

Annual review of housing association private finance



AFFORDABLE HOMES STRONG COMMUNITIES



Contents

Executive summary	2
Introduction	3
Analysis of private finance in housing associations	4
Total private finance	4
Lenders	5
Interest rate management	6
Interest costs	9
Repayment types	12
Forecast private finance requirements	12
Treasury management and efficiency	14

Executive summary

The housing association sector had arranged total private finance facilities of £35.921 billion at 31 March 2005. £25.605 billion of those facilities had been drawn down at that date.

£6.339 billion of new facilities were arranged in 2004-05, with debt of £2.929 billion being drawn down in the same period.

46.3% of private finance was drawn down to refinance existing facilities, over 20% for stock transfer and slightly less than 18% to fund new development.

Of the total loans drawn at 31 March 2005, 63% were arranged on a variable rate basis, continuing the recent trend in favour of more variable facilities. The data for the year suggests an increasing tendency to hedge variable rate debt.

The sector's weighted average interest rate on its fixed rate portfolio at 31 March 2005 was 6.89%, down from 7.04% a year earlier.

Interest rate margins on new variable rate facilities average 45 basis points, but this falls to 36 basis points when the data for a small number of associations subject to significantly higher margins is excluded.

In returns submitted to the Housing Corporation in 2005, associations were forecasting draw downs of almost £5 billion of debt in 2005-06, falling gradually from £4.2 billion in 2006-07 to £3.4 billion in 2009-10.

Treasury management efficiencies represent a significant proportion of the 'whole organisation' gains included in associations' annual efficiency statements.

Introduction

This is the first Annual review of housing association private finance. It replaces the Private finance monitoring bulletin which we have published, with the National Housing Federation, in previous years. Much of the data reflected in the review was supplied, via the Private Finance Regulatory Return (PFRR), by housing associations¹ registered with the Housing Corporation and with more than 250 units in management.

As usual the analysis of data is dependent upon the accuracy of the actual data provided by housing associations. We do not believe that there are any inaccuracies in the data that are material enough to distort the view provided in this review, but as stated in last year's monitoring bulletin there is evidence of associations re-classifying debt and other information within their PFRRs year on year. Readers should also note that as significant amounts of existing facilities are re-financed each year, and because arrangements on existing facilities may be revised, it is not always possible to reconcile movements in balances year on year with the activity that has taken place during the year.

In replacing the monitoring bulletin, this annual review:

- focuses on activities in the year to 31 March 2005 rather than on the cumulative level of activity since the concept of private finance in the sector was introduced by the Housing Act 1988 and
- draws on the full range of information we collect relating to private finance and treasury management, for example in annual accounts and annual efficiency statements, to give a rounder picture of what is happening in the sector.

¹ For the sake of readability, the term 'housing association' is used throughout the Annual review of housing association private finance as a generic term for all registered social landlords, including housing trusts, co-operatives and housing companies.

Analysis of private finance in housing associations

Total private finance

The sector had total private finance facilities of £35.921 billion in place at 31 March 2005. A total of 74% (£25.605 billion²) of those facilities had been drawn down at that point, slightly up on previous years in percentage terms.

Total private finance at 31 March (£ billion)

	2002	2003	2004	2005
Facilities	26.028	30.630	32.954	35.921
Drawn	19.813	22.162	23.927	25.605
Drawn as % of facilities	76%	72%	73%	74%

£6.339 billion of new facilities were raised in the year to 31 March 2005, up 16% on the previous year. There was a similar percentage increase in the loans drawn down in the year. As a result in both of the two years to 31 March 2005 loans drawn represented 46% of facilities arranged in the year.

New private finance (£ billion)

	2001-02	2002-03	2003-04	2004-05
Facilities	3.287	5.980	5.450	6.339
Drawn	1.756	2.401	2.508	2.929

In terms of the reasons for drawing down debt, refinancing of existing facilities continues to be increasingly significant at 46.3% of new loans drawn down (from 31% in 2002-03). Compared with the previous year, in percentage terms, less loans have been drawn to fund a combination of new development/stock purchase and refinancing of existing facilities, with more emphasis on raising debt for liquidity and internal working capital reasons.

² This compares with a figure of £26.9 billion in the 2005 Global accounts of housing associations. The debt in the global accounts includes loans between group companies which in the main are not captured in PFRRs. In addition a number of associations had not submitted a PFRR at the time data was extracted to produce the Annual review of housing association private finance.

Purpose of new private finance drawn in 2004-05 (£ billion)

	Drawn	
New development	0.516	17.6%
Refinancing of existing facilities	1.356	46.3%
Stock transfer	0.606	20.7%
Purchase of other properties	0.028	0.9%
Liquidity and internal working capital	0.273	9.3%
Combination of new development/ stock purchase and refinancing of existing facilities	0.140	4.8%
Other	0.010	0.4%
Total	2.929	

Of the £0.606 billion drawn to fund stock transfers, 78% was drawn by stock transfer associations and 22% by traditional associations. This represents a change from previous years when in excess of 90% of funding of stock transfers was drawn by associations established to take transfer of local authority stock.

Private finance drawn to fund stock transfers in 2004-05 (£ billion)

	Drawn	
By stock transfer associations	0.472	78%
By traditional associations	0.134	22%
Total	0.606	

Lenders

The PFRRs suggest that the ten lenders most active in the sector during the year to 31 March 2005, in terms of facilities agreed, were, in alphabetical order:

- Abbey;
- Barclays;
- Bradford and Bingley;
- Britannia;
- Cheshire;
- HBOS;
- Lloyds TSB;
- Nationwide;
- RBS; and
- Royal Bank of Canada.

Interest rate management

It is possible to analyse the sector's drawn debt at 31 March 2005 by loan type according to interest rate management, together with the debt drawn during the year to 31 March 2005 (see table). Of total debt of £25.6 billion, 63% was in the form of variable rate loans compared with 59% at the previous year end, explained by the fact that 73% of debt drawn down in the year was variable rate in nature. Over half of total variable debt was subject to some form of hedging arrangement, whether that be by way of a short term fix (the predominant arrangement) or a derivative.

The data for debt drawn in the year suggests an increasing tendency to fix or otherwise hedge variable interest rates as associations take advantage of recent comparatively low rates.

Types of loan (£ billion)

	Drawn as at 31 March 2005		Drawn in 2004-05	
Fixed rate	9.021	35%	0.799	27%
Variable rate hedged with term fix	6.070	24%	0.907	31%
Variable rate hedged with derivative	2.133	8%	0.653	23%
Unhedged variable rate	7.818	31%	0.565	19%
Other	0.563	2%	0.005	0%
	25.605		2.929	

We can also analyse the length of fixes on those new variable rate loans that are hedged in that way (see table). In total, 39% of fixes are for terms of up to five years, and almost 70% of fixes are for ten years or less. Compared with the previous year, the trend appears to be towards fixing for shorter time periods (up to ten years) and for less fixing of debt for between 16 and 25 years.

Hedged variable rate loans, drawn in 2004-05, by term of hedge (£ billion)

	Drawn	
Up to 5 years	0.359	39%
6 to 10 years	0.260	29%
11 to 15 years	0.115	13%
16 to 25 years	0.173	19%
Over 25 years	0.000	0%
	0.907	

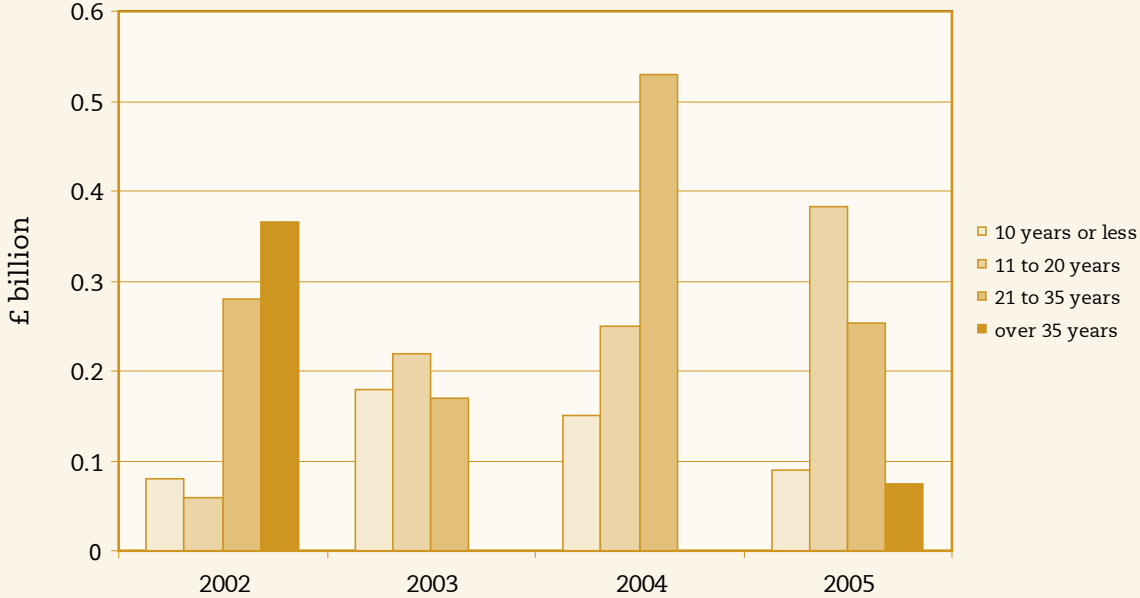
The term of fixed rate loans raised each year is shown graphically in the graph below. Compared with the previous year, a greater percentage of fixed rate debt has been drawn for periods of between 11 and 20 years. Interestingly, some fixed rate debt for terms of more than 35 years was drawn down in the year to 31 March 2005. No such debt was recorded in PFRRs in either of the two years to 31 March 2004.

We can also analyse derivative instruments by the term of the derivative (see table). Of new derivatives arranged, 82% were swaps, meaning that 80% of all derivatives at 31 March 2005 were swaps. Compared with the position existing at 31 March 2004, the average term of collars has increased whilst the average term of swap options has fallen. However, the level of activity on these derivatives is not great. Where activity is greatest – in swaps – the average term is relatively consistent with the previous year.

Derivative instruments (£ billion)

	New in 2004-05	Average term	As at 31 March 2005	Average
Cap	0.014	6	0.118	7
Collar	0.031	9	0.165	8
Swap	0.533	15	1.708	15
Swap option	0.074	10	0.142	16
	0.653		2.133	

Term of fixed rate loans drawn in year to 31 March (£ billion)



Interest costs

Associations provided information on interest costs, both in terms of fixed rates and margins on variable rate borrowings.

The weighted average interest rate on the fixed rate portfolio (fixed rate debt together with variable rate debt hedged by short term fixes) at 31 March 2005 was 6.89%, which compares with 7.04% at 31 March 2004. The weighted average interest rate of total fixed rate debt raised in the year to 31 March 2005 was 5.5%, slightly lower than in the previous year.

Large-scale voluntary stock transfers (LSVTs) continue to have the lowest weighted average interest rate (6.08% compared with 7.32% for traditional associations) for all such debt raised, although traditional associations raised the cheapest fixed rate debt in the year to 31 March 2005 (5.5% compared with 5.56% for LSVTs).

The table below shows the margins associations are paying on variable rate loans. The average margin on new facilities is four basis points higher than in the previous year. As with the previous year, this runs counter-intuitive to

market intelligence that margins are still tightening. This may reflect the different balance of associations taking on new facilities in the year to 31 March 2005 compared with the year to 31 March 2004. A detailed analysis of the margins recorded in PFRRs suggests that a few associations were subject to significantly higher margins on new facilities compared with other associations. Removing those facilities from the data gives an average margin for new facilities in 2004-05 of 36 basis points. The range of terms can also be assessed by considering the quartile positions. For all new variable rate facilities, the first quartile is at 33 basis points, with a third quartile figure of 50 basis points.

Interest margins (basis points) on variable rate loan facilities (£ billion)

New in 2001-02	Margin
2.207	50
New in 2002-03	Margin
4.024	39
New in 2003-04	Margin
3.673	41
New in 2004-05	Margin
1.218	45

The figure below plots the effective interest rate for the sector³ together with the base rate at 31 March of each year. The graph shows associations' rates changing with base rates, but by less than the base rate due to the presence of significant amounts of fixed debt in the sector. At the time of writing, the most recent Bank of England decision, made on 8 June 2006, was to maintain the rate at 4.5%, seven members of the Monetary Policy Committee voting in favour of maintaining the rate, and one member voting against, preferring an increase in the rate of 25 basis points.

The 2005 Global accounts of housing associations said:

“Following three year trends of reducing effective interest rates, this year has seen a slight increase in the ratio. The increase is reflected throughout the traditional association sector although it is marginal for the aggregate average and the median. It is, however, consistent with the increase in interest base rates throughout the period reflected in the 2005 accounts, following a long period of reducing and largely stable interest rates. In the period covered by these

accounts, interest base rates rose by 1% on comparative rates in 2004. Previous years had seen reductions in the base rate during 2002 and 2003, reflected in the reducing effective interest rate results.

“LSVTs have a lower effective interest rate than traditional associations, which is consistent with the position shown in previous years.

“Interestingly the analysis shows that the largest associations have more expensive debt on average than other traditional associations. This could reflect the higher risk profile of those associations which have diversified into an increasing number of market-based activities.”

As with all information produced on a global basis, the average ratios reported in the 2005 Global accounts of housing associations mask a wide range of performance. For traditional associations, the first quartile for effective interest rate is 5.7% and the third quartile is 7.6%, with a mean average of 6.4%. For LSVTs, the figures are first quartile 5.1%, third quartile 6.1% and mean average 6.0%.

³ Effective interest rates are from the Global accounts of housing associations which are produced annually by the Housing Corporation (previously with the National Housing Federation).

Comparison of the sector's effective interest rate and Bank of England base rate



Repayment types

The table below sets out the repayment types for new facilities raised in 2004-05. Almost 40% of new loans are subject to phased repayments with the remainder fairly evenly split between bullet repayments, and annuity/equal instalment of principal (EIP) repayment bases.

Repayment types (£ billion)

	New loans in 2004-05	
Annuity and EIP	1.821	29%
Bullet	2.032	32%
Phased	2.486	39%
	6.339	

Forecast private finance requirements

Below we have set out the private finance draw downs forecast by associations in the five year forecasts (FV5s) they submitted to the Housing Corporation in 2005. Associations were forecasting to draw down almost £5 billion of debt in 2005-06, with

draw downs forecast to fall gradually from £4.2 billion in 2006-07 to £3.4 billion in 2009-10⁴.

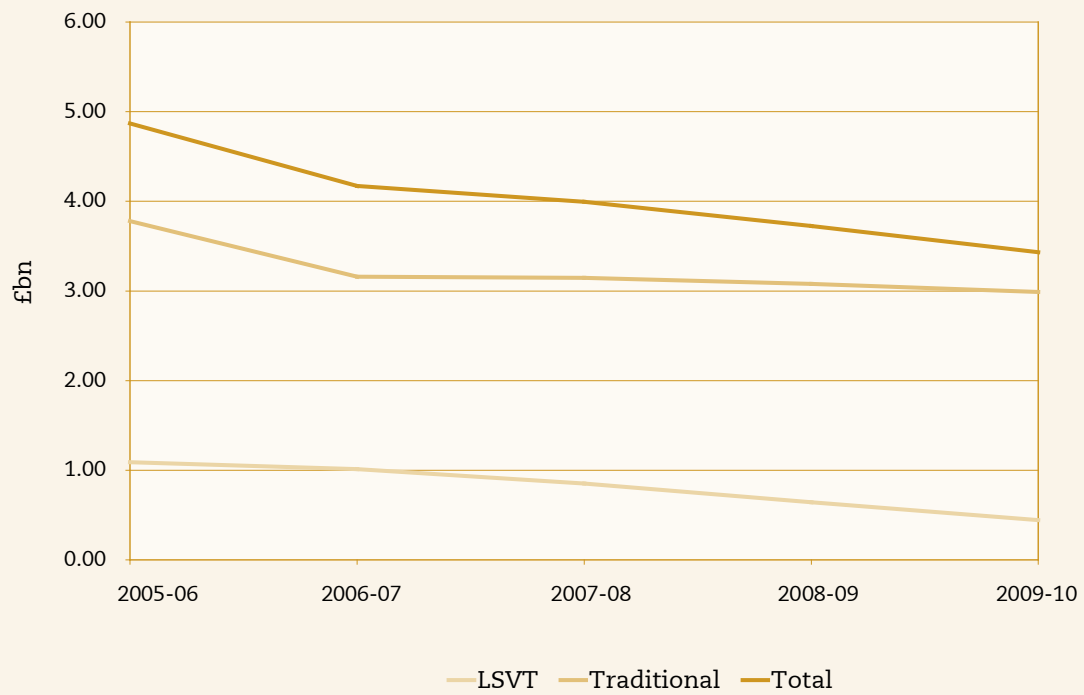
In 2005-06 and 2006-07, 22% and 24% of the new debt is forecast to be drawn by stock transfer associations. This reduces to 13% in 2009-10 as stock transfer associations registered before 31 March 2005 (and therefore submitting an FV5 in 2005) complete their initial improvement programmes.

Based on these forecasts, debt in the sector at 31 March 2010 would exceed £41 billion (taking account of loan repayments forecast). In reality this figure could be higher as:

- associations firm up development plans; and
- new stock transfer associations are registered and undertake their improvement works.

⁴ These figures are relatively high compared with those forecast in the 2004 Private finance monitoring bulletin, as they are gross draw downs forecast, rather than net of scheduled repayments.

Private finance requirements from 2005-06 to 2009-10



Treasury management and efficiency

In March 2006, the Corporation published Evaluation of annual efficiency statements 2005, a sector study analysing the annual efficiency statements (AESs) submitted by larger housing associations to the Housing Corporation in July 2005. Efficiency targets were set by the Government in respect of new supply, capital works, management and maintenance, and commodities. However, 28% of gains claimed by associations in AESs are from ‘whole organisation’ or ‘other’ areas. A significant proportion of the ‘whole organisation’ gains are through treasury management savings. This accords with the amount of refinancing activity which is taking place in the sector – one of the key drivers for this activity being to reduce treasury costs.

One association reported a £224,000 saving on renegotiation of a bond, in addition disclosing that “efficiency savings of £120,000 in 2005-06 are generated from the negotiations on the reductions on margins”.

A second association commented that “savings on interest costs as a result of this [more corporate] arrangement is in the region of £600,000 in 2005-06, with the benefits continuing into the future”.

The Corporation has considered introducing a financing efficiency measure into its suite of performance indicators. This has not proved to be possible, however we are pleased to note that there has been an increase in the amount of public debate in this area, and this should encourage more associations to consider the efficiency of their financing arrangements.

Our offices

Maple House
149 Tottenham Court Road
London W1T 7BN

For enquiries, contact us at:

Tel: 0845 230 7000

Fax: 0113 233 7101

E-mail: enquiries@housingcorp.gsx.gov.uk

Internet: www.housingcorp.gov.uk

CENTRAL

Attenborough House
109/119 Charles Street
Leicester LE1 1FQ

31 Waterloo Road
Wolverhampton WV1 4DJ

Westbrook Centre
Block A Suite 1
Milton Road
Cambridge CB4 1YG

LONDON

Waverley House
7-12 Noel Street
London W1F 8BA

NORTH

4th Floor
One Piccadilly Gardens
Manchester M1 1RG

1 Park Lane
Leeds LS3 1EP

St. George's House
Team Valley
Kingsway Trading Estate
Gateshead NE11 0NA

SOUTH EAST

Leon House
High Street
Croydon CR9 1UH

SOUTH WEST

Beaufort House
51 New North Road
Exeter EX4 4EP

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