financial information and the condition of the stock.

The Housing Finance Corporation is an independent, specialist, not-for-profit organisation that makes loans to Registered Social Landlords. It funds itself through the issue of bonds to private investors and by borrowing from banks. It therefore acts as an aggregating financial intermediary, so diversifying risk for those who make funds available to them and reducing the cost and standardising the loan terms for those Registered Social Landlords that borrow from them.

The sector holds a third of its debt at floating rates and two thirds at fixed rates. This means that the sector has not been able to take full advantage of the low interest rates currently available on short-term loans. There are some associations that are increasing their floating debt, but most are reluctant to do this. Banks are looking closely at how housing associations observe their covenants as any breach of a covenant would enable the bank to increase its margins on the loan.

Diversification of Borrowing

As funding requirements increase it is considered inevitable that Housing Associations will seek to diversify their sources of borrowing. Standard and Poor, the credit ratings agency, had said that it expected Housing Associations to make more use of capital market funding. It said:

"High demand means the sector as a whole is borrowing more from private funding sources… Furthermore, as Housing Associations grow through merger and organic growth, diversifying funding sources to include capital market funding would seem the most logical avenue for the largest Housing Association borrowers".

It is considered that banks may be reaching the limits of what they are prepared to lend to Housing Associations. Consequently, it is expected that in future Housing Associations will make greater use of the capital markets. Conventionally, Housing Associations have approached capital markets by making bond issues. However, other methods are potentially available including:
- Private placements
- Corporate Paper
- Real Estate Investment Trusts
- Stock Market Flotation

Bonds

Housing Association Bonds are becoming an increasingly important source of finance. They became more competitive after 2008 when mark-ups on traditional loans increased. Associations are now seeking to diversify sources of funding. Bonds are now meeting 37% of capital financing needs compared with 5% before 2008.

Private Placement

A Private Placement is like a bond but offered to a select group of investors. Such arrangements can bring in new investors and spread risk, but the terms can be more restrictive than a bank loan and harder to negotiate.

Commercial Paper

Commercial Paper programmes are often used for short-term debt by commercial companies. They are at lower margins than bank loans, are unsecured, need a good credit rating and are used for borrowing of less than a year.

Real Estate Investment Trusts

Real Estate Investment Trusts were recommended by Ms. Kate Barker in her report on affordable housing as a way of encouraging wider investment in affordable housing. It has been possible to establish them since January 2007.

Real Estate Investment Trusts are for-profit companies that rent properties with tax breaks (especially exemption from corporation tax) and that pay investors a dividend. They can borrow funds, buy property and attract investment for potential shareholders. They can also act as refinancing vehicles or as an alternative to the private finance initiative. Under the scheme, Housing Associations sell their properties to the Real Estate Investment Trust thus making a capital gain, while at the same time retaining management of the homes.

They have the potential to bring money into Housing Associations from investors who are new to the market. However, homes at market rents would give investors a higher return than social housing. Consequently, attempts are being made to ensure that they are beneficial for shared ownership and refurbishment.

Tenants may regard REITs as risky as they are for-profit landlords with tradable shares that could therefore be taken over by new owners. They may therefore be more appropriate for new development or market homes.

European Investment Bank

The European Investment Bank has been a major source of funding for housing associations. However, as the United Kingdom has now left the European Union this source of funding is no longer available.

Capital Contributions

Capital contributions are financial contributions to capital spending from a third party that have the same effect as a grant without technically being a grant. These mainly consist of payments under section 106 (planning gain) agreements.

Asset Sales

Asset sales can provide a source of capital funding. Capital receipts from the sale of former council houses are usually shared between the Housing Association and the local authority. The extension of the ‘right to buy’ to housing association tenants would result in an increase in asset sales (see below).

Low Cost Home Ownership

The idea of low-cost home ownership schemes is to allow people to part buy and part rent homes developed by housing associations. Over time, people may increase the share of their ownership as their circumstances change. Do-It-Yourself Shared Ownership is similar to Conventional Shared Ownership but allows people to select a home in the private market and then part own and part rent it, with a housing association taking on ownership of the rented share of the property.

New Approaches

Many housing associations have developed new approaches involving joint ventures or new financial structures. Joint Ventures are used to share risks and rewards and to pool resources and skills. They can be contractual or corporate (company limited by shares or a limited liability partnership). Housing Associations are often charities so to carry out commercial or non-housing activities may need a subsidiary company. This raises the question of powers. Funding can be through equity or loans from the parent company or third parties. Gift aid is used to mitigate corporation tax.

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