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Housing Learning and Improvement Network

Housing LIN

Extra Care Housing and the Credit Crunch: Impact and opportunities

This factsheet explores the effect of the credit crunch on extra care housing. It considers the impact from both housing developers' perspectives and from the local authority or PCT seeking to procure new extra care housing. It draws on discussions with housing organisations and local authorities most actively involved in extra care development as well as relevant background information and literature.

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We help to improve services and achieve better outcomes for children and families, adults and older people including those with mental health problems, physical or learning disabilities or people in the criminal justice system. We work with and are funded by DH Department of Health

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Introduction

This factsheet explores the effect of the credit crunch on extra care housing. It considers the impact from both the housing developers' perspectives and from that of the local authority or PCT seeking to procure new extra care housing. It draws on discussions with housing organisations and local authorities most actively involved in extra care development as well as relevant background information and literature.

The first part explains what the "credit crunch" is and looks at the learning and evidence from the previous recession. The second part of this briefing reviews the impact of the credit crunch on extra care housing and some of the ways of minimizing the negative results.

Overview – Emerging Impact of the Credit Crunch on Extra Care Housing

In a nutshell, the current position in terms of the direct effect of the credit crunch on extra care housing appears to be:

- Many features of the 1989 – 1993 recession are being repeated e.g. sales stopped quickly, loans of value, transfer to renting, sale of whole developments.
- Where housing associations are having to re-negotiate funding, unable to raise new finance, or are in danger of breaching loan covenants this is making them wary of entering into new commitments, possibly delaying or conceivably aborting a proposed project.
- At the level of the associations' overall borrowing there are two key issues. First, the availability of funding and second the terms/conditions of the loan. With a dislocation between London Interbank Offered Rate (LIBOR) and Bank base rate, associations expect borrowing costs to rise, pushing up also the overall cost of development (other things being equal). Associations are having to re-do capital/revenue scheme appraisals using higher borrowing costs, as well as revising their overall business plans/financial projections. However, some other development costs are said to be falling e.g. construction costs.
- Generally, the credit crunch does not appear as yet to have stopped funding for extra care specifically. PFI plans are still underway.
- It is argued that this is partly because funding to RSLs is seen as a better proposition than lending to mainstream developers building for sale. In addition, there is some suggestion that development for more vulnerable people with support needs is a more secure proposition than some other social housing. This is because the eligibility for a range of benefits makes this "Government backed" e.g. the existing Department of Health (DH) and/or Homes and Communities Agency (formerly the Housing Corporation) grant allocations.
- There are some emerging opportunities. Much housing association development depends on providing the affordable housing element of larger sites subject to a Section 106 planning agreement. Whereas most developers have previously been unenthusiastic about including social rented housing on their estates and wish to minimise the affordable housing element; now this is seen as desirable. This in turn means there are some opportunities to provide extra care housing in

place of what was originally proposed – more sites are potentially available.

- Local Authorities are reporting a trend of increased planning applications by private developers for what the developers describe as extra care, but in fact is more like enhanced retirement housing. There are doubts about the seriousness of some of these proposals and the sincerity of the new-found enthusiasm. Locations are not always seen as suitable for extra care.
- The most significant impact specifically on extra care is mixed use developments where the dwellings intended for sale are proving difficult to sell. A variety of strategies are being deployed to deal with this problem. The few private developers with schemes for outright sale are similarly finding it very difficult to complete on sales.
- There is no discernable impact yet on care contracts, although there is a mild concern that when contracts come up for renewal the credit crunch may be used as a reason for low cost increases

The rest of this briefing considers these points in further detail.

Part 1 The Credit Crunch And Lessons From The Past

1.1 The Credit Crunch Simply Explained

What is the credit crunch?

Credit crunch is short hand for there being less credit or money available to borrow. This makes it harder for everyone – whether individuals or big organisations - to spend money, pay bills or grow.

Bank and building societies once had strict "liquidity ratios", whereby the amount of money they could lend was tied quite strictly to the amount deposited with them and the cash and different types of assets held. Now, they not only rely on deposits but also on short terms funds raised in the money market. These funds have become less readily available and much more expensive.

Why has it happened?

In the 1980s, regulations changed so banks and building societies could substantially increase the amount they lent. From the mid 1990s house prices rose steadily as money became freely available. Lending criteria were relaxed to help first time buyers and those on a lower or less secure incom to buy. Lenders then held debt secured on property value rather than on the borrowers ability to repay the mortgage – this is the "sub-prime" debt. These "riskier" loans were then mixed with more secure lending and bundled in packages called "mortgage backed securities". These were sold on to financial institutions who may in turn have resold the debts or further added to the mix making it even less clear what the real risk was and who was carrying it.

In 2007, real estate (house) prices in America began to fall and accelerated down, so undermining the value in the property and thereby the security of the loans. As a result, financial markets quickly lost confidence and trust in those capital assets on which their business model depends and largely stopped lending.

The cost of borrowing money is partly determined by risk.

In the UK, the response of banks/lenders to this uncertainty for housing associations and private sector developers has been:

- to raise the business interest rate – the price of borrowing and
- to demand more security from housing associations/private sector developers eg by utilising any cash reserves or securing loans against their wider property portfolio.

Both of these may affect housing associations and private sector developers seeking to borrow to develop new housing and/or improve or remodel existing stock.

Faced with a recession the position can be expected to worsen as asset values decline, companies make lower 'surpluses', or profits and incomes from rent/sales fall. As a result, there is potential for more to go out of business or for individuals to become unemployed and unable to repay their loans. This increases the risk to lenders even more and thus can trigger a spiral of higher interest charges and/or even more restrictions on lending.

How do Housing Associations secure, manage and re-pay funding for development?

Housing associations are responsible for most extra care development. Schemes are funded in a combination of ways but typically in the public sector:

- An element of grant from either the DH or the Homes and Communities Agency (formerly the Housing Corporation) or occasionally local authority
- Borrowing of the balance by the developer

The borrowings are repaid in two ways:

- The rental income (i.e. after management and maintenance costs) repay the mortgage over a period of 30 or so years and
- Sales of some properties. The receipt immediately reduces the outstanding loan and if there is a margin of surplus because market value exceeds cost of building they can also be used to reduce the debt. This is often presented as being used to subsidise the rented dwellings.

This is a simple picture. In practice, land may be provided by the commissioning authority/ PCT at low or no cost. The association may subsidise dwellings from reserves. In a few cases, a small element of charitable funding may meet some costs.

This is at the level of a single extra care scheme. The 80 or so RSLs which carry out most developments are large businesses with substantial turnovers. At a higher level, they raise money for development and any other activities from a variety of sources. They provide lenders with a business plan and produce profiles showing how the business will repay loans. Typically, these plans project income and repayments over the next 30 years. They often show indebtedness rising for a period (i.e. the cost of all repayment exceeds rental income) before the effect of raising rents each year results in income exceeding the cost of repayments.

These profiles are a snapshot and have to be re-calculated as new properties come on stream, lending is re-negotiated, some loans are re-paid and so on. What follows from this description is that lenders will be concerned about three main things:

- Operating income vs. expenditure – financial viability based on operating cost
- Value of the properties – asset value and
- Rents in relation to loans – loan repayment.

These concerns are translated into contractual “covenants” between the financial institution lending and the organisation borrowing. As explained later, it is these covenants that are an important element in considering the impact on extra care housing.

The narrow, immediate effect of the credit crunch for housing associations and thus most extra care development is that it has become harder to raise money for new schemes and the cost of money has gone up. Five of the seven main lenders, including Nationwide Building Society, the biggest player, have withdrawn from new lending to housing associations (*The credit crunch – where have all the banks gone? Tribal, June 2008*). There are, however, more complex indirect effects. For example, the collapse of the general housing market and the sharp reduction in activity by volume builders has an impact.

In other words:

> *"We face a three way stand off between lenders who won't lend, buyers who won't buy and builders who won't build"* (G15 group of housing associations)

1.2 Evidence from the 1989 – 1993 Recession and its Impact on Retirement Housing

As a nation we have been borrowing more than we are saving. The savings rate has just dipped below zero. The last time the savings rate was so low was in 1989 and the UK entered a recession shortly afterwards. House prices fell while unemployment rose.

The period from the 1960s up to 1989 had seen consistent development of sheltered housing for rent and there were a number of active developers of retirement housing for sale both outright and on shared equity terms. What was the impact of the recesssionon specialist housing for older people?

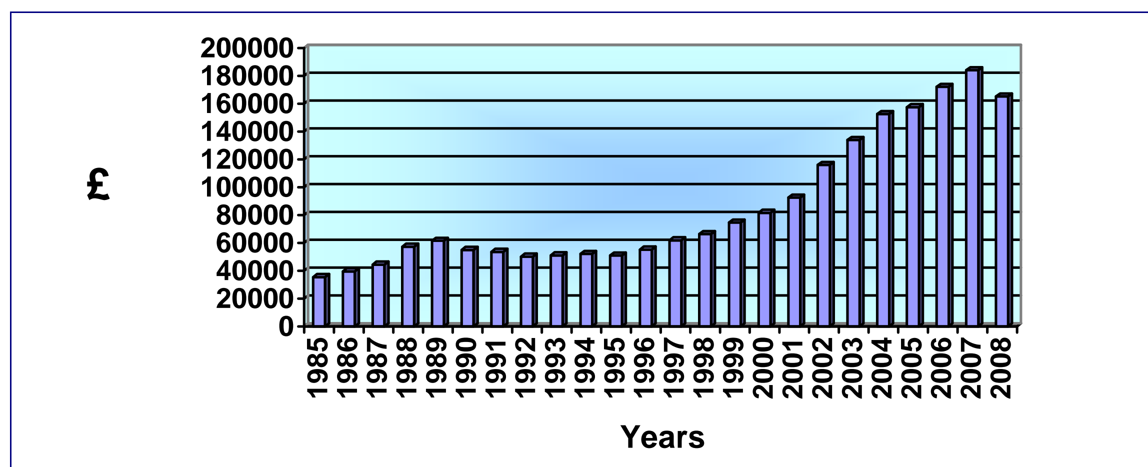
House prices

The graph below, based on the Nationwide House Price index, shows:

- House prices fell rapidly in 1989
- They declined over about 4 years and
- Thereafter there was a faltering recovery.
- From around 1995 a steady increase in prices re-established itself.

Nationwide is the longest running house price index. Over a period of 56 years the average year on year increase has been just over 8%.

Graph 1



Source: Nationwide House Price Index

Sales

In 1991, interest rates peaked at 15-16%. Older people buying retirement housing are last time rather than first time buyers. The cost of borrowing was not directly an issue. Sales of retirement housing collapsed very quickly during 1989. The reason was older people needed to sell their own property in order to move and could not do so.

This left private developers and housing associations with:

- Substantial unsold stock
- Paying very high interest rates on stock
- Stock that rapidly lost value

The difference with 1989 is that interest rates were historically high then whereas now they are relatively low. However, the parallel is that the housing market has collapsed; transactions or completions, according to RICS, are the lowest since records began. In turn, if older people cannot sell they cannot buy into an extra care scheme.

Costs and "deals"

What was the knock-on effect? All the following happened in the period 1989 – 1993:

- Private volume developers stopped building specialist homes for older people and most have never re-entered the market. The main exception is McCarthy and Stone.
- One association had a newly formed subsidiary specifically to develop retirement housing for sale which went into receivership. The repercussions lasted several years.
- Developers with unsold stock offered this to associations and local authorities at substantial discounts on the original market value.
- Housing associations with shared ownership or outright sale schemes similarly sold stock to local authorities who put them into rent.
- Housing association groups with sheltered housing for rent programmes purchased for sale units from their subsidiary/ group member to rent. This created some of the first mixed tenure schemes for older people.

In retirement housing for sale (and extra care) the lease will usually make the individual (or their estate after their demise) responsible for meeting the service charge until the property is re-sold. In the 1989-1993 period, because it became so hard to resell properties, various difficulties arose as properties remained vacant over several years. This may be exacerbated in extra care where, first, the service charge may be higher than in traditional sheltered housing; and, second, there will be an additional care charge.

In 1989 – 1993:

- The extended period taken to resell a property led relatives/ executors to become increasingly frustrated and litigious as debt kept accumulating from the service charge.
- This in turn led to representations to landlords to waive charges or alter the provision of the lease. The way leases work makes this very difficult to do without the agreement of other lessees. In any event, there are significant cost implications of actions like waiving service charges in that many costs are essentially fixed and would have to be borne by fewer remaining residents, thus increasing the average charge.
- Requests were made to associations to repurchase property from executors.

Associations and local authorities had to develop policies and responses to these different scenarios.

Part 2 Impact from provider, developer and commissioner perspectives

Sales in mixed tenure and outright sale extra care housing

As with the previous recession, an obvious effect of the credit crunch has been to stall sales. Extra care providers report they are still taking reservations but it is proving extremely difficult to convert these into sales as prospective purchasers find they cannot sell their own properties.

> *"The mixed tenure model of rent and shared ownership favoured by Housing Corporation and of course the Department of Health is broken as RSLs are finding it very difficult to shift shared ownership in the present market"* (RSL Director).

The issue is not the inability of the older person to get a mortgage or, more likely, to raise sufficient equity through a house sale to buy an extra care dwelling; rather it is the difficulty faced by the person purchasing from them to obtain a mortgage or house sale as a result of the credit crunch. In addition, the general decline in values is making people reluctant to purchase for fear of further falls, thus the sharp decline in the value of properties. Moreover, the valuation of property for sale in extra care has always been problematic partly due to the large volume of communal as opposed to private space and the novelty of the product with limited comparables. Consequently, there is the potential that financial uncertainty could make values of extra care dwellings particularly vulnerable.

Private developers with higher care schemes for outright sale report differing experiences and strategies. A few developments are said to be selling but with completions delayed and only at about a third of the anticipated rate. Other schemes are not selling at all and there are examples of these being offered to RSLs to purchase for renting.

A range of leading RSLs contacted have stated that they have not seen a slowing of interest in extra care properties for sale, so are confident that they have the right 'product' and predict that sales will improve in the longer term. However, there is a clear indication that RSLs will only consider 'mono tenure' in the short term. Many commented that the bottom of the housing market is impossible to predict with certainty. Commentators suggest that if it follows the previous pattern then it will not be for another three years or so. The speed of the downturn is beginning to challenge many developers/providers and it is now recognised that their exposure could be considerable; in particular, where their business model is dependent on mixed tenure schemes. For example, where up to 50% of a scheme is either for outright sale or shared ownership. Creativity is seen as a key component in this market place and consideration is being given by some RSLs to utilising sites or parts of sites for other development activities/change of use e.g. new hotels in London.

A range of innovative strategies are being used including:

- Converting schemes from dwellings for sale into rented. For RSLs and other organisations with Homes and Communities Agency development status this means seeking Corporation consent and additional grant funding. No planning issues are reported as this remains affordable housing. As properties for outright sale have not had any grant input, re-designating them as rented properties increases the number of affordable housing units and this is acceptable to the Homes and Communities Agency.

- In relation to the above, where permission is awaited for converting properties from 'for sale' to 'long term rent', there is a concern among some providers that the Homes and Communities Agency. will insist upon 'short term conversion to rent'. This is perceived by some RSLs as not being a viable option for extra care housing because the RSL would lose the premium on the sale price attributable to a new property and traditionally the resale price of retirement properties is lower than new sales. Another respondent was very reluctant to move to 'long term rental' as they would lose the opportunity to sell the properties when 'the market picks up' and they wished to maintain mixed tenure developments in the longer term.
- Leasing properties due to be sold for an alternative use, for a limited period. For example, a two year lease of six bungalows to be used by people with a learning disability to assist a home closure.
- Converting shared ownership properties into 'intermediate' rent. The issue here for the HCA/DH is that as these properties already had a grant allocation this change does not count as increasing the supply (units) of affordable housing. As a result they are generally reluctant to increase the grant. In one RSL proposal, the rent would be set at a lower value than 'market rent' and the property would be let on an assured shorthold for two to three years. The tenant would then have the option to purchase the property or move home. However, the latter would be an unlikely scenario as RSLs would be unwilling to ask older and frail people to move, and also, the length of tenancy in extra care housing is likely to be shorter than in traditional sheltered housing due to the age and health and well-being of the tenant at time of taking up tenancy.
- Offering 'rent to buy' arrangements in a similar way to mainstream home ownership at either intermediate rents (80% of market rent) or as a straightforward fully subsidised property. The individual rents as a tenant until their previous home is sold and at that point purchases a lease.
- Converting some outright for sale units into shared ownership. The theory is that some purchasers have sufficient other assets to buy part of the equity in a property even if they cannot afford to buy outright until their own property is sold. The offer is to buy part now, secure the property and move without delay with the facility to staircase up at some future date when their previous property is sold. However, it should be noted that in practice those associations with shared ownership dwellings already are finding that these are also very difficult to sell at present.
- A variant on this, for someone who lacks the necessary additional assets to buy a share, is to help them arrange an interest only mortgage to purchase a small share again deferring full purchase. This depends on possessing a sufficient income to make the repayments in the short term, or alternatively on having a relative willing and able to make these payments. Indeed, some respondents are suggesting that families are now assisting parents in this manner. "*We are still achieving some sales where purchasers are using savings or receiving help from families"* (RSL Director).
- The family /friends of a prospective purchaser letting the older person's home on their behalf so producing an income for renting the extra care property in the short to medium term.
- One respondent suggested that the older person's property could be let to the local authority on an assured shorthold tenancy. However, no examples of this approach were provided.

- Again, although in researching this brief this was not reported as a strategy, in principle it would be possible – if the landlord had sufficient resources and was willing to take a degree of risk – to allow the interest cost on some (or all) of the equity to accumulate, and to recover the debt (possibly along with an element of additional charge as a return for risk) when the buyer's own property is eventually sold. The issue for both the purchaser and landlord is the uncertainty about timing and the rate at which the debt will rise because of the effect of compound interest (i.e. as interest on interest builds up).
- A deal with a 'buy to let' landlord. The approach here is to sell the properties earmarked for sale to another individual or organisation that buys property simply in order to let them. The buy-to-let market is now very substantial in the UK although it is in part also being affected by the credit crunch. Historically, investors have viewed buy to let as a way of securing both a rental return and, probably, a long term capital gain. Currently, the capital gain is in doubt, while the rental return will tend to rise proportionately on a new acquisition if properties are purchased for less, although in absolute terms it is reported that in some areas private sector rents are now declining. A small amount of buy-to-let has existed in the retirement market for some years. The credit crunch appears, at the margins, to be expanding this activity to extra care housing.
- Try to unlock the potential purchaser's sale by arranging some form of part exchange via a part exchange company. The offers being made are however reported as being generally too low to be effective.
- RSLs are opting to reduce the price of for sale /shared ownership properties to their cost value to stimulate sales, and adopting a range of additional marketing strategies such as a service charge "holiday" for a limited period, asking LA's for further nominations, and additional open days and events.
- Some RSLs are investigating the option of buying the older person's own home or, if the RSL specialises exclusively in older people, coming to an arrangement with another association that provides general needs housing to acquire the property. There appear to be few successful arrangements to date, although at least one trial is about to get underway. Issues relate to the suitability, condition and cost of the older purchaser's own property when put into general needs letting.
- Mothballing the 'for sale' part of the development, anticipating that, in the long term, the market will improve (or new arrangements will be put in place). In so doing, they are making a judgement that it is better to have a pristine property to eventually sell than a limited rental but with deterioration in property condition.

As mentioned, the interest of the private sector in extra care housing had also been increasing. As in the previous recession, the few private builders with sheltered housing or various forms of development that offer higher care for sale are beginning to offer:

- Whole schemes to RSLs to purchase and put into renting
- Some or all of the unsold for sale units in mixed tenure developments to RSLs to put into renting
- Disposal of land to raise cash/acquisition of land at low cost although to date this seems limited and
- Some economies in procurement

As one commissioner observed: *“Proposed developments are the main concern.”* Many schemes will not ‘stack up’ without the funding released by shared ownership / outright sale, and RSLs are not prepared to take risks at this stage in the economic cycle. On the other hand, there is some evidence that mainstream RSLs are tendering for extra care developments, with the development of extra care helping them in maintaining their development teams, as the market place for new build affordable for sale / shared ownership properties is affected by the credit crunch. At the same time, at least one commissioning organisation contacted has decided to review their extra care strategy as a result of the credit crunch.

Thus in this example, the credit crunch may have a negative impact on extra care development plans in the local area at a time when more RSLs, at least, would be keenly interested in new extra care work.

Borrowing – terms, rates and conditions

The broad picture emerging from RSLs, a leading extra care charitable provider, and in reports from key financial advisors in social lending is as follows:

- Loan facilities already in place for extra care developments (and generally social housing) are being honoured.
- Some RSLs have been concerned this would not be the case and have drawn down funds in advance of their strict need for cash in order to test the ability of banks to deliver promised finance. There have been reports of lenders using technical conditions to delay draw downs from agreed facilities.
- Some funders have approached RSLs who have not actually drawn down funding earmarked to temporarily cancel the drawing facility. This is to enable the lender to free up capital it would otherwise need to set aside.
- The key problem is raising new money. At the time of writing, of seven main lenders to RSLs only two currently remain active in the market.
- The cost of borrowing has risen despite the very low bank rate. RSLs are revising long term business plans using slightly higher long term borrowing assumptions and re-appraising schemes to establish whether they remain viable
- In attempting to raise additional facilities from an existing lender it is reported lenders may seek to re-negotiate existing loans as part of agreeing any additional funding.
- RSLs report that private finance has become scarce, more expensive and there are ‘strings’ attached to the loans which are creating significant challenges to them. On the other hand there is a degree of frustration as RSLs perceive they are being encouraged to ‘land bank’ but in reality they cannot afford to do so.
- RSLs are reporting that when approaching lenders for additional loans the lender’s approach is to ‘roll up’ all their borrowing and charge a new ‘higher’ interest rate on the whole sum. One respondent stated that the interest rate would have been 2% higher than the current rate and another respondent stated that if the organisation had to re-finance *‘this would cost us millions’*. In at least one instance, an RSL has decided not to pursue an extra care housing development for this reason but to date this is the exception rather than the rule.

Some other important issues are continuing to emerge for RSLs. On the 10th December 2008, the newly formed Tenants Services Authority wrote to RSLs about "swaps and stand alone derivatives". These are ways and means of ensuring the organisation can borrow at the most favourable terms but in return the lender is given options to request at short notice additional security in the form of property or cash.

Given the reduction in interest rates over recent months, there is a pattern developing that some banks, faced with their own liquidity problems, are beginning to request this security. It has been reported in the trade press that a few RSLs are known to be struggling to meet these obligations at such short notice.

It is likely that few of the developing RSLs will be completely immune from this pressure and some may have potential security calls that could materialise. Even for RSLs with spare borrowing capacity and high cash reserves, there is a potential risk that these could be needed to meet demands placed on them by their lenders.

In practice this could mean that without "Government backed" guarantees there could be a reluctance in the short term to enter any large development contracts. such as those for extra care schemes, where there is significant financial commitment at the point of signing – in other words the RSL wants to slow down spending, just in case. Thus, there is a risk that some extra care schemes could be deferred until 'the climate' improves.

Loan covenants

Loan covenants are conditions imposed on the borrower. If the borrower does not act in accordance with the covenants, the loan can be considered in default and the lender has the right to demand repayment – usually in full. Covenants are legally binding.

The risk for an RSL in a credit crunch is that it will breach one of the covenants. The lender could demand repayment or more likely seek to impose much more onerous terms, i.e. much higher interest charges. 'In extremis' this may make a particular development, like a large extra care scheme, or indeed a developer programme, unviable.

From a commissioner's perspective, keen to secure more extra care, the key question is whether a developer undertaking a new scheme may fail to keep within the agreed covenant.

Central to loan covenants are key financial ratios. These are set and incorporated in loan agreements and the associations are required to report regularly on their performance.

Ujima example – breaching loan covenants

A recent reported example of an association breaking loan covenant and the impact of this is Ujima housing association which went into receivership in 2008.

Introducing the House of Commons debate, Robert Wilson MP said:

"Loan covenants were consistently breached, yet it is alleged that further loans were sought without the breaches having been declared to the banks concerned. There is some evidence that banks are now much more careful

about lending money to housing associations. Andrew Heywood, deputy head of policy at the Council of Mortgage Lenders, said that the demise of Ujima would exert "upward pressure" on the sector "on its own", meaning without any reference to the credit crunch. In a briefing note on the Housing and Regeneration Bill, which has just gone through the house of Commons, he refers extensively to the same subject and the results of Ujima's effectively going into receivership. As a result of what happened at Ujima, the cost of lending to the sector has risen, adding to the global credit crunch. That means there is:

" 'No certainty' housing associations will be able to raise the estimated £15 billion private finance needed to meet Government house building targets"

That comes directly from the Council of Mortgage Lenders"

Three common requirements are:

- Loan repayments – the business plan should demonstrate loans will be repaid within 30 years. The total loan outstanding – the debt – may increase in early years but the borrower must show that by year 30 the loan will be fully repaid
- Gearing - this is the loan (debt) as a proportion of asset value. The lender wants to know there is more than enough in the way of assets (property) to cover the loan

Debt	£100 m
Asset value	£200 m
Gearing	50%

A typical covenant might require that debt is not more than 75% of asset value.

- Interest cover – the extent to which the operating surplus exceeds the finance costs

Turnover	£30 m
Operating costs	£20 m
Surplus	£10 m
Amount finance cost	£ 8 m
Interest cover	125%

An interest cover covenant might be, for example, no less than 110% in any one year and a higher rating average figure.

A local authority (or PCT) in choosing an RSL (or other organisation) to work with on extra care will want to know that it can raise the necessary cash and will not breach covenants in doing so.

What are the right questions to ask as part of the procurement process? Amongst others The Chartered Institute of Public Finance (CIPFA) suggests these probes:

Questions to ask on treasury management

Relationship with funders/ bankers

- How are the RSL's funders engaged with the RSL's work and business plans?
- Have funders raised any issues and how are these monitored by the governing body?
- Does the RSL regularly monitor and report against covenants included in the loan documents?
- Is this information used to review requirements with funders?

Covenants and compliance

- How many different covenants does the RSL have?
- How does the RSL monitor its covenants position on an on-going basis?
- If there are a range of different variations of similar covenants, is that necessary, and can they not be rationalised?
- How does the governing body gain assurance that there are no covenant breaches during the year and what early warning indicators exist?
- If covenants are tight, what action is being taken to re-negotiate?
- Does the RSL comply with all requirements of its loan agreement (s)?
- What would happen if the RSL breached its loan covenants?
- Is the RSL required to verify covenant compliance at the end of the financial year?

Risk management

- What is the RSL's exposure to fixed and variable rate debt?
- What is the impact of a 0.5%, 1% and 2% increase in interest rates?
- By how much would interest rates need to move to create a covenant breach?
- Do you have sufficient security to borrow funds as and when required to meet your obligations?
- Does your business plan demonstrate the RSL's ability to meet funding conditions and repay interest and principle when due?
- Does the RSL review its treasury management policy on an annual basis and does the Board receive reports on a regular basis?

Source: RSLs Panel Bulletin – Treasury Management in RSLs, CIPFA, April 2007

The commissioner will also want to be assured that other risks have been considered such as projected revenue not materialising due to a fall in tenant or leaseholder income following a decline in interest on savings, private pensions or a reduction in Supporting People funding.

Aware of the potential for damage in breaching loan covenants, the National Housing Federation (the umbrella body for RSLs) advises its members as follows:

NHF Advice – surviving the crunch

- Maintain regular communication with your lenders. They will favour housing associations that maintain a good relationship and where there are no unpleasant surprises.
- At a time when loan conditions are under increasing scrutiny by the banks, housing associations must be careful to comply with all covenants for existing facilities.
- Do not give lenders reasons to renegotiate existing deals. A technical breach of a loan agreement could result in less favourable terms for the housing association.
- Make all payments on time and in accordance with your loan agreement.
- Conserve liquidity (there may be opportunities to make good use of cash during the "bounce back" from the crunch).

Source: Credit crunch update, NHF, October 2008

Alternatives to mortgage finance

The private finance element of extra care development by RSLs comes from the organisation loan facility. In the past, the principle alternative method of raising larger sums has been by the issue of a bond. In this case, the issuer sells the bond to raise substantial amounts of capital for development. It comes to the RSL as one lump of cash when the bonds are sold. Bonds are tradable, there is a market for them, and they can be used as security for loans.

What is a bond?

A legal contract sold by an issuer for example on behalf of an RSL, promising to pay the holder of the bond its face value e.g. £100 plus amounts of interest at future dates.

Since the credit crunch came to the fore, two successful bond issues have been reported…

> *"Circle Anglia has raised £275 million with the biggest ever own-name bond issue by a housing association. The deal broke a record set just two months ago (sic) when Affinity Sutton raised £250 million with the first bond issue by a single association in five years. But Circle Anglia's Aa 3-rated 30 year fixed rate bonds carry a coupon of 7.25% compared with a coupon of 5.98 per cent on the Aa 2-rated Affinity Sutton bonds.*
>
> *Phil Jenkins, a director at RBC Capital Markets, which arranged both issues, said the main reason for the price difference was the shock sustained by the financial system since the Affinity deal"*

Source: Inside Housing, 14th November 2008.

Section 106 sites and planning

RSLs have come to rely heavily on obtaining affordable housing through S106 planning agreements between Local Authorities and private developers. The agreements apply to most larger sites and thus, theoretically, to extra care housing. They specify a certain amount of affordable housing which must be provided. This is commonly delivered by a housing association taking part of the site which is then developed mostly for rented housing.

The research for this Factsheet has revealed instances where planned extra care developments on S106 sites are on hold because the developer has mothballed the whole site. There is also evidence of these developers offering to sell the land to the RSL.

With a substantial reduction in speculative development these S106 sites are drying up. Few extra care schemes are provided as part of a private developers S106 site so this is having little direct effect. It might however lead to opportunities to develop extra care as an alternative to the developer's original plans.

Local authorities have indeed noted a trend of private developers bringing forward proposals for new extra care housing and of making applications for revised planning consents. Authorities, while appreciating the need for some fresh developments of specialised housing for older people in response to demographic shifts, still have some concerns:

- Proposals are not always well informed or well conceived as modern "extra care"
- Details are often vague
- The nature of the relationship with an experienced social housing provider or care provider is often unclear (or non-existent)
- Where an RSL partner is identified it is not always clear they have the necessary expertise or track record specifically in extra care
- Discussion with Adult Social Care may similarly be limited or again may have not taken place at all
- In turn Adult Social Care may have concerns about the possible long term implications of a variety of schemes being developed, on a different basis, where eventually the responsibility for funding or arranging care can eventually fall on the local authority

An underlying concern at this stage is how these applications are to be assessed by planners. It was suggested that further guidance than is currently available from RTPI[1] would be valuable.

For example, the locations of sites being brought forward were often said not to be suitable for extra care, and the conception of what constitutes "extra care" varies considerably. Housing LIN Factsheet 4 contains a useful typology of extra care[2].

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[1] Extra care housing: development planning, control and management, RTPI, (www.RTPI.org.uk/download/3054/GPN8.PDF)

[2] Models of extra care housing and retirement communities, Housing LIN, Factsheet 4 (www.networks.csip.org.uk/_library/Resources/**Housing**/Support_materials/**Factsheets**/Mca_statutory duties_infosheet_**4**.pdf)

Availability and value of land

Volume house builders are being dramatically affected by the credit crunch and inability to sell sufficient properties already built. At the time of writing (late 2008) the share price of one of the biggest constructors, Taylor Wimpey, has reduced from a high in the last year of 229p to 9p, a 96% fall, having reported a loss in the first part of the year. This builder, like several others, is carrying very large borrowings (debt).

The knock on effects for RSLs are:

- Builders offering completed residential dwellings to RSLs at a substantial discount on original valuation. This has little direct result for extra care
- At the margins, where larger general family housing built to a good standard is offered, there are some opportunities reported for diverting to create additional housing for some vulnerable needs groups, if used imaginatively
- Disposal of land, again often at a lower valuation than previously. In theory, if a change in planning can be obtained this might make more sites available for extra care
- RSLs consulted with as part of this research have confirmed that they are receiving calls from land agents on a daily basis. However, many Extra Care developments only stack up with 'free land' and even a 50% reduction in land value is said to be insufficient to create a viable development proposition. One large RSL has confirmed that they have concluded the purchase of a completed scheme from a private developer and were considering purchasing land subject to redefining planning permissions. This provider also remarked that on the whole land prices were still too high.
- There is also a view that County Councils and Local Authorities have sites that are likely to be of more interest to RSLs (free or discounted land is the key aim)

There is some indication that public sector land being made available for extra care housing, on which a market price was being required, is having to be re-valued to reflect new market conditions. This could assist the viability of some new extra care developments.

Private Finance Initiative (PFI) extra care

A small number of Local Authorities have used PFI to modernise sheltered housing and build new extra care housing.

What is PFI?

A Government initiative to encourage partnership between the public and private sector. On the basis of a very detailed specification, housing is provided using private finance. Under a long term contract and lease the rental income (and receipts) goes to the developer who is usually also responsible for maintenance.

PFI relies on private finance. PFI schemes already completed should not be affected by the credit crunch unless re-financing is required at some point or the lenders fail.

The credit crunch is however beginning to impact on newer and planned PFI developments. Funding may not be available. If it is, it may be at a higher cost than originally anticipated. A bulletin issued by 4Ps[3] (the specialist PFI agency) says:

> *"We have noted that margins on senior debt have increased significantly. However these costs are a very small proportion of project costs in local authority PPP/PFI projects so they are not having a significant impact overall. In fact, these increased costs have been offset at least in part in many cases by falls in long term swap rates since July 2007"*

Funding competitions are now described as "a tool to find a lender" at all rather than a way of getting savings or better value. In addition, schemes which include an allowance for some receipts from sales are likely to be adversely affected.

The advice from 4Ps to local authorities with PFI schemes in development or planned includes:

- Develop and implement risk mitigation strategies
- Regularly review bank terms for credibility
- Encourage early involvement by banks, but ensure that they are being managed by bidders
- Reserve the right to have a preferred bidder debt funding competition
- Reserve the right to use prudential borrowing and make capital contributions

Source: Frequently asked questions on the credit crunch, 4Ps, October 2008.

One local authority due to proceed with a second PFI which includes five extra care schemes early in the New Year said:

- *"On the raising of finance for projects we have been told by our financial advisors that the number of banks interested in funding PFI projects has reduced and the amount they are willing to invest is lower than in the past. It is increasingly common for banks to club together to fund a PFI. Banks are considering very carefully which projects they choose to invest in*
- *In terms of attracting bidders – PFI credits are a specific Government grant paid to a local authority to fund a particular project and therefore those projects are viewed as relatively secure. We do not seem to be having any problems attracting construction contractors, who are presumably faced with less projects and therefore it is making ours more competitive. However, we are anxious to achieve strong RSL interest in the project, and have found that some organisations are perhaps more nervous about bidding for these contracts now, because they are expensive to bid for.*
- *In terms of the scope of our project, we are slightly more wary of including accommodation for sale as part of the project, because of the current housing market it may reduce the attractiveness of the project as a whole to the market"*

  (Local Authority Project Manager)

Further information on PFI and extra care housing is contained in a recent joint publication between the Housing LIN and 4Ps, *Shared Equity: Using the Private Finance Initiative to Boost Extra Care Housing*.

[3] 4ps is local government's partnership and project delivery specialist: http://www.4ps.gov.uk/

Builders and Liquidation Risks

As with volume builders, contractors and sub-contractors are also facing challenges in the current economic climate. RSLs are already experiencing the impact from contractors going into liquidation while they are on site which has meant that the contract has had to be re-let. This is a process with related staff resource implications and which creates delays, adding to development costs.

RSLs have also reported that some sub-contractors on their sites have gone into liquidation and although this does not directly affect them in contractual terms there are concerns that delays in completion will result.

Fortunately, at present the impact on extra care specifically appears limited. Contractors used for extra care may already have an amount of ongoing ‘general needs’ development projects with social housing and consequently, thus far, have been less affected by the credit crunch than speculative house builders. There appears to be a positive outcome emerging. One large provider of extra care housing has reported decreases in labour and material costs with savings in the region of 8%.

In one instance there is evidence of a developer on a large inner city site bringing forward the completion of an extra care development (all properties for rent) to gain earlier access to the finance.

Summing up

Loss of capital injection from EC housing developments	• Detrimental effect on the RSL as a whole • From a range of perspectives has the potential to prevent the RSL developing additional stock • Threatens financial covenants • Threatens the financial standing of the RSL
Loss of revenue income	• Rent and service charge income reduced when properties remain empty • Receipts from other service provision reduced, eg. budget projections from commercial kitchen at risk • Projected care hours not delivered resulting in a risk to the provision of 24 x 7 personal care • Innovative strategies need to be adopted, eg. short / long term renting options
Loss of capital injection from EC housing developments	• A stalling of the completion of EC sales although interest in the ‘model’ is reported to be holding up • Planned EC developments utilising S106 sites are being put on hold • Reduction in units developed while the ‘older old’ population is projected to increase • ‘Mono tenure’ schemes do not meet the needs / aspirations of all older people or meet the demand in the marketplace for shared ownership / outright sale EC housing as identified by RSLs • RSLs are being offered EC sites by developers / land agents but on the whole prices are perceived to be too

	high for schemes to stack up financially • Some opportunities are emerging for buying completed schemes from private developers • Feedback that building and labour costs are reducing
Financial implications	• Challenging to negotiate loans at acceptable rates • Some lenders are rolling-up existing loan facilities with new borrowing at increased rates • Lenders demanding higher levels of security where loans are granted • RSL Boards not approving EC housing with shared ownership / outright sale element due to increased corporate financial risk • 'Mono tenure' rented schemes may not stack up financially unless scheme standards are compromised resulting in a reduction of communal facilities / cost cutting in relation to the individual properties

Other relevant Housing LIN publications

Technical briefs:
No 1 – Care in extra care housing
No 2 – Funding extra care housing
No 3 – Mixed Tenure in extra care housing

Toolkit:
Extra Care Housing Toolkit

Factsheets:
No 1 – Extra care housing: what is it?
No 2 – Commissioning and funding extra care housing
Forthcoming – Better marketing for extra care housing

Reports:
Shared Equity: Using the Private Finance Initiative to Boost Extra Care Housing. Housing LIN/4Ps, 2008

Rainy days, Silver Linings: Utilising equity to support the delivery of housing or support services for older and disabled people, Housing LIN 2008

Case study:
Forthcoming – Capital costs in extra care housing

Other Housing LIN publications available in this format:

Factsheet no.1: **Extra Care Housing - What is it?**
Factsheet no.2: **Commissioning and Funding Extra Care Housing**
Factsheet no.3: **New Provisions for Older People with Learning Disabilities**
Factsheet no.4: **Models of Extra Care Housing and Retirement Communities**
Factsheet no.5: **Assistive Technology in Extra Care Housing**
Factsheet no.6: **Design Principles for Extra Care**
Factsheet no.7: **Private Sector Provision of Extra Care Housing**
Factsheet no.8: **User Involvement in Extra Care Housing**
Factsheet no.9: **Workforce Issues in Extra Care Housing**
Factsheet no.10: **Refurbishing or remodelling sheltered housing: a checklist for developing Extra Care**
Factsheet no.11: **An Introduction to Extra Care Housing and Intermediate Care**
Factsheet no.12: **An Introduction to Extra Care Housing in Rural Areas**
Factsheet no.13: **Eco Housing: Taking Extra Care with environmentally friendly design**
Factsheet no 14: **Supporting People with Dementia in Extra Care Housing: an introduction to the the issues**
Factsheet no 15: **Extra Care Housing Options for Older People with Functional Mental Health Problems**
Factsheet no 16: **Extra Care Housing Models and Older Homeless people**
Factsheet no 17: **The Potential for Independent Care Home Providers to Develop Extra Care Housing**
Factsheet no 18: **Delivering End of Life Care in Housing with Care Settings**
Factsheet no 19: **Charging for Care and Support in Extra Care Housing**
Factsheet no 20: **Housing Provision and the Mental Capacity Act 2005**
MCA Information Sheet 1: Substitute Decision-making and Agency
MCA Information Sheet 2: Lawful restraint or unlawful deprivation of liberty?
MCA Information Sheet 3: Paying for necessaries and pledging credit
MCA Information Sheet 4: Statutory Duties to Accommodate
Factsheet no 21: **Contracting Arrangements for Extra Care Housing**
Factsheet no 22: **Catering Arrangements in Extra Care Housing**
Factsheet no 23: **Medication in Extra Care Housing**
Factsheet no 24: **Social Well-Being in Extra Care Housing**
Factsheet no 25: **Nomination Arrangements in Extra Care Housing**
Factsheet no 26: **Housing for People with Sight Loss**
Factsheet no 27: **Attendance Allowance, Disability Living Allowance and Extra Care Housing**
Factsheet no 28: **Day Care and Outreach in Extra Care Housing**
Factsheet no 29: **The Cohousing Approach to 'Lifetime Neighbourhoods'**

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