FINANCING CO-OPERATIVE & MUTUAL HOUSING

Blase Lambert

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1 EXECUTIVE SUMMARY

The final report of the Commission on Co-operative and Mutual Housing (Bringing Democracy Home)[1] highlighted the need for consideration of the role that co-operative and mutual housing could play in national housing strategy. The Finance Group[2] was established to analyse existing financial models for developing co-operative and mutual housing and identify routes and models for the financing of future schemes.

Financing Co-operative and Mutual Housing sets out that analysis before introducing potential warehousing solutions to deliver volume development of new co-operative and mutual housing schemes through partnership working with local authorities and developer housing associations.

The Commission on Co-operative and Mutual Housing was keen for local authorities and communities to have a wide range of tenure models to consider that enable them to match local demands and priorities (the decision over 'what is developed where' should be taken at a local level); the tenure models could include the following:

(a) Rented properties with rent levels set at the redefined affordable rate (80% of market rent)
(b) Rented properties at variable rent levels set according to tenants' incomes
(c) Mutual housing schemes at variable rent levels (including open market levels)
(d) Mutual home ownership and equity sharing mortgage schemes with variable equity stakes (these schemes should be structured to ensure access to mortgages for purchasers)
(e) Mutual retirement schemes (either at full rental or ownership or a mix of both)
(f) Mixed schemes of rental and leasehold ownership
(g) Schemes that include elements of commercial, office and retail space

There are a number of organisations that would develop new schemes if the financing could be secured. Wide ranging discussions held with banks and other financial institutions identified a number of reasons why lenders are reluctant to lend in small quantities to numerous start-up organisations; the key reasons are:

- The loans involved are too small for specialist commercial lending teams and too big for the high street branches of banks
- Lenders do not like lending to new organisations lacking in business and management track records
- Lenders have little appetite for non-recourse loans; unless of a high credit quality
- Sourcing and managing a large portfolio of small loans is resource intensive
- Lenders do not want to have the resource requirement of dealing with default, which is proportionately higher for smaller loans
- A preference to lending to regulated entities

1 Commission on Co-operative and Mutual Housing – Bringing Democracy Home – September 2009
2 Members of the Finance Group are listed in Appendix A

In the short term it is necessary to provide impetus to the development of co-operative and mutual housing which cannot be realised through piecemeal small projects which lack a co-ordinated approach to raising finance. This could be done by a single aggregated solution which would aim to raise an initial bank facility of around £250 million, with a longer term bond refinancing; which would allow recycling of the initial facility.

The finance would be raised through a central warehouse (which could be an existing conduit or lead housing association) that would take charges over current, unrestricted assets and be repayed through social rental cashflows; due diligence and monitoring would be undertaken by the central warehousing organisation.

Development would be undertaken by existing developing housing associations or private developers with a demonstrable commitment to co-operative and mutual housing. Schemes will need to be supported by partner local authorities; possibly contributing public land (where they could retain freehold ownership and grant long leases to the developer associations) to ensure the affordability of the housing developed. Homes and Communities Agency grant, New Homes Bonus and Right to Buy Receipts could also be applied where available.

In developing new schemes with units for open market sale it is assumed the risk of any open market sale units is taken by the developer and that the funding requirement therefore relates to an ongoing affordable housing provision. Development risks could be underwritten by the developer, either via a construction / cost overrun guarantee or via funding the development and transferring ownership on completion.

The schemes developed would then be managed by a local co-operative or mutual housing organisation; this would be dependent on the local organisation gaining CCH Accreditation[3].

An expression of interest has been developed by the team implementing the recommendations of 'Bringing Democracy Home' that will be distributed to identify partner local authorities and housing associations.

In the long term it may be desirable to create a new special purpose conduit (SPC) or utilise an existing one to provide an on-going financing warehouse that would on lend to developer organisations. It may be possible that any public money that is invested goes in as a first loss tranche. The SPC would batch schemes using bank debt which would be financed long term by bond issues (possibly with differing time periods) to institutional investors and individual member investors.

3 Confederation of Co-operative Housing – The CCH Accreditation Framework for Housing Co-operatives – 2010

2 FINANCING CO-OPERATIVE AND MUTUAL HOUSING

Financing Co-operative and Mutual Housing is presented by the Finance Group to the team implementing the recommendations of the final report of the Commission on Co-operative and Mutual Housing, as well as potential statutory, development and investment partners.

'Bringing Democracy Home' highlighted the need for consideration of the role that co-operative and mutual housing could play in national housing strategy and drew the following conclusion regarding financing co-operative and mutual housing:

'Government, through the Homes and Communities Agency (which now incorporates the regulatory functions of the Tenant Services Authority), should support the development of new and innovative funding mechanisms for co-operative and mutual housing in concert with the co-operative and mutual housing sector and the wider co-operative movement.'

We have analysed existing financial models for developing co-operative and mutual housing and identified routes and models for the financing of future schemes and would expect that our work will contribute to the development of a programme of new co-operative and mutual housing developments.

This report examines the current financing of social housing and contrasts it with other European countries (chapter 3), highlights some key issues that may affect the current financing model (chapter 4), outlines existing and new models for financing co-operative and mutual housing in England (chapter 5) and draws on examples from 3 European countries (chapter 6) before exploring warehousing solutions to deliver volume development of new co-operative and mutual housing schemes through partnership working with local authorities and developing housing associations (chapter 7).

Co-operative and mutual housing

Co-operative and mutual housing takes a variety of different forms within the current housing market, although the recent past has concentrated schemes in the social housing sector.

What marks out co-operative and mutual housing as different from other forms of institutional, social and private housing is residents' membership of the housing organisation. This membership entitles them to vote on decisions affecting their homes and gives them a greater level of control over the management of their homes and lives than traditional forms of rental or leasehold ownership housing. Co-operative and mutual forms of housing are particularly ideal at shaping place and creating better outcomes for residents, such as:

(a) mutually supportive communities being established, where residents know that they have friends and neighbours who will look out for them – a tapestry of human interaction that characterises the sector

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(b) mutual support has helped members of co-operative and mutual housing organisations who started out with broken lives start to reshape themselves, get skills, get into work, move on in their lives

(c) ordinary people in co-operative and mutual housing organisations who want to do things to tackle climate change, volunteer as school governors, or participate in various other community activities

(d) co-operative and mutual housing organisations set up in neighbourhoods affected by a lack of trust and lack of community, starting to transform them, helping residents feel like they are part of something

Co-operative and mutual housing is relevant to the current social and political environment and may have the potential to offer much to the new Coalition Government's localism and Big Society agenda and to the emerging Community Right to Build.

Development models

The current co-operative and mutual housing sector includes ownership co-operatives, management co-operatives, co-housing projects and community land trusts[4] ; although this list does not preclude the creation of new models.

The Commission on Co-operative and Mutual Housing was keen for local authorities and communities to have a wide range of tenure models to consider that enable them to match local demands and priorities (the decision over 'what is developed where' should be taken at a local level); the tenure models could include the following:

(a) Rented properties with rent levels set at the redefined affordable rate (80% of market rent)
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(g) Schemes that include elements of commercial, office and retail space

4 A full assessment of existing models was undertaken for the Commission on Co-operative and Mutual Housing by CURS – R. Rowlands – Forging Mutual Futures: Co-operative and Mutual Housing in Practice: History & Potential - 2009

3 CURRENT FINANCING OF SOCIAL HOUSING

Financing housing association development

The financing of social housing by housing associations has been through two key sources, debt and grant. The housing association sector has raised £58 billion through debt financing to date. This comprises facilities from the banking sector (c£50bn) and bonds issued either by individual associations or through conduits (such as The Housing Finance Corporation).

From the late 1990s to 2006, virtually all new debt was raised through bank lending; 85% being loaned from just 5 banks as shown in Table 1.

Bank	Loan Book (£ billion)
Lloyds Group	13.6
Barclays	10.7
Nationwide	9.3
Santander	8.2
Royal Bank of Scotland	8.0
Total	49.8

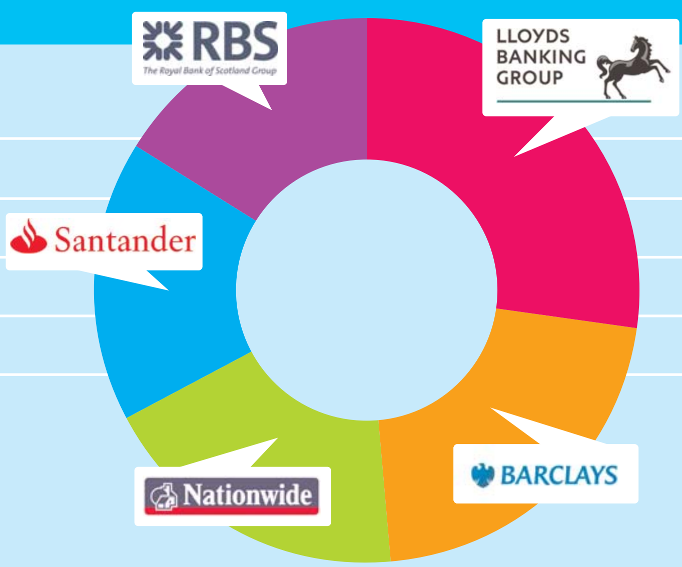

Table 1: The 5 large loan books to housing associations
Source: Tenant Services Authority – Private Finance Strategy - 2010

It is important to prove creditworthiness to lending institutions. A number of large housing associations have decided to obtain credit agency ratings in order to issue bonds in their own name or otherwise demonstrate creditworthiness; this provides publicised scrutiny of the association and its financial model. Table 2 details current bond issues from the housing association sector.

Issuer	Coupon (%)	Maturity	Spread to LIBOR (%)	Rating
Affinity Sutton	5.981	2038	1.20	Aa2
Circle Anglia	7.250	2038	1.38	Aa3
Genesis	6.064	2039	1.48	A1
L & Q	5.500	2040	1.21	Aa2 / AA-
Hyde	5.125	2040	1.18	Aa2
Notting Hill	5.250	2042	1.22	Aa3
Sanctuary	6.697	2039	1.18	Aa2 / AA-
Harbour Funding	5.280	2034	1.10	Aa3 / AA- / AA
Haven (37)	8.125	2037	0.96	Aa3 / AA- / AA
HAF	8.250	2027	0.84	Aaa / AAA
HSL	8.375	2019	1.08	NA
RSL (Fin)	6.625	2038	0.92	AA- / Aa3
THFC (Indexed)	5.650 (real)	2020	-	NA
THFC No 1	5.125	2037	1.27	AA-
THFC No 2	6.350	2039	1.26	A+

Table 2: Social housing bond issues
Source: Evolution Securities – 8th October 2010

Recent bank lending trends have been away from long term loan financing, unless there is a repricing mechanism at say year 5 or 10. Having fallen from a peak of 250 basis points (bps) after Lehman's demise, spreads are now trending up to 150bps – 200 bps for longer maturities (20 years), where available. Currently institutional investors have a surplus of liquidity which is driving their appetite for medium and long term debt at increasingly aggressive margins.

The overall balance sheet for the housing association sector is stable and healthy with adjusted net leverage at 41.58%, interest cover is tighter (standing at an aggregated 113.1% for traditional housing associations)[5]; it should be noted that there are significantly differing levels across sub-sectors (the existing ownership housing co-operative sector is much less geared than sectors that have developed significant numbers of new properties over the last 20 years). The Tenant Services Authority estimates that there is £25 – 30 billion in available funding capacity to 2013 – 14 and currently a debt capacity of £2.9 billion[6], based on free cashflow available to service debt.

The Housing Finance Corporation

The Housing Finance Corporation (THFC) is an aggregating funder for housing associations with a credit rating of A+ / A-1. It is an Industrial & Provident Society that is controlled by a strong board with banking, financial and commercial experience.

The key components of its activities are:

- THFC acts as principal and borrows in its own name. It on-lends immediately; only to Registered Providers
- Funds borrowed are on-lent on similar interest and repayment terms thus ensuring that it is protected against interest rate risk
- THFC makes its own credit assessment of potential borrowers
- THFC's loans are fully secured and it is required to maintain historically conservatively set covenants
- Investors benefit equally from a floating charge over THFC's assets; primarily its secured loans to housing associations and its reserves
- THFC takes out a combination of fixed and floating charges over housing association assets in respect of loans
- Asset cover requirements are underpinned by a conservative valuation methodology; loan security must be valued at 150% of the loan secured.[7]

5 Tenant Services Authority – 2009 Global Accounts of Housing Associations – March 2010
6 Tenant Services Authority – Private Finance Strategy – 2010
7 The Housing Finance Corporation – Investing in Social Housing – May 2010

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Financing social housing – a European perspective

Across Europe there is a range of debt financing models used to develop social housing; these are outlined in Table 3.

Country	Model	Brief outline
Ireland	**Public grants**	Centrally funded grants to approved providers for construction, statutory financial intermediary provides low interest loans for land acquisition, interest financed by central government, limited grants from local authorities.
England	**Debt & grant**	Debt finance raised against future rental cashflows (effectively supported by Housing Benefit) coupled with capital grant as well as discounted land and development contributions under "section 106" provisions.
France	**Savings scheme**	Tax free household savings scheme (CDC) finances off market loans to HLM providers alongside state and local subsidies, tax incentives and other loans. Land provided by local authorities and development contributions.
Austria	**Structured finance**	Long term low interest public loans and grants, combined with commercial loans raised via HCC Bonds and developer / tenant equity sustains tightly regulated form of cost rent limited profit housing. Promotion supported by municipal land policy and land banking.
Switzerland	**Co-operative finance**	Commercial loans, loans from a bond issuing co-operative, revolving loans, and own equity and supported by municipal urban policy and land banking. A liberal rent policy allows landlords to raise rents to recover costs, including changing financing costs.
Netherlands	**Revolving fund**	Replaced direct loans and subsidies with guaranteed capital market loans and rent assistance. Dutch Guarantee Fund (WSW) and Central Fund (CFV) provide security and assist to reduce financing costs. Associations are free to determine own investment strategy, asset base and surpluses intended to be used as a revolving fund to achieve social tasks.
Germany	**Tax privileged**	Federal government has withdrawn from direct supply support and shifted towards demand side subsidies. Municipalities develop their own programs and housing companies are private entities, with a variety of shareholders. Private investment in social housing is promoted via tax concessions. Rents and eligibility depends on level and duration of public subsidy.
Sweden	**Capital market**	Corporate tax exempt municipal housing companies have always been financed by capital market loans which were sometimes backed by municipal guarantees, grants as well the Ministry of Housing's own resources. In the past interest rates subsidies were provided by the central government but these have ceased.

Table 3: Funding strategies for social housing across Europe
Source: CECHODAS Housing Europe – Financing Social Housing after the Financial Crisis – January 2010

In England, debt is levered against a mix of grant and demand side subsidy (through Housing Benefit). Where debt has been guaranteed by the government (eg Switzerland and Netherlands) there is a marginal benefit in terms of pricing (in the Netherlands 50 - 70bps).

Rent setting

Charging rents at below market levels has been a key component of social housing and recent policy had focused on equalising rents across the various social landlords that operate at a local level. The Rent Influencing Regime structured social housing rents around property size and value and local income levels. Average social housing rents have increased over the last 20 years; between 1990 and 1999 real rent increased by over 30% in England[8], a trend that has continued since the turn of the millennium. It should be noted that social housing rents have been effectively constrained by the Rent Influencing Regime and the needs based approach to allocations.

These real rent increases have contributed to the increasing cost of Housing Benefit to the taxpayer, although by far the biggest contributor has been the increase in Housing Benefit paid to tenants in the private rented sector[9] which has increased because of the lack of availability of housing in the affordable social rented sector and rates of Local Housing Allowance (particularly in areas of high demand).

There are various different models for pricing social housing to new and existing tenants that operate across Europe as outlined in Table 4.

The Council for Mortgage Lenders note that: ‘There is a need to explore more fully the interaction between rent and Housing Benefit. Many in the housing sector see greater flexibility in rents as providing not only a more tailored rental offer but also helping to increase the capacity of housing associations to provide more. The value of this to the Government in terms of increasing private investment in new homes needs to be taken into account as part of the work going forward on welfare reform.’[10]

There is a significant opportunity to bridge the funding gap for new developments created by reduced (or no) grant if rent levels are allowed to be set proportionate to market rents or by allowing organisations the flexibility to set rents in line with tenants’ incomes (it should be noted that schemes should not be structured to rely too heavily on higher income tenants); set alongside land subsidies from local authorities.

The Comprehensive Spending Review announced on 20th October 2010 and the publication of its consultation on the future of social housing[11] signal the Government’s intention to explore a more flexible approach to rent setting, creating the ability to develop new affordable housing at rates around 80% of market rents.

8 Joseph Rowntree Foundation – Social Market or Safety Net – 2002
9 Chartered Institute of Housing & Building Societies Association – Wilcox – UK Housing Review 2009/10 – 2010
10 Council of Mortgage Lenders – 21st Century Welfare: Response to the Department for Work and Pensions Consultation – 2010
11 Local Decisions – A Fairer Future for Social Housing: Department for Communities and Local Government – November 2010

Country	Model	On entry	Income exeeds limit?
Austria	Cost-based	**Yes**	Rent unchanged
Denmark	Cost-based, 3.4% of building cost + bank charges	**No**	N/A
Germany	In some regions rents vary with household income	**Yes**	The municipality has the right to raise the rent for people above the limits. However rarely done, as it drives people with social capacity out of social housing estates.
France	Central government decrees maximum rents (vary by region). Cost based related to estate or owner	**Yes**	Tenant should pay small supplement (does not always happen in practice)
Sweden	Set by annual negotiation between landlords and tenants	**No**	N/A
Netherlands	Rent based on utility value of dwelling and target household income level	**Yes**	Rent unchanged
Hungary	Set by local authorities	**Yes**	Unclear
Ireland	Tenants pay % of income in rent	**Yes**	Rent rises
England	Rent Influencing Regime based on local earnings and the dwelling price	**No**	N/A

Table 4: Social housing rents in Europe
Source: London School of Economics – Social Housing in Europe – July 2007

There are a number of key risks around setting rents for the new intermediate tenure at up to 80% of market rents; whilst creating significant additional capacity in high value areas it does not work in many low value areas. There also remain some uncertainties around the Housing Benefit status of these new higher rents. There is a significant risk that rents will be subject to the Local Housing Allowance framework and where they exceed the Local Housing Allowance level, benefit payments will be capped. In addition there is no clarity about whether the maximum benefit caps for individuals and couples / families will still apply.

4 CHALLENGES TO THE CURRENT FINANCING MODEL

Investing in social housing

Housing associations are seen by investors as a low risk, attractive investment primarily due to them being regulated (and therefore being covered by a wider implicit government support) and non-profit distributing with long-term, stable, predictable cash flows underpinned by the Housing Benefit system and the Rent Influencing Regime.

All 3 of these key planks (regulation, Housing Benefits and rent setting) if amended in such a way as to negatively affect stability and predictability could have a significant impact on investors' risk appetite and therefore affect the cost of financing schemes.

The Housing Benefit system is once again under the spotlight since the election of the Coalition Government. Critics of the current system point to three key features:

(a) Those in receipt of Housing Benefit make no contribution to rent below a certain income level
(b) Those in receipt of Housing Benefit are insulated from rent rises
(c) The taper creates a poverty trap that acts as a disincentive for people to seek employment

The Government has recently published proposals through its 21st Century Welfare paper[12]. Concerns within the financial sector at these proposals are highlighted by the response of the Council of Mortgage Lenders:

'The proposals as set out in the consultation if applied to the payment of Housing Benefit will result in a loss of confidence and appetite for lending to and investment in the sector. This will end the existing highly effective public / private model for funding affordable housing. Increasingly reliance has been placed on investment through the capital markets as well as established bank lending to deliver new affordable housing for rent and home ownership. The concern is that the welfare reform proposals as set out could fundamentally alter the availability of capital market investment and further restrict bank lending for this market.'[13]

The regulation of housing associations has been the subject of a recent review with the key components of governance and financial viability (along with the regulation of the services provided) set to be transferred from the Tenant Services Authority to the Homes and Communities Agency by April 2012[14]; how the onset of Tenant Panels will impact on the future of regulation will be key to the success of the new regulatory approach.

Changes to the regulation of the financial sector

The financial crisis of 2008 has brought under the spotlight how banks and other financial institutions are regulated and has highlighted the shortfalls of the Basel 2 arrangements[15]. The Basel 2 Pillars of minimum capital requirements, the supervisory review process and market discipline failed to prevent the near collapse of the international banking sector.

12 Department for Work and Pensions – 21st Century Welfare – 2010
13 Council of Mortgage Lenders – 21st Century Welfare: Response to the Department of Work and Pensions Consultation
14 Department for Communities and Local Government – Review of Social Housing Regulation – October 2010

The outcome of further reviews has led to Basel 3 which further strengthens the capital and liquidity buffers that banks must carry. The key points are:

(1) An increase in the Tier 1 Capital Ratio from 4% to 6%
(2) Introduction (from 2016) of a Capital Conversion Buffer of 2.5%, on top of Tier 1 Capital, which will be met with common equity, after the application of deductions
(3) Introduction (from 2016) of a Countercyclical Capital Buffer within a range of 0% – 2.5% of common equity or other fully loss absorbing capital according to national circumstances
(4) Additional loss absorbing capacity for systemically important banks (the details are yet to be finalised for this component)

These changes will result in lower profits for banks; additionally, moving banks away from their structural dependency on short term funding is likely to require European banks to raise in excess of £1 trillion, a truly staggering quantity of new deposits and bond issues will be required to fund this requirement with a likely associated increase in deposit and bond rates.

Set alongside this there is likely to be an extension of the Pillars into other financial sectors as demonstrated by the implementation by November 2012 of the Solvency 2 Directive across the European insurance industry.

Additionally, changes to the mortgage market currently mooted by the Financial Services Authority could place restrictions on the ability of first time buyers and those on low incomes to access mortgage finance.

Current development issues

The Credit Crunch that followed the initial financial crisis of 2008 has led to 2 main consequences for development:

(1) All forms of supply have declined and thus so has Section 106 affordable housing of all forms
(2) The development of affordable housing has become increasingly challenging with the reduction in cross-subsidy and reduced levels of grant

In addition, the Government has provided high levels of additional support to the current financing model since 2008; £9.5 billion in fact. With reductions in capital subsidy it will become increasingly difficult to maintain the delivery of affordable homes. During 2010, a proportion of new private sector housing units included some form of funding from the Homes and Communities Agency (e.g. Kickstart); thus adding a private sector impact to public finance tightening.

As a result local authorities will not be able to rely on any of the normal sources of supply, or the traditional sources of cross-subsidy, so they need to think of being proactive and drawing on what resources they have available (including land, other assets and the benefits of schemes like the New Homes Bonus[16]), matched alongside new sources of development financing.

15 Bank for International Settlements, Basel Committee on Banking Supervision – International Convergence of Capital Measurement and Capital Standards – June 2006

16 The Government has set aside £900 million over the course of the Spending Review period to incentivise local authorities to create new affordable homes and bring empty properties back into use.

5 FUNDING MODELS FOR CO-OPERATIVE AND MUTUAL HOUSING IN ENGLAND

(i) Existing Models

Government funded co-operative and mutual housing

(a) Ownership housing co-operatives

These co-operatives are fully mutual (all members are tenants). The significant majority were developed during the 1970s and 1980s using the standard social housing grant model. There are currently 243 such co-operatives registered with the Tenant Services Authority; they are serviced in three ways, through direct member voluntary input, through employment of staff members and through employment of management services organisations. Most of these co-operatives were developed by dedicated co-operative housing development agencies, the largest of which is CDS Co-operatives (CDS).

CDS Co-operatives - In the mid 1990s, CDS was part of The Kent Housing Partnership with three other main partner housing associations (Moat Housing, Orbit and Hyde) and four other small housing associations. The Kent Housing Partnership was funded by the Housing Corporation over 3 years to build 2,300 homes in Kent; CDS's share was 430 homes, mostly for rent but some shared ownership. The Co-operative Housing Finance Society (CHFS) was established, part funded by CDS and match funded by the Housing Corporation through Innovation and Good Practice grants; this enabled mortgage finance to be raised at lower than commercial rates by issuing lenders a cash-backed 12 month interest guarantee, professional management services, acting as an intermediary with step-in rights and monitoring the 9 developed housing co-operatives' performance and compliance with loan covenants.

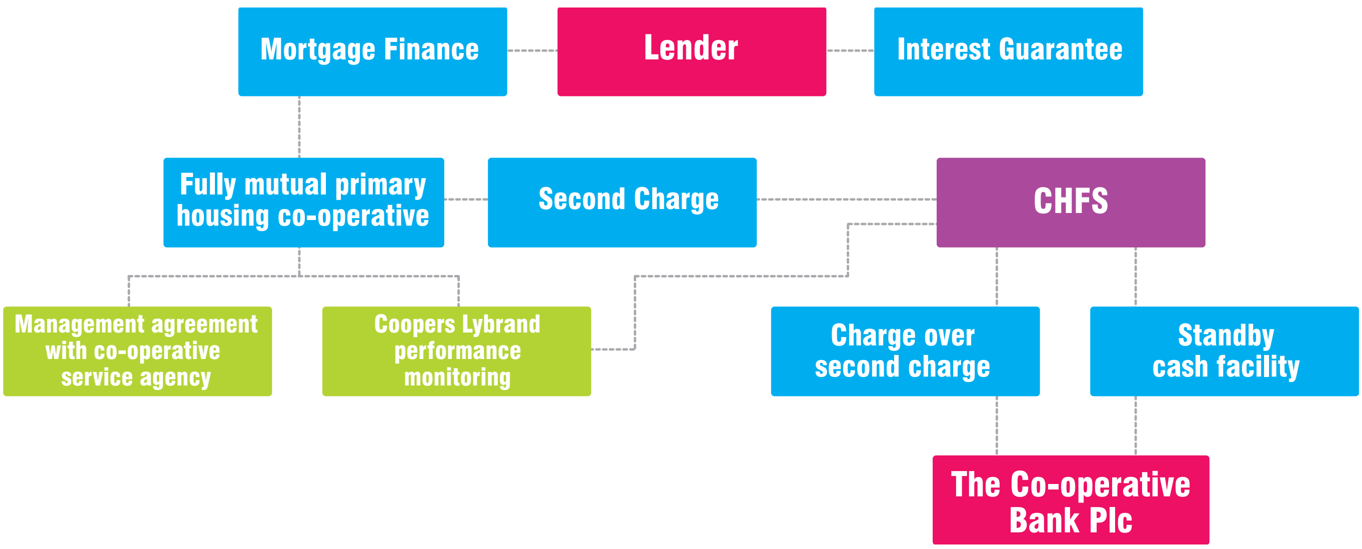

Chart 1: The legal structure of the Co-operative Housing Finance Society

Redditch Co-operative Homes (RCH) and its 6 leasehold housing co-operatives have been the only significant development of Government funded new ownership housing co-operatives in the last decade. They have developed 289 properties through a partnership between Accord Housing Association and Redditch Borough Council; the board is split equally between representatives from the neighbourhood co-operatives, Accord Housing Association and local authority. Chart 2 outlines the development and management model for the Redditch co-operatives.

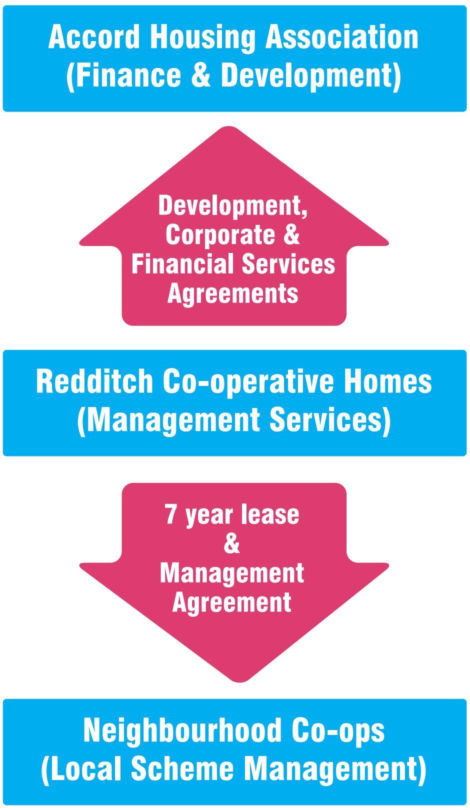

Chart 2: The Redditch Model for large scale housing co-operative development and management

The funding structure has developed over a period of time particularly as RCH has become a more substantial operation as well as the property transactions being de-risked.

Since RCH's inception, the acquisition of land and subsequent housing construction has been undertaken by Accord Housing Association, all associated risks have therefore been managed by a substantial housing provider as well as the initial development funding costs. Once the properties have been completed, and de-risked they are then capable of being transferred to RCH at a price agreed at time the scheme was originally developed.

The funding model for RCH can be explained in two phases.

Phase 1 – In 2003 Accord agreed a £6.5 million on-lending facility with RCH. The sole purpose of this facility was to fund the acquisition of properties from Accord. This on-lending facility allowed the assets acquired by RCH to be charged against an external Accord loan facility, as third party security.

Between 2003 and 2009, this arrangement enabled RCH to acquire 146 homes at a net cost of £6 million. Through this on-lending arrangement RCH benefited from a lower cost of funds, than had it attempted to borrow directly from the financial markets.

Phase 2 – In 2010, the Accord Group arranged a £135 million group wide cross collateralised loan facility with 2 funding institutions. These new facilities enable each member of the Accord Group, including RCH to borrow up to an agreed limit over the next 5 years, on a 30 year long term annuity basis. Security is charged by each member of the Group and can be utilised on a group wide basis. Loan covenants are generally monitored at a group level, thereby smoothing out the annual financial positions. With this new facility, RCH replaced its existing on-lending arrangement with Accord Housing Association, whilst still benefiting from the Group's borrowing scale, reputation and its ability to secure a more competitive cost of finance.

Other examples of housing associations / development trusts acting as developer and enabling local co-operative management include Coin Street Community Builders (4 leasehold management co-operatives in London), Hexagon Housing Association (10 tenant management co-operatives in London) and The Guinness Trust (development of Homes for Change Housing Co-operative and Work for Change with subsequent co-operative management in Manchester).

(b) Tenant Management Organisations

These co-operatives are non-fully mutual (tenants choose whether to become members). The significant majority were developed during the 1980s and 1990s on local authority housing estates through the Tenant Empowerment Programme; a smaller number were developed in housing association properties with Housing Association Grant funding or through stock transfers from local authorities to housing associations.

WATMOS Community Homes was established in 2002 through the stock transfer programme with funding from Lloyds Bank. It owns 1800 homes managed by 8 neighbourhood tenant management organisations; its board is made up of 8 tenant representatives and 4 independents.

(c) Glenkerry House

Glenkerry House is a 14 storey tower block of 78 flats on the Brownfield Estate in Poplar, London designed by the studio of the controversial Brutalist architect ErnŒ Goldfinger.

Since 1979 it has been run as a shared ownership housing co-operative. The co-operative bought a 99-year lease from the Greater London Secondary Housing Association, partly funded by grants from the Housing Corporation and the Greater London Council (GLC), and raised about a third of the cost from sales to residents (members). The GLC also provided a loan for the remainder (after grant and sales) of the cost, the interest on which is covered by ground rent charged to residents.

The freehold is now owned by the London Borough of Tower Hamlets. Residents buy and sell the leaseholds of their homes from the council at half the open market valuation, as assessed by the District Valuer.

Non government funded co-operative and mutual housing

(a) Loan stock funded housing co-operatives

Radical Routes was set up in 1992 having grown from a small group of housing co-operatives which developed in the 1980s which made it possible to raise investment centrally through a national investment scheme. It made loans to co-operatives to top up bank loans by issuing loan stock. In 1998 Rootstock was established which issues withdrawable shares to raise funds. In total over 40 loans have been made to co-operatives totalling in excess of £600,000; these have been used to lever a further £1.5 million for developing housing co-operatives.

(b) Right to Manage Companies

The Commonhold and Leasehold Reform Act 2002 provides a right for leaseholders to change the appointment of the management of their building to another provider, by setting up a mutual organisation to take over from the freeholder those rights of appointment of management of the building. All leaseholders in the property are entitled to be part of the Right to Manage Company and have equal right of access to and voting powers.

(c) Co-housing

There are 8 co-operative co-housing communities (with as many as 60 others at varying stages of development) that have been established to provide a community based approach to owner occupation where developments are funded through a collective mortgage which helps spread risk. Springhill Co-housing in Stroud was the UK's first new build co-housing scheme. The Threshold Centre in Dorset is the first mixed-tenure co-housing scheme to gain planning permission and government funding.

(d) Community Gateway Associations

There are 4 stock transfers that adopted the Community Gateway model[17] in England (Preston, Watford, Braintree and Lewisham). These were funded through bank financing with gap funding through loan write offs where necessary.

(e) Development Trusts

Development trusts can create co-operative and mutual housing schemes. One such example is Coin Street Community Builders which financed its purchase of the Coin Street area in Southwark in 1984 by borrowing £1 million from the Greater London Enterprise Board and the Greater London Council. It subsequently repaid these loans and financed its developments by borrowing from banks and the Nationwide Building Society. Alongside a community garden, neighbourhood centre, community and sports centre, shops, restaurants, cafes and exhibition spaces, it has developed 220 properties of varying sizes which are managed on long leases by 4 housing co-operatives.

(ii) New development models and potential funding sources

(a) Mutual Home Ownership

CDS developed the model for Mutual Home Ownership[18] as an innovative approach to developing intermediate market housing on land owned by a community land trust. Instead of owning an individual property or a percentage share of an individual property, resident

17 Confederation of Co-operative Housing, Chartered Institute of Housing & Co-operatives Union: Empowering Communities – The Community Gateway Model – January 2003

18 The Co-operative Party – New Foundations: Unlocking the Potential for Affordable Homes – January 2009 members own equity shares in a portfolio of properties mutually owned by them and other residents. The number of shares a member owns depends on what they can afford; the rent payable by members being geared to 35% of net household income.

(b) European Investment Bank

The European Investment Bank (EIB) is the bank of the European Union. It has 6 'priority lending criteria'[19] which include 'protecting and improving the environment and promoting sustainable communities' . The EIB could be an important future avenue for debt financing. Through The Housing Finance Corporation, it has lent over £600m to the English housing association sector and on a project basis to a number of large projects. It has recently allocated £70 million of funds to Scottish housing associations at competitive rates and the Scottish Government (as indeed is the UK Government) is actively exploring opportunities for substantially more funding from the EIB.

(c) The Big Society Bank

The Big Society Bank will ensure that all the money from dormant bank accounts made available to England is put to good use for the benefit of society. By expanding the social investment market place and helping to attract extra private sector investment it is expected that over time the Bank will generate hundreds of millions of pounds for charities, social enterprises and voluntary groups to fund social projects across the country, creating opportunities for social action and community involvement. As a wholesale organisation, the Bank will invest in financial intermediaries in the social investment market, who in turn will increase access to finance for frontline, social organisations[20].

(d) Scotland's National Housing Trust

The Scottish Government has proposed establishing a National Housing Trust initiative. An assessment by the Scottish Futures Trust concluded that a £4 million Scottish Government guarantee provision could potentially bring up to 25 times that amount from private sources to provide up to 2,000 homes while supporting around up to 2,000 jobs[21]. The scheme would be a national sponsored private rental programme with debt that is guaranteed by the Scottish Government being supplied by local authorities and equity by the private sector.

(e) New housing association flexible products

New products are being developed by housing associations that offer residents the chance to buy their properties in stages (such as L&Q's 'Up to You' and Gentoo Genie); it should be noted that these are not mutual or co-operative schemes and products, however there is no reason why such schemes could not be rolled out as such.

(f) Equitisation of housing associations

There is a growing school of thought that equitising housing associations is a viable and desirable method of increasing financing to the sector by allowing access to the standard equity sources; raising up to £30 billion without the need for on-going

19 European Investment Bank Corporate Plan 2010 – 12
20 Cabinet Office – CAB 126-10 – 19th July 2010
21 Scottish Government – Housing: Fresh Thinking, New Ideas – May 2010

grant support. Policy Exchange has proposed 3 mutual models (the BUPA, John Lewis & Co-op Models) for housing associations to adopt to realise this potential[22].

(iii) Revenue funding streams

(a) Community Land Trust Fund

Community land trusts (CLTs) originated in the USA in the 1960s. One of the most significant features of CLT ownership in the USA is that in the recent housing market collapse, mortgage default rates have been less than 0.6%: less than one tenth of the national rate. This has been attributed to the CLT's vetting of the purchaser and their loan arrangements, as well as ongoing support if owners get into financial difficulties.

In England CLTs aim to develop affordable housing and community resources through co-operative ownership by acquiring land through public investment, planning gain or philanthropic or charitable gifts and holding it in perpetuity.

The CLT Fund has been established (with contributions from the Esmee Fairburn Foundation, the Tudor Trust, the Charities Aid Foundation, the Nationwide Foundation and a private investor) to offer financial support to community groups and is separated into 3 separate funds:

- The Feasibility Fund – provides for a consultant to work with the group for a 'scoping day'
- The Technical Assistance Fund – provides grants up to £2,500 for a consultant to work up the ideas from the 'scoping day' into a fundable business plan including community involvement, financial, procurement and legal issues
- The Investment Fund – provides secured and unsecured loans for pre-development work (surveying, procurement and planning) and development finance which tops up bank loans and grant funding. The Investment Fund does not provide construction or any long term financing.

(b) Tenant Empowerment Programme

Establishing new mutual housing organisations requires revenue funding to build the capacity of the residents to manage their housing scheme. The Tenant Empowerment Grant is currently available to residents associations on local authority estates to assist them in examining their empowerment options and developing them into Tenant Management Organisations where appropriate. A review of this programme is currently being undertaken, during which it has been suggested that the scope of the programme (or any replacement programme) should be widened to include revenue support for new build co-operative and mutual schemes and Community Right to Build schemes.

22 Policy Exchange – Natalie Elphicke – Housing People; Financing Housing - 2010

6 FUNDING MODELS FOR CO-OPERATIVE AND MUTUAL HOUSING IN EUROPE[23]

A number of interesting lessons can be learnt from other European countries approaches to developing housing co-operatives; if applied to England these could be beneficial to enabling future developments.

(a) Germany

Housing co-operatives are exclusively financed through member contributions and mortgages. 40 housing co-operatives own their savings institutions. The members put their individual savings in their saving institution for medium and long term investment with an interest rate that is a little higher than a commercial bank. The members get back the interest earned at the end of the investment contract. This arrangement provides working capital for the housing co-operative that can be used for building modernisation and maintenance. These housing co-operatives are successful and financially sound.

(b) Sweden

Depending on the project, members / tenant-owners finance between 30% and 50% of the development cost and the rest of the financing is raised by the co-operatives through loans from banks and other private financial institutions. Tenant-owners can normally get a loan from the banks equivalent to 75% (up to 90%) of the down payment required.

HSB and Riksbyggen (a company owned by building unions and housing associations as a co-operative economic association) have both set up saving mechanisms whereby individuals can save to buy their future co-operative housing shares. Individuals who use this mechanism receive priority on new developments and benefit from better prices than the co-op shares sold on the regular market. However, there is not a mandatory mechanism to buy existing co-operative shares. It is also possible for members, upon a positive credit assessment, to get a loan from a financial institution to pay for their shares using the value of the shares as collateral. HSB Security Guarantee and other guarantees provided by the developer protect the financial security of the housing co-operatives for the first 7 years by purchasing any unsold apartments and taking financial responsibility for them.

(c) Switzerland

In 1991 the 3 umbrella non-profit / co-operative housing associations founded the Bond Issuing Co-operative (BIC), in collaboration with the Federation Housing Office. In 2007, 350 housing co-operatives were members of BIC,

23 Source: ICA Housing

238 of them participated in bond issues in 2007. Since 1991, over 30,000 non-profit dwellings have been financed by these means.

Commercial banks provide mortgage loans up to 80% of the total investment or property value.

The government supports financially the development of housing co-operatives by providing:

- financing to the revolving funds administered by the umbrella organisations that provide low-interest loans to housing co-operatives
- guarantees to the bonds issued by BIC
- counter-security to specialised mortgage co-operatives which in turn guarantee up to 90% of total investment.

BIC secures capital from the market by issuing bonds with 7 to 10 year terms. Bonds are guaranteed by the government. These funds are available to housing co-operative members of BIC. The interest rate is lower and remains the same throughout the term of the bond. It benefits tenants by keeping lower rents.
The umbrella organisations administer two funds: a revolving fund (financed by the government) and a solidarity fund (financed by members' contributions). Both funds provide loans to complete financing of the project and to reduce the costs. Loans are available to new construction, renovation, acquisition and / or take back of existing buildings according to applicable rules and ratios.

The principle of transferring public land in most cases on a leasehold basis to co-operatives with the state holding the freehold to ensure public accountability is a key driver of co-operative development in Switzerland and has much applicability in England to the Coalition Government's localism agenda and to the potential development of co-operative and mutual housing.

7 FINANCING THE DEVELOPMENT OF NEW CO-OPERATIVE AND MUTUAL HOUSING

Current barriers for individual small schemes

Wide ranging discussions were held with banks and other financial institutions[24] that aimed, among other things, to identify why lenders are reluctant to lend in small quantities to numerous start-up organisations; the key reasons are:

(a) The loans involved are too small for specialist commercial lending teams and too big for the high street branches of banks
(b) Lenders do not like lending to new organisations lacking in business and management track records
(c) Lenders have little appetite for non-recourse loans; unless of a high credit quality
(d) Sourcing and managing a large portfolio of small loans is resource intensive
(e) Lenders do not want to have the resource requirement of dealing with default, which is proportionately higher for smaller loans
(f) A preference to lending to regulated entities

In general the financing terms will follow the risk profile of the underlying project rather than the strict structure of the borrower. In the current market there is minimal appetite for speculative residential development among the major lenders, outside the major housebuilders or very selective schemes.

The potential of Real Estate Investment Trusts

In January 2007 the UK-REIT regime was introduced as a tax efficient vehicle for large-scale indirect property investment. Since then more than three-quarters of the UK's major listed property companies have converted and it is often suggested that the structure is the most suitable listed vehicle for investment in residential property, however, to date only two UK-REITs contain residential property in their portfolio and there are no REITs that invest solely in residential property.

A recent Government consultation asked a number of questions about the suitability of the UK-REIT structure for investment in the private rented sector[25]; although the same questions could apply to a REIT funding vehicle for co-operative and mutual housing.

'The majority of respondents suggest that Residential REITs would be viable under the current model if suitable portfolios existed for purchase, a key theme that emerged was that some of the requirements of the REITs regime may also act as a barrier to residential investment. The Government would therefore propose to carry out further work looking at the barriers to residential investment through UK-REITs, and whether changes to the entry requirements of the regime might encourage the emergence of new REITs, including residential REITs.'[26] It is recommended that the potential for the

24 A full list of organisations who contributed to the development of this report are listed in Appendix B
25 HM Treasury – Investment in the UK Private Rented Sector – February 2010
26 HM Treasury – Government response to the consultation on investment in the private rented sector – September 2010

REIT model to be utilised at a future date is kept in mind by those creating funding models for developing co-operative and mutual housing.

A warehousing solution

The requirements of the various parts of the co-operative and mutual housing sector for new development finance are varied; some require £1 million for an individual scheme, some £20 million to enable a number of schemes and some £50 million for large single schemes. In our discussions with banks and other financial institutions it has become clear that these collective requirements can be best met through a single warehoused solution. In the short term this must be through a collaborative approach with existing developers with a demonstrable track record.

In the short term it is necessary to provide impetus to the development of co-operative and mutual housing which cannot be realised through piecemeal small projects which lack a co-ordinated approach to raising finance. This could be done by a single aggregated solution which would aim to raise an initial bank facility of around £250 million, with a longer term bond refinancing; which would allow recycling of the initial facility.

The finance would be raised through a central warehouse (which could be an existing conduit or lead housing association) that would take charges over current, unrestricted assets and be repayed through social rental cashflows (these schemes could be a mix of the development models identified in Chapter 1 or new models); due diligence and monitoring would be undertaken by the central warehousing organisation.

Development would be undertaken by existing developing housing associations or private developers with a demonstrable commitment to co-operative and mutual housing. Schemes will need to be supported by partner local authorities; possibly contributing public land (where they retain freehold ownership and grant long leases to the developer associations) to ensure the affordability of the housing developed. Homes and Communities Agency grant, New Homes Bonus and Right to Buy Receipts could also be applied where available.

In developing new schemes with units for open market sale it is assumed the risk of any open market sale units is taken by the developer and that the funding requirement therefore relates to an ongoing affordable housing provision. Development risks could be underwritten by the developer, either via a construction / cost overrun guarantee or via funding the development and transferring ownership on completion.

The schemes developed would then be managed by a local co-operative or mutual housing organisation; this would be dependent on the local organisation gaining CCH Accreditation[27].

27 Confederation of Co-operative Housing – The CCH Accreditation Framework for Housing Co-operatives - 2010

An expression of interest has been developed by the team implementing the recommendations of 'Bringing Democracy Home' that will be distributed to identify partner local authorities and housing associations.

A long term mutual Special Purpose Conduit

In the long term it may be desirable to create a new special purpose conduit (SPC) or utilise an existing one to provide an on-going financing warehouse that would on lend to developer organisations. It may be possible that any public money that is invested goes in as a first loss tranche. The SPC would batch schemes using bank debt which would be financed long term by bond issues (possibly with differing time periods) to institutional investors and individual member investors; a basic model is shown in Chart 3. Setting up the SPC (including addressing governance and legal issues) would require a phased development program leading to an established organisation that is operational. The board of the SPC would need to be made up of a mix of members with experience in banking, financial management, risk management and co-operative and mutual housing. The SPC could be an Industrial & Provident Society with notional shareholding held by a number of stakeholder organisations (including CCH, partner banks, housing associations and financial institutions, the Homes and Communities Agency and the co-operative movement).

Scoping the longer term viability of creating a new SPC requires further work. A number of banks, financial institutions and legal firms noted such an organisation's value and have expressed interest in assisting in its development. Funding should be identified and secured to enable a feasibility study to be commissioned that will build on the initial discussions conducted as part of the work of the Finance Group, map a development path and model the financial, legal and governance structure of the proposed SPC.

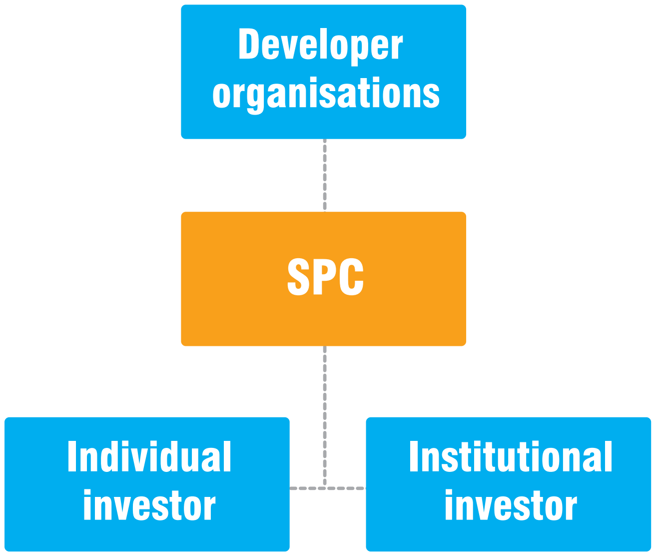

Chart 3:
Basic structure for Special Purpose Vehicle

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Appendix A

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Appendix B

Organisations consulted with by the Finance Group

Our thanks go to those who met with us from each of the organisations listed below for their candour and insight.

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Steve Amos (Barclays Corporate)

CCMH
Commission on Co-operative and Mutual Housing

cch
Confederation of Co-operative Housing

CIH

NATIONAL HOUSING FEDERATION

iN business for neighbourhoods