Department for
Communities and
Local Government

Increasing the Borrowing Capacity of Stock Transfer Housing Associations

Consultation

March 2015
Department for Communities and Local Government

This document/publication is also available on our website at www.gov.uk/dclg

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About this Consultation

Scope of this consultation

Topic of this consultation:	Increasing the Borrowing Capacity of Stock Transfer Housing Associations
Scope of this consultation:	This consultation invites proposals and ideas on how to increase the borrowing capacity of housing associations in relation to the valuation of properties transferred from local authorities.
Geographical scope:	England only

Basic Information

To:	Large Scale Voluntary Transfer Housing Associations, Lenders, Surveyors, Tenants, and representative groups and bodies
Responsibility for the Consultation:	This consultation is being run by the Affordable Housing Management and Standards Division in the Department for Communities and Local Government.
Duration:	13 March 2015 to 31 May 2015
Enquiries (including requests for the paper in an alternative format) to:	For further information about this consultation please e-mail lsvt.valuation@communities.gsi.gov.uk
How to respond:	Consultation responses should be submitted by email to: lsvt.valuation@communities.gsi.gov.uk Or by post to: Stock Transfer Housing Association Consultation: Affordable Housing Management and Standards Division Department for Communities and Local Government Fry Building 2 Marsham Street London, SW1P 4DF

Additional ways to become involved:	We are willing to engage with Large Scale Stock Transfer Housing Associations, lenders, tenants and any other interested parties during the consultation process.
After the consultation:	A summary of the responses to the consultation will be published on the Department's website in due course.
Compliance with the Code of Practice:	This consultation document and the consultation process have been planned to adhere to the Government Code of Practice on consultation. The consultation is to gather information and ideas and therefore the period of consultation will be eleven weeks.

Introduction

1. Since 1988, there have been just over 300 large-scale transfers of housing stock by over 200 local authorities, collectively transferring over a million properties from the public to the private housing association sector. Transfers can only take place where a majority of tenants have voted in favour in a ballot.

2. Transfer brings in higher levels of investment, allowing stock transfer housing associations to borrow from the open market. This means that backlogs of stock improvements can be carried out more quickly than could be done under local authority ownership and enables additional private sector investment in new affordable housing.

3. We want housing associations to be well placed to build more, much needed homes. Household projections are increasing by 221,000 per year.[1] For decades, there have not been enough homes to meet the needs of our growing and ageing population.

4. Homes previously transferred from local authorities to a housing association are generally valued on the assumption that they will continue to be let as social housing into the future. Typically, this means they are valued at 30-40% of market value. The value placed on these properties effects how much a bank will lend and how many new homes the housing association can build.

5. If the approach to the valuation of these homes is needlessly hindering borrowing, then we want to find ways to address that. However, in doing so we need to understand any effect on social tenants and ensure that we do not compromise their protections. Therefore through this consultation we are seeking views on the current approach, suggestions, and the implications.

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[1] DCLG Household Interim Projections, 2011 to 2021

Housing transfers and borrowing capacity

6. Overall, there are around 1,500 housing associations currently operating in England and they own or manage around 2.7 million homes. 44 per cent of these homes (around 1.2 million) are owned by stock transfer providers, which are those housing associations that have taken on transferred stock.[2]

7. Collectively, these stock transfer providers are borrowing almost £19 billion of external debt to support their long term business plans. This will be used mainly to buy homes, make improvements and build more homes.

8. The financial profile of stock transfer providers is very different from that of traditional housing associations. As a group, they are much more heavily indebted.

9. In 2013, transfer providers' average interest cover[3] (a key measure of their ability to service the interest on their debts) stood at 118.3 per cent, compared to 147.3 per cent for traditional providers.[4] They were also much more heavily geared,[5] with average gearing of 205.1 per cent, compared to 66.7 per cent for traditional housing associations.[6]

10. The degree of debt in this sector changes over time. In the early years after initial transfers, the stock transfer providers' debt peaks in order to finance the purchase of the stock from the local authority and to pay for major repair commitments.

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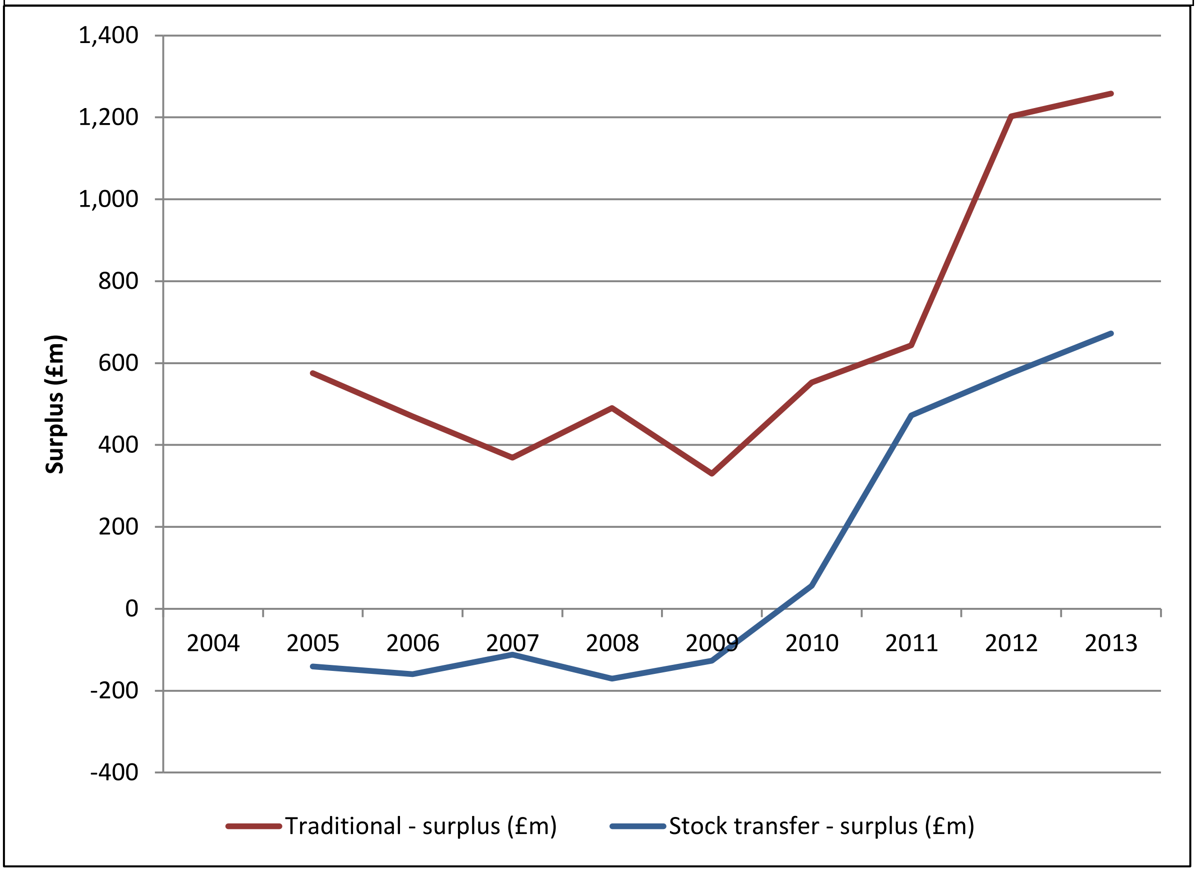
[2] HCA Global Accounts of social housing providers, 2013
[3] Definition of interest cover: this is calculated by comparing the interest paid with net earnings (before interest, taxation, depreciation and amortisation with all major repairs spending included). The lower the percentage, the more the organisation is burdened by debt expense.
[4] HCA Global Accounts 2013
[5] Definition of gearing: debt as a proportion of grant and reserves (excluding revaluation reserves). The higher the percentage, the more debt the organisation has in comparison to equity.
[6] HCA Global Accounts 2013

11. As stock transfer providers' debt matures, promises are met and the debt is paid down, the provider will eventually begin to generate surpluses which could be used to finance investment in new stock and build new homes.

12. Over 75 per cent of stock transfers took place before 2006. This means that many of these providers have started generating surpluses.

13. As the graph below shows, the stock transfer sub-sector was in deficit before 2010. By 2013, stock transfer providers were generating a total surplus of £672 million (around 35 per cent of the sector's overall surplus).

Figure 1: Annual surpluses in the registered provider sector[7]



[7] HCA Global Accounts 2013

14. There are a number of factors which affect how much a housing association can borrow:

    a. The amount of income generated to cover interest payments on debt;
    b. Business plan agreement – if financed by a single lender, as most transfer providers are, that lender signs off the business plans annually and changes to the plan will require the lender's consent;
    c. Existing loan agreements including balance sheet covenants, such as gearing or debt per unit which constrains borrowing capacity; and
    d. The value of the stock that is used as security for the loans.

Housing transfers and tenants

15. When homes are transferred from a local authority to a housing association, this can only be done with the support of tenants through a majority positive vote in a ballot. Without this, the transfer cannot go ahead and the stock remains with the local authority.

16. When transferring, residents take with them some additional rights and protections, including:

    - a preserved Right to Buy;
    - Secretary of State consent is required for the onward disposal of homes, including by a lender in the event of a loan default; and
    - From 2014/15, leaseholders will have their service charges for major works and repairs capped at £10,000 (or £15,000 in London) for the first five years after transfer.

17. Some stock transfer providers have said that the consent regime for the onward disposal of homes has an impact on how the properties are valued.

18. In considering any proposals the Government will ensure that protections for tenants are maintained and not compromised.

Housing transfers and valuations

19. Some stock transfer providers have told us that they could build more homes if their stock was valued differently.

20. Their properties are assessed based on Existing Use Value for social housing. This means there is an assumption that these properties will continue to be let as social housing and that any vacant homes will be re-let to housing association tenants. Typically, the valuation would be 30-40% of market value.

21. This is not always the situation for a traditional housing association where stock has not come from a local authority. Their properties are not usually assumed to remain as social homes into the future and so they are assessed on Market Value, Subject to Tenancies. This is typically valued at 60% of market value.

22. The market value for any property will vary based on local geographic markets and trends over time. There will also be significant geographic variations for the percentage of market value at which the Existing Use Value for social housing is assessed.

23. Valuations are carried out by surveyors commissioned by lenders. The government does not set the valuation approach.

24. We therefore want to understand what drives the valuation methodology, why stock transfer valuations are lower than traditional housing associations and whether there are underlying and ongoing reasons for the difference. We would welcome suggestions on what could be done differently.

25. In considering any proposals for change, we must ensure that housing associations continue to be financially viable and do not take on undue risk.

How to tell us your views

26. We would welcome your views and responses to the questions set out in the next section. Please send your comments to: lsvt.valuation@communities.gsi.gov.uk

27. The closing date for responses is Sunday 31 May 2015.

Consultation Questions

We would like responses to the following questions along with any other ideas on how we can increase the borrowing capacity of stock transfer housing associations:

Question 1: What are the main constraints on stock transfer providers' financial capacity in the period after transfer?

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

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

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

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

Question 6: What would encourage lenders to allow stock portfolios to be broken down into optimised lot sizes to attract valuation premiums?

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

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

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

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