



**2008 annual review of  
housing association  
private finance**

**TSA**

**TENANT  
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# Introduction

This is the first annual review of housing association private finance published by the Tenant Services Authority (TSA), continuing the process of an annual review introduced by the Housing Corporation. The primary purpose of the 2008 annual review of housing association private finance is to provide an overview of treasury management in the housing association sector and its key private finance data.

Traditionally the data used for this review has been compiled from the Private Finance Regulatory Return (PFRR) submitted as part of the Electronic Annual Accounts (Form FVA). This is submitted by social housing providers registered with the TSA and with more than 1,000 units owned or in management. Therefore the PFRR is usually received in September and relates to the position at the end of March.

As part of the TSA's response to regulating in the current environment, significant amounts of additional treasury management information is being collected either through the quarterly surveys or from targeted engagement with some providers. This information will provide an update of the position, and how it has changed, since the PFRR was completed in March.

As a result the annual review of housing association private finance is split into three sections:

- the first section provides figures from the PFRR, including tracking changes between 2007 and 2008
- the second section concentrates on the most up to date information we have from the January 2009 credit market quarterly survey
- finally, the third section offers a view of the finance markets based on the experience of a housing association treasury manager, Alison Cambage from Bromford Housing Association. In her section, Alison offers a practitioner's view of the credit crunch, what this has meant for her organisation over the past year and gives her opinion on what the future may hold

As in previous years, the analysis of data is dependent upon the accuracy of the actual data provided by housing associations. We do not believe that there are any inaccuracies in the data that are material enough to distort the view provided in this review. Readers should note that as significant amounts of existing facilities are re-financed each year, and because arrangements on existing facilities may be revised, it is not always possible to reconcile movements in balances year on year with the activity that has taken place during the year.

# Part A

## Executive summary

With the UK economy now officially in recession and the ongoing problems in international credit markets, housing associations are facing the most challenging times known to the sector. Although the housing association sector is being impacted by the downturn, on the whole it continues to be remarkably resilient. The continued ability of the sector to access private finance, albeit at higher rates than previously, demonstrates that housing associations remain an attractive investment to lenders.

This review shows that at 31 March 2008:

- the sector had a total of £48.5 billion arranged loan facilities, with 72% (£35 billion) drawn
- new facilities arranged in the year totalled £8.3 billion, with 84% (£7 billion) of these drawn
- 64% of total debt was fixed or short term fixed<sup>1</sup>
- 54% of new debt arranged in the year was variable
- the average margin on total variable debt was 36 bps
- the weighted average interest rate for variable debt was 5.88%
- the weighted average interest rate for fixed debt was 6.59%

For the first time the annual review of housing association private finance includes information from the latest quarterly survey, undertaken in January 2009. Highlights of the survey information show that in January 2009:

- the sector has £53.1 billion total facilities in place, with 73% of these (£39 billion) drawn
- there is £28.2 billion of security in place to cover the £14.1 billion un-drawn loan facilities
- over the next 12 months the sector plans to drawdown a further £5.6 billion of debt, £5.2 billion of this is already in place
- margins on new debt are likely to be at least 150 bps, but this is making the sector more attractive to institutional investors, with £735 million raised through bond issues in the six months to December 2008
- there are 32 associations with less than 12 months worth of facilities in place, the TSA is working closely with these associations
- in the last quarter 34 associations experienced margin calls on interest rate swaps, with a total value (security and cash) of £430.9 million but all calls were met

<sup>1</sup> Short term fixed loans are long term variable rate loans but in the short term the interest rate has been fixed, usually at the start of the loan agreement. Fixed rate loans are those where the interest rate is fixed over the whole life of the loan.

## Part B

# Private finance regulatory return

### Total private finance

At 31 March 2008 the sector had £48.51 billion of arranged loan facilities in place, an increase of 12% on the 2007 total of £43.5 billion. Of these loan facilities, 72% or £34.96 billion had been drawn down to fund business activities. Table One below summarises the position in 2008 compared to 2007.

£743 million (2.1%) of the total drawn loan of £34.96 billion at 31 March 2008 was classified as falling due within one year of the balance sheet date, a slight increase on the year before.

### New debt arranged in the year

In total associations arranged circa £8.3 billion of new facilities during the 2007-08 financial year, of which almost £7 billion was drawn in the year. As shown in Table One above the net increase in the sector's debt was some £4.03 billion, indicating that some of the new facilities arranged and drawn were used to repay or refinance existing debt.

Other reasons for the increase in debt are to fund new development; major repairs improvement programmes; stock transfers; or a combination of these factors. The reasons for the change in debt will vary by the type of association, the stage of development of the organisation and the activities which the association is involved in.

Table 1 Total loan facilities and drawn loans at 31 March 2008

Total Position	2008 £m	2007 £m	% Difference
Facility	48,505	43,498	12%
Drawn loans	34,962	30,927	13%
Drawn as % of total facility	72%	71%	

## Stock transfers versus traditional associations

Stock transfer associations, particularly those that have been in existence for less than six years and are still within their major repairs reinvestment period, have a significantly different debt profile to traditional associations.

Table Two below shows the total facilities and drawn loans at 31 March 2008 split between stock transfer and traditional associations.

New stock transfers make deficits in the early years as they complete the post-transfer stock reinvestment programme. Generally, once they have completed these reinvestment programmes, stock transfers and traditional associations borrow mainly to finance new development. In the short term however some traditional associations may be borrowing to fund major repair programmes, particularly as they continue to work towards achievement of the Decent Home Standard. In addition, some traditional associations are undertaking partial stock transfers and at times will be drawing down debt to fund reinvestment programmes. Table Three below splits the net change in debt figures by stock transfer and traditional association.

**Table 2 Loan facilities and drawn loans split by association type**

Total Position	Stock transfer £m	% of total	Traditional £m	% of total	Total £m	
Facility	18,259	38%	30,246	62%	48,505	100%
Drawn loans	12,640	36%	22,322	64%	34,962	100%
Drawn as % of total facility	69%	74%		72%		

**Table 3 Split of net change in debt by association type**

	Net change in debt £m	%
Traditional associations	2,457	61%
Stock transfers	1,577	39%
Total	4,034	100%

**Table 4 Split of new facilities arranged and drawn by association type**

New debt	Stock transfer £m	% of total	Traditional	% of total	Total £m
Facility	2,834	34%	5,496	66%	8,331
Drawn loans	2,097	30%	4,864	70%	6,962

Table Four indicates that stock transfer associations used £520 million to refinance existing debt; the corresponding figure for traditional associations was £2.4 billion. Prior to the onset and deepening of the credit crunch associations used refinancing as a method of seeking more favourable borrowing rates, which in turn drove many of the efficiency gains achieved by the sector. The cost savings achieved through these efficiency gains were often used by the sector to improve the service delivery and range of services offered to tenants.

In the current climate, associations are very aware that this is no longer the case. Refinancing existing debt would in the vast majority of instances lead to significantly worse terms (both headline rates and other fees) as lenders seek to re-price debt upwards. Therefore, the levels of refinancing shown in Table Four are unlikely to occur again in the short to medium term.

## Lenders

The ten lenders with the largest total facilities in the sector as at 31 March 2008 were, in alphabetical order:

- Abbey
- Barclays
- Britannia
- Dexia
- HBOS
- Lloyds TSB
- Nationwide
- RBS
- Royal Bank of Canada
- THFC

There was a slight change in the top ten compared to 2007, with the Royal Bank of Canada replacing Bradford & Bingley, which sold its social housing loan portfolio to Dexia in November 2007.

At 31 March 2008, this indicated that the lending community was fairly stable, however, since that date there have been obvious changes to the make up of the key funders to the social housing sector. The deepening of the liquidity problems caused by the credit crunch reduced the appetite and ability of

many lenders to work with the sector. At one time there were only three known funders who were open for business, although this situation began to improve towards the end of 2008.

Last year's review noted "the effect of the credit crunch may have caused some lenders to review the extent of their individual exposure and there are concerns that some may be looking to improve margins". This situation has now come to pass with lenders setting stricter controls over the exposure they have to individual associations, geographical areas and types of business activity. In addition, lenders have significantly revised their assessment of pricing of debt within the sector to reflect differential risk profiles and the higher cost of borrowing. As discussed in Part C of this review, this means that the margins offered for new, or refinanced, variable rate debt are likely to be in the region of 150-200 basis points (bps) – a far cry from the 20-40 bps shown in the section on interest costs on page 8 as being achieved in the year to 31 March 2008. In addition, there is evidence that fees for arranging new facilities, overdrafts and non-utilisation fees for committed facilities are increasing

However, it is not just the lenders who need to consider their individual exposure. The issue of

counterparty risk faced by housing associations is also becoming a factor as the pool of active funders is decreased, either by withdrawal from the sector or merger. The lack of available funding means that opportunities to refinance are limited. Therefore this risk needs to be managed more proactively than in the past.

The last annual review of housing association private finance also noted, "It is likely that the larger groups and associations, particularly ones with significant development programmes, will seek alternative forms of financing such as the capital markets." In December activity in the bond market continued with £180m of new bonds issued, bringing the total of institutional investment in the last six months to £785 million. If margins continue to increase or stabilise around 100-150 bps it is

likely that the housing association sector will be come increasingly attractive to these institutional investors.

## Type of debt

Table Five below shows total drawn debt and new debt drawn in the year split by type of debt, either variable, short term fixed or fixed. The term variable rate refers to a loan where the interest remains variable over the whole loan term. Short term fixed loans are long term variable rate loans but in the short term the interest rate has been fixed, usually at the start of the loan agreement. Fixed rate loans are those where the interest rate is fixed over the whole life of the loan.

**Table 5 Total and new drawn debt broken down by debt type**

	Total drawn debt	% of total drawn debt	New debt drawn in year	% of new debt drawn in year
	£m	£m	£m	
Variable	12,465	36%	3,730	54%
Short term fix	5,833	17%	924	13%
Fixed	16,664	48%	2,309	33%
<b>Total</b>	<b>34,962</b>	<b>6,962</b>		

The split between each type of debt, in percentage terms, has remained constant between 2007 and 2008 for both total and new drawn debt. This indicates that the sector continues to borrow more new variable rate debt in order to keep the total split of fixed plus short term fixed debt to variable at roughly two-thirds to one-third.

Indications are that circa £5 billion of the sector's variable rate debt is hedged with some form of derivative; either stand-alone or embedded in loan agreements. The majority of these derivatives instruments are in the form of a swap or swap option. The use of derivatives, particularly in relation to mark to market margin calls, is discussed in more detail in Part C.

## Interest costs

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

The weighted average interest rate on the fixed rate portfolio (fixed rate debt together with short term fixes) at 31 March 2008 was 6.59%, a slight increase from 6.51% at 31 March 2007. The weighted average interest rate of total fixed rate debt raised in the year to 31 March 2008 was 5.35%, compared with 5.07% for the previous year.

For variable rate debt the weighted average interest rate on the portfolio at 31 March 2008 was 5.88%, up from 5.53% the previous year. The weighted average interest rate of variable rate debt raised in the year to 31 March 2008 was 5.98%, compared with 5.51% for 2007. The margin achieved on the variable rate debt portfolio was 58 bps compared to 36 bps in 2007. Slightly surprisingly the margin on new variable rate debt raised in the year was down from 30 bps in 2007 to 28 bps in 2008. However, this is likely to reflect those associations who secured debt in the early part of 2007-08, where margins of 10-20 bps were seen in some cases before the credit crunch had a significant impact.

## Part C

# January 2009 quarterly survey

### Introduction

In January 2008, as part of its regulatory response during the credit crunch, the TSA instigated a quarterly survey of housing association finance directors, which sought their opinion of the finance and housing markets.

The latest quarterly survey, the fifth of its kind, was undertaken during January 2009 and in total there were 251 respondents, split almost 50:50 between single entities and larger group structures.

Table Six below shows the geographical split, as per the TSA regulatory structure, of the 251 associations who completed the survey.

The survey is structured into a number of sections, which gather information on loan facilities, security, derivatives, asset sales and unsold units. The relevant private finance sections are discussed in more detail below.

### Loan facilities and security

Section one of the survey gathers information on currently arranged loan facilities, drawn loans, unutilised facilities and security in place that is charged or ready to be charged against these facilities. Table Seven provides summary figures from the latest survey.

**Table 6** geographic split of respondents to the January 2009 quarterly survey

	London & South East	North & West Midlands	East Midlands & East of England	South West	National Total
Number of respondents.	68	116	39	28	251

**Table 7 Summary figures for loan facilities and security**

	London & South East £m	North & West Midlands £m	East Midlands & East of England £m	South West £m	National Total £m
Current total loan facilities agreed and drawn or in place for drawdown	24,395	18,525	6,478	3,687	53,085
Current outstanding loan amount	18,684	13,375	4,332	2,624	39,016
Facilities available but not drawn	5,710	5,149	2,146	1,063	14,069
Current total security ready to be charged against facilities available but not drawn	12,532	9,829	3,071	2,807	28,240
Total available security that is unutilised and ready to be charged against new facilities	13,181	9,356	1,298	1,876	25,711

From the table it can be seen that in the ten months following 31 March 2008, the arranged facilities in the sector rose by just under £5 billion; from £48.5 billion in the PFRR to £53.1 billion disclosed in the latest survey. Forty-six per cent of these facilities were arranged by associations regulated from London & South East and a further 35% were arranged by North & West Midlands regulated providers. In total 73% of these facilities were drawn at the time the survey was completed, leaving £14.1 billion undrawn loan facilities in place and ready to be drawn.

Survey respondents reported that there was adequate security of £28.2 billion in place to be charged against these un-drawn facilities, double the available un-drawn facilities in place. In addition, the sector disclosed it had a further £25.7 billion available as currently unutilised security available to be charged against future borrowing needs.

On the face of it, this is a positive situation given the total security available to be charged against arranged or future facilities. However, at a time of falling asset values the levels outlined above may in fact be lower than the current values held in the balance sheet. In addition, lenders are also changing their attitude to certain types of asset offered as

security and this could potentially diminish the pot further.

## Planned drawdowns

The sector plans to drawdown just over £5.5 billion of private finance in the coming 12 months, with 93% of these drawdowns coming from facilities already in place. The high percentage of drawdowns from existing facilities reflects the move by associations to reduce the need to go to the financial markets in the short term if possible. Lack of available credit and higher price of funding offered, coupled with the potential re-pricing of existing debt is ensuring that the majority of providers have at least 18 months worth of loan funding in place. In many cases associations are making significant business decisions such as shutting off all new development to ensure that they do not need to secure new funding in the medium term, giving the markets sufficient time to stabilise.

Nationally, 23 associations intend to arrange new loan facilities in the coming 12 months. These new facilities account for the £382 million of drawdowns planned from new facilities that are yet to be arranged shown in Table Eight.

**Table 8 Planned drawdowns in the coming 12 months**

	London & South East £m	North & West Midlands £m	East Midlands & East of England £m	South West £m	Total £m
Planned drawdowns over the next 12 months.	2,436	2,053	768	337	5,594
Drawdowns planned from existing facilities.	2,186	1,937	747	337	5,207
Drawdowns planned from new facilities yet to be arranged.	249	112	21	0	382

## Derivatives

A continued dissociation of the London Inter Bank Offer Rate (LIBOR) from the base rate is identified as a concern by many FDs responding to the quarterly surveys. The graph below tracks the movement of both LIBOR and the base rate since November 2007, generally accepted as the real on set of the credit crunch.

A number of associations have entered into free standing derivative instruments in order to hedge their risk to rising variable interest rates. As Alison Cambage says in part D of this review:

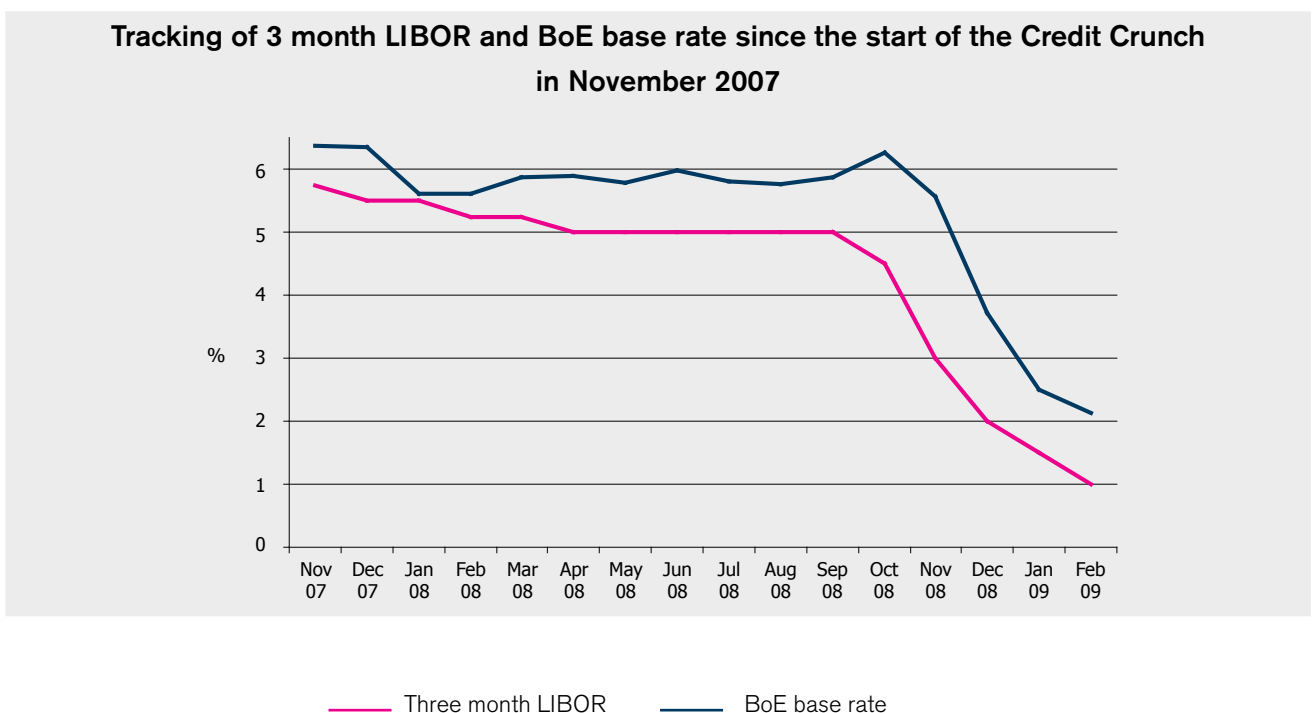
“These stand alone arrangements have served us well as a sector. We have been able to access competitive rates of fixing without having to deal on an embedded basis which made us a captive audience for the facility banks. Refinancing has been possible without the pain of breakage costs, therefore allowing great benefits in terms of long term cost savings.”

However, a free standing interest rate swap is subject to ongoing ‘mark to market’ valuation. In the vast majority of cases the differences in the mark to market valuations fall within the allowed

threshold limits specified in the swap agreement or International Swaps and Derivatives Association (ISDA). However, if the yield curve moves sufficiently this may result in an association having to provide cash or property security to the swap counterparty, known as a margin call. These are often payable at 48 hours notice and can therefore place significant pressure on the cash flows of associations.

In late 2008, due to an unprecedented shift in the yield curve, a number of associations faced margin calls from their swap counterparties. Table Nine provides further details of the known calls thus far. Information gathered by the TSA shows that 75% of those providers disclosing they have free standing derivatives have been subject to a margin call, with the total value of these calls amounting to £431 million cash and security. This figure is

**Graph 1 Tracking of LIBOR and BoE base rate from November 2007 to February 2009**



slightly higher than previously published as further, albeit smaller, calls have been made in the new year. Associations successfully managed to meet these calls as they fell due.

Half of the associations subject to margin calls are regulated from London & South East, and the calls made to these providers amount to 73% of the total margin call amount.

Many organisations have mitigated the risk of future calls by negotiating with their counterparties to either charge additional security to cover future calls or to 'collapse' the swap into the underlying loan agreement.

## Views of the finance market

In each of the quarterly surveys undertaken to date FDs have been asked for their views on whether the finance markets in the last quarter has improved, deteriorated or stayed the same.

Unsurprisingly, earlier in 2008 there was a bias towards a deteriorating finance market as conditions worsened considerably. In the October survey the corresponding figures were: Improved – 1%; Stayed the same – 23% and Deteriorated – 76%. Table Nine shows that opinion has moved slightly towards improved in the January survey, but 95% of respondents believed that things had not got any better over the past three months. Another factor to consider is that many FDs' reasons for citing a market that had stayed the same was that

**Table 9 Summary of views of finance markets in the January 2009 survey**

Has your view of the finance markets over the past three months:	L & SE	N &WM	East	SW	Nationally
Improved?	5%	8%	3%	0%	5%
Stayed the same?	35%	40%	28%	43%	37%
Deteriorated?	60%	52%	69%	57%	58%

they had been extremely pessimistic in earlier surveys and their view has not changed in the past three months.

## **Covenant compliance and potential risks to continued compliance**

The January survey revealed that only two associations were anticipating a covenant breach in the coming 12 months, and in both cases the associations were in advance negotiations with their funders to obtain a waiver.

Whilst this is reassuring news, there are a number of factors with the potential to present a risk to the on-going meeting of covenants at the year end and into the early part of the next financial year. Two key factors are discussed below.

The TSA would urge those associations that are not already regularly monitoring covenant compliance on at least a quarterly basis to do so in the future, as a number of these factors could crystallise rapidly and would not be picked up soon enough in an annual monitoring cycle. Also associations should be regularly stress testing their business

plan assumptions and forecast figures to ensure covenant compliance is maintained in the future.

- Relationship with lenders

Over the course of 2008 lenders have re-evaluated the relationships they have with their clients. The constraints on the availability of new funding due to lack of liquidity in the credit markets have caused a revised assessment of risk, leading to a desire to re-price debt accordingly. As noted in the section on the PFRR, margins of 20-40 bps were the norm in the sector a year ago. However, the deepening of the credit crunch has led to most indicative offers of funding being made at margins of 150 bps and above.

Whilst the majority of associations do not need to access new funding, and thus should not be subject to these higher rates, there is also a move from the lenders to look to re-price existing debt where possible to more fully reflect current market conditions. Triggers for re-pricing can include failure to provide requested information in a timely manner, material adverse change clauses and other events that require lender approval. A covenant breach, real or "technical", is almost certain to lead to a re-pricing of debt and may be far harder to negotiate than previously.

Therefore it is crucial that associations manage their relationships with their lenders closely to ensure that re-pricing of debt is not triggered unnecessarily.

- Impairment

The following is an extract from a letter sent by the TSA to housing association CEOs in February 2009.

“The fall in value of land and buildings in the last year may result in some associations needing to make an impairment charge within their annual accounts. A charge is deemed necessary where there has been a permanent diminution in value of the asset. This is more likely to be an issue for those associations with substantial development activities, those that have land banks, or empty properties built for outright sale or shared ownership where the adverse market conditions have resulted in a loss in value. Those associations who are mainly providing social housing rental schemes will probably be less likely to be affected by impairment.

“In extremis poor financial results affected by impairment might result in covenant breaches. Accounting rules in these circumstances require all debt to be classified as a short term liability. This can be an issue if a technical covenant breach has occurred at the balance sheet date – even if subsequently waived.”

Although the TSA believes that some associations will suffer impairment charges, it is not anticipated as being a sector wide problem. The January survey revealed that 108 associations had land banks totalling £1.3 billion and a number of associations had unsold Low Cost Home Ownership units, which may have fallen in value in the current market. In total 51 associations disclosed they were anticipating impairment charges in the 2008-09 accounts amounting to at least £76 million.

The TSA would encourage all associations to consider and discuss impairment with their external auditors at an early stage in the audit process, as well as keeping their lenders informed as the position emerges

## Part D

# A practitioner's view

### **Alison Cabbage – Director of Treasury Bromford Group**

The following piece is an overview of how the events of the last 18 months have both affected the sector and, more specifically, been handled within the Bromford Group, a 25,000 unit group of associations based predominantly in the Midlands, where I have been Director of Treasury for over two years.

I have been in treasury for over twenty years, in housing, blue chip corporates and even as a relationship director for one of our major banks (gamekeeper turned poacher!). I thought therefore that I had seen it all. I remember BCCI and Barings and a whole host of mini crises but nothing like the events we find ourselves experiencing now. We are in uncharted territory.

So, there we all were back in mid 2007 without a care in the world (we just didn't realise it then). We were in the era of 'Unlocking the Door' and Gordon Brown was aiming for three million more homes by 2020. Grant levels were falling, bank lending was rising and Bromford was planning 1,000 new homes per annum. The Warwick Finance

Conference in the spring of that year had been the usual well attended success and I recall particularly a session run by Piers Williamson, Chief Executive of THFC and Gabrielle Berring, then Head of Housing Finance at HBoS, which debated whether or not margins could go any lower. We were still in the world where sub 20 basis points was 'normal' (seems a lifetime ago) and the eight or more banks seriously funding the sector were able to provide enormous sums for term facilities. This limited number of funders is unusual and not to be found in other sectors of the economy. Housing association's low risk (almost zero) profile mean that those banks willing and able to model pricing on this basis are able to offer much lower margins, in the knowledge their lending is both secured against an increasingly valuable asset (before the recent price falls!) and also because the chances of an association being allowed to fail are remote in the extreme. Turning anywhere else for funds seemed unnecessary, unless you were a seriously big association and the capital markets inevitably beckoned.

Then the crunch hit and I won't bore you with the run of events as we have all watched with horrified fascination Robert Peston's emerging tale on the news each night for over 18 months.

How did this situation affect the Bromford Group? Bromford reacted immediately and professionally. I know I am expected to say that but it really is the case and the result of the work that goes into the supportive and healthy culture of the Group. A 'Leadership Programme' heavily supported by the Executive Team is offered to senior managers and assists both training in leadership skills but more importantly allows a highly effective network within the group. It bonds together the 'decision makers' and allows very swift reaction to changing circumstances. This kicked in overnight within the group and the leadership team refocused rapidly. All of the 'Armageddon' conversations were had, many scenarios considered and communicated. Decisions were therefore more swiftly arrived at. It was what we refer to internally as a 'moment of truth'.

- We arranged several gatherings of the senior team and good communication across the group was at the forefront of our aims
- Piers Williamson came in to talk to the leadership group about the situation as part of a group 'Credit Crunch' event to discuss what measures we should take internally and quickly
- Our Lloyds Bank team kindly arranged for their economist to speak to us about the economy and prospects for the sector

- Within a very short space of time our Group Finance Director and Director of Business Planning reran business plans to stress test all the possibilities
- Development was scaled back, the shared ownership and outright sale tap was turned off, only completing those developments already underway

To an extent the Bromford Group was, and is, lucky. Our surplus is not reliant on sales of shared ownership units; we had no land bank to consider revaluing. We also had a lot of built up value within the security already in charge to funders, being a few years into the revaluation cycle. This meant that there was no pressure to find more security to top up falling asset cover covenants. In addition, we had over two years of committed facilities signed up and ready to use. We were in pretty good shape to deal with the events of 2008.

How have we seen the sector change while all this was going on? In addition to the obvious impact on the individuals trying to get a mortgage to buy a portion of shared ownership properties and the knock-on effect that has on sector income, housing associations have seen a massive drop in lender interest ourselves as borrowers. What had been a strong list of over eight funders dropped to three

real contenders in a very short space of time. This had the effect last year of putting a great deal of stress on associations who had been allocated development programmes but who did not have the facilities already in place to support them. All of a sudden, the projects didn't make the same financial sense they had before. The banks that were (and are) still in the sector are clearly in a very different position to 2007 and the effects are numerous:

- The need to hold more capital against the funding which banks offer us means there is less money to spread about and it needs to work harder for them
- The money lent to us at pre crunch margins is now causing banks 'pain' as it costs more to provide
- The attitudes of relationship managers have in some cases changed dramatically; sometimes they have to convey tough messages, something which has not been the case before
- Margins have shot upwards but show no sign of settling, it has very much been a case of them changing every few weeks!
- Arrangement fees have risen and non-utilisation fees are back. The sector hasn't seen the latter for some time. Now the cost of having new facilities in your back pocket for the future, with non utilisation fees attached, doesn't make so

much sense anymore and makes future planning that little bit more uncertain

- The pressure is certainly on from the banks for us to draw facility lines – and to fix drawings!
- Covenants are tighter and in many cases becoming tighter still. For those struggling, for whatever reason, to achieve the financial and non financial covenants required, we have entered a more serious period where the friendly bank manager will re-price your entire loan facility if you breach any part of the agreement, or if you want to add to a facility, or restructure your group, or change anything, whether it strengthens your risk profile to them or not

Strange times indeed.

To add to the misery, just before Christmas we entered the bizarre world of margin calls from our stand alone swap positions. Suddenly, due to the unprecedented shifts in the yield curve, those of us with stand alone positions found ourselves breaching thresholds within the ISDAs we held with some of our banks. These stand alone arrangements have served us well as a sector. We have been able to access competitive rates of fixing without having to deal on an embedded basis which made us a captive audience for the facility banks. Refinancing has been possible without the pain of

breakage costs, therefore allowing great benefits in terms of long term cost savings. Advisors have liked these stand alone deals and boards have liked them. The sector as a whole has been able to act in a more flexible manner because of them. Should we have seen the massive calls that occurred over the Christmas period coming? Yes we should, but this risk was a measured one. Not having stand alone positions with a bank with whom no lending relationship existed was one of Bromford's policies and served us well. We emerged pretty much unscathed. Having cash or security available to pay a call was always the sensible strategy, even being able to drop deals into an underlying variable loan position with the same bank (albeit at a penalty rate hike) was also an option, but it was the speed of the shift in the curve that took many by surprise. No one could say they saw that coming. These savage moves in rates across the curve have been alleviated somewhat in recent weeks and calls will reduce as a consequence but it has been a nasty wake up call. If rates had continued to dive across the curve the sector would have been seriously damaged. Estimates at the time believed that over £1 billion had been sucked out of the sector to pay for calls, although the final figure was closer to half this amount. Nevertheless this still amounted to money and security that should be available to fund development.

Within Bromford our longer term reactions have included:

- acting to focus the attention of the organisation on spending wisely and considering each development project in even more detail than before. The mantra, proposed by our Director of Financial Reporting '...if this was your last £1,000 would you spend it on.....' is adopted across the group. Surprisingly straightforward
- we pinched the government's acronym COBRA, and use it for our own newly formed internal committee, chaired by our Group Finance Director, to assess all of our development spending in infinite detail bearing in mind our precious cash resources. This committee meets fortnightly and nothing gets to the Executive Board for approval without going through COBRA first
- Bromford have set up a new Treasury Committee with delegated authority from all of the group and member boards for treasury strategy. This smaller group of people who all possess a finance, banking or treasury background are able to assemble and react quickly to changing circumstances, thereby cutting the lead time previously required to go through the series of boards in the organisation. It is now far more fit for purpose in a rapidly changing environment

- Bromford's treasury team meets regularly with our funders and advisors keeping up to date with developments, allowing the Executive team to lobby across the sector from a more informed position where we feel necessary
- we check and double check our covenants, not just the reporting of historical levels (it's too late by the time you report them) but against business plans and different stress test scenarios to forecast any future issues and concerns. We call our relationship managers each quarter to confirm they have everything they require. We even add the newly styled TSA treasury response form to the list of information we send
- we put even more emphasis on charging security, to build up a pre charged pool of security for 'unforeseen' events
- all of this additional work has an obvious impact on a small treasury team

Planning for the future, the treasury have some constraints to consider. The unpredictability of the economic climate is certainly one, but in addition:

- availability of future facilities. We see very few 'long term' facilities left on offer these days. LOBOs or short term facilities (pretty much the same thing at the end of the day) or capital

markets/bond issues are very much the only options available

- security issues are a limiting factor for us like many others – greedy old bonds using up too much security, old stock scattered about and difficult to charge, the time taken to get stock into charge and the potential bottleneck of us all trying to use the Pru as Security Trust, all present problems
- refinancing or adding to existing facilities. If we want to consider this we know that there will be a potential re-price of all the low margin facilities we already have drawn. It is not a great choice but the only way to allow growth for the future. It will be all about timing!

In the meantime we have to continue to consider our treasury strategies and keep them flexible enough to allow for the business to react to change. We still need to fund development and we still need to stick to policy.

It is now the unpredictability of the economic situation that poses the greatest threats.

- Will our banks still be able to fund and will some of our potential customers be able to obtain mortgages?

- Will new funders enter the sector, attracted by the increased margins and low risk?
- Will grant increase to alleviate the need to raise so much private finance? (Happily we have seen this start to happen in the last few weeks)
- Will the RPI link to rental income be severed or changed next year as RPI is forecast to fall into negative territory?
- Will all housing associations survive this period and how will those requiring assistance be helped?
- We have already seen some associations assisted from within the sector but can this continue? How will this impact on the banks risk profile of the sector?
- Where will margins end up?
- Will we all end up having to go to the capital markets for sizable funding?

What, in my view, is most important overall is the level of communication to all stakeholders. Treasury needs its relationships to work at optimum levels with funders, solicitors, valuers and regulators. The support available within this sector is very different from the corporate treasury world and banking world. Colleagues in other associations are more able and willing to assist each other through these difficult times. Together with the support of funders within the sector and the regulators and other related bodies all working towards the overall aim of assisting more people into their own homes, we will hopefully emerge from this period a lot wiser and ready to grow.

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## **2008 annual review of housing association private finance**

This publication provides an overview of treasury management in the housing association sector and its key private finance data.