Closing the Acorn Housing financing and the future funding of social housing

Ireland's Housing Magazine · Round Table Discussion

HOSTED BY

IRELAND'S HOUSING MAGAZINE

eolas magazine

Closing the Acorn Housing financing and the future funding of social housing

In December 2017, Oaklee Housing, advised by Centrus and ByrneWallace, completed a €50 million financing with Nord/LB to acquire 250 social houses over the course of the next two years. In order to deliver the financing structure, Oaklee created a new special purpose vehicle, Acorn Housing which is a wholly owned subsidiary of Oaklee, and is also a registered charity. The principal parties involved in the deal discuss how this type of financing can help shape private finance for the social housing sector and look at how affordable housing could be financed.

What were the greatest challenges in the delivery of this innovative financing?

Jason Murphy

The greatest challenge was putting together a structure that meets the needs of a diverse group of stakeholders and primarily as advisors to Sharon and her team in Oaklee to meet their requirement to minimise risk. The use of limited recourse financing minimises risk and has minimal impact on leverage that will allow growth for the entity into the future at a sustainable level. It was also doing something different that hasn't been done before.

Nina Murray

It was the first time we undertook this type of funding and although we know where we wanted to get to, we were not sure of the milestones – the structure and how it would work. What would it look like? We also wanted to determine the risk level from the state's perspective. We were also dealing with an international funder who didn't have previous experience or competence in funding social housing projects in Ireland.

Sharon Cosgrove

The biggest challenge for us was that it was an entirely new process. To date our funding has been from the Housing Finance Agency (HFA) and we know how that works, whereas this funder hadn't funded social housing in Ireland before. We were all learning. We had to figure out how all the various stakeholder relationships would work under this new arrangement. There were also internal challenges within Oaklee, as with any organisation that is doing something new. The team had to deal with different covenants than to those of the HFA and gearing up to meet the requirements of the funder. One of the challenges for our board, particularly the audit and risk committee, was looking at the risk associated with the project. The limited recourse nature of this type of funding is excellent in mitigating some of the risks. The third challenge is the complexity with the number of work streams involved. We had to deal with statutory bodies such as the charity regulator, the housing regulator and solicitors on tax, property, governance

Sharon Cosgrove

and banking. That was a challenge from a project management point of view.

Deirdre McBennett

From a legal perspective, one of the initial challenges was dealing with a private funder whose preference was to have a suite of bespoke and tailored documentation; and working to achieve that within the parameters of the existing Council agreements, being the Capital Advance Leasing Facility (CALF) and Payment and Availability Agreement (P&A) documents, which from the Housing Agency/Department perspective were considered non-negotiable. Working within those constraints proved challenging at times when seeking to work collaboratively with the funder and to address their requirements. The international location of the funder also meant that certain issues (e.g. insurance requirements for multi-unit developments) were viewed differently from a risk perspective than might have been the case with a domestic funder.

John O'Connor

The biggest challenge was getting people and organisations to understand the financing structure and the arrangements. The next challenge was managing the interaction between the finance experts and everyone else. The finance experts can get a little bit cocooned. The level of complexity and the amount of work involved was much greater than anyone initially thought.

What are the key benefits of this type of transaction for the social housing sector?

John O'Connor

The innovative aspect of this financing is its funding structure, as opposed to banking debt. It brings a diversity of funding and we need a diversity of investors. It was very attractive from the Government's point of view in meeting social housing need.

Nina Murray

It proves that off-balance sheet, non-exchequer investment can be done. The risk appetite aspect was important. A greater level of risk needs to be absorbed by both sides. The process involved us establishing what those new risks were and trying to finds ways to mitigate against them in a way that satisfied everyone.

Sharon Cosgrove

The benefits from a project finance point of view have been set out by others but from an AHB [approved housing body] perspective it gives us a facility rather than finance on a scheme-by-scheme approach. With this facility we have €50 million; we know the clock is ticking and it is only for acquisitions which enables the speedy delivery of social housing units. It will give us capacity to deliver 250 units in a number of tranches by December 2019. It also gives us certainty of funding.

Deirdre McBennett

The key benefit from an AHB's perspective, and therefore in turn for the social housing sector in general, is that through the SPV [special purpose vehicle] structure, liability and recourse, and hence also risk, is ring-fenced within the SPV entity, which obviously makes the structure much more attractive to AHBs. From a risk perspective it is an attractive model. The scale is important also for the sector, and the utilisation periods for drawdown of funding are sufficiently tight that they focus the minds on delivering residential units at scale.

Jason Murphy

When I was looking to try and bring this type of financing to the sector, the real benefit I was seeking was the ability to bring in very low-cost finance. Traditionally, funders of the housing association sector in Ireland and the UK lend on a corporate lending basis in a real estate environment which has a higher margin cost than in the infrastructure sector. It has also requirements in terms of leverage and maturity of debt that is much shorter than what is needed for this sector. By bringing in infrastructure lenders into the social housing sector we were able to get much longer term, fixed rate finance to give certainty over cost and risk with lower margins. We were trying to achieve more efficient funding which ultimately should result in less cost for the AHB and less support needed from the state and better value for money – that essentially is the key benefit for the sector.

Sharon Cosgrove

The limited recourse structure protects Oaklee and allows us to raise considerable debt finance as an AHB without risking the parent company. It allows us to achieve growth, which is essential as one of the main developing AHBs that are trying to deliver on the targets in 'Rebuilding Ireland'.

Jason Murphy

That risk mitigation aspect is crucial for the sector. The expectation is for the sector to grow quite significantly, and by allowing these limited recourse financings to be put in place, you are isolating the risk associated with that growth and outside the existing charity's operations.

Nina Murray

On a practical level, we learned a lot about the existing funding structures we administer on behalf of the local authorities. We learned a lot about how the Capital Advanced Leasing Facility (CALF) can operate for this type of structure. Up until now it had only been used in the context of HFA draw downs. Working with another lender who has different requirements was a learning aspect which has led us to review the operation of CALF in order to support further investments like this.

What is your view on the impact of AHBs remaining on the Government's balance sheet?

Nina Murray

The priority is to support AHBs in delivering social housing in the context of 'Rebuilding Ireland'. There is no quick fix in terms of financing. There are a lot of technical aspects of the [reclassification] issue and the Department of Housing is working closely with the sector and the Department of Finance and the Department of Public Expenditure and Reform to do that technical assessment. The first part of the assessment was carried out as part of the draft stability programme update in April. It gave us the first indication of the impact of reclassification on the Government deficit, which is quite marginal in real terms. That creates a bit of confidence and has led to a wider debate about the role of AHBs in delivering social housing. The net effect is that it is a technical issue and it is 'business as usual' for the sector.

Sharon Cosgrove

As an AHB that has been reclassified we are concerned about the impact this might have in the long term. It is good to hear from the Department of Housing and the Minister that it is business as usual. In the Housing Alliance we have worked with economists on this and looking a few years ahead, the tier 3 AHBs will have substantial development pipelines of activity. Whilst the impact on the government balance sheet and GDP at present isn't that bad, when you project forward it looks to be €3 billion in the best-case scenario and it could be up to €7 billion or more, which is over 2 per cent of GDP. It is the medium and long-term impact that is the concern and could have the impact of significantly constraining our capacity to deliver in the future.

John O'Connor

One of the biggest issues for the AHBs is how organisations operate and how they are governed. Are they going to operate as public bodies or as organisations somewhere between public bodies and the private sector? It is important to be clear on this. For example, if public procurement requirements for public bodies are to be applied to AHBs, then that will impact on how they will operate. The other impact is that as government capital funding it is restricted and it is likely over time to come under the control of the Department of Finance. This is a concern if AHBs remain on the government's balance sheet in the longer term.

Jason Murphy

The obvious impact of the sector remaining on the government balance sheet is the potential to ultimately constrain government and the sector. Essentially, if AHBs come onto the balance sheet it could impact government debt amount and while there is only a small amount of debt at present, that could become more significant in the future. In the UK, the reclassification had a significant impact but they quickly worked to address the issues around it. For the AHBs the concern must be that it could limit their potential. Clearly the message from government is that it doesn't. However, as a board member of an AHB it increases the perception of risk as you also need to address public body status in how you run the organisation. That will take up management time and add to the volume of complex issues facing the sector. The biggest impact of reclassification is therefore the possibility of limiting the potential of AHBs.

Deirdre McBennett

Reclassification in my view opens up the sector to the additional challenge of competing for Exchequer funding, which

in the context of the immediate and timely action needed to address the homelessness crisis, is a worrying development unless suitable workarounds are available and can be implemented with speed.

Do you have any views on the best model for affordable housing in Ireland?

John O'Connor

There are two areas in affordable housing: affordable rental and affordable purchased housing. On affordable rental, secondary debt is provided through CALF and that allows an AHB to rent at a lower level. That model is based on affordable rental schemes in the USA. With affordable rental and purchase we need to think long term; even beyond the time of debt or project finance. We need to think 50, 60 or even 70 years in order to make it work. In other countries they take this long-term view. The debt is paid off with the concept of maturation and then rent can be provided at a much lower level. For affordable rents think long-term with secondary funding.

With affordable purchase housing you need a facility to allow people to purchase a house at a reduced cost but at a discount and they always have to pay it back and the concept that will come into effect will be an equity charge that will allow for the funding of affordable housing.

Jason Murphy

For something to become affordable from where it stands today, someone has to pay for it. A subsidy is required and if that is going to be from the state, that support – just like if it was support for social housing – needs to be available for as long as required. There will be some people who will depend on it forever and others who will need it for a period of time. It's important to be equal and fair and to have a model that recycles that support when it is no longer needed.

John O'Connor

That recycling element is critical as if it is not recycled, the subsidy will be lost. It is like the CALF. It is funding that will eventually be paid back in the same way. It's not lost money as it can be recycled.

Nina Murray

As regards the State subsidy, the Government has already decided that the use of the State's land bank will be the subsidy. On the purchase side, being able to retain or claw back that subsidy is critical to the sustainability of that model. Initial indications from local

authorities is that there is the potential of around 4,000 homes from the land bank. The target in the medium to long term is for the delivery of 10,000 affordable homes. The second thing is the introduction of the 'Rebuilding Ireland' mortgage home loan, which is a low interest fixed-rate loan creating more affordability. On the rental side, it is widely accepted that the subsidy needs to be progressive and the Government favour the cost rental model. The Housing Alliance is working closely with the Department of Housing to work this out. There are a couple of pilot projects in Dublin to test the concept.

We also need to understand what we mean by affordability. There is a perception that in parts of the country there is an affordability problem, whereas that might actually be a supply problem.

Sharon Cosgrove

The AHBs are very well placed to help in this area, particularly with the affordable rental models. I don't have a fixed view if it should be supported by CALF, land or a revenue subsidy. All things should be considered. As the CEO of an AHB I would want to look at the financial model and risk and see how that stacks up over time. As for innovation, some of the solutions may be in joint-venture structures with the private sector. We need to think outside the box on this and certainly there is an appetite for doing that from the AHBs. For example, in Oaklee we changed the wording of our constitution almost three years ago to allow us to diversify into affordable housing.

Deirdre McBennett

The structure of the leasing model involving an agreement for lease and lease arrangement is something that from a legal perspective is familiar territory. The challenge will be to develop and combine different structures and proposals, to come up with a cohesive model that works to the strengths of the key stakeholders.

John O'Connor

There are lots of ways affordable housing can be done but it comes down to 'mind the gap'. You have the gap between the market rent or price and the affordable rent or purchase. You can cover that gap by funding CALF, or by land, or by taxation or planning gain measures such as Part V. There are a range of ways that that gap can be covered.

What is the biggest challenge in financing social housing in Ireland today?

Nina Murray

There is a commitment by the Government of €6 billion of Exchequer funding in 'Rebuilding Ireland' and the commitment in the National Development Plan to continue to invest in social housing. There is also a commitment to the sector and the role of the AHBs. In that context reclassification is a big issue. The complexity of the J-Vs and SPVs is challenging for all stakeholders. Traditionally, AHBs have grown quickly by harnessing these debt financing models. The issue now is to take on further risk in the face of these new challenges.

Deirdre McBennett

Regulation is critical. Government and potential funders need to be able to take comfort from the governance and transparency that exists around AHBs. The voluntary regulation code for AHBs has made significant progress in achieving that aim and building on the proven track-record of the AHB sector in this area. The introduction of a statutory regulator to oversee that effective governance will enhance this position further. Another challenge is scalability and utilisation. Projects such as Project Acorn, while very positive in terms of addressing the funding piece, highlight the need for a supply pipeline and timely access to housing stock, so that the ambitious targets of AHBs can be met. The type of housing being catered for is also an area that needs focus. With an ageing population and declining family size, there needs to be a shift in focus away from construction of three and four-bedroom houses.

Nina Murray

The availability of existing housing stock meant that in Oaklee's case their funders could see that the units already existed. The shared focus needs to be on creating new supply opportunities

John O'Connor

which increases the risk element and adds in more complexity.

Jason Murphy

Everyone recognises the desire to create mixed tenure developments. The financing of pure social housing is actually quite straightforward. The complexity arises when you look at mixed tenure development. It is also important for the State to ensure that there is adequate risk transfer and that it gets good value for money. With Part V developments, the social housing part is actually the smaller part of the development. To undertake private housing development on a large scale now is very risky and therefore the delivery of social housing has become mixed into the complexity of delivering all housing.

Sharon Cosgrove

The challenge for the AHBs is that there is a very small number of bodies that are gearing up for development. We need more AHBs gearing up and considering the use of these types of non-recourse vehicles to mitigate risk. Looming interest rate increases could also be a major challenge for everybody. I would like to see the domestic banks responding to the need for fixed interest rates over the longer term for the AHB sector.

Jason Murphy

We are heading into a higher interest rate environment after a period of historically low rates. Ultimately, any increase in interest rates is a cost and the more costs go up the less houses you can deliver. One of the benefits of this type of structure is long-term fixed rate funding. Some of the funding that has come into the sector in the past has been fixed rate for five to 10 years. After that period, the AHB is exposed to potentially higher rates.

John O'Connor

Getting the right type of housing in our cities and towns is critical. Three-quarters of all housing throughout the country is for one, two and three-person households. We need to be delivering the right housing and for social housing it needs to be in the context where we are funding the right mix of housing.

At a basic level, there is a lot of funding available but the most important thing is to get it bedded down where the funders and the AHBs and others are making that funding work and getting the investment in smoothly.

In terms of funding the AHBs, we need to strengthen the sector, not only for social housing but also for affordable housing. We need to get funders comfortable with not only social housing but also with affordable rental housing. It is getting the whole thing working smoothly and availing of the investment. There is a very good match between long term funding, such as pension funds, and social housing.

Participants

Sharon Cosgrove
Sharon Cosgrove joined Oaklee Housing as CEO in May 2016, having previously held a number of senior roles, including CEO of the Asthma Society of Ireland, CEO of Sonas Housing, and a period as interim Head of Projects in the Combat Poverty Agency. Sharon has led urban multi-disciplinary regeneration teams in South Dublin and in Bristol City. As a freelance consultant she worked with government agencies; local authorities; health authorities, as well as community and voluntary organisations.

Deirdre McBennett
Deirdre McBennett is a banking lawyer at ByrneWallace and has been a partner in the firm's Banking & Finance Department for over 13 years. She acts for a range of domestic and international financial institutions, credit unions, private equity houses, alternative lenders, semi-state bodies and corporates. Deirdre specialises in corporate lending transactions, senior and mezzanine debt structures, leveraged acquisition finance, real estate finance, project finance, syndicated loans, loan sale transactions and debt restructuring. Deirdre lectures on the Law Society of Ireland Professional Practice course (PPCII), and its diploma courses in Corporate Law & Governance and Insolvency & Corporate Restructuring.

Jason Murphy
Jason Murphy is founder Director and Head of Centrus in Ireland, Centrus Advisors. He has over 18 years' experience financing and advising on infrastructure projects for housing associations, infrastructure investors and regulated utilities in the UK and Ireland. As a highly regarded contributor in the housing markets, he has produced many articles/publications and is a regular speaker at conferences/seminars in the housing sector.

Nina Murray
Nina Murray is a Principal Officer at the Department of Housing, Planning and Local Government and head of the Social Housing Leasing Programmes Unit. She has responsibility for the delivery of a range of social housing programmes under the Government's 'Rebuilding Ireland' Action Plan, across the Build, Acquisition and Lease streams which in the main, seek to harness the opportunity of privately owned property and investment into social housing, including by the approved housing body sector. She has direct responsibility for the management of a number of the Department's current and capital funded social housing programmes including the Rental Accommodation Scheme (RAS); the Social Housing Current Expenditure Programme (SCHEP); the Capital Advance Leasing Facility (CALF); Leasing including the new Enhanced Leasing; and the Repair and Leasing Scheme (RLS), as well as policy development and management of the two Mortgage to Rent schemes; and oversight of policy and legislation underpinning legacy local authority housing loans and also local authority mortgage arrears issues.

John O'Connor
John O'Connor is Chief Executive Officer for the Housing Agency, which is a statutory body set up under the aegis of the Department of Housing, Planning and Local Government. John is a structural engineer by background and has a wide range of experience in both the public and private sectors. He has extensive experience in the development, provision and direct delivery of housing, particularly in the areas of social housing, affordable housing and regeneration projects. The Agency was established to provide the Department, local authorities and approved housing bodies with support and advice on the delivery of housing and housing services; in addition to a range of other services.

IRELAND'S HOUSING
MAGAZINE

eolas
magazine

Clifton House · Lower Fitzwilliam Street · Dublin 2, D02 XT91 · Tel: 01 661 3755