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Funding Options in Social Housing



The Housing Finance Corporation Limited

Learning Outcomes

1 Describe how the current financial climate impacts on funding options for social housing providers

2 Detail the different types of debt capital and explain the advantages and drawbacks of each

3 Explain how interest covenants are affecting choices about debt

4 Understand equity partnerships, including their possible advantages and drawbacks



Summary of social housing development and/or retrofit finance market?

Overview

- Whilst some grant funding is available for social housing development and retrofit, **debt funding** has always been an important source of finance

What is Debt Funding?

- **Debt funding** involves borrowing money, repaying interest on the loan each year and repaying the borrowed money in the future

CHALLENGES OF BORROWING MONEY?

- Challenges of borrowing money:
 - I. **Interest rates** have risen significantly in recent years.
 - II. Loan often come with an **'interest cover' covenant**. This is a maximum ratio of debt to earning and minimum ratio of earnings to interest costs. As rates and borrowing have increased some HAs are close to these covenant levels.
 - III. **Strained balance sheets** – Sustainability of adding debt to balance sheets in a higher rate, higher inflation and lower government grant environment to finance development / retrofit works needs to be considered carefully.

What are the challenges with associations taking on debt to finance the development of new homes or to improve existing ones?

For debt to be a viable option for the sector, it needs to be:

1

✓ Available – No issue at present

2

✓ Repayable – No issue at present

3

× Affordable – Affordability of debt is the biggest challenge

What are the current advantages and drawbacks of specific methods of debt?

1) Bank Funding

Benefits

- ✓ **Flexible** - Revolving Credit Facilities – it is possible to withdraw money, use it to fund development, repay the loan, and to then withdraw it again when needed
- ✓ **Cost effective**

Drawbacks

- × **Loan covenants**
- × **Short-term requiring regular financing**
- × **Variable interest / interest rate**

2) Capital Markets Finance - Own-name public bonds issued by HAs

Benefits

- ✓ **No financial covenants** or other restrictions (e.g. mergers)
- ✓ **Low-cost long-term debt option**

Drawbacks

- × **High fixed costs to issue a bond**
- × **Resource intensive**
- × **Large Debt Requirement** - Need to raise hundreds of millions as debt, as investors that would hold own name bonds focus on larger deals

What are the current advantages and drawbacks of specific methods of debt?

3) Aggregators – Source funds from capital markets and on lend to HAs

Benefits

- ✓ Gives HAs most of the **features of a public bond**, but without the need for an individual organisation to raise hundreds of millions of pounds of debt
- ✓ **Less resource intensive**
- ✓ **Shared fixed costs**

Drawbacks

- × **Aggregator management fees** means it may not be as cheap as a public bond

4) Affordable Homes Guarantee Scheme – Government backed loan scheme

Benefits

- ✓ **Lowest-cost funding option**
- ✓ £3bn of funds committed to the scheme in February 2024

Drawbacks

- ✓ **Application process can be time-consuming**
- ✓ **Loan Covenants**
- ✓ Other terms and conditions such as **reporting requirements** and building beginning within 3 years of money being lent.

What are the current advantages and drawbacks of specific methods of debt?

5) Private Placements

Issue debt securities directly to Private Investors

Benefits

- ✓ **Flexibility on tenor** (the length of time remaining before a financial contract expires)
- ✓ Possible for the provider to **tailor requirements** for specific needs

Drawbacks

- × May need extra terms and conditions compared to public bonds, and even covenants
- × Usually more expensive than public bonds

6) NWF Backed Schemes

Provides financial guarantees to support retrofit lending

Benefits

- ✓ **Unsecured loans**
- ✓ **Financial guarantees of up to £750m announced** (further announcements expected)

Drawbacks

- × Funding can only be spent on permissible 'retrofit' measures
- × Some extra ESG reporting requirements
- × Limited guaranteed funding available

Are there forms of capital other than debt which could help meet the sector's needs?

Equity Funding

- 'Equity Partnerships' enable social landlords to **secure additional capital, avoiding drawbacks of debt capital**
- Unites not-for-profit social housing organisations with newer, for-profit registered providers of social housing.

Benefits

- ✓ Additional capital can make it possible to deliver development and retrofitting programmes.
- ✓ Allows parties to capitalise on their strengths and areas of expertise, improving residents experience.

Models / Structure

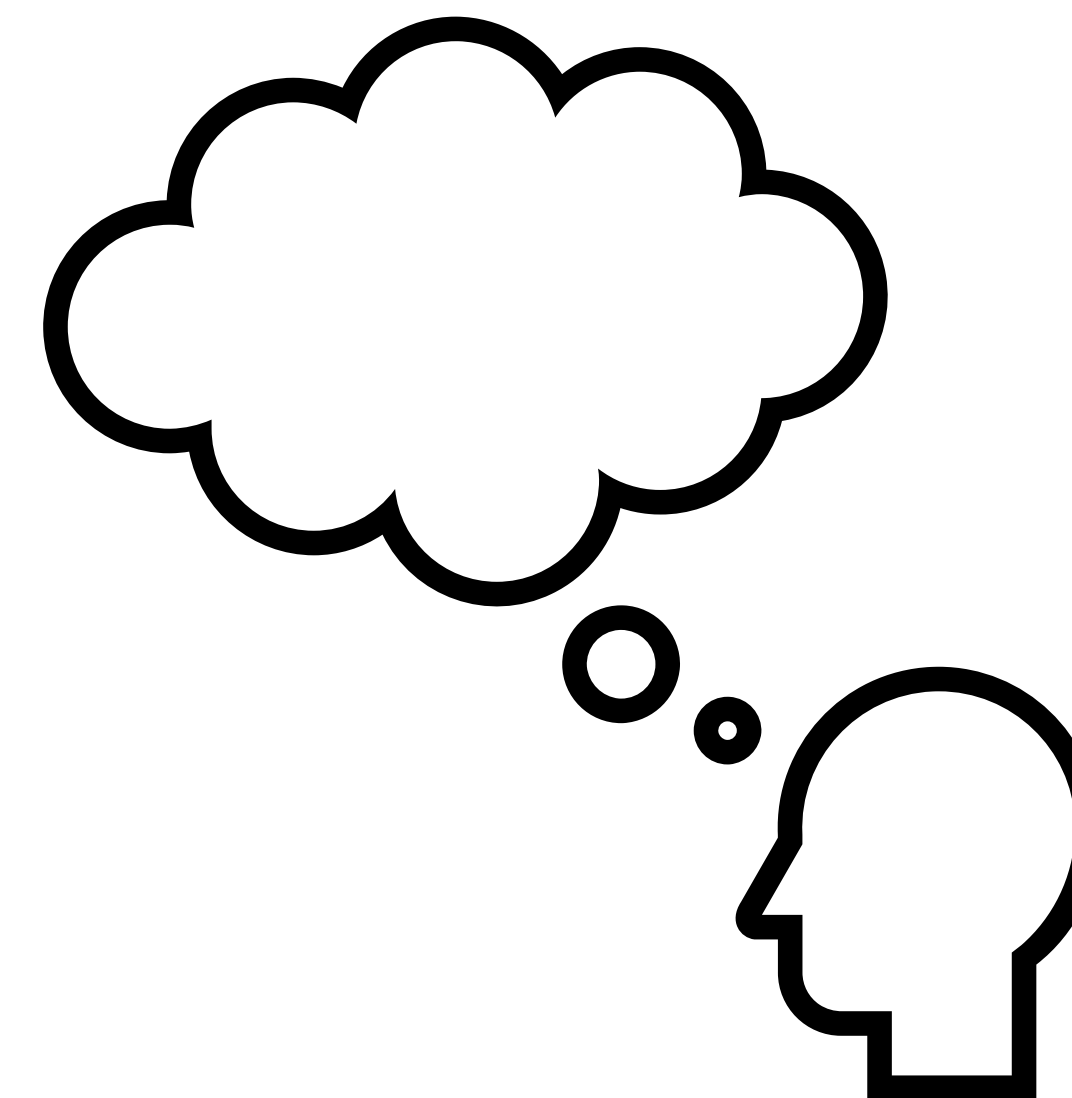
- Equity partnerships can see partners buying ownership stakes in a company or venture – with different investors purchasing equity to become shareholders.
- A report from the BPF outlines some of the possible set-ups for such collaborations:
 - I. A for-profit owns a property, but outsources its day-to-day management to a housing association
 - II. A for-profit owns the property, but leases it to a housing association
 - III. The housing association sells assets to a for-profit
 - IV. An ownership joint venture between the for-profit and housing association
 - V. With new stock, it could be that a for-profit directly invests in such property. Alternatively, there could be development joint ventures with housing associations

Drawbacks

- × Potential managerial capacity may not be able to keep pace with rapid growth in units supported by PE
- × Potential funding to be more expensive than debt
- × Reduced control / greater levels of expected returns
- × PE not always the right solution for individual HAs face
- × Need to understand contingencies if PE relationship does not work out

What will social housing finance leaders consider when making decisions about funding options?

- I. There is **no one universal best approach** to funding. Individual leaders will need to consider the specific make-up and circumstances of their organisations.
- II. They need to be careful to **consider how a funding choice** works for an organisation in the **here and now and into the future**.
- III. Boards should ensure they **understand the funding decisions** they are making, drawing on advice from sector professionals where appropriate.



Summary

- Current financial environment presents potential funding challenges to social landlords.
 - Problematic at a time when there is a need to build more homes, and to improve safety and energy efficiency of existing stock.
 - Debt capital remains a viable option but involves more complex considerations than it once did.
 - Alternative funding models are increasingly being used however are not without risk.
- There are challenging decisions to be made on how best to finance social housing, both within individual organisations and at a national level.

