29 May 2015

Response:

Increasing the borrowing capacity of stock transfer housing associations

The National Housing Federation is the voice of affordable housing in England. We believe that everyone should have the home they need at a price they can afford.

That’s why we represent the work of housing associations and campaign for better housing. Our members provide two and a half million homes for more than five million people, and nearly half of these homes are the result of transfers from local authorities. The majority of transferred homes are owned by Large Scale Voluntary Transfer housing associations (LSVTs).

As we will make clear in our answers to the questions below, the borrowing capacity of LSVTs is restricted by how transferred homes are valued for loan security purposes. This limits the development potential of these housing associations, thereby obstructing the delivery of the affordable homes which this country so badly needs. We have received case studies from 14 housing associations, and this revealed the potential benefit of a change the Government could make to be an additional capacity to deliver in excess of 18,000 new homes.
Question 1: What are the main constraints on stock transfer providers’ financial capacity in the period after transfer?

LSVTs fund the purchase and improvement of properties that have been transferred from local authorities by taking on considerable levels of debt. Because LSVTs are initially 100% debt-funded, have no reserves and, because of their major repairs obligations initially they are loss making. As a consequence of these debt levels, LSVT’s financial capacity is restricted in the period after transfer.

The amount of improvement undertaken by housing associations to transferred housing stock is often in excess of that required by regulation such as the Decent Homes Standard. Housing associations have committed to this higher standard of refurbishment for the benefit of their tenants and can in many cases lead to increased efficiency and lower management and maintenance costs in the future. However this can lead to higher costs for the LSVT housing associations at the outset.

Question 2: How do these change as the provider matures and passes peak debt?

As LSVTs mature, they build up reserves and meet their transfer obligations and so pass their peak debt. In addition, as they begin to build up reserves and (as a result of significant refurbishment programmes) property values increase, many want to develop more homes but are constrained from doing so as they come up against the limits of available security.

Measures specifically aimed at increasing the capacity of LSVTs have the potential to address these anomalies and make a significant difference to the delivery of new affordable homes across the country. It will also mean that LSVTs are able to begin their development programmes at an earlier point.

Question 3: What are the main reasons why lenders prefer a lower value for transferred stock?

Section 133 of the Housing Act 1988 sets out restrictions on how LSVT homes can be disposed of to a non-social housing provider, known as the consent regime. The specific consent regime for transferred homes drives the valuation of these homes for lenders and means they are valued for loan security purposes at ‘Existing Use Value – Social Housing’ (EUV-SH).

As a consequence, because of the uncertainty this presents to lenders should they need to foreclose on a social housing property used as loan collateral, they place a restriction on the valuation of property – limiting to its value to use as a social housing asset – EUV-SH. This is only about 30 – 40% of what the home is actually worth and is the lower of two possible valuations for social housing.

If the consent regime was amended and, as a result, these restrictions removed, housing associations would be able to value all of their stock at ‘Market Value Subject to Tenancy’ (MV-
STT), which equates to around 60% of market value. This is the valuation method available to traditional housing associations and needlessly creates an uneven playing field between traditional housing associations and LSVTs. If MV-STT was universally available to LSVTs this would unlock considerable additional borrowing capacity for the development of new affordable homes, at no cost to the public purse.

Many housing associations have it written in to their existing loan agreements that they can switch between EUV-SH and MV-STT if the consent regime is changed. This means they could take immediate advantage of the change to increase their borrowing capacity and develop more new homes than they would otherwise be able to do.

In many cases, the switch to the higher valuation is likely to be a gradual process as funders may not want to be in a position where all their security on a specific loan is via a concentration of LSVT stock valued at MV-STT, particularly where these are in a tight geographical area.

**Question 4: Following a transfer of stock, what could encourage lenders to release security for the raising of finance at an earlier stage?**

If the consent regime was amended and, as a result, the associated valuation restrictions removed, housing associations would be able to value all of their stock at MV-STT, which equates to around 60% of market value. This would unlock considerable additional borrowing capacity for the development of new affordable homes, at no cost to the public purse.

Lenders would take a principled view on how they would invest in individual LSVTs based on the strength of their balance sheet, financial management, etc. Part of this assessment could be reflected security collateralisation.

**Question 5: What would lenders need in order to be comfortable with a higher valuation?**

Lenders to housing associations are already comfortable using MV-STT, as this valuation is typically used for lending to traditional housing associations. By way of example, The Housing Finance Corporation have used MV-STT for a number of decades and remain confident with this approach. Overall, MV-STT is a well understood and consistent form of valuation.

LSVT’s maturing financial profile means they are often assessed as being on a similar risk basis as a traditional housing association. However, if MV-STT is perceived as being a more risky valuation method than EUV-SH, lenders will reflect this by adjusting their asset cover requirements for example by using 115% rather than 105%.

Further, lenders will only lend if they are comfortable that housing associations are able to service the debt secured against the higher valuation. Changing the valuation from EUV-SH to MV-STT will not change the fundamentals of lending decisions, but will enable those LSVTs with the financial clout to use their assets more efficiently and increase their financial capacity.
Question 6: What would encourage lenders to allow stock portfolios to be broken down into optimised lot sizes to attract valuation premiums?

This valuation approach means that housing associations would still be unable to use the higher, more consistent and more reliable MV-STT. In addition breaking down portfolios into optimised lot sizes is typically used to mitigate the impact of not being able to use MV-STT and maximise property valuations for lending purposes. Securing the more fundamental change would render this unnecessary.

Question 7: What are the main reasons why surveyors value transferred stock at a lower percentage of market value?

Surveyors are commissioned by lenders to value transferred stock and it is therefore the lenders that set out the specific scope for the valuations, which includes the type of valuation to be undertaken by the surveyor.

Question 8: What scope is there for changes to the assessment approach to result in increased property values?

Amending the consent regime to lift Section 133 restrictions on the way housing associations can value their properties for loan security purposes (specifically transferred stock) will release considerable additional borrowing capacity, which is currently artificially constrained.

The National Housing Federation has collected examples from a sample of 14 housing associations which show that this change could increase their borrowing capacity by almost £2bn, often doubling their existing capacity and significantly increasing the money they can invest in new homes. Modelling from this sample shows that these housing associations would be able to build an additional 18,300 new homes if this change was made (see appendix). The Federation has argued that this change would allow associations to take on more debt to develop additional affordable homes and to increase LSVT housing associations’ options for accessing finance.

Question 9: What steps could the Government take to unlock additional financial capacity amongst stock transfer providers?

Section 133 of the Housing Act 1988 sets out restrictions on how LSVT homes can be disposed of, known as the consent regime. The specific consent regime for transferred homes drives the valuation of these homes and means they are valued for loan security purposes at EUV-SH. This is only about 30 - 40% of what the home is actually worth and is the lower of two possible valuations for social housing.
If the consent regime was amended and, as a result, these valuation restrictions removed, housing associations would be able to value all of their stock at MV-STT, which equates to around 60% of market value. This would unlock considerable additional borrowing capacity for the development of new affordable homes, at no cost to the public purse and with little risk to lenders.

There are a number of further options for the Government to unlock additional financial capacity of LSVTs whilst still protecting social housing. For example, the Government and the Regulator could work together to issue a ‘General Consent’ provision for the disposal of LSVT stock, along the same lines as applies to other social housing not transferred from a local authority. This would effectively allow housing associations to value their stock at the higher MV-STT for loan purposes, releasing additional borrowing capacity for the development of new affordable homes.

If the Government decides that legislation is necessary to lift the Section 133 restrictions we would hope they look for the earliest possible opportunity to make the legislative changes necessary.

Given the current housing crisis, increasing the borrowing capacity of housing associations so they can build more homes at no cost to the public purse is a change that will have a positive impact over the years to come.

**Question 10: What would be the possible implications for tenants from any change?**

The vast majority of tenants in LSVT properties have an assured tenancy, either lifetime or fixed term with the remainder on starter tenancies, which normally become assured tenancies after a probationary period. This means that even in the theoretical worst case scenario of a housing association defaulting on a loan (housing associations have an unbroken ‘no default’ record), where the current restrictions were lifted so these properties could be sold outside of the social housing sector, the tenant would still be protected. No tenant with an assured tenancy could be evicted from the property for this reason and it could only be sold on the open market on vacant possession.

If the home were sold on the open market, it is true that the rent of a tenant would not be protected and any new landlord could increase the rent to market levels. However, tenants in transferred properties would still have a significant degree of protection even if the consent regime was amended (and Section 133 restrictions lifted). All disposals under Section 172, which would apply if Section 133 restrictions were lifted, would require the consent of the Homes and Communities Agency, which has, as its remit, the protection of social housing. Furthermore, Sections 144 to 154 of the Housing and Regeneration Act 2008 gives the Homes and Communities Agency powers to intervene in the affairs of housing associations giving further protection to social housing and social housing tenants within the sector.
Currently Section 133 restrictions apply to all transferred properties, regardless of the time of transfer and whether the tenant living in the property at the time of transfer has moved on, artificially and excessively limiting the valuation of these homes indefinitely. Amending the consent regime for all transferred properties would be the most effective way of releasing the capacity in these homes and would deliver the biggest impact in terms of the number of additional homes that could be delivered.

As set out above, we do not believe lifting the restrictions on disposals would pose any risk to existing tenants. However, if the Government were to deem that tenants living in council homes at the time of transfer (i.e. those with the preserved Right to Buy) do require an additional degree of protection, the consent regime could be amended so it only applies to these tenants, rather than on the property itself. Once the tenant had moved on, Section 133 would no longer apply and the home would be treated the same as any other housing association home and could be valued at MV-STT. However, this option is not preferable as it would take much longer for all the stock to reach the higher valuation and it would not have as significant an impact on the additional number of new homes that could be delivered as possible.
Appendix: Case studies

Case study one: Longhurst Group

The Longhurst Group are a group of housing associations who, together, own and manage 18,000 homes across the Midlands and the East of England. Across the Group there are around 4,500 properties that are restricted to an EUV-SH valuation by virtue of the Section 133 restriction.

They estimate that the removal of the Section 133 restriction on these properties would allow them to deliver an extra 1,000 homes over several years, thanks to an increased borrowing capacity of £65 million.

Background: An MV-STT valuation on the transfer properties would create an additional borrowing capacity of around £65 million. The increase in valuation would be over £70m but allowing for the additional asset security cover that is more typically required on MV-STT valuations would give a realistic figure of £65m.

Assuming the homes are all built for rent, the £65m additional borrowing capacity would enable Longhurst to build an additional 525 – 550 new homes. The development of these 525 – 550 new homes would have a value for loan security purposes of around £35m and would facilitate the development of a further 285 – 300 new homes. Similarly the development of the 285-300 new homes would create a value for loan security purposes of £18.5m and would in turn fund the development of another 150 new homes.

Longhurst Group’s above estimate of 1,000 extra homes is based on conservative assumptions around average development costs and an assumption that this would be to fund new affordable rented homes. It also takes the cost of servicing new debt in terms of interest payments into account within the assessment. Their development programme is currently made up of 35-40% Low Cost Home Ownership products. So, assuming a similar profile for what the initial £65m could deliver in terms of new homes, then 1,000 units could reasonably increase to 1,300 units.

Longhurst have discussed this potential change with the lenders over the last couple of years and funding agreements allow a switch between valuation methods if the restriction is lifted.

Case study two: Coastline

Coastline is a stock transfer housing association, managing 4,000 homes in the South West of England. They estimate that removal of the Section 133 restriction would allow them to deliver an additional 1,131 homes over the next eight to ten years [staying within current balance sheet covenants], thanks to an increased borrowing capacity of £100 million. These homes would be in addition to their current development programme of around 750 homes over the next five years.
**Background:** Coastline’s EUV-SH level stock valuation at 31 March 2014 was £129 million. Moving to a MV-STT valuation would increase the total stock valuation to around £280 million. Assuming asset cover is 110% on EUV-SH and 130% on MV-STT, the loan supportable on the assets increases from £117 million to £217 million, an increase in borrowing capacity of £100 million.

**Case study three: Yarlington**

Yarlington Housing Group is a stock transfer housing association, managing 9,500 homes in the South West of England. The organisation has 3,113 rented properties that are restricted to an EUV-SH valuation by virtue of the Section 133 restriction.

Yarlington estimates that the removal of the Section 133 restriction would allow them to deliver an extra 1,800 homes over the short to medium term, thanks to an initial increased borrowing capacity of £109 million.

Yarlington has a further 5,581 units valued at EUV-SH with a funder where they don’t currently have the ability to switch to the higher [MV-STT] valuation even if the Section 133 restrictions were lifted. However, lifting the restrictions on these properties will still have a long-term benefit for Yarlington because as these properties are released from charge, as the loans amortise, they could be charged to an alternative funder at a higher value.

**Background:** A MV-STT valuation on the 3,113 transfer properties would create additional borrowing capacity of around £109 million. The increase in valuation would be over £134m, but allowing for the additional asset security cover that is required on MV-STT valuations would give a realistic figure of £109m.

Yarlington’s above estimate of 1,800 extra homes is based on current assumptions around average development costs and an assumption that the current profile of their programme (70% Rented, 30% Low Cost Home Ownership) would continue.

The £1,095m additional borrowing capacity would enable Yarlington to build an additional 950 new homes. The development of these new homes would have a value for loan security purposes of around £56m and would facilitate the development of a further 485 new homes. Similarly the development of the 485 new homes would create a value for loan security purposes of £28.6m and would in turn fund the development of another 250 new homes. This process would continue for several years.

**Case study four: Soha**

Soha is a stock transfer housing association, managing 5,850 homes in South Oxfordshire. Soha has a current programme to develop around 1,260 new homes over the next five years. They estimate the removal of the Section 133 restriction would allow them to deliver an additional
900 homes over several years (staying within current and projected interest cover ratio covenants), as a result of increased borrowing capacity of £110 million.

Background: A reputable social housing sector valuer has provided an indication of the potential scale of uplift if the Section 133 restriction was removed for SOHA. The uplift was estimated to be around £130 million. Current asset cover of 105% on EUV-SH and of 130% on MV-STT would give additional borrowing capacity of around £110 million.

Case study five: Sovereign

Sovereign Housing Association owns 35,000 properties across the South and South West of England. Approximately 19,000 of their properties are affected by Section 133 restrictions. Sovereign estimates that, over time, lifting the Section 133 restrictions would enable them to build an additional 3,700 homes.

Background: Assuming an average EUV-SH of £65,000 with an asset cover requirement of 105%, and that MV-STT values would be 50% higher but with asset cover requirements of 115%, the increase in borrowing capacity would be c. £435m, sufficient to fund at least 3,700 new properties initially.

Case study six: Progress Housing Group

Progress manages 9,950 properties predominantly in the North West of England. The organisation has 2,680 properties that are currently restricted to EUV-SH valuation by virtue of the Section 133 restriction.

Overall the total number of additional units potentially deliverable by Progress from removal of the restriction is 840

Background: Progress estimates that the removal of the S133 restriction would unlock increased borrowing capacity of £40m from existing permitted loan facilities, which would allow delivery of an extra 420 homes over the short to medium term.

Progress has a further 1,966 units valued at EUV-SH with a funder that does not currently permit borrowing against MV-STT, even if S133 restrictions were lifted. However lifting these restrictions would still have a benefit as loan agreement amendments in the short term may be possible, and they could be charged to an alternative funder in the longer term as the properties are released from charge due to loan amortisation. This would also provide an additional estimated £40m borrowing capacity, which could equate to delivering a further 420 new homes.
**Case study seven: Cross Keys Homes**

Cross Keys Homes is a stock transfer housing association managing over 10,000 homes in the Peterborough area. Peterborough itself and wider Cambridgeshire are high housing growth areas.

**Cross Keys estimate that removal of the Section 133 restriction would permit further delivery of an additional 1,218 homes over the next eight to ten years** (staying within current balance sheet covenants) by increasing borrowing capacity by £168m. Further use of shared ownership tenure could increase this still further (by about 100 new homes if 30% of the programme was shared ownership) and is in addition to an existing programme expected to achieve 1,250 new homes over the next five years.

**Background:** Assuming a total EUV-SH of £300m with an asset cover requirement of 110%, and that MV-STT values would be £440m with an asset cover requirements of 125%, the increase in borrowing capacity would be c. £79m, sufficient to fund at least 610 new properties initially.

*These new properties could then be used as extra security and with an MV-STT of £57.5 a further 354 new properties could be developed.*

*These 354 further properties could then lead to an extra 205 new properties, from the MV-STT valuation of £33m for these 354 properties."

**Case study eight: DCH**

DCH formed from a merger of one traditional housing association and three LSVT associations. In total it owns approximately 19,000 rented properties of which approximately 7,800 are ex LSVT stock and subject to EUV-SH restrictions.

In total DCH would be able to borrow an additional £260m and develop almost 2,000 new homes if this change were made.

**Background:** Of DCH’s 7,800 ex LSVT stock approximately 6,300 units are secured to lenders who permit an MV-STT valuation to be adopted, and a further 750 will shortly become available as security for new borrowings. The remainder will become available to secure replacement borrowings within the next 5 years.

*DCH estimate that the removal of the S133 restriction would immediately allow them to borrow an additional £140m to deliver approximately 750 rented properties and 320 shared ownership properties. Each additional property developed would generate additional borrowing capacity and they estimate that over a 10 year period DCH could borrow an additional £120m to develop a further 900 rented and shared ownership properties.*
**Case study nine: Great Places Housing Group**

Great Places owns or manages approaching 18,000 homes across the North West and Yorkshire. Great Places is a “mixed” housing association, combining around 1,800 properties received through estate transfers from Manchester and Sheffield City Councils, together with around 16,000 properties brought into the Group through traditional development, or through historic merger.

The move to Market Value subject to Tenancy (MV-STT) valuations would represent a £18.2M increase in the amount of loan funding for 1,719 properties that can be secured. **This would allow Great Places to develop around 400 additional homes:** 200 homes in the next five years, around 130 further new homes in the five years after that and around 70 further homes in the five years after that.

**Background:** Great places currently have 1,719 transfer properties secured for loan purposes using the EUV-SH valuation method (as required for such properties), totalling £57.3M and averaging £33.4K each. The properties are hence able to secure £54.6M of loan funding at the required 105% asset cover ratio.

If Great Places were able to switch to MV-STT valuations, following a removal of the s133 restriction, they believe that they would achieve valuations averaging £48.7k, and totalling £83.7M. This would secure £72.8M of loan funding at the higher 115% asset cover ratio used for MV-STT valuations.

**Case study ten: Town and Country Housing Group (TCHG)**

TCHG is a stock transfer association, originally formed to receive the stock owned by Tunbridge Wells Borough Council, over 20 years ago. TCHG now provides more than 9,000 affordable homes in 22 local authority areas in Kent, Sussex, Surrey and South London, with more than a third of the stock having been built by themselves.

**TCHG estimate that they could provide an additional 1,000 homes over the next three to five years if they were able to value their transferred stock at MVS-TT.**

**Background:** TCHG estimate that the removal of the Section 133 restriction would enhance their borrowing capacity by around £150m. This would be subject to negotiation with lenders on a variation to a loan agreement. The extra 1,000 homes that could be developed over the next 5 years would be in addition to the 200 per annum currently planned by TCHG for the next three years.

**Case study eleven: Halton Housing Trust**

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Halton Housing Trust is a not for profit housing association that owns and manages 6,400 homes in the Cheshire towns of Runcorn and Widnes. Halton formed in December 2005 following a transfer of homes from Halton Borough Council.

Halton estimate that the removal of section 133 restrictions will increase their borrowing capacity by approximately £24 million. This would enable them to build an additional 400 homes.

**Case study twelve: Bracknell Forest Homes**

Bracknell Forest Homes is an LSVT formed in 2008 following the transfer of 5,600 rented and 1,100 leasehold dwellings from Bracknell Forest Council.

It is estimated that removal of the section 133 restriction could increase the borrowing capacity of Bracknell Forest Homes by about £90m which would support delivery of a further 700 properties in the medium term. These homes would be in addition to the 850 homes currently included within the business plan.

**Case study thirteen: Riverside Group Limited (Riverside)**

Riverside has 15,000 properties which have transferred to the Group as part of five Large Scale Voluntary Transfers from local authorities, four in 2002 which Riverside consider to be mature transfers, and the most recent in 2010.

If Riverside’s transferred stock was valued at MVS-TT it would enable Riverside to develop an additional 1,300 properties over the next five years.

*Background:* The removal of Section 133 restrictions enabling MV-STT valuations to be used on transfer stock will increase Riverside’s borrowing capacity. In the case of Riverside where stock has been valued on both an EUV-SH and MV-STT basis average values per property are £35k and £50k respectively. If this valuation uplift is applied to Riverside’s 15,000 transfer properties and allowing for the increase in asset cover from 105% to 115% for stock valued on an MV-STT basis then £145m of additional debt could be raised.

**Case study fourteen: Plymouth Community Homes (PCH)**

PCH Ltd was formed following the LSVT of Plymouth City Council’s 15,000 stock in 2009.

PCH currently manages approximately 14,500 homes in Plymouth. An MV-STT valuation on PCH properties would create an additional borrowing capacity of around £185m. This increase would
mean PCH could build an additional c. 1,400 – c. 2,000 more houses (dependent on levels of grant and shared ownership).