



COUNCIL of MORTGAGE  
LENDERS

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COUNCIL OF MORTGAGE LENDERS  
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## **Better Value from Housing Association Grant Changes to Grant from 2008/9**

### **Response by the Council of Mortgage Lenders to the Communities Scotland consultation paper**

**25 March 2008**

#### **Introduction**

1. The Council of Mortgage Lenders (CML) is the representative trade association for mortgage lenders. Our 157 members and 85 associates comprise banks, building societies, insurance companies and other specialist mortgage lenders who, together, lend around 98% of the residential mortgages in the UK. In addition, CML members have lent £43 billion UK-wide for new-build, repair and improvement to social housing.
2. The CML Scotland welcomes the opportunity to respond to the consultation paper, *Better value from housing association grant – changes to grant from 2008/9*

#### **General comments**

3. This response needs to be read in conjunction with our recent response to the green paper: [\*Firm Foundations: the future of housing in Scotland\*](#)
4. We can fully understand and support the Government's desire to increase the supply of new social housing through the housing association sector while achieving greater efficiencies in doing so. The proposed reduction in housing association grant (HAG), outlined in the consultation paper, will undoubtedly reduce the level of public subsidy required per every new house built, but will require additional finance to be raised through the private sector as the reduction in HAG will not be compensated by efficiencies alone.
5. We believe that while the risk profile of the housing association sector remains good so far as lenders are concerned, recent events such as the turmoil in the financial markets and the failure in England of Ujima housing association has increased its risk profile. There should, however, be a continuing interest amongst lenders to support housing associations who are developing new housing in Scotland, and it is our view that capacity exists within the sector to take on additional borrowings. The Scottish Government should, however, be aware of short-term issues of funding capacity amongst lenders due to the capital markets' crisis, which has made it extremely difficult for lenders to raise funds from that source on acceptable terms. In the present climate, it is not a foregone conclusion that all those seeking additional finance will get it.
6. Both in the consultation paper and in Firm Foundations, a great deal of emphasis appears to be being placed on the historic strength of the balance sheets of housing associations in Scotland to support the view that they will be able to secure additional finance from lenders. However, using asset cover as a measure of borrowing capacity is not viable, and the decisions of lenders will be primarily driven by the ability of housing associations to

generate net cash flows to both service and repay borrowings. For this reason, assumptions on rental growth will be fundamentally important for lenders.

7. Housing associations can only subsidise new developments from their existing asset cover on a limited number of occasions, and there is little doubt that increased gearing and demands on security cover will eventually impact on lending covenants, which are, in any event, likely to strengthen in the current financial climate. It is likely that the difficulties of valuers in identifying value for asset cover will increase, and it is very possible that the level of HAG will not be matched by valuation. This will place further demands on housing associations to subsidise individual developments.

8. The analysis by the Scottish Federation of Housing Associations of the proposed changes to HAG which appears on their website shows the private finance factor increasing to 21.76 from 18.14, but the cost factor only increases by 19.25. The net effect is to reduce HAG by 9%, but increase private finance by 35%. A simple serviceability test based on an assumed interest rate of 6% shows a minimum rent of £3,255 required as opposed to a base assumption of £2,700. This illustrates the dilemma that rent increases are required to meet repayment and to match valuation or the housing association has to subsidise each unit by between £5800 and £8700 which may not be sustainable in the long term.

9. Lenders will, undoubtedly, have to assess carefully those housing associations who will continue with new housing development as levels of gearing will increase and interest cover will decrease, and it may be that it will be pace of change which will be of concern to lenders, many of whom will have 30-year loan agreements in place.

10. The proposed new model is likely to mean that it will only be larger housing associations who will undertake development activity in the future, but it has to be borne in mind that lenders in Scotland have traditionally supported smaller housing associations in undertaking such activity in the belief that they would continue to grow by undertaking this activity albeit on a small scale and also in some cases to assist in maintaining financial viability. It is clear that lenders will wish to review individually with these housing associations their future financial plans and viability.

11. These changes to the HAG model are taking place against a background to changes in the regulatory model for housing associations in Scotland and as outlined in our response to Firm Foundations it will be important for the new regulatory arrangements to command the confidence of lenders if they are to finance the additional supply of new social housing which the Scottish Government is seeking to achieve. This is particularly true when the funds of lenders are limited and against the backdrop of economic and housing market uncertainty. Housing associations should expect to see the funding market differentiate to a greater degree between those representing a sound lending proposition and those representing greater uncertainty in relation to risk.

## **Rents**

12. We note that it is proposed that in the HAG model the assumption on rent levels will be amended so that instead of increasing by inflation they will rise by 1% above inflation and this is based on the fact that average secure rents have increased by 2% over inflation over the past five years. As outlined above rental levels are fundamental in assessing borrowing propositions and we have doubts regarding the sustainability of a policy which allows rents to grow faster than costs. Given the importance of this to lenders, it is a matter on which we would like to have discussions with the Scottish Government to understand their future policy in this regard.

## **Voids**

13. The consultation paper proposes a reduction in void levels in the model from 2% to 1%. This does appear to be an aggressive assumption even for new-build stock when we believe the sector average at 31 March 2006 was 2.4%, and it has to be borne in mind that one of the reasons for increasing supply is that currently there is a shortage of new social housing which will have reduced void levels. We would suggest that a fairer average for voids would be to set at the long-term average rate as opposed to the current rate.

## **Private finance**

14. We have commented above on how we believe that the risk profile of the sector is changing and in our response to Firm Foundations on the current turmoil in the capital and financial markets. Both lenders margins and cost of funds have been at historically low levels in recent years and it is unlikely that these levels will be sustained going forward and we would suggest that housing associations should be budgeting based on an upward price correction in terms of interest rates going forward. On the basis that many housing associations hedge interest rate exposure some comfort can be drawn that the proposed assumption on borrowing costs reflects the current level but this can quickly change with additional exposure having to be met elsewhere from within the housing association's core business. This is an aspect of the model which will have to be closely monitored.

## **Inflation**

15. The UK Government's target is 2.5% and while due to short-term pressures are currently running above this level we would expect to see downward pressure to bring down to the target figure. We would, therefore, be in favour of keeping the existing assumption of 2.5%.

## **Further contact**

16. This response has been prepared by the CML in conjunction with its members. Any comments or enquiries should, in the first place, be directed to:

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