Housing LIN
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Funding Extra Care Housing TECHNICAL BRIEF

Part Two: Capital funding

The social rent model of Extra Care Housing has evolved in the period since publication of the original 'Funding Extra Care Housing' Technical Brief by the Housing LIN. In parallel with the social rent model, providers from all sectors also implemented an increasingly diverse range of schemes, mixing tenures and uses as well as offering extensive facilities and services to suit a wide range of needs and preferences.

However, economic and housing market conditions have challenged the assumptions previously made in the appraisals for all forms of housing with care, testing some schemes to the point of financial failure and subjecting others to ongoing review and re-orientation in an effort to maintain their operational viability. This Part of the updated Technical Brief provides an overview of:

- the current sources of capital funding
- which of these sources are likely to be most appropriate for Extra Care Housing schemes
- how the characteristics of schemes influence the available range of funding
- what funders expect to be considered in submissions for funding and in appraisals
- a review of the appraisal types that could be used.

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Current sources of funding

This section is equally relevant to housing and care providers and local authorities with responsibility for housing and/or adult social care.

KEY POINTS

This overview of current sources of funding should be of use to:

Commissioners in housing and adult social care

- As a briefing on the diverse range of development funding sources that developers and providers may wish to utilise.
- As an introduction to funding terminology that may be unfamiliar.
- As a guide to the funding sources that may be most relevant to their particular commissioning objectives.

Developers/Providers

- To act as a prompt to consider a number of the current funding sources.
- To assist in deciding which funding sources may be most appropriate to their planned scheme.

In the previous Housing LIN Technical Brief, the emphasis was predominantly towards social rent and capital grants from central Government, including the Department of Health (DH) and Homes and Communities Agency (HCA). However, given that in recent years there has been a shift away from the former regime of grant funding, it is now appropriate to look at the alternative funding sources that contributed to the growth in private market provision of housing with care, along with consideration of the newly emerging additional routes to funding that can be accessed for both the social and market versions of this form of housing.

The funding sources covered here are listed in Table A on page 21, before being reviewed individually. Those that are most likely to be used for housing with care are marked with a tick ✓, the remainder are included as they have been suggested as possible sources in recent years.

Table A: Main funding sources

✓ indicates those most likely to be used for housing with care

SUBSIDY FUNDING	NON SUBSIDY FUNDING
HCA Affordable Homes Programme 2011-15 ✓	Local Authority prudential borrowing
DH Care & Support Specialised Housing Fund 2013-17 ✓	Local Authority housing revenue account ✓
Public land at nil or below market value ✓	Group banking facilities ✓
Capital subsidies from Local Authorities ✓	Own name bond issues ✓
Section 106 planning obligations ✓	Social finance ✓
Charitable fundraising ✓	Scheme specific banking facilities ✓
	Construction contractor finance ✓
	PFI and LIFT programmes ✓
	Private equity partners
	High net worth individuals
	Institutional investors ✓
	REITs and Property Investment Trusts ✓
	Property unit trusts and OIECs ✓
	Public pension funds ✓
	Consortia of pension holders

SOURCES OF SUBSIDY FUNDING

KEY POINTS

Given that Extra Care Housing schemes are relatively expensive in terms of build cost per unit and many of the schemes to date have been developed with high proportions of units for social rent and in areas with low property values, subsidy funding has been an essential contribution to the growth of the Extra Care Housing stock.

Although the size of the core HCA housing funding programme has been reduced, there are other significant subsidy funding sources that remain and this section considers the relative suitability and availability of these sources for Extra Care Housing.

✓ Homes and Communities Agency Affordable[20] Homes Programme 2011-15

While the proportion of the total affordable housing funded through the HCA allocated to housing for older people has been relatively consistent in recent years, (at circa 6% of the overall number of homes within the former and current programmes), we are now operating in the context of much reduced funding in the Affordable Housing Programme (AHP) for 2011-15, combined with the Homes and Communities Agency having a more diverse range of Investment Partners competing for funding, a shift towards loan type funding rather than grants, longer term programme-based rather than scheme-specific funding agreements with Investment Partners, and a shift to prioritise units at 'Affordable Rents' (ie, set at up to 80% of market rent) and low cost home ownership, rather than social rents.

These changes in the AHP greatly restrict the potential scope for subsidy funding of housing with care when compared with former years, but the programme remains relevant and useful to the HCA's Investment Partners (IPs), in particular due to familiarity of the participants with the process, and also the flexibility introduced in the new programme-based contracts which allows IPs to better manage changes in delivery timetables without losing their funding allocations. Conversely, at the time of writing, the large forward allocations made to these programmes means that less than a third of the total 2011-15 programme's value remains unallocated.

Notably, the AHP is based on much lower average subsidy levels per unit than in previous programmes and this will provide a significant test for funding applications for new housing with care schemes, as this model has evolved into a challenging combination of both high development cost and high operating cost. How new applications fare in the context of tougher tests of value for money remains to be seen, but most providers of the established Extra Care Housing model are already reconsidering their approaches to both build cost and operating cost.

A further complication of the current AHP is the separation of London from the rest of England, giving the Greater London Authority control of the programme within the capital, instead of the HCA, and potentially leading to differing priorities for allocations in London.

Finally, at the time of writing, we are awaiting details of the government's Comprehensive Spending Review and any announcement of further capital monies that may form part of the HCA's programme beyond 2015.

20 *In this Technical Brief, we use the capitalised form 'Affordable' when referring to the specific definition of affordability used in the Affordable Homes Programme and the Department of Health Care & Support Housing Fund, as defined below, ie rents at up to 80% of market rent. Elsewhere, we use 'affordable' in its everyday sense.*

✓ Department of Health Care & Support Housing Fund 2013-17

This recently launched Department of Health (DH) Fund is intended to fund housing for any of the following:

- older people
- people with dementia
- people with learning disabilities
- people with physical and sensory disabilities, or
- people with mental health problems.

The DH will make up to £160m available in this Fund to support the development of specialist housing outside London for older people and adults with disabilities over the 5 years from 2013/14. This new Fund will be administered by the HCA for schemes outside London, unlike its predecessor, the DH Extra Care Fund, which the DH administered itself.

The DH will also make up to £60m available for developments in London, which will be administered by the Greater London Authority (GLA) in a mirror of the arrangements for the current Affordable Housing Programme.

Unlike the programme based approach of the HCA's Affordable Homes Programme, awards from the new DH Fund for schemes will be made on a scheme specific basis and allocated in two phases, the first of which will only deal with Affordable housing, (defined in the DH fund prospectus as Affordable Rent and Shared Ownership). Applicants for schemes outside London must achieve HCA Investment Partner status before any payment can be made and all applications must involve a Registered Provider to act in the landlord role.

Notably, the Fund is intended to increase capacity of the following:

- housing that meets the Housing our Ageing Population: Panel of Innovation (HAPPI) design criteria and falls within the HAPPI definition of 'specialised housing models'[21]
- co-operative housing, or
- co-housing schemes.

The above are not yet well represented features of provision in the stock previously funded by either the AHP or the former DH Extra Care Housing Fund. However, the new Fund signposts to the Housing LIN's online directory of DH funded Extra Care Housing[22] to highlight innovation in the sector that has led to improved health and wellbeing outcomes for residents. With regard to the latter, and further to the Prime Minister's Dementia Challenge, the focus on dementia offers the potential for an improved quality of life for people with low level dementia, if new housing based specialised housing provision avoids, or at least delays, admission into institutional health or registered care settings. Further

21 *www.homesandcommunities.co.uk/ourwork/happi* *www.housinglin.org.uk/APPGInquiry_HAPPI*

22 *www.housinglin.org.uk/Topics/ECHScheme/*

information can be found in the Housing LIN resources on innovations in Housing and Dementia.[23]

One of the key features of the new DH Fund is to stimulate the wider market for specialist housing, and Phase Two is intended to encourage greater provision for private market home ownership.

This second phase of the Fund will be developed in the coming months and is expected to be launched in the summer of 2013. At this time, the DH and HCA are looking for expressions of interest from wider market developers for the funding on offer in Phase Two. The Housing LIN will be reporting back on the Fund's progress from time to time, as well as documenting the completion of successful schemes on its online directory of DH funded schemes.[24]

See the end of the section for a link to the full DH/HCA joint prospectus.[25]

✓ Public land at nil or below market value

The barrier of high development costs to the more widespread delivery of housing with care has, on occasions, been addressed through the use of public land at nil or below market value. This represents a number of challenges to public bodies considering this route, not least of which is an expectation in central Government that surplus land is disposed of for the highest achievable receipt. The key term here is the use of the term 'surplus' and the Housing LIN Viewpoint No 31, *Collaboration between Registered Providers and NHS Trusts: Building an Asset*,[26] and the report by One Housing Group, *Making creative use of NHS Estate*,[27] are both relevant to how reuse of existing health assets can be achieved in particular.

Some LAASCRs have also utilised their landholdings to subsidise housing with care schemes, usually linked to the Authority being granted Nominations Rights to units in the completed schemes. This is typically part of a re-provision strategy in areas where Authorities are seeking to reduce or end their direct provision of registered care and nursing homes and wish to increase the capacity of housing with care as a replacement for, or part of preventative measures to reduce their future need for placements in, registered care and nursing homes. At a unitary level, some Local Authorities have made former school sites available for redevelopment as Extra Care Housing schemes.

As with the DH Fund mentioned above, there are potential cost savings and

23 *www.housinglin.org.uk/Topics/browse/HousingandDementia/*

24 *www.housinglin.org.uk/Topics/ECHScheme/*

25 *www.hcaacademy.org.uk/sites/default/files/our-work/care_and_support_specialised_housing_fund_prospectus.pdf*

26 *www.housinglin.org.uk/_library/Resources/Housing/Support_materials/Viewpoints/Viewpoint31_NHS_Land_Disposals.pdf*

27 *www.housinglin.org.uk/_library/Resources/Housing/OtherOrganisation/Making_creative_use_of_NHS_estate.pdf*

improved outcomes to be had from increasing the capacity of housing with care for older people, which will continue to underpin Local Authorities' decision making in how their existing assets may best be used and in planning new provision.

How Local Authorities and other public bodies might use public land to pump prime new Extra Care housing is discussed further in the articles written by Darren Crocker, Charlotte Cook and Tina Hothersall in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[28]

✓ Capital subsidies from Local Authorities

Authorities have in some cases allocated capital expenditure to foster growth in the provision of Extra Care housing; for example, utilising their Personal Social Services Capital Allocation to deliver services that support personalisation, reform and efficiency.[29] Despite budgetary pressures, this is again seen by some LA ASCRs as an intervention that will produce long term savings in social services spending on institutional placements.

This has acted as a very useful measure that delivers new provision in a highly targeted way without reliance on the AHP or other national funds. This is particularly effective in enabling the controlled closure of Local Authority care homes through subsidies for alternative forms of local provision.

One example of this is a County Council's recent procurement of nominations rights in new Extra Care Housing to be built on the Council's own land, which the provider will pay for at pre-determined values, in return for capital grants from the County. The Council has made available £12. 65m of capital for the 160 social rent units in the overall programme, which has been divided into two phases for procurement purposes. This capital effectively subsidises the individual units to a similar level as the previously available HCA grants and enables the programme to be delivered without a reliance on HCA or DH grants.

An alternative approach is that taken by a County Council, where £10m of capital was allocated to support Extra Care Housing, half of this being made available as a grant and the remaining half being created by Council borrowing, which is then repaid over a period as a revenue charge from the Adult Social Care budget. The capital fund of £5m can be used as a balancing figure in an 'internal market' in order to secure County Council sites that are available for redevelopment but have higher land values than can be derived from an Extra Care Housing scheme.

Continuing budgetary constraints are likely to affect such expenditure but the prospects for Authorities to achieve long term cost savings through alternative

28 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

29 *www.dh.gov.uk/health/2013/02/lassl-2013-1/*

forms of provision will remain a strong influence on decision making where capital expenditure is possible.

The potential use of Tax Increment Financing (TIF) by Local Authorities to fund new Extra Care housing remains a possibility albeit one that is at present being discouraged by the Treasury. TIF involves Local Authorities using projected future income, such as Business Rates or Council Tax, to underwrite upfront subsidy for development. This is described in more detail in the article written by Charlotte Cook in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012). [30]

✓ Section 106 planning obligations

The use of Section 106 planning agreements to oblige developers to provide Affordable Housing will continue after the introduction of the Community Infrastructure Levy (which will address the wider investment requirements within each Local Authority). Most of the affordable housing provided to date under Section 106 agreements has been general needs accommodation and recent Central Government statements have suggested that Local Authorities should consider scaling down, or even removing, obligations to provide affordable Housing, (or make payments to the Authority in lieu of direct provision), if they are having an adverse effect on scheme viability which is preventing schemes being commenced.

Developers are well versed in negotiating Section 106 obligations of all types, but particularly in respect of Local Authority demands for affordable Housing as these can be challenged both through interrogation of the housing demand evidence provided by the Local Authority and also through the developer's scheme viability information.

The Community Infrastructure Levy may be used by Local Authorities to fund a wide range of infrastructure that is needed as a result of development. This includes transport schemes, flood defences, schools, hospitals and other health and social care facilities, parks, green spaces and leisure centres. The intention was to remove uncertainty from planning gain negotiations associated with Section 106 agreements, providing developers with improved forward visibility of the costs likely to be imposed on most forms of development. Note that CIL is charged on the chargeable floor area of the eligible types of development but also that not all Local Authorities have chosen to apply the levy. Affordable housing contributions are not replaced by CIL and still need to be negotiated for each individual site in the context of planning policy and project viability.

30 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

Given that Extra Care Housing has a far higher capital cost per unit than general needs housing, the potential for using Section 106 agreements to oblige developers to either directly provide Extra Care housing, or payments to the Local Authority to be used to provide Extra Care Housing, is probably quite limited due to the limitations of overall development viability and the increased complexity of negotiations regarding demand evidence and Extra Care Housing scheme costs.

However, there have been some instances of Extra Care Housing schemes being promoted by providers as a substitute for existing general needs affordable Housing obligations in Section 106 agreements and this may well suit all of the parties involved where an Extra Care Housing scheme can provide and share facilities on large scale housing developments that are normally difficult to fund and resource independently, for example: a local community hall; small shop, or GP consulting room (see Housing LIN case study No. 47, which describes Mill Rise in Newcastle under Lyme and provides an example of community facilities in an Extra Care Housing scheme).[31]

✓ Charitable fundraising

Many organisations that are active in the provision of Extra Care Housing have charitable status and benefit from large endowments and ongoing bequests. There are, however, further methods of charitable fundraising which are demonstrated in the activities of a large Extra Care Housing village provider. The provider's large scale villages of housing with care have used conventional sources of subsidy such as AHP and DH grants, but they have also obtained some additional funding through:

- a directly owned network of 60 high street charity shops
- pre commencement establishment of local community based fundraising and income generation activities
- donations from grant giving trusts and foundations.

The name and activities of this particular provider not only emphasise its charitable status, it also demonstrates an approach to fundraising similar to the mainstream big name charities outside of the housing and care sector. This additional source of funding is married with the involvement of volunteers in the operation of the completed schemes, fostering both initial forward interest from prospective residents and a growing local familiarity with the scheme which provides a pipeline of new residents as vacancies arise.

This type of relationship building is likely to require considerable management commitment and a resource to co-ordinate all of the activities and individuals involved. However, for providers adopting this approach, it does reduce their reliance on other funding sources and has in some cases also enabled them to become much more widely recognised by the public than many other RPs and not-for-profit providers.

31 *www.housinglin.org.uk/_library/Resources/Housing/Practice_examples/Housing_LIN_case_studies/Case_study_47.pdf*

SOURCES OF NON SUBSIDY FUNDING

KEY POINTS

The reduced availability of core HCA housing funding has contributed to an increased interest in development models that avoid a reliance on capital subsidies. A reduced need for capital subsidies may involve either a differing approach to scheme characteristics, eg accommodation size, extent of facilities, tenure mix or achievable revenue, or the use of alternative sources of funding, or a combination of both.

This section introduces the current non-subsidy sources of funding and considers their relevance to Extra Care Housing.

Local Authority prudential borrowing

There is little evidence of prudential borrowing by Local Authorities being associated directly with housing with care schemes, other than the County Council example given above on borrowing to specifically fund its Extra Care Housing plans. It is understandable that providers would be attracted to the use of money through prudential borrowing due to the relatively low interest rates. However, given the constraints on any form of public borrowing in the short and medium term, the prospects for funding new provision through this source seem very low.

Prudential borrowing is a form of public borrowing in the United Kingdom that can allow Local Authorities to exceed the caps placed on their other debt and liabilities. This type of borrowing must comply with the Prudential Code.

✓ Local Authority Housing Revenue Account

The discontinued Housing Revenue Account (HRA) subsidy system involved the national pooling of rents. Rents and expenditure needs were assessed: rents were then pooled nationally and allowances to spend money were allocated to Authorities on the basis of need. If the rents received in an Authority exceeded their allowance, then that Authority paid the surplus into the system (known as negative subsidy) and vice versa where the allowance was greater than the rents received.

The HRA self-financing settlement made a one off adjustment to the finances of all housing stock-holding Authorities in April 2012, after which time the Authorities will retain their future rent income and be free to invest in areas agreed with tenants and residents locally. This HRA settlement only affected those Local Authorities that still have their own housing stock and has the potential to allow some of these Authorities to fund new development, including Extra Care Housing schemes, subject to the specific borrowing restrictions set by Central Government at the time of the settlement. These are the subject of possible relaxations and do at the very least place Local Authorities on an equal footing to Registered Providers when they are bidding in the HCA Affordable Housing Programme.

The Housing Revenue Account (HRA) was the former system under which all Council housing rental income in England was aggregated together into a single ring fenced national account, (along with 75% of right to buy receipts). Central government then redistributed this HRA pool to those Councils in England with housing stock.

The HRA self-financing settlement came into effect at the end of the 2011/12 financial year and made a one off adjustment to the funding of Councils in England who had retained 50 or more units in their housing stock. Instead of housing rental income being pooled nationally and redistributed by central government, the self-financing settlement allowed Councils to retain their housing rental income and plan for 30 years of income and expenditure, including development and continuing improvements to the stock.

The intended outcomes of the settlement are a combination of reduced costs and greater local decision making, giving Authorities more freedom in housing asset management decisions, including the future of existing sheltered housing. The ability of each Authority to develop new stock will differ depending on: the amount of Decent Homes work that is still required; the decisions made regarding their housing investment strategy, and their new funding arrangements.

The potential of Local Authorities' HRA related income and investment to fund new Extra Care housing is discussed further in the article written by Steve Partridge in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[32]

✓ Group banking facilities

This form of funding is typical of both speculative housebuilders and construction contractors, in that they have an overall banking facility, usually with a single bank, and are relatively free to manage their business activities and cashflow within the covenants of the banking facility. The terms of this facility may include specific limitations on the activities of the business, for instance project types, individual project values and their locations.

The emphasis in this funding model is on the internal risk management of the

32 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

business, usually through standardised project reporting and authorisation procedures that provide checkpoints at key stages of each individual scheme when senior management must formally review progress to date against forecasts, and agree to the scheme proceeding further. The setting out of fixed criteria against which all schemes are tested at various stages is key to the ability of businesses with both a large geographical coverage and multiple schemes in progress to operate effectively.

This approach is evident in one major private sector developer of retirement housing and 'tailored care' but is not widespread.

Similarly, the conventional volume housebuilders who are public companies listed on the major UK stock exchange have had their own banking arrangements severely tested by the post 2008 housing market. The resulting more demanding banking facilities have subsequently required schemes to reach higher levels of forecast surplus/gross profit/Internal Rate of Return (IRR) than pre 2008, as a method of introducing a contingency against shortfalls in actual financial outcomes. It is not untypical to see gross profit requirements of 25% (ie before deduction of office overheads and funding costs) in order for open market speculative general needs housing to be considered proceedable. In addition, this would be subject to a deduction of circa 12% for overheads and funding costs, leaving a typical target net profit of 13%.

Note: *managing cashflow is not just to stay within banking covenants but also to avoid under- utilisation fees being applied by banks where facilities are not being fully utilised. These can be particularly difficult to avoid in scheme specific banking facilities due to the inability to spread costs and revenue variations across multiple schemes.*

Internal rate of return (IRR) is a measure of the rate of growth that a project is expected to generate. While the actual rate of return that a project eventually produces will often differ from its originally forecast IRR, a project with a substantially higher forecast IRR value than other available options would still provide a much better chance of strong growth.

IRRs can also be compared against prevailing rates of return in the securities market, (securities being shares or bonds and the market typically being the stock exchange). If an investor is unable to find any projects with IRRs greater than the returns that can be generated in the financial markets, it may simply disregard the projects on offer and choose to invest its retained earnings into the market.

✓ Own name Bond issues

Large businesses may also use issues of own name Bonds as a method of raising funds, although the appetite for these in the market will depend on the covenant of the business. Some larger 'general needs' RPs and construction companies have begun to issue retail Bonds in recent years and these have been very well received by the markets due to the relative strength of these entities (due to their asset base), being oversubscribed and receiving investment grade credit ratings of between AAA and A.

Most Bonds are issued with long-term maturities in excess of 30 years or more and command a premium of around 2% to gilt yields. Total sums raised by RPs to date vary between £75m and £850m.

For smaller 'general needs' or specialist RPs or those without an established credit rating, private placement could offer an alternative route to new investors and, in recent years, there are examples of where this has raised sums of between £48m and £130m. Private placement can provide smaller sums than retail Bond issues but will probably incur higher interest rates than their retail equivalents.

Note: *sums raised through Bonds may not necessarily be used for new development; the terms of the Bond issue will set out the purpose of the issue and this may be limited to refinancing the ongoing operation of a RP rather than any expansion of its stock or activities.*

A Bond is a financial instrument for raising capital, often used as an alternative to issuing shares. Bonds differ from shares in two major aspects: firstly shareholders have an equity stake in the company whereas bondholders have loaned money to the company, secondly bonds are typically issued with a fixed duration as with a fixed term loan, for example a company may issue 5 year bonds paying an interest rate of 5%. In this sense they are more predictable than shares, although the value of the bond may vary during its duration, which in turn affects the yield arising from the bond.

A Covenant is a financial parameter that determines key aspects of a business, for instance the size of its borrowings. Covenants are usually imposed by lenders and bankers. If covenants are broken (or breached), the lender or banker may exercise their right to repayments of loans or other penalties.

Covenant is also a general term used in respect of the financial standing and robustness of a business. Lenders, bankers and investors will be wary of businesses with poor covenants as they are high risk investments with a greater likelihood of default.

Long term maturities may be 10 years or more, maturity being the point at which the principal value of a Bond becomes repayable to the holder.

Gilts are bonds issued by governments of good financial standing, such as the United Kingdom or United States of America, (the latter are referred to as Treasury Securities). Gilts are regarded as a relatively safe investment to hold with stable yields.

The use of **Private Placement** involves the sale of securities to a relatively small number of invited investors as a way of raising capital. Investors involved in private placements are usually large banks, mutual funds, insurance companies and pension funds. Private placement is the opposite of a public issue, in which securities are made available for sale on the open market.

✓ Social finance

Social finance is typically directed at interventions into groups such as rough sleepers, vulnerable adolescents, ex-offenders or those with long term health conditions. As the purpose of social finance is to improve outcomes and payments are dependent on these improvements being achieved, services must be planned in detail and delivered within a robust reporting system.

This makes social finance more appropriate to services and projects that can be set within very well defined baseline and completion positions over a fixed term, such as small scale provision for people with dementia or learning difficulties. There are already examples of health commissioning for dementia accommodation and services which improve outcomes and avoids an over reliance on institutional settings which could be very appropriate to social finance.

The potential of social finance to fund new Extra Care housing is considered in Housing LIN Viewpoint 16, written by Brian Bailey and Martin Rich, entitled *Can Extra Care Housing funding needs be met with funding from Institutional Investors?* (published in July 2010).[33]

Social finance is an outcomes based method of financing service provision using **Social Impact Bonds**. These bonds are associated with an outcomes-based contract in which public sector commissioners commit to pay for significant improvement in social outcomes. Private investment is used to pay for services, which are delivered by service providers with a proven track record. Financial returns to investors are made by the public sector on the basis of improved social outcomes. If outcomes do not improve, then investors do not recover their investment.

33 *www.housinglin.org.uk/_library/Resources/Housing/Support_materials/Viewpoints/Viewpoint16_Institutional_Investors.pdf*

✓ Scheme specific banking facilities

The use of scheme specific banking facilities is most frequently associated with Special Purpose Vehicles (SPV) and Joint Ventures (JV), where either: overall banking facilities are insufficient or inappropriate to fund the new scheme(s); an SPV is being used to manage risk associated with the new scheme(s); or multiple partners are involved so no pre-existing banking facility can be used. The banking may be provided by a single bank or by a syndicate of banks within which one bank acts as the lead.

In the current market, the number of banks willing to make new loans for any form of property development is very small and their terms are relatively short term, with refinancing being necessary after only 5 or 6 years. Rates being quoted are 6% – 6. 5% but the main restriction on access to this finance will be the low Loan to Cost ratios now being applied, as these have fallen to circa 60% this year. This requires the developing entity (or the combination of partners in a JV), to have the necessary equity to cover the remaining cost, which will in turn limit their capacity to progress multiple schemes simultaneously.

It should also be noted that these types of facilities will incur costs for valuations, facility agent fees, arrangement, exit and legal fees plus the cost for monitoring surveyors to provide frequent scheme specific reporting to the bank(s). There could also be non utilisation fees, if the overall facility is underutilised, (as mentioned in the previous section regarding Group banking facilities).

Just as Bonds and company debts are traded, so too is scheme specific debt and this can be done without the prior knowledge or agreement of the debtor, breaking previous lines of communication and relationships built up from the origination of the scheme(s). This can be particularly disruptive in non-mainstream housing projects, such as Extra Care Housing, where the funders may not readily understand the client group or the operational model being financed.

A Special Purpose Vehicle (SPV) is a company or other legal entity, such as a Limited Liability Partnership (LLP), created solely for a particular financial transaction, or a series of transactions. The SPV's debts may, or may not, enable recourse of the lender to the parent companies of the SPV. In this way, the parent companies may use an SPV to distance themselves from the SPV's potential liabilities should it fail.

A Joint Venture (JV) may be formed for the cooperation of two or more entities in which each agrees to share profit, loss and control in a specific project, or programme of projects.

The **Loan to Cost ratio** is used in property and construction finance to compare the amount of the loan used to finance a project to the cost to build the project. If the project will cost £1 million to complete and the borrower is asking for £800,000, the loan to cost (LTC) ratio would be 80%. Note that the £1 million cost figure would have to include all of the costs necessary to complete the project, ie site acquisition, construction labour & materials, professional fees, statutory fees, as well as essential fitout items such IT equipment and furniture.

As an alternative to loan to cost, the **Loan to Value** (LTV) ratio compares the amount of the loan being requested to the open market value of the completed project.

✓ Construction contractor finance

Many of the larger main contractors now offer finance for the development phase of schemes in order to support their construction activities, including the development of Extra Care Housing. This may be bundled in with early equity contributions to cover the costs of pre-construction commencement work, such as site investigations, appraisals, planning and design development. It is important for client bodies to be able to distinguish between these external costs, internal costs being accrued by the main contractor, and finance charges directly arising from the finance being provided.

As a minimum, pre-construction costs should be budgeted in detail with the main contractor, which can then be used to benchmark competitive quotes, with selection, appointment and payment arrangements pre-agreed between the client body and the main contractor. In addition, the main contractor's internal costs and finance charges should be transparent rather than bundled into a single contract sum. Anything less than this cannot be checked for value for money and compared with the open market.

The rates charged by contractors for development finance will depend on their own funding situations; examples of current levels of main contractor finance are circa 6.5% – 7.5%. Where a main contractor provides some equity contribution to forward fund early costs this may well be charged at a higher rate, more akin to mezzanine finance levels, which could be 9% – 11.5%, hence the need to have these differing rates declared in the main contractor's offer.

Readers who are unfamiliar with the structure and terminology of loan facilities and debt funding may find it useful to refer to the article written by Niall Henderson in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[34]

34 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

Equity contributions, or equity investments, are money invested in a business, usually in return for shares. This money is not repaid through the normal activities of the business, although the shareholder may receive dividend payments in return for their continuing investment in the business. The money is instead only returned when the shares are sold.

Mezzanine loans are often used by developers to secure supplementary (or top up) financing for development projects in addition to the main debt for the project, (usually known as the senior debt). Mezzanine loans are higher risk than the senior debt as they are subordinate to the senior debt; ie mezzanine loans are only repaid after the senior debt is settled. It is therefore normal for mezzanine loans to be at comparatively high interest rates and for mezzanine funders to require direct guarantees from the developer(s) as security for their loan rather than just relying on the project generating sufficient value to meet all of the loans associated with it.

✓ PFI and LIFT programmes

Extra Care Housing has previously been funded through the Private Finance Initiative (PFI), but came to a temporary halt while the future of PFI as a whole was reviewed. The 2012 Autumn Statement contained announcements regarding a new model for future PFI procurement, (to be known as PFI 2). These changes are intended to make the procurement procedure quicker, allow the public sector to appoint directors to the boards of PFI companies, require more frequent financial reports and enable public bodies to obtain a share of PFI profits.

Although the original form of PFI has been criticised as poor value for the public purse, the Local Improvement Finance Trust (LIFT) version used in healthcare has delivered small scale projects with fewer negative associations. Some LIFT schemes have been associated with Extra Care Housing projects on sites shared with new health facilities and this could still have merit on sites with are suitably located, large enough and where there is value in the proximity between the housing with care and the type of health facilities being provided (see Housing LIN Case study No. 40).[35]

The current use of PFI for Extra Care housing and a short description of how PFI schemes are typically structured is included in the article written by Coralie Foster in the Housing LIN 'Get Smart'

35 *www.housinglin.org.uk/_library/Resources/Housing/Practice_examples/Housing_LIN_case_studies/Case_Study_40.pdf*

Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[36]

Local Improvement Finance Trust (LIFT) is a particular form of **Private Finance Initiative (PFI)** scheme, intended to bring private finance into primary and social care and community infrastructure, for example GPs' surgeries. The use of LIFT is led by Primary Care Trusts with the participation of Local Authorities and enables health and social care facilities to be built, or refurbished, and new profit-making companies made up of public and private sector partners, the private sector having a controlling interest. These facilities are then made available to the NHS through long term leases.

Private equity partners

Private equity has played a large part in business expansion and restructuring, the latter still being evident among businesses that have been underperforming and which offer private equity investors the opportunity to improve performance and achieve an increase in value to be realised through an exit from the business.

Private equity firms have recently taken large stakes in Housebuilders and Main Contractors, and are again increasing their presence in the care home sector, despite the failure of Southern Cross. The failure was caused by the rent burden arising from the sale and leaseback of properties previously instigated by private equity firms, along with the Property Company/Operating Company structures, (OpCo/PropCo), that have been adopted by some private sector care home providers. This pattern of whole business investment is unlikely to change and as private equity is less attracted to either steady returns or one off/scheme specific involvement, it is unlikely to provide any major new finance for housing with care.

Property Company/Operating Company (OpCo/PropCo) structures deliberately separate the property and operating activities of a scheme in order that these can be owned, traded and controlled independently of each other. A developer would typically use this type of structure to simplify the sale of these interests to other parties in order to achieve an exit from a scheme, for example the sale of the Property Company to a long term investor.

36 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

High net worth individuals

The most commonly used international definition for High Net Worth Individuals, (HNWIs), is people who have over $1m, (£620k), in investable, (ie, liquid), assets. According to the most recent World Wealth Report, (Capgemini/Merrill Lynch 2011),[37] there were around 441,000 people in the UK in this group in 2011, a fall of 2. 9% compared with 2010. While this group's investments are diversified across many asset classes, many HNWIs have been badly affected by poor results from their investments in previous property developments and in financial products designed specifically for them, leaving them with a legacy of 'problem' investments and a reluctance to engage in new property schemes. As a result, they are unlikely to provide a significant source of new finance for new Extra Care Housing schemes.

✓ Institutional investors

The HCA has sought to generate interest among institutional investors, (principally Pension Funds and Insurance Companies), in the housing sector. The key barriers were previously considered to be Stamp Duty on bulk purchases and shortcomings in the suitability of Real Estate Investment Trusts, (REITs), both of which had been addressed, yet investment had still been slow until very recently.[38] There are now signs that some of the large institutional investors are ready to make significant long term commitments to 'general needs' housing, with quoted rates of 4. 5% being on far more attractive terms than the other currently available sources.

How the resulting investment will be directed to housing with care remains to be seen and institutional investors will still be free to trade their investments according to their investing priorities, so it is notable that retail market orientated REITs and Property Investment Trusts for housing are also gaining traction, as both of these would feed an enlarged potential pool for retail trading of shares in housing investments.

The priorities of institutional investors and their expectations regarding returns are described in more detail in the articles written by David Dent, Niall Henderson and Coralie Foster in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[39]

37 *www.ml.com/media/114235.pdf*

38 *www.gov.uk/government/uploads/system/uploads/attachment_data/file/11586/2204242.pdf*

39 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

Stamp duty is a form of tax charged on the transfer of shares or securities, as well as certain transactions involving partnerships.

Stamp duty land tax (SDLT), is a transfer tax for land transactions, derived from stamp duty.

A Real Estate Investment Trust (REIT) is a company that owns and often manages income producing property or property related assets. REITs provide a way for individual investors to earn a share of the income produced through property ownership without them having to buy and hold the properties themselves. The property assets owned by a REIT may include office buildings, shopping centres, hotels, warehouses, or, (in the US), mortgages or property related loans. REITs often specialise in one type of property.

Property Investment Trusts are offshore vehicles that were set up before the REIT legislation made onshore property companies tax-efficient. Some have since converted into REITs. Traditional investment trusts and property investment trusts are typically managed by external teams, unlike REITs which are usually managed directly by in-house teams.

✓ Real Estate Investment Trusts and Property Investment Trusts

The same aggregation effects raising the interest of Institutional Investors is also creating workable scale for the creation of new Real Estate Investment Trusts, (REITs), and Property Investment Trusts.

At present, UK REITs are solely property owning entities that collect rents from those properties and distribute this income to their shareholders. There are Mortgage and Hybrid REITs in the USA which, as their names suggest, either solely provide debt finance for property or blend debt finance with property ownership. The UK Government has been lobbied to introduce these other forms of REIT in order to create more liquidity in the property debt market and take up existing bank loans. Recent reforms have offered relatively little to foster the establishment of residential property focussed REITs. However, the recent 2012 Autumn Statement has included a commitment to further consultation in preparation for further reforms that will enable REITs to fit the social housing model.

As regards progress with other types of property owning REITs, those established in the UK to date are predominantly conversions of pre-existing commercial property investment portfolios and, in

the present economic climate, have not been well regarded as investments due to concerns regarding the weaknesses in the income stream from their holdings.

It is therefore interesting to note the recent evolution of the product, Single Access Funding – REIT (SAF REIT), now named 'Houses4Homes', as it is primarily intended to fund supported housing and housing with care. While the emphasis of the SAF REIT is on refinancing existing stock in order to reduce costs for housing providers, it has tested both the appetite of potential REIT investors for housing as a use class, and also the terms on which such a REIT can be acceptable to housing providers, Local Authorities and investors.

Further comment on the role of REITs in funding new development can be found in the articles written by Darren Crocker and Charlotte Cook in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012). [40]

✓ Property unit trusts and OIECs

Other than the relatively new REITs, the existing non retail and unlisted property related investment vehicles on the stock exchange are primarily Property Unit Trusts and Open Ended Investment Companies, and these can be used by Local Authority Pension Funds or other institutional investors to finance new

40 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

development. As with the current UK property REITs, these are also property owning entities that collect rents and distribute income to their shareholders. However, these are not yet very active in the housing sector.

✓ Public pension funds

Public sector pension funds in the UK have traditionally had commercial property investments, often in shopping centres and retail parks, but the move into housing is still very small in terms of the overall size of these funds. Their counterparts in Canada have been regular investors in private sector housing with care, (ie, senior living in that market), due to the relative stability of this sector's returns and, while our specialised housing sector is configured quite differently to that of Canada, in future, the same long term benefits to investors and providers could be derived from public sector pension fund investment in UK Extra Care Housing across all tenures and needs levels.

The potential for public pension funds to participate in new development is considered further in the article written by Coralie Foster in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[41]

Unlisted companies are not listed on any stock exchange and their shares are not traded through stock exchanges. Unlisted shares are instead traded either informally directly between the parties involved or through dealers.

Open ended investment companies are a type of company or fund in the UK that is structured to invest in other companies, with the ability to adjust constantly its investment criteria and fund size. The company's shares are listed on the London Stock Exchange, and the price of the shares is based largely on the underlying assets of the fund.

Consortia of Pensionholders

As most private sector occupational pension schemes have changed from being final salary based to money purchase arrangements, Self Invested Personal Pension Schemes, (SIPPs), and Self Administered Pension Schemes, (SAPS), have become an increasingly important part of pension planning for people across a wide range of income levels. Those using SIPPS and SAPS require pension administrators and often use online dealers for self-advised trading in equities.

41 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

However, the pensions rules also allow direct investment in property, (subject to some understandable restrictions, ie this cannot be residential property for the pension-holder's own use). This is only viable if the individual's pension fund is large or it can be combined with other funds in a consortium.

Some Independent Financial Advisors, (IFAs), have promoted the consortium approach to SIPPs pension-holders in particular, initially for hotel developments but now for care homes. This could potentially fund Extra Care Housing schemes, but the cost of meeting management fees and needing multiple individual participants is likely to limit the usefulness of SIPP consortia.

Public procurement considerations

Public subsidies through the use of public land or capital grants will fall under the rules regarding Procurement and State Aid, which are outside the scope of this Technical Brief. It should be appreciated that in the case of housing with care, Public Procurement considerations are further complicated by the operational aspects of the completed scheme, in particular the care and support services discussed in Part Three: Revenue Issues.

Practice has varied in England. To date, a minority of LA ASCRs have commissioned multiple services (accommodation, housing management, care and support) together in single procurement procedures, while most others have separated these out, or only procured the care – and possibly housing-related support – services. From a Public Procurement and State Aid perspective, the separation of bricks and mortar related provision from care and support services is prudent, as it mitigates against the risk of double funding and anti-competitive behaviour.

However, there are instances where developers and providers have specifically sought to provide all of the services in Extra Care Housing schemes, either to achieve operational continuity across each aspect of the scheme and/or to obtain some cost and revenue advantages. This multi service approach does offer some potential for offsetting the high initial costs of development with revenue generated through the long term operation of, and provision of services such as care and support in the completed scheme. Indeed, the financial outcome of simple development models that rely entirely on sales revenue, and separate their initial accommodation offer from any subsequent non-property services, is far more dependent on housing market conditions during the sales period than the longer term 'develop and operate' models. How the choice of operating model for an Extra Care Housing scheme can influence the available range of capital funding sources is considered in the next section.

How scheme characteristics influence access to funding sources

This section is equally relevant to housing and care providers and local authorities with responsibility for housing and/or adult social care, as an indication of how differing characteristics in Extra Care Housing schemes will have implications for capital funding.

KEY POINTS

This is important for:

Commissioners in housing and adult social care

- As commissioning objectives may determine the model of Extra Care Housing that developers and providers offer to commissioners.
- The model of Extra Care Housing adopted will in turn effect the range of funding sources available to Developers/Providers.
- The range of funding sources available will also determine the size of the funding pot available to each programme or individual scheme.
- As the funding sources chosen will in turn contribute to the overall cost of delivery.

Developers/Providers

- To act as a checklist at strategy and/or scheme concept stage.
- To highlight how funding options may be affected by decisions made during d the evolution of strategy and/or individual scheme concepts.

There is a strong correlation between the characteristics of individual Extra Care Housing schemes and the most suitable funding source. This section will consider the key characteristics that influence access to funding, which are:

- ownership or use only
- single scheme or multi-scheme programme
- scheme type & operational model
- public sector 'buy in'
- common partners in all schemes or multiple partnerships/JVs
- use of Special Purpose Vehicles, and
- tenure mix.

Ownership or use only

The first choice to be made is whether the completed scheme needs to be owned, as this would then exclude the use of property REITs, Property Investment Trusts, Property unit trusts and OIECs, or whether it is acceptable to have a lease or operating/ management agreement for the property via an Operating Company, (OpCo), while the property is then owned by a separate Funding Company, (FundCo), and/or Property Company, (PropCo).

PFI is one such split structure, with annual payments being due to the FundCo/PropCo for use of the facility, the payments varying according to whether the property reverts to the 'client body' (which could be the commissioning Local Authority in a PFI scheme or the commissioning Health body in a LIFT scheme), or remains with the PFI delivery partners at the end of the term. These and other PropCo structures often seek to link payments to the Retail Prices Index (RPI) in order to prevent the income of the 'landlord' PropCo being eroded by inflation. As with the SAF REIT example given previously, this form of automatic rent escalation is unappealing to providers due to the lack of any correlation with changes in their own income from the scheme.

However, a more equitable arrangement can be used in OpCo/PropCo structures where variations in income are a shared risk and equally, both parties gain if betterment can be achieved. Given that the number of RPI linked leases is dwindling in sectors that had previously had this built-in escalation of rents, ie retail and commercial property, funders may be more willing to accept either risk sharing or periodic rent reviews in future.

Single scheme or multi-scheme programme

In terms of their suitability for either single schemes or multi-scheme programmes, Table B following shows which funding sources align most readily with either level of development.

Table B: Suitability of funding sources for single schemes and multiple schemes

Single scheme	Multiple schemes	SOURCES OF FUNDING
✓	✓	HCA Affordable Homes Programme 2011-15
✓	✓	DH Care & Support Housing Fund 2013-17
✓	✓	Public land at nil or below market value
✓	✓	Capital subsidies from Local Authorities
✓	✓	Group banking facilities
✗	✓	Own name bond issues
✓	✗	Social finance
✓	✓	Scheme specific banking facilities
✓	✓	Construction contractor finance
✗	✓	Institutional investors
✗	✓	REITs and Property Investment Trusts
✗	✓	Property unit trusts and OIECs
✗	✓	Public pension funds

Single schemes can potentially be aggregated into larger multi-provider programmes for institutional investment, REIT or Property Investment Trust purposes but this is more likely to be possible once they are complete and fully occupied. In the meantime, these schemes could be delivered using Construction Contractor finance but the Contractor would obviously need to satisfy themselves that the client body was capable of paying off the construction finance debt at the Contractor's desired exit point, ie Practical Completion or after a pre-agreed period after practical completion, usually 1 year, regardless of the client body's preferred long term method of finance.

Scheme type & operational model

Beyond the simple alignment of funding to the scale of the intended development, the actual nature of the scheme will be of keen interest to potential funders as this will directly influence their evaluation of the risk associated with the scheme. This is especially true of Extra Care Housing, as it encompasses a broad church of providers, occupants and operating models. As a result, funders may find it difficult to determine whether the proposed scheme should be categorised as housing, care or even more akin to a hotel or health scheme in terms of risk and value.

The importance of this categorisation cannot be underestimated, as it then leads to specific expectations regarding valuation methods and the returns from the completed scheme. Housing values outside the Home Counties are still 'weak', combining low rates of both sales and mortgage lending with a restricted release of distressed assets on to the market by lenders. This means that yields (returns to investors on the investment) for housing portfolios are high at 10% – 12%, reflecting the combination of relatively poor property values and high risks.

In comparison, the yields for care home investment portfolios are currently at 7% – 9%, which is still relatively high when compared to other asset classes, due to concerns regarding fee cuts by Local Authorities, difficulties in maintaining profitable occupancy rates and gearing.

Other than the conventional owner occupation retirement housing and assisted living products of the largest private sector developer, Extra Care Housing schemes vary to such a degree in their target markets and operation that simple translation into either a housing or care asset is not always appropriate.

The particular challenges of categorising Extra Care housing and how it relates to the established residential development and care provider sectors is included in the article written by Melville Knight in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[42]

Distressed assets are often in default of their banking or borrowing terms (or covenants) and may have been taken under direct control of the lenders through possession orders or may be subject to a forced sale in order to repay debts. Distressed assets will typically be sold below their perceived value due to the forced nature of their sale.

Yield refers to the income returned on an investment. It may be the interest or dividends received from a security or project. Yield is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

Public sector 'buy in'

Funders will still attach significant weight to public sector support for schemes in their decisions regarding what to fund,

42 www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656

and the terms of that funding, even though block contracts and long term contracts are unlikely to be available. The key here is demonstrating 'buy in' from public bodies that will underpin the operational phase of the scheme, eg through Nominations Rights or referrals from public Social Care, Housing and/or NHS bodies ie Clinical Commissioning Groups. Schemes that have been procured through OJEU compliant public procedures and that use either public land or capital subsidies will have the greatest credibility here.

JVs that give the public sector a stake in the completed scheme will give funders comfort regarding 'buy in' but will necessarily be more complex to manage than a JV that will deliver and manage scheme(s) within which units will be made available to people who are nominated by Social Care, Housing and/or Health but which is independent of any other public involvement. JVs that do include public sector partners must be careful to balance involvement with risk allocation, as the sustainability of schemes through effective management and operational efficiency must not be compromised by impractical referral or occupancy practices. Multi sector involvement therefore has to be in the spirit of a shared objective, ie, the sustainability of the scheme(s), and allow flexibility in operating arrangements to accommodate changes in needs and demand.

The importance of joint working and partnerships between the public and private sector, both formal and informal, are described further in the articles written by David Dent, Niall Henderson and Charlotte Cook in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[43]

Common partners in all schemes or multiple partnerships/JVs

Relationships and responsibilities will clearly be more difficult to manage across a programme of schemes that involve multiple partnerships or joint ventures, rather than in a programme involving the same partners in every scheme. Funders may well prefer the relative simplicity of the latter in deciding who to fund, as maintaining long term partnerships over multiple sites enables roles to be refined and expertise to be consolidated, with cumulative experience being rolled forward through each successive site.

Moreover, a funding arrangement for a single partnership delivering multiple sites could more easily be configured to allow for variations in the rate of progress, if the reporting and authorisation procedures provide management with control of the programme's overall draw down from the funding facility.

The alternative of serial partnerships involving differing partners will be far less efficient and run the risk of 'reinventing the wheel', with less consistent

43 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*

performance in terms of cost, quality and programme. This is not to say that a one off partnership cannot produce an acceptable outcome, just that managing a multi-scheme programme with differing partners in each scheme is far more demanding for the client entity than a single overarching partnership.

Use of Special Purpose Vehicles

Special Purpose Vehicles (SPVs) are more useful to ring-fence assets and finance than to control the risk exposure of the parent bodies, as parent company guarantees are routinely required to ensure SPVs are not abandoned if their fortunes fall short of the original expectations. Looking at it another way, in the current economic climate, an SPV may actually be a useful risk management tool in separating the fortunes of a scheme from those of the parent(s), giving it a commercial and operational life of its own that can survive the failure of a parent entity.

Funders will need to see SPVs set up in a suitable legal form that addresses the equity stakes and tax priorities of the parent entities, with roles that make the best use of their respective experience and resources. Gaps can be filled by 'buying in' experience and resources, either as individual employees of the SPV, or as consultants or contractors. This can go as far as outsourcing the operation of completed schemes using management agreements and using third party providers for care, support, catering, cleaning, maintenance, etc.

Specific SPV types, such as Local Asset Backed Vehicles (LABV), are discussed in more detail in the article written by Darren Crocker in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[44]

Tenure mix

The choice of tenure mix in an Extra Care Housing scheme will have a considerable effect on how the proposed scheme is perceived by potential funders, through the emphasis given to initial development revenue and operating income. For example, where units are offered for long leasehold outright sale only, the model is simple and well known with only the local planning requirements for Affordable housing units to complicate the achievable income.[45]

This type of long leasehold outright sale model is also simple in that the development revenue ends with the last legal completion in the scheme, (albeit costs can run on 1-2 years beyond this, due to the warranty commitments made within each individual sale). In traditional long leasehold models of development,

44 *www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656*
45 *www.housinglin.org.uk/Topics/browse/Design_building/Planning/?parent=8582&child=8654*

(such as blocks of general needs apartments), the subsequent operational phase of the scheme does not generate revenue that is available to the individual scheme appraisal. Instead it is entirely separate and subject to the provisions of the *Landlord and Tenant Act 1987* which require management to be carried out in a fair and transparent manner through whatever structure of Management Company and Managing Agents the developing entity puts in place.

In **conventional mixed tenure** arrangements for the UK, the split of tenures will determine how the scheme is perceived and also how it could be most effectively marketed and operated.

Wholly social rent schemes will rely heavily on nominations and referrals from public bodies, (which, as mentioned previously, is a great draw for potential funders), so marketing and branding can reasonably be aimed at relationship and community building, whereas open market schemes will require a different approach to reach the target market, explain the offer and achieve sales at an acceptable rate.

More **unusual or complex tenures** can be a much harder sell to potential funders and residents, in an already poorly understood sector. Private rented Extra Care Housing has the advantage that it can bundle together accommodation and services to provide a genuine alternative to traditional residential care homes. The fee arrangements can also achieve parity between self funded and state funded residents. This model is focussed on operating revenue derived from the long term provision of multiple services and, despite being a conventional combination of housing with domiciliary care, moves towards being perceived as a care home for funding and valuation purposes. (While private rented Extra Care Housing is unlikely to be aimed at people who need assistance through the benefits system, it is worth mentioning that such developments are unlikely to be classed as Exempt Accommodation, and eligible costs for Housing Benefit purposes will be pegged to Local Housing Allowances – see various references in Part Three: Revenue Funding).

Note: *this type of 'inclusive service' provision could well come under close scrutiny by the Care Quality Commission, (CQC), with a resulting risk of registration as a care home. While the CQC have so far been willing to accept that the current schemes of this type are housing provision, it is prudent to consult with the CQC before planning any new schemes based on this model and consider how the statutory definition of a care home applies in each case. Three key points to address in order to reduce the risk of registration are:*

- *there must be clear separation between the provision of accommodation and provision of care*
- *a suitable form of housing tenancy must be used*
- *tenants must have a choice of care provider.*

A less radical departure from conventional tenures is the Lifetime Lease, the fee for which is calculated based on the life expectancy of the resident at the time of entry. This will predictably be more cost effective for people with shorter life expectancies, who may be able to buy their lease for 50 – 60% of the outright leasehold sale price. This tenure is still evolving but can be adapted to provide an equity stake in the property resale value, (as an alternative to Shared Ownership/Shared Equity tenures), if residents are able to pay slightly more at the outset. This kind of tenure provides a conditional form of home ownership for people with limited equity, (or who wish to have a larger proportion of their equity in cash), but will again impact on appraisals in terms of the size and timing of anticipated revenue to cover development costs unless the units involved are sold on to an investor entity at full value prior to them being sub-let, for them to hold over the long term as a landlord.

An **Equity Stake** is held by the shareholders in a company and is often translated into the percentage they own in the business. The owner of a large percentage of the business (often described as a significant equity stake) may be able to exercise control over the company's activities or enable them to initiate a merger, buyout or other change in the ownership and control of the company.

12 Evidencing and informing funding applications

This section is particularly relevant to developers, housing and care providers, but also should assist local authorities with responsibility for housing and/or adult social care. It provides an indication of what topics funders will wish to see considered in applications for funding and appraisals.

KEY POINTS

This is useful for:

Commissioners in housing and adult social care

- To aid understanding of the number of topic areas which contribute to appraisals and submissions for the funding of Extra Care Housing schemes.
- To understand the alternatives available in each aspect of creating an appraisal and submissions for funding.

Developers/Providers

- To act as a checklist at appraisal stage.
- To ensure the implications for subsequent funding options are appreciated as the original concept for the scheme is translated into an appraisal and the submission for funding is assembled.

This section will consider the following funding application related topics:

- local demand and capacity
- scheme programming
- relationships with public bodies
- delivery costs
- tax/VAT treatments
- sales and marketing strategy
- scheme operating costs.

Local demand and capacity

The demographic data for the UK is readily accessible and all Social Care and Health Authorities use ONS forecasts of the local shifts in the population age profile in their strategic planning for Health and Social Care. At the time of writing, the Housing LIN and the Elderly Accommodation Counsel are testing out a predictive modelling tool to assess demand for a range of local housing with care options and help inform Local Authority Market Position Statements, as set out in S*trategic Housing for Older People: Planning, developing and delivering housing that older people want*.[46] Indeed, the implications for housing are less well consistently appreciated among the public bodies responsible for housing strategy, with many Local Housing Authorities yet to fully engage with the merits of, and growing demand for, housing with care for older people.

In addition to the Housing LIN and EAC modelling tool, the Institute of Public Care at Oxford Brookes University has written a useful briefing paper *Market Position Statements and Housing.* [47]

While providers will be encouraged to use the free Housing LIN resources, it will be more likely to fall upon them, as providers of proposed housing with care scheme, to design and commission their own form of market assessment, including a demand and capacity analysis for the specific location and type of Extra Care housing scheme under consideration.

For example, market assessments typically seek to establish:

- if their scheme's particular combination of location, accommodation and services will have a sufficiently large catchment of people who meet the proposed income
- any age and needs based eligibility criteria, and
- any other local market factors that may influence their investment decision.

Assuming the analysis shows the scheme is likely to readily achieve full occupancy, this type of detailed and scheme specific market assessment is then effective in explaining the merits and impacts of the scheme to local housing, planning, social care and health commissioners but, more importantly, it becomes a valuable tool in discussions with potential funders as it can demonstrate clarity in what the provider intends to offer, who this will be offered to and what proportion of these people will need to take up the offer in order to fill the scheme. Without this assessment of the potential market for a scheme, the assumptions in the appraisal will lack essential supporting evidence.

A fundamental part of assessing demand and capacity for a new Extra Care housing

46 www.housinglin.org.uk/Topics/browse/HousingExtraCare/ExtraCareStrategy/SHOPv2/

47 www.housinglin.org.uk/_library/Resources/Housing/SHOP/HLIN_SHOPBriefing1_MPS_digitalversion03.pdf scheme should involve an early stage review of the scheme mix, taking into account the varying occupancy rates for each unit size and tenure which are evident in completed schemes and the general needs housing occupied by older people.

Without such a review, cost per unit is relied on alone and it is increasingly appropriate to isolate capital cost per resident as an indicator of scheme value for money and to ensure schemes will be occupied as efficiently as possible, eg by avoiding under occupancy in larger units.

The need to consider unit mix and delivery costs in appraisals is also covered in the article written by Darren Crocker in the Housing LIN 'Get Smart' Guide *Innovative Funding and Delivery Options in Extra Care Sheltered Housing* (published in December 2012).[48]

Scheme programming

Programming an Extra Care Housing scheme from initial conception through team assembly, procurement, implementation and operation will inevitably require informed judgements on the duration of each stage. It must also recognise the key milestones and where the risk of unrecoverable delays is greatest. Realistically achievable time periods are therefore essential, as over optimism can convert into unavoidable underperformance and excessive pessimism can prevent schemes proceeding past initial appraisal stage.

Indeed, each activity will have its own benchmark time period for the type of scheme under consideration and it is best to base the-- programme on scheme specific advice from specialists in each field plus cross referencing with any information available from similar previously completed schemes.

Relationships with public bodies

Where schemes are either delivered due to public procurement, or are intended to compete for contracts or referrals, time and resource must be allocated at an early stage to ensure that relationship building and procurement processes can be accommodated. Funders will take comfort from any public 'buy in', but this takes time to achieve and can be subject to delays at any point in the process.

Delivery costs

Pre-development costs are often underestimated, usually due to the work involved being more complex than anticipated and more protracted. Pre-planning community consultation work is an increasing feature of the planning process in England but Extra Care Housing also benefits from a preceding stage of consultation and support gathering from Social Care and Health Authorities, before engaging in the usual pre-planning

48 www.housinglin.org.uk/Topics/browse/HousingExtraCare/FundingExtraCareHousing/?parent=1007&child=8656

consultation process with the Housing and Planning Authority. In addition to the core technical requirements for architectural, engineering and landscape design, housing with care schemes will still be subject to the potential need for a wide range of technical work, such as fire safety, noise surveys, vibration surveys, ecological surveys, tree surveys, ground investigation, remediation strategies, traffic surveys, highway and drainage assessments, sustainability assessments, green travel plans and landscape impact assessments, so it is advisable to budget for as many of these as possible.

Tax/VAT treatments

JVs and SPVs have their own implications for tax and VAT, with combinations of public bodies, charities and private companies being a challenge even for experienced financial officers. The development and operating phase of housing with care schemes can introduce even more complexity, especially where there are extensive communal facilities or mixes of uses ie, for residents and/or wider community within the same scheme.

Funders will expect the implications of differing partnerships and uses to be understood and provisions made in appraisals for tax and VAT where necessary, such as partial VAT recovery of building costs or business rates on areas used for commercial enterprises within schemes.

Sales and marketing strategy

The emphasis in planning the marketing of Extra Care Housing schemes will vary in some aspects according to the tenure mix of the scheme. A wholly social rent scheme may require more emphasis on consultation with potential residents as well as local relationship and community building. Open market schemes may have less formal engagement with social care, housing and health commissioners but still need to engage with local older people's community groups as one route to their potential market.

Budgets for marketing costs in open market schemes will typically be set at 2. 5% of the gross revenue, which is intended to cover: all staff costs; advertising; marketing material; plus the set up costs and running costs of the marketing suite and/or show units. The appraisal must show how and when the budget will be spent over the whole duration of the scheme's development phase, (ie, up to achieving full occupancy), and operational models that require the provider's ongoing involvement, (for example, in market rental income, buy backs, exercising pre-emptions and resales), will need a rolling marketing spend and resource.

The importance of the timing of marketing stages must be reflected in appraisals. Early pre-planning community consultation is the ideal time to begin explaining the offer and gathering forward interest, so marketing input is required in the design of the consultation process and material, with early information packs ready to be despatched to respondents and sufficient resource made available to manage this process and the forward interest list. The subsequent triggers for early bird sales releases, local information events, opening marketing suites and show units must all be set, programmed and resourced beforehand. A well thought out and fully costed marketing strategy, that correlates with the appraisal, programme and cashflow, will reassure funders that the scheme will be marketed to the best possible effect in terms of sales, lettings and fill up rates.

The achievable revenue assumptions in the appraisal will need to be evidenced, which can be done as part of the market assessment process described in the above section regarding demand and capacity analysis. As most open market Extra Care Housing is purchased outright with no mortgage, the individual units are only infrequently subjected to the normal processes of mortgage lenders instructing local valuers, and opinions on how units should be valued differ considerably. The main obstacle to the usual approach to valuation is the lack of comparator schemes, which also sustains a lack of understanding of Extra Care Housing among the local agents often asked to provide pricing advice.

Some providers have consistently sought a premium for open market Extra Care Housing, sometimes up to 20% above the most comparable local stock, (ie comparable in terms of accommodation, size and location). These providers argue that this premium is justified by the communal facilities and services available to residents in Extra Care Housing. Indeed, the facilities may well take up 30%–40% of the building floor area and a sales premium can help to offset their capital cost). However, appraisals that show revenues based on this premium approach will be subject to challenge by funders and/or residents, and providers will need to make a strong case that not only can premiums be achieved at first sale, they can be sustained at resale and a sufficiently large catchment exists for the scheme at this level of pricing.

In the present economic climate, the evidence regarding the sustainability of premium pricing is mixed, with open market resales frequently occurring well below the originally achieved sales prices and settling at, or even below, the most comparable local stock. It is therefore more prudent to base forecast revenue on the values of comparable local stock, allowing for the differences in quality, age and specification as you would for any new-build housing scheme when pricing it against the existing local stock. This will undoubtedly place stresses on the viability of the scheme and require a thorough review of what combination of saleable accommodation and communal facilities achieves the optimum overall financial return.

The Housing LIN has published a number of useful resources that explore in detail approaches for valuing and marketing Extra Care Housing. [49]

Scheme operating costs

The importance of revenue to offset capital costs has been mentioned previously, as well as the stresses on existing care and support arrangements in Extra Care Housing schemes. However, the basic operating costs of the scheme and resulting service charges are equally important to achieving appraisals that satisfy funders regarding the ability of the potential residents to afford the charges and whether they represent value for money.

The overall cost of occupancy is a key consideration for potential residents and Extra Care Housing schemes vary in what is included in their charges, eg heating and hot water in individual units may be metered as an individual's cost but could also be included in the service charge. Open market long leasehold residents are likely to react adversely to the principle of service charges in general, requiring a marketing approach that highlights what is included and, preferably, transparency and accountability in how these charges are used in the scheme. For example, high service charges can be a significant barrier to entry, even when unit rents or leasehold sale prices are set at levels that are commensurate with the local market, as this type of ongoing charge relies on income rather than equity.

Issues around the setting of service charges, and the availability of welfare benefits to assist Extra Care Housing residents meet housing costs, are addressed in Part Three: Revenue Funding.

However, appraisals for leasehold properties should also clearly show the proposed levels and treatments of Ground Rents, particularly the proposed escalation provisions for these and whether the capitalised value of the Ground Rents has been taken as revenue, based on an assumption that this interest will be sold on to an investor.

Note: *the latter requires a presale to be set up in order to avoid the freehold right of first refusal in the Landlord and Tenant Act, which would considerably diminish the prospects of an investor sale.*

49 www.housinglin.org.uk/Topics/browse/HousingExtraCare/ExtraCareStrategy/HousingStrategyExamples/?parent=975&child=8551

13 Appraisal types for extra care housing schemes

This section is particularly relevant to developers, housing and care providers, but also should assist local authorities with responsibility for housing and/or adult social care. It describes the various appraisal methodologies that may be adopted for Extra Care Housing schemes.

KEY POINTS

This is useful for:

Commissioners in housing and adult social care

- As an introduction to differing appraisal types that developers and providers may provide.
- As an introduction to appraisal terminology that may be unfamiliar.

Developers/Providers

- To consider the most suitable appraisal type for each model or scheme.

The appraisal type used will be influenced by both the tenure mix of the proposed scheme and the ownership/operating model being adopted. This section will briefly describe the most commonly used appraisal types, which are:

- Gross Yield and Net Yield
- Net Present Value
- Residual Land Value
- Internal Rate of Return.

Gross Yield and Net Yield (rent income and EBITDA versions)

Gross Yield is the simplest method of assessing viability and often used as a quick calculation for private sector residential and commercial property investments that generate rental income. This is simply the rental income expressed as a percentage of the capital investment required.

Net Yield is sometime used by RPs as a rough initial test of viability and uses the net rental income in the first year, rather than the gross rental income, again expressed as a percentage of the capital investment required. While a more accurate approach than Gross Yield, the Net Yield calculation is still only based on one year's performance and does not take into account long term fluctuations in operating or landlord's costs.

Simple Yield calculations are more appropriate to ownership models that let properties to occupiers on full repairing and insuring leases, typically commercial, retail and industrial properties, as the landlord's costs are much reduced due to the tenant's liabilities for routine maintenance. Major expenditure by the landlord will only be incurred if the building is remodelled, refurbished or redeveloped after the end of the lease.

EBITDA (earnings before interest, tax, depreciation, and amortisation) based yield calculations are more common for care and nursing home properties, ie, relatively complex operating businesses. In this case, the EBITDA figure is used in combination with the capital investment to calculate the yield.

In all of the above situations, the indicative market value of the property can be estimated by applying the currently achievable yields to the rental/EBITDA figures. The lower the yield, the higher the market value, hence properties in economically weak areas or use classes will show the highest yields, due to the combination of low property values and higher risk for the owner. Low yield properties at high prices in economically strong areas offer buyers lower risk and the potential for capital gains.

Net Present Value

This is the most common method of judging viability used by Registered Providers. It compares the Net Present Value (NPV) of net rent income with the finance required and produces an NPV Surplus (or deficit) figure from the following calculation.

In this case, the NPV of net rent and sales is calculated using discounted cash flow, ie, applying a discount factor to the cash flow figures to represent the costs of carrying debt, based on judgements regarding interest rates over the period of time being considered. This enables the appraisal to reflect the relative value of money at differing times, for example at a discount rate of 5. 0%, (this figure being whatever the market's view of average interest rates is at the time for the housing sector over the period of the investment), £200,000 in 30 years would be worth £46,275.

If the NPV shows a significant surplus then the scheme could be recalculated with alternative tenure mixes, lower rents, lower sales values or even higher costs, (if a higher standard or design or specification is desirable). If the NPV is a deficit, then the scheme requires a thorough review of revenue and costs to optimise them, ie,

eliminate, or at least minimise, the costs that do not add tangible value to the scheme. This may involve differing approaches to design, specification, procurement, management or operation.

Where it has not been possible to balance revenue and costs, subsidy will be required in order to break even, sources of which may be either: the external capital grant(s) referred to previously; current reserves of the client body; or, any operating surplus from services such as care and support.

The NPV appraisal is therefore the best method for testing differing operating models that include multiple income sources and ongoing operational costs.

Residual Land Value

The Residual Land Value (RLV) appraisal is the most common method for judging viability in the private housing sector, as it focuses on short term development outcomes and is used principally to establish an acceptable land value in appraisals, (this being the volume housebuilders' main variable between sites). This method itemises all of the direct costs of the scheme, (ie, professional fees, site preparation costs, build costs, sales and marketing costs and legal fees), and deducts these from the Gross Development Value, (GDV), which for speculative housebuilding is simply the total forecast sales value of all units within the scheme, (after allowing for sales incentives such as discounting from advertised prices, carpets and curtains and/or assisted move packages). Housebuilding Gross Profit is calculated as a percentage of GDV, (rather than the commercial sector practice of basing this on cost), and the appraisal template will show the resulting RLV for the required level of Gross Profit.

This method is used in negotiations for Section 106 purposes with Planning Authorities and District Valuers, as it demonstrates the scheme's ability to meet the costs of planning obligations such as the provision of Affordable housing. However, small variations in the inputs of build cost or sales revenue can lead to large variations in the achievable profit and RLV figures. This requires a high degree of judgment regarding the build cost and sales revenue figures to 'pitch' these at a level that is neither too optimistic, nor too pessimistic, hence the need for informed interpretation of these appraisals by Planning Authorities.

Non-housebuilder RLV appraisals will include the funding costs within the overall costs deduction, rather than treating these as a post appraisal deduction at Group level. RLV appraisals for leasehold properties should also show the capitalised value of Ground Rents, as these remain an attractive type of investment which can generate a useful additional source of revenue, as long as a presale is set up to avoid the freehold right of first refusal in the Landlord and Tenant Act.

The RLV method is ideal for schemes that have a clean exit point, ie, after concluding the onward sale of all interests in the scheme to either individual occupiers or third party investor(s), as this method relies on neat time limited assessments of costs and revenue, with an exit from ongoing liabilities. Where schemes are sold leasehold, appraisals will need to include shortfalls in service charges during the sales period but any liabilities are then assumed to end with the final legal completion, (other than warranty obligations and any adoptions of roads, sewers and open spaces which are subject to maintenance periods and final inspections at a later date).

Internal Rate of Return

For a long period of time, private housing sector appraisals were judged principally by the Gross Profit they produced and, as mentioned previously, a Gross Profit of 25%, (ie, profit before the deduction of office overheads and funding costs), is currently typical among housebuilders. This high threshold has been set by the housebuilders' bankers and senior management, as a method of creating a contingency against the high degree of risk involved in speculative housing development in the current housing market.

Over the last decade, Internal Rate of Return (IRR), has become at least equally as important as Gross profit, if not more important, in judging the relative profitability of schemes. IRR shows the return on the investment over the period and allows this to be compared with the return that would be available from placing the investment funds in a deposit account over the same period, (and other alternative investments for the same funds). In order to be consistent and reliable, IRR figures must be derived from detailed cash flows, ie, those based on accurate timings for costs, revenue and the investment of capital. They therefore require schemes to be sufficiently well advanced, (or of a predictable and consistent cost/revenue model, as is often the case with private sector freehold outright sale volume housebuilding), to allow a cash flow to be prepared.

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Capital funding conclusion

The growth of the Extra Care Housing stock had, until recently, involved a considerable amount of capital subsidy from Central Government. This subsidy cannot be relied upon to the same degree and new schemes will have to be modelled differently both in order to require less, or no, capital subsidy and to enable them to draw from a more diverse range of funding arrangements. This in turn requires more creative and open minded thinking amongst all those involved, whether they are commissioners, developers or providers, in order to continue to increase the range and quality of Extra Care Housing for older people and other people with needs that general needs housing cannot accommodate.

KEY POINTS

- The range of funding sources is wide, but not all of these are suitable for Extra Care Housing.
- There is continuous change in the funding 'marketplace', with an increasing interest in long term investment in both social rented and privately rented housing.
- Government reforms, such as those to Local Authority pension funds and REITs, are gradually removing barriers to investment in housing.
- For commissioners, when setting their commissioning objectives, they should take into account the interconnections between any specific model of Extra Care Housing that these objectives envisage and the consequences of adopting that model for funding.
- For developers and providers, the implications for the subsequent availability of funding must be continuously acknowledged and reviewed during the conception of both strategies and individual schemes.
- In order to obtain offers of funding, developers and providers will need to consider and evidence the key assumptions on which their scheme and appraisal has been based.

About the Housing LIN

Previously responsible for managing the Department of Health's Extra Care Housing Fund, the Housing Learning and Improvement Network (LIN) is the leading 'learning lab' for a growing network of housing, health and social care professionals in England involved in planning, commissioning, designing, funding, building and managing housing, care and support services for older people and vulnerable adults with long term conditions.

The Housing LIN welcomes contributions on a range of issues pertinent to housing with care for older and vulnerable adults. If there is a subject that you feel should be addressed, please contact us.

For further information about the Housing LIN's comprehensive list of online resources and shared learning and service improvement networking opportunities, including site visits and network meetings in your region, visit www. housinglin. org. uk

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