

# Funding and building the homes Scotland needs

**A proposal by the  
union UNISON to  
develop a new  
stream of finance to  
provide much  
needed social and  
affordable housing  
in Scotland**

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## **Introduction**

This paper outlines a proposal from UNISON Scotland, developed with assistance from the Scottish Federation of Housing Associations, to finance social housing in Scotland. It recognises Scotland's current housing crisis and the cost of finance to build new houses for rent. In particular it looks at the potential for utilising local authority pension funds as a source of finance.

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# Housing in Scotland

The latest statistics confirm that Scotland has a housing crisis. In Scotland there are approximately 1.5 million owner-occupied homes, 290,000 privately rented homes, 275,000 homes rented from housing associations and 320,000 homes rented from local authorities. There are also 87,000 empty homes across Scotland.

The key problem is that not enough homes are being built in Scotland. In 2011-12 there were 10,039 dwellings built by the private sector, 4,776 dwellings built by housing associations, 1,085 dwellings built by local authorities.

This rate of build is insufficient to address the housing needs of the 335,000 households on social housing waiting lists across Scotland. Of these, 157,700 people were on waiting lists and 30,200 were on transfer lists. 71,000 households are overcrowded and 65% of those are families with children. Many of the homes that we do have are in poor condition with 298,000 homes in Scotland affected by dampness or condensation.

A total of 62 per cent of Scotland's social housing currently falls beneath the new Scottish Housing Quality Standard.

At a time of falling real wages and welfare benefit cuts housing costs are beyond many families. The average house price in Scotland has increased from £73,570 in 2001 to £179,863 in 2011, an increase of 144 per cent. The average weekly Local Authority rent in Scotland has risen from £39.30 in 2001-2002 to £59.94 in 2011-12, an increase of 53 per cent.

UK Government cuts have seen a reduction in the capital budget Scotland receives from Westminster and there has been a consequential cut in the Scottish Government's housing budget.

## Funding options

Cuts to the Scottish block grant and SG budget choices have had an impact on the funding available for housing, together with the banking sector's reluctance to lend. The Scottish Government is working with the RSL sector to identify further funding opportunities such as a Scottish Housing

Bond, through which a number of Scottish landlords would jointly access bond finance.

The Scottish Government has also announced a new Innovation and Investment Fund. It is open to any constituted body to provide new affordable housing for any type of tenure and will be designed to support entirely new approaches to funding and delivery of new affordable homes. For RSLs this signals a move away from subsidy calculated at individual project level and will require RSLs to contribute substantially increased resources from, e.g. borrowing capacity across existing stock, reserves or cross-subsidising activities.

The National Housing Trust (NHT) for Developers Scheme is aimed at getting stalled housing developments back on track, and bringing these properties into the mid market rental stream. These properties are rented for between 5 to 10 years, with the rental income covering the borrowing costs. A number of RSLs are also looking at a variant of this option the (newly launched NHT for RSLs Initiative) to deal with an increasing demand for mid market properties and the option of using this to cross-subsidise their social rented properties.

While these initiatives are welcome, they are not at the scale required to tackle Scotland's housing crisis. Shelter Scotland estimates we need 10,000 new homes every year and the Scottish Government's action plan for housing – Homes Fit for the 21st Century, falls considerably short of that.

## Pension funds

The Scottish Local Government Pension Fund (LGPS) is a funded scheme administered by 11 funds with regulations devolved to the Scottish Government. The funds are currently valued at £24.1bn. The funds are currently invested in a range of areas including: 26% in UK equities, 45% in overseas equities and the balance mostly in gilts (7%), bonds (6%) and property (7%). They are a significant source of investment in the Scottish economy.

Both UNISON and the Scottish Government have suggested that the funds might be invested in infrastructure including housing. There are difficulties with this approach as the government is

not a party to investment decisions and scheme members (staff) may be wary of government interference in their pensions. This is particularly so at a time when members of the LGPS Scotland are facing further reforms. Therefore a proposal that has the support of the main local government trade union and others could help in alleviating those concerns. It would also demonstrate the economic potential of public service pensions.

Since we initiated discussions on this issue there have been similar developments elsewhere in the UK. In England the local government minister has announced plans to double the amount pension funds can invest in infrastructure projects. According to a survey by Greenwich Associates, many funds are reviewing their position and some have begun to change the balance of their portfolios to close mounting funding shortfalls while reducing volatility. The Greater Manchester Pension Fund is to use their fund to invest in local housing projects with an initial 240 homes being built. Strathclyde Pension Fund is investing, albeit relatively small amounts, in new businesses.

Local authority pension funds are already invested in all manner of projects – from property to infrastructure. However, funds are less often focusing investment on local projects.

A report published by the Smith Institute, Centre for Local Economic Strategies, Pensions Investment Research Consultants and the Local Authority Pension Fund Forum has also highlighted the issue. The research showed that while fund managers said they wouldn't accept lower returns in exchange for delivering local benefits, it did detect a growing interest in finding new ways to invest generally and in maximising the social, environmental and economic impact of pension funds. Paul Hackett, Director of the Smith Institute said, "This group of people are very careful, they don't want to be in the spotlight but do "get it" and want to invest in projects with social and economic value."

The Future Homes Commission (2012) argued that Britain needs a revolution in the scale, quality and funding of home building. They recommend a kick-start from an independent Local Housing Development Fund, financed and owned by local authority pension funds. They said, "But there is a way to kick-start housing expansion. Concerted action by local authority pension funds.

This is the right decision for the fund managers, who need to achieve higher returns than they are getting in the equity or bond markets, while the councils themselves win because it provides more affordable housing."

Richard Murphy of Tax Research puts it rather more forcefully, "At a time when conventional pension fund investment policy is simply guaranteed to lose people money in the UK because of inept management, market corruption and excessive charges why aren't pension funds being invested in things that we really need, like housing, where the payback over a period of, say, 25 years is exactly the sort of return a pension fund needs?"

## Proposal

Any investment in housing from pension funds would have to provide a rate of return equivalent to that achieved by current investments. Or as an alternative, could be subsidised by the Scottish Government using their housing finance, stretching the budget further than commercial finance.

The most straightforward investment would be in middle market housing. However, as can be seen above, the greatest need is for social housing. This might be accommodated in mixed developments or through cross subsidy. It might also be an opportunity to provide rented or shared equity accommodation for other workers, including many UNISON members, who are finding it difficult to access housing in the current property market.

Our proposal is to invest pension funds with one or more housing associations. The technical term for a registered housing association or co-operative is a "Registered Social Landlord" (RSL). An RSL is a not-for profit corporate entity who's objective is in essence to provide good quality rented accommodation at rents which are generally affordable to those on the lowest incomes, without recourse to benefits. This is generally known as "social rent". There are 167 housing associations operating in Scotland. RSLs are registered and regulated by the Scottish Housing Regulator which is an independent body funded by the Scottish Government to regulate RSLs in accordance with Government policy. Typically, an RSL will be an Industrial and Provident Society and will in most cases be charitable. They will normally own, manage, maintain (and in some cases develop)

housing for 'social rent'. RSLs are governed by voluntary boards of management. Almost all boards have tenant representation; some are governed exclusively by their tenants.

Although RSLs are generally self-financing, many receive capital funding to build new homes. Since the 1970s, when new council house building declined, capital funds were diverted to RSLs to replace the provision of new homes. Initially funding 100% of the costs of new homes, funding has gradually decreased over time to around 30% of the capital cost with the RSL borrowing from banks and other financial institutions to provide the remaining 70%.

RSLs have always represented a very low risk to lenders and this was reflected, pre credit crunch, in extremely low margins, in some cases as low as 20 basis points. Loans were for 30 years with the ability to fix. This reflects a number of factors including:

- assets of around £7.125bn as against debt at £2.6bn;
- a huge demand for social rented housing with a waiting list of 335,000
- Projected new supply of around 6,000 PA
- Good performance in housing management, maintenance and refurbishment
- Indirect government regulation
- Government intervention in the event of individual RSL encountering difficulties, essentially making RSL lending 'sovereign debt'.
- Historic above-inflation rent increases unlikely to change in the future

However, since the credit crunch, banks are experiencing a lack of capital with which to lend. Coupled with more stringent conditions under Basel II, and BASEL III on the horizon means banks are less likely to lend at all, let alone at the previous margins. At time of writing, the cost of borrowing is largely the same as pre-crunch, RSLs now experience much higher margins with much lower rates. Furthermore, lending is made available for 10 years at most with a 5 year review – effectively 5 years. RSLs financial models are geared towards repayment of loans over 30 years or more. Clearly this represents a risk. Despite these challenges the sector can offer investors:

- Strong balance sheet / cash and asset backed security
- Insatiable demand for product

- Quasi-state regulation
- Government backing – very low risk of failure
- Index-linked income streams
- Track record
- Low gearing
- Generally good asset cover
- Robust and credible business plans
- Match pension funds expectations / long term lending – hands off
- Good fit with "ethical" investment policies
- CML quote: Report by CML concluded "the key requirement for investors are that landlords are effectively regulated, operate to a credible business plan reflecting local market conditions and produce a reliable steady income stream and return for investors"

### **What does the sector need from an investor?**

- Long term lending
- Rates that recognise low risk / track record / and security offered
- Reasonable covenants
- Agreed purposes
- Relatively small amounts
- Bullet repayment rather than amortised

### **What form might the investment take?**

- Secured lending – new build & development
- Secured lending – existing stock
- Sale & leaseback
- Others?

## **Conclusion**

This paper outlines a proposal to develop a new stream of finance to provide much needed housing in Scotland. The aim is to develop one or two initial projects to test the viability of the idea with one or more local authority pension funds. We have had some preliminary discussions with housing associations that would be interested in this approach.

We believe that this is an idea whose time has finally come.

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(updated) March 2013

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